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Contracting in China: Comparative Observations on Freedom of Contract, Contract Formation, Battle of Forms and Standard Form Contracts

Nicole Kornet*

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1. Introduction

Trade between the EU and China has increased dramatically over the past years. China is now the EU's second largest trading partner, and its number one source of imports. The EU is China's biggest trading partner. The international transactions between European businesses and their Chinese counterparts form the backbone of this large volume of trade. Despite the importance of trade with China and China's growing strength and influence on the world market, businesses and their lawyers tend to feel some discomfort about Chinese law and the legal system they will encounter in their business dealings with their Chinese counterparts.

China and most EU member states are contracting parties to the United Nations Convention on Contracts for the International Sale of Goods (CISG), which provides a set of international, uniform rules applicable to international sales contracts.[1] This potentially diminishes the need to become acquainted with Chinese contract law in some situations; however, it does not make it entirely unnecessary for at least four reasons. First, the scope of application of the CISG is restricted to certain contracts for the international sale of *goods*; it does not govern all international business transactions such as the provision of services, leases, financing etc. Secondly, the CISG does not govern all aspects of a contract of sale. For example, Article 4 CISG excludes issues relating to the validity of the contract or any of its provisions. Thirdly, Article 6 CISG leaves businesses free to contract out of the CISG by incorporating a choice of law clause for the law of a particular country. Lastly, under Chinese law, in certain situations the application of Chinese law may be mandatory (e.g., Article 126 of the Chinese Contract Law provides that for a Chinese-Foreign Equity Joint Venture Enterprise Contract or a Chinese–Foreign Cooperative Joint Venture Contract, Chinese law shall apply). It therefore becomes important to gain some understanding of Chinese contract law.

In view of the volume of trade between Europe and China, and the need to become acquainted with Chinese contract law, this article aims to provide some comparative observations concerning Chinese contract law from a European perspective. In the context of international business transactions, in particular international sales, businesses frequently transact on the basis of standard form contracts. This raises issues of contract formation and the freedom of parties to determine the terms of their contract. Particular attention will be given to the extent to which Chinese contract law recognizes freedom of contract as a fundamental principle underlying contractual relations (4), the rules relating to contract formation (5) and in particular the battle of forms (6) as well as the control of standard terms (7).

Before turning to these issues, a brief overview of the sources of Chinese contract law will be given (2). The focus in this article will be on the provisions of the Chinese Contract Law (hereafter: CCL) enacted in 1999.[2] The CCL provides the legal framework for the formation,

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* Dr. Nicole Kornet BA LL.B.(Hons) LL.M. is Assistant Professor of Commercial Law at the Faculty of Law of Maastricht University.

[1] Non-Contracting States in the EU include the United Kingdom, Portugal and Malta. Moreover, China has made a reservation to the applicability of the CISG on the basis of Article 1(1)(b) CISG when one of the contracting parties is situated in a non-Contracting State.

[2] On the Chinese Contract Law of 1999 see Bing Ling, *Contract Law in China* (Hong Kong: Sweet & Maxwell Asia, 2002); Zhang Mo, *Chinese Contract Law. Theory and Practice* (Leiden: Martinus Nijhoff Publishers, 2006); Wang Liming, 'An Inquiry into Several Difficult Problems in Enacting China's Uniform Contract Law. (Translated by Keith Hand)', 8 *Pacific Rim Law & Policy Journal* 2 (1999), 351-392; Wang Liming and Xu Chuanxi, 'Fundamental Principles of China's Contract Law', 13 *Columbia Journal of Asian Law* 1 (1999), 1-34; James C. Hitchingham, 'Stepping up to the Needs of the

performance and enforcement of contracts. This legal framework constitutes, however, only one dimension for understanding how contracts and contract law function in China. The implementation of the law and the role and function of contracts depends on the society, the cultural and legal heritage and traditions and the politico-economic environment within which they operate. An extensive discussion of those dimensions in China falls outside the scope of the present article; nevertheless some observations will be made below (3).[3]

2. Sources of Chinese Contract Law in a Nutshell

Before the enactment of a unified contract law in 1999, contract law in China was primarily contained in three separate laws, each dealing with a particular area of the law of contract. The three pillars of Chinese contract law were the Economic Contract Law (hereafter: ECL) of 1981 applicable to domestic 'economic' contracts, the Foreign Economic Contract Law (hereafter: FECL) of 1985 applicable to 'economic' contracts between domestic and foreign parties, and the Technology Contract Law (hereafter: TCL) of 1987. The coexistence of these three laws resulted in a fragmentary approach to contract law and meant that the law of contract was piecemeal, often inconsistent and at times incomplete.[4]

With the entry into force of the CCL in 1999, the ECL, FECL and TCL were repealed. Article 1 CCL embodies the purpose of the new, uniform law on contract law: 'This law is formulated in order to protect the lawful rights and interests of contract parties, to safeguard social and economic order, and to promote socialist modernization'. This new contract law was needed to support China's transition from a centrally planned economy to a socialist market economy and to facilitate economic growth. The CCL aims to facilitate international economic, trade and technological cooperation by incorporating rules consistent with international practices into Chinese law. This reflects the 'subtle and incremental shift in recent years to a model based more on international practice and international treaties' that can be seen in the reform of Chinese law.[5] In the CCL, this can be observed in many provisions which were clearly influenced by international instruments such as the CISG and the Unidroit Principles of International Commercial Contracts (UPICC). The CCL also aims to provide contracting parties with more protection, and provide them with 'more freedom and flexibility in their contractual relations',[6] while at the same time providing 'legal means and bases for the governmental regulation of contracts so as to protect the interests of the state and the public'.[7]

International Marketplace: An Analysis of the 1999 "Uniform" Contract Law of the People's Republic of China ', 8 *Asian-Pacific Law & Policy Journal* 1 (2000), 1-29; Feng Chen, 'The New Era of Chinese Contract Law: History, Development and a Comparative Analysis', 27 *Brooklyn Journal of International Law* 1 (2001), 153-191; John S. Mo, 'The Code of Contract Law of the People's Republic of China and the Vienna Sales Convention', 15 *American University International Law Review* 1 (1999), 209-270; C. Stephen Hsu, 'Contract Law of the People's Republic of China', 16 *Minnesota Journal of International Law* (2007), 115-162; Jacques H. Herbots, *Contracteren in China* (Gent: Larcier, 2008).

[3] See e.g. Philip J. McConnaughay, 'Rethinking the Role of Law and Contracts in East-West Commercial Relationships', 41 *Virginia Journal of International Law* (2001) 427-480; Patricia Pattison and Daniel Herron, 'The Mountains are High and the Emperor is Far Away: Sanctity of Contract in China', 40 *American Business Law Journal* (2003), 459-510, p. 460 [also available at http://www.cisg.law.pace.edu/cisg/biblio/pattison-herron.html last visited 13.01.2010]; John H. Matheson, 'Convergence, Culture and Contract Law in China', 15 *Minnesota Journal of International Law* (2006), 326- 382.

[4] See e.g. Ling, *Contract Law in China*, *supra* note 2, p. 15; Hitchingham, 'Stepping up to the Needs of the International Marketplace: An Analysis of the 1999 "Uniform" Contract Law of the People's Republic of China ', *supra* note 2, pp. 3-4: Jainfu Chen, *Chinese Law: Context and Transformation* (Leiden: Martinus Nijhoff Publishers, 2008), p. 443.

[5] Chen, *Chinese Law: Context and Transformation*, *supra* note 4, p.73.

[6] Hitchingham, 'Stepping up to the Needs of the International Marketplace: An Analysis of the 1999 "Uniform" Contract Law of the People's Republic of China ', *supra* note 2, p. 2-3.

[7] Ling, *Contract Law in China*, *supra* note 2, p. 15.

The CCL comprises two main parts: General Provisions and Specific Provisions. The General Provisions lay down rules that are applicable to all contracts, such as the general principles of contract law, rules on formation of contracts, validity of contracts, performance of contracts, amendment and assignment of contracts, discharge of contractual rights and obligations, liability for breach of contract, provisions concerning the relationship between the CCL and other laws, contract interpretation and choice of law. The Specific Provisions contain 15 chapters dealing with specific types of contracts, such as contracts for sales, donation, lease, financial lease, work, supply of electricity, gas and water, loan, technology, storage, warehousing, carriage, construction projects, commission, brokerage and intermediation. Where a contract falls within the categorized, nominate contracts, the relevant rules of the Specific Provisions for that type of contract will apply. Non-categorized, innominate contracts are governed by the General Provisions. According to Article 124 CCL, provisions concerning a nominate contract that is similar to the non-categorized, innominate contract may be applied analogously.

The CCL is not the only source of legislative rules on contract law. Rules of Chinese contract law can also be found in the General Principles of Civil Law (GPCL) of 1986, which contains general rules for all civil juristic acts that are also applicable to contracts. The GPCL contains provisions on fundamental principles, natural persons, legal persons, civil juristic acts and agency, civil rights, civil liability, prescription, application of law in civil relations with foreigners and supplementary provisions. A number of other laws dealing with specific topics are also relevant to contract law such as advertisement law, agriculture law, construction law, consumer protection law, insurance law, copyright, law against unfair competition and maritime law etc. When looking at the sources of Chinese contract law, administrative regulations,[8] ministerial rules,[9] local regulations and rules and the authoritative interpretations of the Standing Committee of the National People's Congress and the Supreme People's Court must not be overlooked.

In 1999, the Supreme People's Court issued its first judicial interpretation on questions of law arising out of the application of the CCL; it was followed in 2009 by a second interpretation.[10] These interpretations provide guidance and resolve conflicts in the interpretation of the relatively short and generally formulated provisions of the CCL, making the law usable and giving it meaning. [11] Due to the relative newness of the CCL, and for instance the influence of international and foreign sources on its drafting, the guidance provided by the Supreme People's Court aims to prevent or correct inaccurate interpretations of the provisions of the CCL by lower courts which may result for example from a lack of the necessary (legal) background to interpret the provisions in conformity with the legislator's intent.

In view of the many sources of law relevant to contracts, there is a potential for conflicting rules to exist. For this reason, the CCL contains a provision that regulates the relationship between the CCL and these other sources. Article 123 CCL provides that 'where other laws

[8] Several important types of contract are regulated solely or primarily by administrative regulations, e.g. Contracts for the assignment and transfer of land-use rights, contracts for the operation of state-owned enterprises, contracts for transactions in futures, contracts for import of technology.
[9] These ministerial rules often provide for regulatory norms on specific matters relevant to contracts, e.g. licensing, registration, performance, assignment, dispute resolution and liability.
[10] Interpretation of the Supreme People's Court on Certain Issues concerning the Application of the Contract Law of the PRC, issued on 19 December 1999: Interpretation of the Supreme People's Court on Certain Issues concerning the Application of the Contract Law of the PRC, issued on 13 May 2009.
[11] Chen, *Chinese Law: Context and Transformation*, *supra* note 4, p.198.

have other provisions for contracts, those provisions shall apply'. It is generally agreed that this provision does not apply to the GPCL, otherwise the practical effect of the new provisions in the CCL would be undermined.[12] The GPCL contains more general rules that govern contracts if an issue is not dealt with in the more specific provisions of the CCL, provided such rules are not inconsistent with the CCL. The GPCL therefore has a gap-filling function. In essence, Article 123 CCL refers to the laws relating to specific topics such as advertisement, agriculture, construction, consumer protection, insurance, copyright, unfair competition, maritime transportation etc. The provisions of these 'other laws' will prevail over the CCL, because they deal with matters not dealt with in the CCL. Provided they are not inconsistent with the CCL, these other laws can govern contractual issues on which the CCL is silent.[13]

3. Contract Law and Contract Practice

Contracts and the law of contract provide the legal framework within which the contracting parties transact. This legal framework only constitutes one dimension for understanding how contracts and contract law function. The implementation of the law and the role and function of contracts depends on the society, the cultural and legal heritage and traditions and the politico-economic environment within which they operate. A distinction should therefore be made between the black letter law and the way in which the law is implemented, as well as between contract law and contract practice.

Although it will be seen that the CCL mirrors European concepts in many ways, it should be kept in mind that these concepts tend to 'run contrary to traditions which have evolved in China over millennia'.[14] In this context, it should be observed that a central concept in dealings in China, in the interpersonal, bureaucratic or business context, is *guanxi*. *Guanxi* refers to the relationship, connections and networks between people, which 'include mutual obligation, reciprocity, goodwill and personal affection'.[15] *Guanxi* is essential for business success in China. Westerners often regard *guanxi* 'to be no more than cronyism tainted by bribery and corruption', but this is to misunderstand the concept, which is focused on trust, honour and shared experiences.[16] The cultural attitude towards contracting practice, in relation to the role of contracts and contract law as well as enforcement mechanisms, is consequently influenced by this emphasis on relationships, reciprocity and respect.[17]

It should also be noted that the Chinese and European conceptions of a written contract differ greatly. In Europe, the signing of a contract often indicates the 'conclusion' of a business deal. The parties are required to perform their obligations, and should a dispute arise, the courts are to enforce the terms that have been agreed upon by the parties. In contrast, from a

[12] See Ling, *Contract Law in China*, *supra* note 2, p. 28.
[13] Ibid., pp. 27-28; Hitchingham, 'Stepping up to the Needs of the International Marketplace: An Analysis of the 1999 "Uniform" Contract Law of the People's Republic of China', *supra* note 2, p. 28.
[14] Matheson, 'Convergence, Culture and Contract Law in China', *supra* note 3, p. 371.
[15] Pattison and Herron, 'The Mountains are High and the Emperor is Far Away: Sanctity of Contract in China', *supra* note 3, p. 484; Matheson, 'Convergence, Culture and Contract Law in China', *supra* note 3, p. 374; also see Axel Hagedorn, 'Western and Chinese Contract Law. A Comparative Cultural Perspective', in Heidi Dahles and Harry Wels (eds.) *Culture, Organization and Management in East Asia. Doing Business in China* (New York: Nova Science Publishers, 2002), 13-37, p. 30.
[16] Pattison and Herron, 'The Mountains are High and the Emperor is Far Away: Sanctity of Contract in China', *supra* note 3, p. 484.
[17] Chunlin Leonhard, 'Beyond the Four Corners of a Written Contract: A Global Challenge to U.S. Contract Law', 21 *Pace International Law Review* (2009), 1-36, p. 15.

Chinese perspective, the signing of a contract indicates the beginning of the business relationship; it anticipates rather than defines the resulting relationship.[18] Although not meaningless, much less importance is attached to the contractual terms. In determining how the parties should respond to various events and contingencies that arise as the relationship unfolds, the express terms of the contract are not controlling. They are expected to be overridden, or at least modified and informed, by relational and surrounding circumstances. Parties are expected to make mutual adjustments and accommodations in response to the events that occur. Contracts are 'considered unnecessary, sometimes offensive, when rules of loyalty and mutual obligation structure the business environment'.[19] The Chinese often regard the written contract as a formality, leading them to frequently ignore it.[20]

Since a contractual relationship is based on trust and honour, the Chinese traditionally do not rely on the enforcement power of the law.[21]They tend to look upon the law negatively, and there is a general cultural aversion to conflict which means that they do not expect to refer contractual disputes to the courts for adjudication.[22] In a society in which the collective interest is paramount, resorting to contract enforcement mechanisms and participating in adjudication is seen to amount to 'an unseemly emphasis on private interests'.[23]

When disputes are adjudicated, however, the focus also appears to be different, in the sense that the objective is to reach a peaceful resolution of the dispute; a reconciliation between the parties, with a view to allowing the relationship to continue. The actual merits of the case play a less significant role when compared to the status of the parties, surrounding circumstances, reciprocal adjustment, and maintaining the relationship. These factors tend to inform the merits of the case and are taken into account when settling the dispute.[24] Consequently, dispute resolution focuses on upholding the contractual relationship, as opposed to upholding the terms of the contract. Consequently, there is a cultural difference in the way contractual obligations are enforced.[25]

Furthermore, even if disputes are taken to court, litigants encounter major difficulties to have court rulings and decisions enforced, since China struggles with various institutional weaknesses.[26] As Chen writes: 'Having laws is one thing; having them properly implemented is another'.[27] The courts generally lack professional competence and independence from

[18] See Pattison and Herron, 'The Mountains are High and the Emperor is Far Away: Sanctity of Contract in China', *supra* note 3, p. 491; McConnaughay, 'Rethinking the Role of Law and Contracts in East-West Commercial Relationships', *supra* note 3, p. 446.
[19] Pattison and Herron, 'The Mountains are High and the Emperor is Far Away: Sanctity of Contract in China', *supra* note 3, p. 487-488.
[20] Leonhard, 'Beyond the Four Corners of a Written Contract: A Global Challenge to U.S. Contract Law', *supra* note 17, p. 16.
[21] Ibid., p. 15.
[22] Ibid., p. 16; McConnaughay, 'Rethinking the Role of Law and Contracts in East-West Commercial Relationships', *supra* note 3, p. 450.
[23] McConnaughay, 'Rethinking the Role of Law and Contracts in East-West Commercial Relationships', *supra* note 3, p. 450.
[24] Ibid., pp. 447-448.
[25] Pattison and Herron, 'The Mountains are High and the Emperor is Far Away: Sanctity of Contract in China', *supra* note 33, p. 460.
[26] See Chen, *Chinese Law: Context and Transformation*, *supra* note 42, p. 661 ff. On the complexity of the situation in China see Randall Peerenboom, 'Judicial Independence in China: Common Myths and Unfounded Assumptions'. (September 1, 2008) La Trobe Law School Legal Studies Research Paper No. 2008/1. Available at SSRN: http://ssrn.com/abstract=1283179 (last visited 13 January 2010).
[27] Chen, *Chinese Law: Context and Transformation*, *supra* note 4, p. 653.

political interference.[28] There is a lack of qualified, well-trained judges. Courts can suffer from local protectionism in the adjudication and enforcement of judgements, in particular since local governments appoint judges, pay their salaries and are often able to influence the outcome of cases that involve local interests. However, local protectionism appears to have decreased in economic advanced urban areas.[29] Judicial corruption is also regarded as 'a serious barrier to the realization of the rule of law in Chinese society'.[30] Furthermore, when courts do deal with the substantive issues, it is not uncommon for contracts to be invalidated on formal grounds 'thus frustrating the expectations of the parties'.[31] Due to these institutional weaknesses the independent, third party enforcement power of the state lacks credibility. [32] Consequently, in the absence of a consistently enforced legal framework, *guanxi* plays an important role.[33]

4. Freedom of Contract in Chinese Contract Law

4.1 Introduction

In Europe, freedom of contract forms the corner stone of modern contract law. It is well-accepted that individuals are free to determine their own affairs, decide who to contract with and on what terms.[34] Freedom of contract is of particular importance in an open market economy as it ensures that businesses are free to decide to whom they will offer their goods or services, and by whom they wish to be supplied, as well as to freely agree on the terms of those transactions. This process of voluntary exchange promotes economic growth through competition and the efficient allocation of resources. An important question is consequently: does Chinese contract law recognize the principle of freedom of contract?

The pre-1999 Chinese contract laws did not explicitly recognize freedom of contract as a principle underlying the law of contract. This is not surprising since in a centrally planned economy: where the central importance of the state plan is consistently emphasized, there is little room for a principle such as the freedom of contract. Businesses or individuals do not have free access to the market, since every sector is subject to, and the market is driven by, the central government's pre-determined plan. The economic contract formed the tool for fulfilling the state plan and contracts that did not comply with the requirements of, or violated, the mandatory state plan were void (see e.g. Articles 4, 11, 7 ECL and Article 58 GPCL). Economic contracts were also subject to administrative supervision by administrative departments, which involved the inspection and supervision of their conclusion and performance, arbitration of disputes, investigation and disposition of illegal contracts, and certification. Consequently, it was 'inconceivable' then for individuals to think of being free

[28] Matheson, 'Convergence, Culture and Contract Law in China', *supra* note 3, p. 377; Chen, *Chinese Law: Context and Transformation*, *supra* note 4, p. 653; Michael Trebilcock and Jing Leng, 'The Role of Formal Contract Law and Enforcement in Economic Development', *Virginia Law Review* 92 (2006), pp. 1517 – 1580, p. 1554.
[29] See Fu Yulin and Randall Peerenboom, 'A New Analytic Framework for Understanding and Promoting Judicial Independence in China' (1 February 2009). Judicial Independence in China: Lessons for Global Rule of Law Promotion, Randall Peerenboom (ed.) New York, Cambridge University Press, 2009. Available at SSRN: http://ssrn.com/abstract=1336069 (last visited 13 January 2010).
[30] Trebilcock and Leng, 'The Role of Formal Contract Law and Enforcement in Economic Development', *supra* note 28, p. 1554.
[31] Ibid., p. 1562.
[32] Ibid., p. 1554.
[33] Pattison and Herron, 'The Mountains are High and the Emperor is Far Away: Sanctity of Contract in China', *supra* note 3, p. 484, who write that people with *guanxi* 'accomplish just about anything, even when it is against the rules'.
[34] See for example, Article 1:102 PECL; Article 1.1 UPICC for general statements about freedom of contract.

to enter into a contract with others.[35] Viewing contracts as tools to fulfil the state plan and subjecting them to administrative supervision significantly compromises the freedom of contract and involves governmental interference in business. As China transitions towards a market economy, the role of the mandatory state plan has diminished substantially. This is also reflected in the CCL. Whereas the pre-1999 contract laws made frequent reference to the role of the state plan, the CCL makes no express reference to it. Only Article 38 CCL refers to the possibility of the state to issue a mandatory plan or state purchase order.

In view of the main objectives of the CCL to adapt Chinese contract law to the socialist market economy, to incorporate rules that are consistent with international practices and to facilitate economic growth, there is less room for governmental interference in contractual relations and growing support for affirming freedom of contract as a fundamental principle of contract law in China.[36] Whether freedom of contract should be included in the CCL was consequently a much debated issue.[37] It was argued that in a market economy, party autonomy and the freedom to decide whether to enter into transactions is necessary to promote competition in the market place and to bring about the efficient allocation of resources. Despite this, the principle of freedom of contract has not been explicitly incorporated in the CCL.

This does not mean that Chinese contract law does not recognize an individual's freedom to enter into contracts. Although not explicitly incorporated in the CCL, the Chinese concept of freedom of contract can be constructed out of three provisions in the CCL which embody its constituent elements: the principles of equality, voluntariness and *pacta sunt servanda*.

4.2 The Principles of Equality, Voluntariness and *Pacta Sunt Servanda*

Article 3 CCL embodies the principle of equality. It provides that a contract is an agreement between equal parties and that one party is prohibited from imposing its will upon the other. Article 3 is to be understood as meaning that a state authority, as a contracting party, does not have the right to force another natural or legal person to enter into a contract, and within that contract, the parties are equal in their legal status with respect to its formation, performance, obligations and liability for breach.[38] Consequently, where the state, a state agency or a state-owned enterprise is a party to a contract, it is deemed to have an equal legal status to the other party and shall have no privilege over that other party.[39] This principle of equality is not an independent principle as such, but a component of the Chinese concept of freedom of contract.

Equality of parties has been a 'battleground' in China for many years, 'strik[ing] at the heart of the politico-economic system'.[40] Prior to 1999, contracting parties were subject to administrative command, which could lead to inequality between the parties. Through its incorporation in the CCL, Article 3 CCL constitutes an important affirmation that contracting

[35] Zhang, *Chinese Contract Law. Theory and Practice*, *supra* note 2 p. 52; also see Wang, 'An Inquiry into Several Difficult Problems in Enacting China's Uniform Contract Law', *supra* note 2, p. 356.
[36] Zhang, *Chinese Contract Law. Theory and Practice*, p. 51-52; Wang, 'An Inquiry into Several Difficult Problems in Enacting China's Uniform Contract Law', *supra* note 2, p. 357.
[37] See for instance, Wang and Xu, 'Fundamental Principles of China's Contract Law', *supra* note 2, p. 10; Wang, 'An Inquiry into Several Difficult Problems in Enacting China's Uniform Contract Law', *supra* note 2 pp. 356-358; Ling, *Contract Law in China*, *supra* note 2, pp. 40-41.
[38] Zhang, *Chinese Contract Law. Theory and Practice*, *supra* note 2, pp. 72-73.
[39] Ibid., p. 73
[40] Chen, *Chinese Law: Context and Transformation*, *supra* note 4, p. 453.

parties are not subject to the command of administrative power when transacting and constitutes an important safeguard to the freedom of contract. Incorporation of a principle of equality in the CCL is thus seen as an important step in Chinese contract law.

Article 4 CCL contains the second constituent element of the Chinese concept of freedom of contract – the principle of voluntariness. It provides that a 'party is entitled to enter into a contract voluntarily under the law, and no entity or individual may unlawfully interfere with such right'. Article 4 is perceived to introduce a 'dramatic change in favour of freedom of contract',[41] since it recognizes the principle of party autonomy. It is this right to 'enter into a contract voluntarily' that is regarded as containing the essence of the Chinese concept of freedom of contract.[42] Article 4 CCL also contains an important safeguard to the freedom of contract. It prohibits third parties from intervening unlawfully in the conclusion of a contract.

The principle of voluntariness or party autonomy contained in Article 4 CCL was adopted as a compromise: it gives parties the right to voluntarily enter into a contract, but emphasizes that the right must be exercised 'according to law'. Although this principle is viewed as a 'watered-down' version of freedom of contract, it is seen to embody an individual's right to freely decide whether or not to contract, with whom, on what terms and in what form, which is 'almost identical to [the substantive rights, NK] under the conventional notion of freedom of contract'.[43]

That the parties are free to decide on the terms of the contract is not expressly made clear in Article 4 CCL. Nevertheless, when read in conjunction with Article 12 CCL, which provides that 'the terms of the contract shall be prescribed by the parties', it seems that Chinese contract law also recognizes the parties' freedom to determine the content of their contract.[44]

The third constituent element of the Chinese concept of freedom of contract – *pacta sunt servanda* or sanctity of contract – is contained in Article 8 CCL. Pursuant to Article 8 CCL, once a contract has been lawfully formed, it is binding upon the parties. They are under a duty to perform their obligations under the contract, but also have the right to demand performance from the other party. The parties are bound by the terms of the contract and may not unilaterally modify them or cancel the contract. A party that fails to perform its obligations under the contract will be held liable, unless the non-performance is excused. Furthermore, when a dispute arises between the parties, it will be resolved in accordance with contract.[45] The contract will be protected by law.

Also relevant in the context of freedom of contract is the freedom of the parties to choose the form of their contract. Before the enactment of the CCL, all contracts had to be in writing in order to be valid. For this reason, China also made a reservation to Article 11 CISG on form requirements. Article 10 CCL now removes this written form requirement, recognizing that valid contracts can be concluded orally or 'in any other form'. In practice, there appears to be a general trend in Chinese courts to limit the enforcement of oral contracts, which led the Supreme People's Court in its second judicial interpretation to affirm that where parties'

[41] Zhang, *Chinese Contract Law. Theory and Practice*, *supra* note 2, p. 53.
[42] Ibid., p. 54; Ling, *Contract Law in China*, *supra* note 2, p. 42 refers to the principle of voluntariness as being recognized as a 'substitute' for the principle of freedom of contract; Hsu, 'Contract Law of the People's Republic of China', *supra* note 2, pp. 121-122, who views the Contract Law as upholding the spirit, if not the exact word, of freedom of contract.
[43] See Ling, *Contract Law in China*, *supra* note 2, p. 43.
[44] Ibid., p. 43; Zhang, *Chinese Contract Law. Theory and Practice*, *supra* note 2, p. 57.
[45] Zhang, p. 84

conduct is sufficient to indicate they intended to enter into a contract, then the courts should enforce such a contract as a contract formed by in another form.[46]

Article 10 CCL is made subject to laws or administrative regulations that require certain contracts to be made in writing, for example guarantee contracts. It should be noted, however, that Article 36 CCL provides that where the law requires a contract to be concluded in writing, but the parties fail to do so, if one party has performed its main obligation and the other party has accepted the performance, the contract is formed nonetheless. In view of this change in Chinese contract law, the question is, whether China will now withdraw its reservation to Article 11 CISG.

4.3 Restrictions to the Freedom of Contract

Incorporation of these principles of equality, voluntariness and *pacta sunt servanda* in the CCL would appear to facilitate and safeguard to a large extent contracting parties' freedom of contract. This freedom is not, however, unrestricted. Consideration of other provisions of the CCL make apparent that Chinese contract law gives priority to the collective interest over the individual rights and interests of contracting parties. This has the effect of restricting individual's freedom of contract. Consider, for instance, the very first provision of the CCL, which outlines the objective of the CCL. Article 1 CCL provides that the CCL 'is formulated in order to protect the lawful rights and interests of contracting parties, to safeguard social and economic order, and to promote socialist modernization'. The exercise of the freedom of contract provided by the principles discussed above is thus always subject to the promotion of collective goal: safeguarding the Chinese social and economic order.[47] Other provisions also have the effect of restricting individuals' freedom of contract, such as provisions relating to mandatory plans, governmental approval, administrative supervision, and other mandatory provisions, but also vague and open norms which could potentially be construed to limit or undermine the parties' freedom of contract.

Article 38 provides 'where the state has, in light of its requirements, issued a mandatory plan or state purchase order, the relevant legal persons and other organizations shall enter into a contract based on the rights and obligations of the parties prescribed by the relevant laws and administrative regulations'. Businesses may be assigned a state task through administrative means, or one business may be designated by the state to purchase from another business entity. In these situations, the task or order must be taken and performed by the assigned businesses.[48] They have limited freedom and are required to conclude contracts to implement them in accordance with the state plan.[49] Although this provision could have a significant impact on a party's freedom to contract, in practice, few mandatory plans exist, and those that do exist are being transformed into state procurement contracts.[50]

A lawfully formed contract becomes effective, in accordance with Article 44, upon its formation. However, if such effectiveness is made subject by law to a procedure such as approval, the contract does not become effect until such approval has been obtained. The CCL does not, however, specify which contracts are subject to governmental approval. Instead,

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[46] See Steve Dickinson, China Contract Law: Going All Clear On US Now. China Law Blog, 4 June 2009, available at http://www.chinalawblog.com/2009/06/china_gets_all_new_on_contract.html, (last visited 8 January 2010).
[47] Herbots, *Contracteren in China*, *supra* note 2, p. 29.
[48] Zhang, *Chinese Contract Law. Theory and Practice*, *supra* note 2, p.120.
[49] Ibid. p. 120.
[50] Ling, *Contract Law in China*, p. 47.

Article 44 refers to the 'relevant law or administrative regulations', which means that the legislature or an administrative agency may decide 'from time to time' which contracts are to be subject to approval.[51] Contracts requiring approval include contracts involving foreign investments such as a joint venture contract, contracts entered into by and between the recipient and supplier for introduction of technology, contracts for the exploitation of offshore petroleum resources in cooperation with foreign enterprises, the transfer of patent right by Chinese enterprise or individual, the first time import of pharmaceuticals, and the transfer of a right of land use.[52]

Pursuant to Article 127 CCL, regulatory authorities (the administration of industry and other relevant authorities) shall 'be responsible for monitoring and dealing with any illegal act which, through the conclusion of a contract, harms the state interests or the public interests'. This provision thus allows administrative intervention with the parties' contractual rights with the aim of protecting the interests of the state in maintaining economic order and social stability.[53] Before the enactment of the CCL, the regulatory authorities had a broad supervisory power, including the inspection and supervision of the conclusion and performance of contracts. Article 127 CCL has limited the role of administrative supervision to dealing with illegal acts committed under the guise of a contract that harm state or public interests. Administrative supervision no longer extends to the advance examination of contracts, although as was mentioned earlier, some contracts do require approval. It is unclear from Article 127 CCL how the administrative supervision is to be conducted and what the boundaries of such supervision are. Article 127 CCL does make clear, however, that administrative supervision must be based on express authorization under laws and administrative regulations.[54]

Article 7 CCL imposes further restraints on the parties' freedom by providing that in concluding and performing a contract, the parties shall abide by the laws and administrative regulations, observe social ethics, and may not disrupt the social and economic order or harm the public interests. The priority of the collective interest over the rights and interests of the contracting parties also can be seen in this provision. In comparison to the previous contract laws, which contained numerous mandatory provisions, it must be said that the impact of mandatory law has been 'drastically reduced' in the CCL, in order to respect the parties' freedom to establish the content of their contract.[55] Provisions in the CCL reflect more often the nature of default rules, often containing the proviso 'unless the parties have agreed otherwise'. Also, under the ECL, compliance with law included compliance with state policy in the absence of applicable law. The reference to policy has been abandoned in the CCL. Nevertheless, ZHANG warns that 'one should not underestimate the potential influence of government policies on contractual activities'.[56] Article 6 GPCL also still provides that where there is no relevant provision of law, civil activities must comply with state policies, and state policy is generally regarded as a supplementary source of law.[57] Furthermore, the CCL does

[51] Zhang, *Chinese Contract Law. Theory and Practice*, *supra* note 2, p. 120.
[52] Zhang, *Chinese Contract Law. Theory and Practice*, *supra* note 2, p. 65.
[53] Ibid., p. 62.
[54] See for instance Article 50 of the Consumer Rights and Interests Protection Law.
[55] Hsu, 'Contract Law of the People's Republic of China', *supra* note 2, p. 121.
[56] Zhang, *Chinese Contract Law. Theory and Practice*, *supra* note 2, p. 62.
[57] Ling, *Contract Law in China*, *supra* note 2, p. 37.

not define 'social ethics', and therefore gives considerable discretionary power to intervene in contractual relations to promote 'good moral standard and fair practices'.[58]

4.4 Reflection

Does Chinese contract law recognize an individual's freedom of contract? Although the CCL does not explicitly recognize freedom of contract as an underlying principle of contract law, Articles 3, 4, 8, 10 and 12 CCL incorporate constituent elements of what is understood in European legal systems to be freedom of contract. In these provisions, the CCL incorporates the principles of equality, voluntariness and *pacta sunt servanda*. Following these principles, individuals are free to decide whether or not to contract, with whom, on what terms and in what form. Looking at these principles more closely, they appear to emphasize two separate elements, which are significant in view of the transition from a centrally planned economy to a market economy: respect for party autonomy and no government interference.[59]

Clearly, the law and administrative regulations restrict the freedom to conclude contracts. But this is also the case in Europe. The difference may lie in the nature of, and extent to which, such restrictions are made. Also the fact that local laws and administrative regulations are frequently inconsistent with laws issued at higher levels is relevant in this context.[60] Due to local protectionism and ignorance of national law, there is often an unwillingness or inability of local governments to enforce higher level, national laws.[61] This disconnection between the central government and local governments fosters uncertainty in contracts.

Although Article 4 CCL recognises party autonomy by stressing that no entity or individual may unlawfully interfere in the conclusion of contracts, it does not prohibit interference entirely. Interference is permitted, provided that it is lawful. Depending on what is understood as 'lawful interference' in practice, the autonomy of the parties could be undermined and subject parties 'to certain unpredictable restraints'.[62] An important issue is consequently how the boundary between lawful and unlawful intervention is established in practice. If the concept of 'lawful interference' is interpreted broadly, the autonomy of contracting parties, and thus an essential element of the principle of freedom of contract, will be undermined.

That the parties to a contract are to be treated as equal is laid down in Article 3. However, in practice, when a private enterprise enters into a contract with a state entity or state-owned enterprise, government interests are affected and the private company may find it difficult to be treated equally. Local protectionism, for example, may make it difficult for a private company to have the same access to remedies as its state-owned counterpart, since the local government might use means available to it to protect the state-owned enterprise in which it has an interest.[63]

The CCL recognizes a greater freedom for individuals to freely enter into contracts when compared to its predecessors; however, the principles constituting the Chinese concept of freedom of contract have to be applied within the Chinese politico-economic environment and within in a society where structural problems make their enforcement difficult or at least lead

[58] Zhang, *Chinese Contract Law. Theory and Practice*, *supra* note 2, p. 62; Herbots, *Contracteren in China*, *supra* note 2, p. 29.
[59] See Zhang, *Chinese Contract Law. Theory and Practice*, *supra* note 2, p. 56.
[60] Matheson, 'Convergence, Culture and Contract Law in China', *supra* note 3, p. 377.
[61] Ibid.
[62] Zhang, *Chinese Contract Law. Theory and Practice*, *supra* note 2, p. 59.
[63] Ibid., p. 74; Chen, *Chinese Law: Context and Transformation*, *supra* note 4, p. 669.

to inconsistency.[64] The unclear, vague and open formulation of provisions, render them not only susceptible to inconsistent interpretation, but also 'gives judges the power and latitude to construe laws in ways that serve the public interest'.[65] In this context, it should also be noted that the courts that are required to enforce the CCL lack sufficient numbers of qualified judges, and are prone to political influence.[66] In a single party, socialist state, public policy plays an important role; consequently, the influence that the Party inevitably exercises over the judiciary should neither be underestimated,[67] nor overstated.[68] Therefore, to actually be able to answer the question whether Chinese law recognizes freedom of contract as an underlying principle of contract law, it is necessary to look behind the letter of the law contained in these separate principles to establish how they are applied in practice, taking these factors into account.

5. Contract Formation

5.1 Introduction

Prior to the enactment of the CCL, under the ECL, FECL, TCL, the requirements for contract formation were rather rigid: contracts had to be in written form, contracts with foreign parties were subject to governmental approval (Articles 5 and 7 FECL), and the terms of the contract were prescribed. Furthermore, these laws did not contain general rules on how a contract was to be formed. The CCL relaxes these requirements and introduces general rules on contract formation.

Article 2 CCL defines a contract as 'an agreement between natural persons, legal persons or other organizations with equal standing, for the purpose of establishing, altering or discharging a relationship of civil rights and obligations'. The formation of a contract therefore requires the parties to reach agreement on the particular transaction or relationship to be established, altered or discharged. Like continental legal systems, Chinese contract law does not require the contract to be supported by consideration, as is the case in common law systems.

Agreement can be reached in a variety of ways. Traditionally, in European legal systems, the process of reaching agreement is analyzed in terms of an offer made by the offeror that is accepted by the offeree. Article 13 CCL incorporates this 'offer and acceptance' model into Chinese contract law: 'a contract is concluded by exchange of an offer and an acceptance'. Due to the absence of such rules in the previous contract laws, the introduction of these rules on offer and acceptance can be regarded as a 'significant improvement'.[69] Articles 32 and 33 CCL deal with those situations in which a contract is not concluded by means of offer and acceptance, for instance when the parties simultaneously sign their copies of a formal contract upon the conclusion of their negotiation. It should be noted that for certain contracts in China, despite the contract being formed in accordance with the relevant provisions on offer and

[64] Matheson, 'Convergence, Culture and Contract Law in China', *supra* note 3, p. 375; Chen, *Chinese Law: Context and Transformation*, *supra* note 4, p. 653.
[65] Matheson, 'Convergence, Culture and Contract Law in China', *supra* note 3, p. 378.
[66] Ibid., p. 377; Chen, *Chinese Law: Context and Transformation*, *supra* note 4, p. 653; Trebilcock and Leng, 'The Role of Formal Contract Law and Enforcement in Economic Development', *supra* note 28, p. 1554.
[67] Matheson, 'Convergence, Culture and Contract Law in China', *supra* note 3, p. 380.
[68] See Peerenboom, 'Judicial Independence in China: Common Myths and Unfounded Assumptions', *supra* note 24, who writes that 'the Party's role in the legal system and its impact on judicial independence is generally overstated and assumed – without a close examination of the Party's actual role and its consequences – to be pernicious'.
[69] Ling, *Contract Law in China*, *supra* note 2, p. 62.

acceptance, government approval is required. In that case, where governmental approval is required, Article 44 CCL provides that the contract only becomes effective after the completion of the approval or registration. Article 8 of the Supreme People's Court's second judicial interpretation of the CCL provides, however, that where one party fails to perform its obligation to obtain governmental approval it will be held liable for its failure and will be obliged to compensate the other party for any losses caused by such failure; and the court may permit the other party to obtain the relevant governmental approval at the breaching party's cost. Consequently, a party who is under the obligation to acquire approval cannot sabotage the contract from taking effect by failing to obtain such approval.

When looking at the rules on offer and acceptance, they reflect traditional rules that can be found in many continental legal systems. There are many similarities with the provisions of the, for instance, Dutch Civil Code, and it is also clear that the Chinese legislator has been inspired by the CISG and the Unidroit Principles of International Commercial Contracts. A closer look will be taken below at the rules on offer and acceptance contained in the Contract Law.

5.2 Offer

In contrast to for instance the civil codes of the Netherlands, France and Germany,[70] Article 14 CCL does provide a definition of an offer. Article 14 CCL requires two conditions to be fulfilled for a proposal to be regarded as an offer. First, the proposal must manifest the offeror's intention to be bound by the contract upon the acceptance of the offeree. Secondly, the proposal must contain specific and definite terms.

When it comes to determining the intent of a party to be legally bound, European legal systems differ in their approach. In English law, it is sufficient that the offeree reasonably thinks that the other party intends to be legally bound. The English approach is thus an objective one, which focuses on the outward appearance.[71] In contrast to English law, French law gives the requirement of consent a more subjective meaning. This subjective approach to the 'meeting of minds' is related to the doctrine of the autonomy of will which plays a significant role in French contract law. French law will only hold a person legally bound by an agreement if it was his real intention to be bound. The difference between these approaches is that an objective approach focuses on the outward manifestation of a party's intention to be

[70] Although the term 'offer' is introduced by Article 6:217 Dutch Civil Code (hereafter BW), no provision in the Dutch civil code contains the conditions which a proposal must fulfil in order to be treated as an offer. However, an offer is treated as a juridical act (*rechtshandeling*) under Dutch law and is governed by Articles 3:33 – 3:35 BW which essentially require the offeror to declare his intention to be bound by his offer and thus conclude a contract (the legal consequence aimed at), if the offeree accepts his terms. Similarly in German law, an offer is not defined in the Civil Code, however, it is treated as a declaration of intention (*Willenserklärung*), which must also contain the outward manifestation of the declaring party's (offeror or offeree) intention to be bound. In France, Article 1108 Civil Code (hereafter CC) establishes the requirements for the validity of a contract. It provides that the parties must consent to the contract, but it does not contain specific rules on contract formation, such as the requirement of an offer and acceptance. Article 14 of the UN Convention on Contracts for the International Sale of Goods (hereafter CISG); Article 2:201 of the Principles of European Contract Law (hereafter PECL), and Article 2.2 of the Unidroit Principles of International Commercial Contracts (hereafter UPICC) contain definitions of an offer that are similar to the Chinese definition.

[71] See *Smith v Hughes* (1871) LR 6 QB 597, 607; *Storer v Manchester City Council* [1974] 1 WLR 1403, 1408; See for comparative observations on contract formation Nicole Kornet, 'Contract Formation in England, the Netherlands and the Principles of European Contract Law', in Jan Smits and Sophie Stijns (eds.), *Totstandkoming van de Overeenkomst naar Belgisch en Nederlands Recht* (Antwerpen: Intersentia, 2002), 33-58, 33-58.

bound and therefore protects the other party's reliance on statements and conduct, and the subjective approach focuses on a party's actual intention.[72]

The CCL adopts an objective approach to determining whether the offer indicates an intention to be bound.[73] When it comes to interpreting the statements made by the parties, the CCL emphasizes the objective meaning to be given to the parties' statements. When looking for the intention of the parties, it is generally agreed that it is necessary to look to the parties' 'declared' intention as opposed to their 'genuine' intention which is to be found in the parties' inner minds.[74] ZHANG explains that 'if it could be reasonably believed from the offeror's conduct that the offeror has the intent to make a contract, a contractual obligation may arise upon effective acceptance by the other party'.[75] Therefore, whether a communication constitutes an offer depends on its outward appearance and if it indicates the offeror's intention to be bound upon acceptance of the offer by the offeree, and not on the offeror's subjective intention. In this way, the offeror is made responsible for his method of communication, and the offeree's reasonable reliance is protected.

The second requirement for a proposal to constitute an offer relates to the content of the offer. The proposal must contain specific and definite terms, so that a contract can be concluded upon the assent of the offeree. The offer must therefore contain the essential terms of the contract, making it clear to the offeree what the major terms of the contract are.[76] A clue as to what those major terms are can be found in Article 12 which provides that the contract should contain at least eight essential terms: names and domiciles of the parties; the subject matter; quantity, quality; price or remuneration; time limit for, place and method of performance; liability for breach of contract; and method for dispute resolution. Nevertheless, where a contract lacks one or more of these terms, the contract may still be effective, according to Article 12 CCL, provided it is possible ascertain the content of the contract. Where the contract leaves a gap in its express terms, it may be possible to fill the gap with the parties' subsequent agreement on supplementary terms, other relevant provisions in the contract or trade usage (Article 61 CCL), or the law. For instance, the court can establish such essential terms as quality, price or remuneration, and place, time or method of performance in accordance with Article 62 CCL.[77] However, since no provision is made in the CCL for

[72] Whereas English law focuses on the objective appearance of agreement and French law on the subjective meeting of minds, there seems to be some tension between the subjective and objective approaches in German and Dutch law, which can be seen to adopt an intermediate position. In Dutch law, it seems to follow from Article 3:33 BW that if there is a discrepancy between the party's actual intention and his declaration, there is no offer. It would seem that the party's actual intention will prevail. However, this provision must be read in conjunction with Article 3:35 BW which protects the reasonable reliance of the other party. The party making a declaration of intention will consequently be bound by that declaration if the other party could justifiably rely on the outward appearance of the declaration of intention. In Germany, whether a person has made a declaration of intention with certain content is established on the basis of the outward appearance of the declaration to the party to whom it is made. However, if a party is held to have made a declaration of intention with certain content, he may avoid the declaration for a mistake as to meaning or a mistake as to expression (§119 BGB).

[73] Ling, *Contract Law in China*, *supra* note 2, p. 65, and on interpretation of contracts, see §5.1.1.

[74] Ibid., p. 226.

[75] Zhang, *Chinese Contract Law. Theory and Practice*, *supra* note 2, p. 92. However, further on he seems to argue that the party's actual intent is required.

[76] See Ling, *Contract Law in China*, *supra* note 2, p. 65; Zhang, *Chinese Contract Law. Theory and Practice*, *supra* note 2, p. 93 refers to 'the very basic items that are sufficient to form the contract'.

[77] For example, where the quality requirement was not clearly defined in the contract, the performance shall conform to the state standard or industry standard, or in the absence of such standards, according to the customary standard, or the standard consistent with the purpose of the contract (Article 62(i) CCL). For a comparative study of gap filling techniques in England, Germany and the Netherlands, see Nicole Kornet, *Contract Interpretation and Gap Filling: Comparative and Theoretical Perspectives* (Antwerp: Intersentia, 2006).

determining the identity of the parties, the subject matter of the contract or the quantity, it would seem that these terms are truly essential in order to form a valid contract.[78]

Under the previous contract laws, judges applied the concepts of *heqing, heli, hefa* ('according to people's feelings or affection, according to propriety or reason, according to the law') to fill gaps to decide cases, in particular because of the 'very incomplete legal framework' for contracts.[79] Whether judges will continue to adopt this approach now that the legal framework for contract is more complete remains to be seen. Despite more detailed rules in the CCL, the gap filling techniques provided by Articles 61 and 62 CCL still offer the courts considerable discretion to intervene in the content of the contract. Article 61 CCL provides that the gap will be filled in accordance with 'the relevant clauses of the contract or usage of trade', and Article 62 indicates how the court should establish essential terms such as quality, price or remuneration, and place, time or method of performance. Consequently, although the CCL aims to make contracting more flexible by eliminating the strict requirements relating to the terms of the contract under the ECL, FECL and TCL, where parties do not specify the terms of their contract in more detail, they may face greater difficulty when assessing their risks and liabilities due to the discretion provided by the gap filling standards.[80]

Like European legal systems, the CCL makes a distinction between offers and invitations to treat. Certain communications will not be treated as an offer, for instance a delivered price list, announcement of auction, call for tender, prospectus or a commercial advertisement (Article 15 CCL).[81] However, with respect to a commercial advertisement, if they meet the requirements of an offer under Article 14 CCL, i.e. the advertisement manifests an intention to be bound upon acceptance by the offeree and it contains specific and definite terms, it will be treated as an offer. This seems to be inspired by Article 14(2) CISG which provides that a proposal made to the public is generally to be considered an invitation to treat, 'unless the contrary is clearly indicated by the person making the proposal'.[82]

5.3 Effect and Duration of the Offer

Like many civil law systems, Chinese law adopts the receipt theory for determining the time when an offer becomes effective.[83] Thus, Article 16 CCL provides that 'an offer enters into effect when it reaches the offeree'. The CCL does not contain a provision that indicates when the offer is treated as reaching the offeree. However, 'reach' is generally construed to mean that the offer must arrive within the sphere of control of the offeree.[84] Consequently, it is not necessary for the offer to take effect that the offeree actually sees or reads the offer. Interestingly, Article 16 CCL has adopted Article 15(2) of the Uncitral Model Law on

[78] Also see Hitchingham, 'Stepping up to the Needs of the International Marketplace: An Analysis of the 1999 "Uniform" Contract Law of the People's Republic of China ', *supra* note 2, p. 8.
[79] Ibid., p. 13, fn. 64.
[80] Ibid., p. 13.
[81] On offers versus invitations to treat, see Ling, *Contract Law in China*, *supra* note 2, pp. 66-69; Zhang, *Chinese Contract Law. Theory and Practice*, *supra* note 2, pp. 94-99.
[82] Similarly, Article 2:201 PECL which allows an offer to be made to the public. To constitute an offer, there must be sufficiently definite terms and an intention to be bound.
[83] See for example, §130 German Civil Code (hereafter BGB), Article 3:37 BW; Article 1:303 (2) PECL; Article 2.1.3 UPICC; Article 15 CISG.
[84] Ling, *Contract Law in China*, *supra* note 2, p. 70; Zhang, *Chinese Contract Law. Theory and Practice*, *supra* note 2, p. 99; Hitchingham, 'Stepping up to the Needs of the International Marketplace: An Analysis of the 1999 "Uniform" Contract Law of the People's Republic of China', *supra* note 2, p. 9. Similarly, Article 1:303(3) PECL; Article 1.10(3) UPICC; Article 24 CISG.

Electronic Commerce to provide a specific provision on when an offer is deemed to reach the offeree in the case of communication of an offer by electronic message.[85] The incorporation of this provision is an illustration of the Chinese legislator's attempt to create a Contract Law that reflects international practices.

Article 17 CCL also adopts a rule that is commonly recognized in European legal systems, that the offeror can prevent the offer from becoming effective (and thus possibly becoming bound to an irrevocable offer) by withdrawing the offer, provided such withdrawal reaches the offeree before or at the same times as the offer.[86]

Pursuant to Article 20 CCL, the offer is terminated, and can therefore no longer be effectively accepted to conclude a contract if (i) the offeree rejects the offer, (ii) the offeror validly revokes the offer (see below, section 5.4), (iii) the offeree does not dispatch his acceptance within the fixed time period or, in the absence of a fixed time period, within a reasonable period of time, (see below, section 5.5) or (iv) the offeree's acceptance materially alters the terms of the offer, in which case the acceptance constitutes a counter offer (see below, section 5.5).[87] These circumstances are similar to those found in European legal systems.[88]

5.4 Revocation of an Offer

An important issue in the context of contract formation is whether the offeror is permitted to revoke his offer once it has become effective. In European legal systems, it is possible to observe divergent approaches to the issue of revocability.[89] Thus, in English law, an offer can always be revoked up until the acceptance has been dispatched (in case the mailbox rule applies) or communicated (in all other cases). In contrast, German law holds that the offeror is bound by the offer once it has taken effect (§145 German Civil Code), and consequently he may not revoke the offer. When looking at the Chinese provisions on the revocability of offers from a common law perspective, they will appear problematic;[90] however, they will be familiar for many civil law lawyers, since the approach adopted by the Chinese legislator is similar to that of the Dutch legislator and can also be found in the CISG, PECL and UPICC.[91]

The starting point under Article 18 CCL is that offers are, in principle, revocable until the offeree has dispatched his acceptance. However, Article 19 CCL provides that the offer may not be revoked in two situations.

First, an offer is irrevocable if it expressly states that it is irrevocable, for instance by using the word 'irrevocable' or similar phrases. An offer is also treated as expressly indicating that it is irrevocable if it states a fixed time for acceptance. By stating a time period for the acceptance of the offer, the offeror promises to keep the offer open for the duration of that

[85] 'When a contract is concluded by the exchange of electronic messages, if the recipient of an electronic message has designated a specific system to receive it, the time when the electronic message enters into such specific system is deemed its time of arrival; if no specific system has been designated, the time when the electronic message first enters into any of the recipient's systems is deemed its time of arrival'.
[86] Compare §130 BGB; Article 3:37 BW; Article 15(2) CISG; Article 1:303(5) PECL; Article 2.3(2) UPICC.
[87] See below for a discussion of modified acceptance in the context of the battle of forms.
[88] Compare §146, 147, 148, 150 BGB; Articles 6:221 and 6:225 BW; Articles 17, 18 CISG; Articles 2:203, 2:206, 2:208 PECL; Articles 2.1.5, 2.1.7, 2.1.11 UPICC.
[89] For a comparison of Dutch and English law and the PECL, see Kornet, 'Contract Formation in England, the Netherlands and the Principles of European Contract Law', *supra* note 71.
[90] See Hitchingham, 'Stepping up to the Needs of the International Marketplace: An Analysis of the 1999 "Uniform" Contract Law of the People's Republic of China ', *supra* note 2, p. 10.
[91] Compare Article 6:219 BW; Article 16 CISG; Article 2:202 PECL; Article 2.1.4 UPICC.

time period. This could be problematic since not every reference to a fixed period of time for the acceptance of the offer necessarily indicates that the offer is irrevocable during that period of time. A fixed time period for acceptance may simply indicate that the offer lapses on expiry of that time period, leaving the possibility open for the offeror to revoke the offer in the meantime.[92] Chinese doctrine seems to suggest, however, that by simply fixing of a time period for acceptance in the offer is sufficient to make the offer irrevocable during that period of time, even if the offer does not explicitly refer to the irrevocability.[93]

The second exception to the revocability of offers protects the offeree's reasonable reliance on the offer.[94] An offer is also irrevocable if the offeree has reason to believe the offer is irrevocable and he has acted upon this belief. From the wording of Article 19 CCL it is not clear whether the offeree's belief is to be assessed subjectively or objectively. The wording of Article 19 CCL appears to indicate that a subjective belief in the irrevocability of the offer is sufficient – the offeree must have reason to regard the offer as irrevocable. LING explains, however, that the offeree's belief is subject to an objective test of reasonableness: the offeree's belief in the irrevocability of the offer must be reasonable in the given circumstances.[95] In addition to the offeree having a reasonable belief in the irrevocability of the offer, the offeree must also have acted upon this belief. In other words, the offeree must have commenced preparations for performance of the contract, for instance by purchasing raw materials, hiring workers, renting premises, arranging finances.[96] The evaluation of competing offers and market investigations would not constitute sufficient preparatory actions to render an offer irrevocable. The preparatory actions taken in reliance on the belief must also be reasonable.[97] Whether the belief and the action undertaken by the offeree are reasonable in the circumstances will depend on the terms of the offer, the nature of the transaction, the offeror's conduct and statements, previous dealings between the parties and trade usage.[98]

5.5 Acceptance

Pursuant to Article 25 CCL, a contract is formed when the offer has been accepted. Article 21 CCL provides that an acceptance is the 'offeree's manifestation of intention to assent to an offer'. Whether the offeree's declaration of intention manifests his intention to assent to the offer depends on the interpretation to be given to the acceptance.[99] The CCL adopts an objective approach to agreement, following which it is the outward appearance of the offeree's statement that is relevant. However, the acceptance must be complete, unconditional and unambiguous.[100] The content of the acceptance must be consistent with the offer. If the offeree accepts the offer but makes alterations to the substantial terms of the offer, the purported acceptance will be treated as a rejection of the offer and constitute a counter offer (Article 30 CCL). The effect of a modified acceptance will be discussed further below in the context of the battle of forms (section 5).

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[92] See the discussion concerning the correct interpretation of Article 16(2) CISG. Whether a fixed time period for acceptance also indicates that the offer is irrevocable during that time period will depend on the interpretation to be given to the offer in accordance with Article 8 CISG.
[93] See Ling, *Contract Law in China*, *supra* note 2, p. 72; Zhang, *Chinese Contract Law. Theory and Practice*, *supra* note 2, p. 101.
[94] See Ling, *Contract Law in China*, *supra* note 2, pp. 72-73.
[95] Ibid., p. 73; Zhang, *Chinese Contract Law. Theory and Practice*, *supra* note 2, p. 102.
[96] Ling, *Contract Law in China*, *supra* note 2, p. 73.
[97] Ibid., p. 73.
[98] Ibid., p. 73.
[99] Ibid., p. 76. See above, section 5.2.
[100] Ibid., p. 76.

Article 22 CCL requires the offeree to notify the offeror of his acceptance, unless the relevant usage or the offer indicates that acceptance by manifested by conduct. There is no required form for the communication of acceptance, and the offeree should use any reasonable means for the communication of his acceptance.[101] The offeror may specify a particular method of communication for acceptance in the terms of the offer. It seems that the offeree may adopt a different means than the one specified, provided it is 'more expeditious or advantageous' to the offeror than the means specified in the terms of the offer.[102] Chinese contract law allows acceptance by conduct. For example, the offeree can unequivocally indicate his acceptance of the offer by starting to perform the contract; if the offeror is notified of such acts, the offeree is considered to have accepted the offer.[103] Where there is a trade usage that the offeree's act constitutes acceptance without notice, the acceptance becomes effective when the offeree performs the act.[104] Although it is not explicitly stated in Article 22 CCL, silence or inactivity on the part of the offeree does not amount to acceptance, unless it is agreed between the parties, or there is an applicable usage.[105] Interestingly, Article 171 CCL provides that in the case of a sale by trial, the buyer is deemed to have made the purchase if he fails to manifest his intention to purchase or reject the subject matter at the end of the trial period. In this situation, the law deems silence or inactivity by the offeree to constitute acceptance.

Article 23 CCL provides that the offeree's acceptance must reach the offeror within the period fixed by the offer for acceptance. However, if the offer does not fix a time period, the acceptance shall be dispatched immediately if the offer is made orally or where the offer is not made orally, the acceptance must reach the offeror within a reasonable period of time.[106] What is regarded as a reasonable period of time will be determined in accordance with industrial usages, customs, previous dealings, the nature of the business, the method of communication used and the time normally needed for the offeree to make a sound decision.[107] Article 24 CCL contains a specific provision indicating when the period of acceptance commences. In the case of communication by letter or telegram, the period for acceptance commences on the date shorn on the letter or the date on which the telegram is handed in for dispatch. If the letter does not specify a date, the period commences on the posting date stamped on the envelop. Where an offer is made through means of instantaneous communication (telephone, fax, etc.), the period of time commences once the offer reaches the offeree.

Article 25 CCL clearly states that the contract is formed once the acceptance becomes effective. Article 26 CCL subsequently elaborates that the acceptance becomes effective once it reaches the offeror.[108] The CCL thus adopts the receipt theory, which is commonly applied in continental legal systems.[109] If the acceptance does not need to be notified, the acceptance

[101] Ibid., p. 77.
[102] Ibid., p. 76.
[103] Ibid., p. 77. Compare §151 BGB; Article 3:37 BW; Article 2:204 PECL; Article 18 CISG; Article 2.1.6 UPICC
[104] Ibid., p. 77. Compare §151 BGB; Article 18(3) CISG; Article 2.1.6(3) UPICC.
[105] Zhang, *Chinese Contract Law. Theory and Practice*, *supra* note 2, p. 107. Also see Article 18(1) CISG; Article 2.1.6 UPICC; 2:204(2) PECL. Dutch and German contract law require a declaration of intention, which can take any form (statement or conduct), and thus requires some outward manifestation from the offeree.
[106] Compare Article 2:206 PECL; Article 2.1.7 UPICC.
[107] Zhang, *Chinese Contract Law. Theory and Practice*, *supra* note 2, p. 105.
[108] Compare §130 BGB; Article 3:37(3) BW; Article 2:205 PECL; Article 18(2) CISG; Article 2.1.6(2) UPICC.
[109] Contrast with the English approach with respect to non-instantaneous communications of acceptance, to which the mailbox rule is applied. In that case, the acceptance becomes effective when it is dispatched. For comparative observations on contract formation, see Kornet, 'Contract Formation in England, the Netherlands and the Principles of European Contract Law', *supra* note 71.

becomes effective once the act of acceptance has been performed in accordance with the relevant usage or the requirements of the offer. It will be recalled that Article 16 CCL dealt specifically with the issue when an offer transmitted by electronic means reaches the offeree. Article 24 CCL does not contain a similar provision with respect to the acceptance. However, a closer look at Article 16 CCL reveals that it is not restricted to offers. Article 16 CCL applies to the conclusion of a contract by the exchange of electronic messages; therefore the rule contained therein also applies to the acceptance.

The offeree can prevent the acceptance, and thus the contract, from taking effect by withdrawing the acceptance. Such withdrawal must, pursuant to Article 27 CCL, reach the offeror before or at the same time as the acceptance.[110] A late acceptance is treated as a new offer, unless the offeror advises the offeree without delay that the acceptance is valid (Article 28 CCL).[111] If the acceptance was dispatched within the time period and would have reached the offeror on time under normal circumstances, the acceptance is valid, unless the offeror informs the offeree without delay that the acceptance has been rejected on grounds of delay (Article 29 CCL).[112]

The CCL also deals with particular situations where contract formation does not follow the traditional process of offer and acceptance. Where the parties enter into a contract by a memorandum of contract, the contract is formed when it is signed or sealed by the parties (Article 32 CCL). However, if prior to signing or sealing the contract, one of the parties has already performed its main obligation and the other party has accepted the performance, the contract is formed (Article 37 CCL). Article 33 CCL provides that where the parties enter into a contract by the exchange of letters or electronic messages, one party may require the execution of a confirmation letter before the contract is formed. In that case, the contract is only formed upon execution of the confirmation letter.

6. Battle of forms

6.1 Introduction

In international business transactions, especially international sales, businesses frequently transact on the basis of standard form contracts. By preparing standardized contract terms in advance to be used on a repeated basis, businesses are able to simplify and facilitate the contracting process and thus increase business efficiency, in particular where there are a high number of transactions that are capable of being standardized. The use of standard forms by businesses can cause of the most difficult problems in relation to the formation of contract: the battle of forms.

A battle of forms occurs when during the process of contract formation, the parties exchange standard forms containing divergent terms. For example, a buyer may send an offer using its own standard form and the seller will purportedly accept the offer using its own standard form. Each party's standard form is drafted in advance with terms that are favourable to that party. Consequently, the forms rarely correspond. The standard form used by a seller will, for instance, generally include a disclaimer of warranties and significantly limit the seller's

[110] Compare §130 BGB; Article 3:37(5) BW; Article 1:303(5) PECL; Article 2.1.10 UPICC.
[111] Compare Article 6:223(1) BW; Article 21(1) CISG; Article 2:207(1) PECL; Article 2.1.9(1) UPICC. Slightly different: §150 BGB a late acceptance is a new offer.
[112] Compare §149 BGB; Article 6:223(2) BW; Article 2:207(2) PECL; Article 21(2) CISG; Article 2.1.9(2) UPICC.

liability; whereas the buyer's form generally requires extended warranties and entitles the buyer to a generous measure of consequential damages. Each party generally does not read the terms of the other party's form and believes that it has contracted on the basis of its own terms. A battle of forms tends to give rise to two main questions: first, has a contract been concluded? Secondly, if so, what are its terms?

6.2 Three Approaches to the Battle of forms

A comparative inquiry shows that there are three main approaches to dealing with the problem of the battle of forms: the 'last shot', 'first shot' and 'knock out' approaches.[113]

English law adopts a 'last shot' approach, which follows from a strict 'mirror image' approach to contract formation.[114] Since the purported acceptance contains terms different to the previous form (the offer), it is not a mirror image of the offer and is therefore treated as a counter offer. The contract is formed when the last form in the exchange of forms has been accepted. This usually occurs through conduct; the party that receives the last form will start to perform which will be treated as acceptance of the terms contained in the last form. Consequently, the content of the contract is determined by the terms contained in this 'last shot'. This approach can also be found in the CISG, albeit less strict than the English 'mirror image' rule. Article 19(1) CISG provides that a purported acceptance to the offer that contains additions, limitations or other modifications is a rejection of the offer and constitutes a counter offer. Article 19(2) CISG provides, however, that if the additions, limitations or other modifications do not materially alter the terms of the offer, the reply will constitute an acceptance, unless the offeror objects without undue delay. The CISG thus makes a distinction between material and immaterial alterations in order to determine the effect of a purported acceptance.

An alternative approach, which can to a certain extent be seen in Dutch law, is the 'first shot' approach to the battle of forms. Article 6:225(1) and (2) DCC provide that an acceptance that differs from the offer is to be regarded as a counter offer unless the alterations are minor and the offeror does not object to the alterations. However, Article 6:225(3) applies specifically to the battle of forms. It provides that where the offer and acceptance refer to different standard terms, the second reference to standard terms is ineffective, unless it expressly rejects the applicability of the standard terms referred to in the first reference. The content of the contract is in this case determined by the terms in the first shot.[115]

In German law, §150(2) BGB appears to adopt the 'last shot' approach. However, German law tends to separate the issue of contract formation from the issue of determining the content of the contract when it comes to the battle of forms. The problem of the battle of forms is dealt with by 'knocking out' terms that conflict. A contract will be regarded as validly concluded if it becomes clear that the parties did not want the contract to fail simply because of conflicting standard terms. To establish the content of the contract, the terms of the contract

[113] On the battle of forms, see Omri Ben-Shahar, 'An Ex-Ante View of the Battle of the Forms: Inducing Parties to Draft Reasonable Terms', *International Review of Law and Economics*, 25/3 2005), 350-70; Peter Schlechtriem, 'Battle of the Forms in International Contract Law. Evaluation of Approaches in German Law, Unidroit Principles, European Principles, Cisg; UCC Approaches under Consideration.' in Karl-Heinz Thume (ed.), *Festschrift Für Rolf Herber Zum 70. Geburtstag* (Newied: Luchterhand, 1999), 36-49, also available at http://www.cisg.law.pace.edu/cisg/biblio/schlechtriem5.html (last visited on 13 January 2010).

[114] See *Butler Machine Tool Co Ltd v Ex-Cell-O Corporation Ltd* [1979] 1 WLR 401.

[115] As a result of this provision, most sets of standard terms include a provision that rejects the applicability of the other party's standard terms.

are analyzed. Any conflicting terms are 'knocked out' of the contract since the parties have clearly not reached consensus on those matters. The gap that is left by the 'knocked out' terms is subsequently filled by the applicable law. The German courts also adopt this approach when applying the CISG to the battle of forms.[116]

The PECL and UPICC have dedicated specific provisions to the problem of the battle of forms. They also adopt this 'knock out' approach. According to Article 2:209 PECL, where the offer and acceptance refer to conflicting general conditions, the contract is nevertheless formed, unless one of the parties has indicated, other than by way of a general condition, that it does not intend to be bound by a contract on this basis, or if it informs the other party without delay that it does not intend to be bound. Where a contract has been formed, the general conditions that do not conflict form part of the contract and conflicting terms are 'knocked out'. Article 2.1.22 UPICC includes a similar provision.[117] These specific provisions in the UPICC and the PECL override the general rules on offer and acceptance according to which a last shot approach would be adopted: Article 2.1.11 UPICC and Article 2:208 PECL (like Article 19 CISG) provide that a purported acceptance that contains modifications, limitations or additions constitutes a counter offer, unless the alterations are not material and the offeror does not object to the discrepancy.

The knock out approach tends to separate the issues of contract formation and the content of the contract. In a case of the battle of forms, the parties generally intend to contract with each other and they will have reached agreement on the essential terms. Whereas the last shot approach would lead to the conclusion of a contract on terms that are biased to the party who sent the last form, the knock-out approach tends to focus on establishing the content of the contract on the basis of the parties' consensus – those terms that correspond in both parties' forms are enforced – and the applicable law, which fills in the gaps left by the terms that have been cancelled out.

6.3 The Battle of Forms in Chinese Contract Law

Having canvassed different approaches to the battle of forms, it is now time to consider how this problem is dealt with in the CCL. According to Article 30 CCL, the terms of the acceptance shall be identical to those of the offer. In other words, the offeree must accept the terms of the offer in their entirety, and not add, qualify or modify any of those terms. The Chinese legislator has recognized in Article 30 CCL, however, that such a 'mirror-image' approach could discourage the formation of a contract and could undermine the agreement actually reached between the parties who wish to perform the contract. For this reason, Article 30 CCL provides that only where the acceptance materially alters the terms of the offer is the acceptance to be regarded as a counter offer. Where the changes to the offer are not material, Article 31 CCL provides that the acceptance is valid and the terms of the acceptance will prevail, unless the offeror objects to such changes without delay, or if the offer indicated that no changes to the terms could be made in the acceptance.

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[116] On a recent decision along these lines, see Mª Del Pilar Perales Viscasillas, 'Battle of the Forms and the Burden of Proof: An Analysis of BGH 9 January 2002', *Vindobona Journal of International Commercial Law and Arbitration*, 6/22002), 217-28, also available at http://www.cisg.law.pace.edu/cisg/biblio/perales2.html (last visited on 13 January 2010).

[117] Article 2.1.22 UPICC: 'Where both parties use standard forms and reach agreement except on those terms, a contract is concluded on the basis of the agreed terms and of any standard terms which are common in substance unless one party clearly indicates in advance, or later and without undue delay informs the other party, that it does intend to be bound by such a contract'.

The CCL thus distinguishes between material and non-material alterations to the offer. When is an alteration to an offer to be regarded as material? Article 30 CCL explains that changes concerning the subject matter, quantity, quality, price or remuneration, time, place and method of performance, liabilities for breach of contract or the method of dispute resolution are material changes to the terms of the offer. These terms can be viewed as essential terms of a contract and the parties must reach agreement on them. The drafters of the CCL have indicated that Article 30 CCL should not be viewed as containing an exhaustive list; the terms specified are indicative of certain types of terms, the modification of which, could be regarded as material.[118] Following the text of the CCL, *any* alteration, even an insignificant alteration, made to one of these specified terms consequently constitutes a material alteration. This approach could lead to incorrect results. Minor alterations to one of the specified terms may not significantly alter the parties' relationship and could reflect ordinary trade practice.

In order to avoid such incorrect results, Article 30 CCL should be read in light of Article 31 CCL. The determinative criteria should be the 'materiality' of the alteration, and not the nature of the term. Whether any alteration to the offer is to be regarded as material, thus rendering the purported acceptance a counter offer, should depend on the individual circumstances of the case. Article 30 CCL should thus be seen as containing a rebuttable presumption that alterations to the specified terms are material.[119] It remains open to the offeree to subsequently show that the alteration is not material, in which case the acceptance including the non-material alterations is valid, unless the offeror objects without delay to the changes. Thus, alterations to the specified terms should raise a presumption of materiality, but should not automatically result in the acceptance being treated as a counter offer.

It is clear that the Chinese legislator has been influenced by the approach of Article 19 CISG and Article 2.1.11 UPICC. Although a mirror image is generally required for the formation of contract, the CCL provides that where alterations to the offer are minor, the purported acceptance will be valid, subject to the possibility of the offeror to object. This means that in the context of the battle of forms, where standard forms generally incorporate materially different terms (for instance concerning the liability of the parties), the last shot approach would seem to apply. The terms of the contract generally will be determined according to the standard terms incorporated in the offeree's form. Where the acceptance includes non-material alterations, the contract will be concluded on the basis of the original offer subject to the non-material alterations made by the offeree in his acceptance. The offeror will usually be unaware of the alterations made to his original offer and will fail to object immediately since in business, the parties rarely read each other's standard terms. Alternatively, if the acceptance contains significant alterations (which is the more likely scenario, since the objective of using standard forms is generally to incorporate terms in the contract that favour one's own position), the purported acceptance constitutes a counter offer, which subsequently needs to be accepted by the original offeror. Since the original offeror is unlikely to read the standard terms proffered by the other party, he will be under the impression that a contract has been concluded on the basis of the terms contained in his own standard form and proceed to perform his side of the bargain (for instance by delivering or taking delivery of the goods). In accordance with Article 22 CCL, such conduct can be construed as an acceptance of the counter offer. When a dispute arises, the original offeror will be confronted with the terms contained in the other party's standard form, which likely will differ significantly from the terms he thought he was contracting on.

[118] Ling, *Contract Law in China*, *supra* note 2, p. 80.
[119] Ibid.

In view of the inspiration the Chinese legislator drew from various international instruments, including the UPICC, it would have been advisable to adopt a provision similar to Article 2:209 PECL and 2.1.22 UPICC which specifically deals with the battle of forms. The approach adopted in both sets of principles is more in line with the underlying notion of contract formation: establishing a meeting of minds. When business parties contract on the basis of standard forms, they generally have the intention to contract with each other. The issue that needs to be settled is the terms of the contract. Those terms that correspond in both forms clearly reflect consensus between the parties and should be applied to the contractual relation. However, where the parties' forms conflict, such terms should be 'knocked out', as they do not reflect a meeting of minds between the parties. The gaps that are left by the 'knocked out' terms can be filled by trade usage and the applicable law. This approach is more likely to achieve a just result than a 'last shot' approach which could lead to the original offeror unwittingly concluding a contract based on entirely on the other party's terms.

Article 44 provides that a contract that has been formed lawfully will become effective upon its formation. However, the lawful formation of the contract must be distinguished from its validity or the validity of individual terms in the contract. A contract generally will be 'be effective and enforceable if (a) it is made by the parties who possess the required legal capacity, (b) it is the product of real intention of the parties, and (c) it does not violate any law or public interest'.[120] This last aspect can be important in the context of standard form contracts. Although the contract has been formed in accordance with the relevant rules, (some of) its terms may not be valid for violation of law or public interest.

7. Standard Form Contracts

7.1 Introduction

To simplify and facilitate the contracting process and increase business efficiency, businesses often use standard forms in their international business transactions, especially in international sales transactions. Once it has been established that a contract has been concluded and which set of terms govern the contractual relation, it is necessary to establish the validity of those terms. In the context of international sales transactions, this is a matter for national law since the CISG does not deal with the validity of terms (Article 4 CISG).[121] It therefore becomes important to consider how Chinese contract law regulates the use of standard terms as Chinese law could be the applicable national law. In view of the extensive use of standard terms in international contracting, the control of such terms by national law is of great importance to modern contract law. There appears to be a growing use of standard form

[120] Zhang, *Chinese Contract Law. Theory and Practice*, *supra* note 2, p. 150.
[121] On standard form contracts and the CISG, see for instance, Jan Hellner, 'The Vienna Convention and Standard Form Contracts', in Petar Sarcevic and Paul Volken (eds.), *International Sale of Goods: Dubrovnik Lectures* (Oceana, 1986), 335-63, available at http://www.cisg.law.pace.edu/cisg/biblio/hellner.html (last visited on 13 January 2010).

contracts in China,[122] for which reason, Chinese contract law, for the first time, contains specific provisions regulating the use of standard terms.[123]

Article 39(2) CCL defines standard terms as 'contract provisions which were prepared in advance by a party for repeated use, and which are not negotiated with the other party in the course of concluding the contract'.[124] Where standard form contracts are used, there is typically an inequality of bargaining power which allows one party to force its standard terms on the other party on a 'take-it-or-leave-it' basis, or as a result of a battle of forms, one party's terms are imposed on another, otherwise equal, party. The regulation of standard terms in the CCL is aimed at preventing surprise on the part of the other party through a notification requirement (7.2) and upholding the principles of fairness and equality (7.3).

7.2 Notice

Since standard terms are not the product of negotiations between the parties, but formulated in advance by one of the parties and provided to the other party in a pre-printed form on a 'take-it-or-leave-it' basis, there are concerns that the other party could enter into a contract without knowing the nature and content of the terms and could consequently be taken by surprise since the standard terms may be seriously detrimental to its interests. For this reason, Article 39 CCL requires the contracting party using standard terms to call the other party's attention to any provisions excluding or limiting its liability and to explain such provisions upon request of the other party. This notification requirement applies even where the other party has expressly or implicitly consented to the application of the standard terms.[125]

The user of the standard terms must give notice 'in a reasonable manner'. Whether notification has been given in a reasonable manner will depend on the individual circumstances of the case, taking into account the nature of the transaction, the language of the standard term, and the extent to which the user of the standard term exempts liability.[126] The user may be required to specifically communicate the exclusion or limitation clause to the other party, print them in a distinctive colour, style or size, or display them on its premises.[127] In Article 6 of its second judicial interpretation of the CCL, the Supreme People's Court confirmed that a user of standard term complies with this requirement when it uses words,

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[122] Zhang, *Chinese Contract Law. Theory and Practice*, *supra* note 2, p. 138, 140, in particular refers to the use of standard terms in contracts involving insurance, transportation and the use of public utilities, as well as contracts concluded through the Internet, in particular in relation to services. Ling, *Contract Law in China*, *supra* note 2, p. 108, explains that standard terms and standard form contracts were used as a means of enforcing mandatory state plans. The government would impose standard terms from which the parties could not derogate. More recently, standard terms are used by industries monopolised by government or state-owned enterprises, or heavily regulated industries such as banking, post and telecommunications, public transportation and public utilities. Many standard terms are prescribed by government departments, in governmental documents and ministerial rules, in order to protect enterprises within their jurisdiction.

[123] Compare: the use and validity of standard terms in business-to-consumer transactions has been regulated at EU level, see Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts, *OJ* L 95, 21.4.1993, pp. 29–34. The validity of standard terms in business-to-business transactions is left to national law, see for instance, §305a ff. BGB; Article 6:233 ff. BW; Unfair Contract Terms Act 1977 (England).

[124] Similarly, Article 2.1.9 UPICC.

[125] Ling, *Contract Law in China*, *supra* note 2, p. 111. Compare Article 2.1.10 UPICC which renders standard terms that could not reasonably have been expected by the other party to be ineffective, unless they were expressly accepted.

[126] Ibid., p. 111. According to Professor Wang Liming, whether a reasonable way for notification has been used depends on (i) the set up of the notice document, it should be sufficiently legible to attract the other party's attention; (ii) the method of giving the notice; (iii) the degree of explicitness of the language used in the notice; (iv) the timing of the notice, it should be given before the contract is concluded, or during the formation process; and (v) the degree of the awareness of the other party (Wang Liming, *Studies on Contract Law*, Vol. I., People's University Press, 2002, pp. 394-395, cited in Zhang, *Chinese Contract Law. Theory and Practice*, p. 139).

[127] Ling, *Contract Law in China*, *supra* note 2, p. 111.

symbols, or for instance a particular font or typeface to attract the attention of the other party. The notice must be given prior to the conclusion of the contract.

This duty of notification also requires the user to explain the term or terms, if requested to do so by the other party. Consequently, if the user of the standard terms does not explain the term or fails to explain them clearly and accurately, the standard term is not binding. The duty to explain the terms is initiated by the other party, who will request the user to explain the nature and content of the terms. In the absence of such request, there is, in principle, no duty to explain. However, the principle of good faith (Article 6 CCL) may require the user to explain standard terms, even in the absence of a request by the other party, if the language of the term is difficult and the exclusion of liability extreme.[128] With respect to such terms, a duty to explain appears to be incorporated in the duty to notify in a reasonable manner.[129]

Failure to explain a term will lead to the invalidity of that term. This invalidity only applies to the term that has not been explained, the other provisions of the contract remain valid. This could consequently lead to an unexpected disadvantage or shift in bargain to the user of standard term, who based the price of the contract on the limitation clause. The underlying rationale for this approach is to prevent improper advantage-taking by the user of standard terms and to facilitate informed decision-making by the other party.[130] In this way, the requirement of notice can be seen to promote the principles of equality and voluntariness in Articles 3 and 4 CCL respectively. Following this approach, the other party cannot be taken unawares by terms that it does not wish to accept. This would in particular be the case if the duty to notify extends to all 'surprising terms' and not just those that exclude or limit the user's liability.[131]

In light of the notification and explanation requirements, foreign businesses dealing in China using standard form contracts should review their standard forms with a view to considering whether they sufficiently draw attention to exemption and limitation clauses, in particular since in practice Chinese courts tend to apply these provisions, even where the parties have agreed the contract is governed by a foreign law, since the courts view these rules as a matter of public policy that cannot be waived.[132] Furthermore, it is advisable that the user of a standard form provides a written explanation and/or that the other party acknowledges that it has received such explanation.

Where there has been a battle of forms, it would therefore seem that the party sending the last standard form is under an obligation to make the other party aware of the fact that its terms, for instance, exclude or limit liability. It is this exclusion or limitation of liability, which is likely to constitute a material alteration to the terms of the offer, causing the purported acceptance to be treated as a counter offer. The other party, who would generally be unaware of the discrepancy between the offer and the purported acceptance, is likely to continue to perform the contract, believing the contract to be based on its own terms. This performance

[128] Ibid., p. 111.
[129] Ibid., p. 111.
[130] Ibid., p. 112.
[131] See Article 2.1.20 UPICC, which requires the express consent of a party to terms it could not reasonably have expected, so-called 'surprising terms'; §305c BGB provides that standard business terms 'which in the circumstances, in particular with regard to the outward appearance of the contract, are so unusual that the other party to the contract with the user need not expect to encounter them, do not form part of the contract'.
[132] See for example, Steve Dickinson, China Contract aw: Going All Clear On US Now. China Law Blog, 4 June 2009, available at http://www.chinalawblog.com/2009/06/china_gets_all_new_on_contract.html (last visited 13 January 2010).

will generally be regarded as acceptance by conduct of the counter offer. Rather than contracting on its own terms, the original offeror is unwittingly agreeing to contract on the other party's terms. The requirement of notification will protect the original offeror from accepting the counter offer by conduct in ignorance of the altered liability provision. Consequently, the original offeror must expressly accept the exclusion or limitation of liability in the counter offer. Applied in this way, the notice requirement of Article 39 CCL could mitigate the negative consequences of the 'last shot' approach to the battle of forms.

7.3 Principle of Fairness

Since standard terms, by their nature, are supplied by one party in the absence of negotiation with the other party, there is a real risk that the user of the terms will abuse its advantage and impose unfair terms on the other party. According to Article 5 CCL, 'the parties shall abide by the principle of fairness in prescribing their respective rights and obligations'. This obligation to determine the rights and duties of parties in accordance with the principle of fairness is repeated explicitly for standard terms in Article 39 CCL. Consequently, when drafting the standard terms, the user must be guided by the principle of fairness.[133] The principle of fairness is aimed at achieving a balance in the rights and obligations of the contracting parties and incorporates concepts of proportionality, and the reasonable and just allocation and sharing of rights and obligations and risks.[134]

LING explains that a direct application of the principle of fairness to challenge the validity of contractual term is rare. Instead, most unfair contract terms are challenged by way of an unconscionability review.[135] Pursuant to Article 59(1)(2) GPCL, a contracting party can petition a court or arbitral tribunal to amend or cancel a contract if it is evidently unfair or 'grossly unconscionable' is voidable. This so-called unconscionability review is also adopted in Article 54(1)(2) CCL. Since the provision in the CCL is based on that of the GPCL, the Supreme People's Court judicial interpretation with respect to Article 59 GPCL would seem to apply. According to the Court, an unconscionable contract involves two elements: 1) one party exploited its advantageous position or the other party's inexperience and; 2) there is evident unfairness in the terms of the contract.

With respect to the first element, a party has an advantageous position if there is a disparity of bargaining power. This disparity can stem from all kinds of advantages that one party may have over another, for example political, economic, technological or information advantages.[136] Inexperience denotes a general lack of life experience or in the particular kind of transaction involved.[137] It is not clear whether exploitation or inexperience is a constitutive element of unconscionability or merely a significant factor. This is relevant in the context of business transactions, where parties are generally considered to be equal. LING explains that the courts sometimes only look to the substantive unfairness of the terms, without making any finding on exploitation.[138]

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[133] Compare: Article 4:110 PECL allows a party to avoid a standard term that, contrary to good faith and fair dealing, leads to a significant imbalance in the parties' rights and obligations; §307 BGB invalidates a standard term that contrary to the principle of good faith is unreasonably disadvantageous to the other party; Article 6:233 BW inquires whether a term is 'unreasonably onerous'; and Unfair Contract Terms Act 1977 (England) applies a reasonableness test to the standard term.
[134] See Zhang, *Chinese Contract Law. Theory and Practice*, *supra* note 2, pp. 74-75.
[135] Ling, *Contract Law in China*, *supra* note 2, p. 52; Zhang, *Chinese Contract Law. Theory and Practice*, *supra* note 2,p. 75.
[136] Ling, *Contract Law in China*, *supra* note 2, p. 191.
[137] Ibid., p. 192.
[138] Ibid., p. 192.

With respect to the second element, a term is evidently unfair if there is 'a flagrant disequilibrium of the rights and duties of the parties under the contract, and the benefit that the contract confers on one party must be totally disproportionate with the performance that that party has undertaken'.[139] Whether such disequilibrium exists will depend on the nature and the purpose of the contract. The CCL contains specific provisions on certain types of contractual terms that are, by their nature, susceptible to unfairness, such as exemption clauses, deposit clauses, and liquidated damages clauses. Article 53 CCL invalidates, for example, a term that excludes liability for personal injury to the other party. This term is deemed to be evidently unfair.

In addition to this general requirement of fairness, Article 40 CCL declares certain standard terms to be void. A standard term that falls under Article 52 and Article 53 CCL is invalid. Article 52 CCL provides that a contract is invalid: if (i) it was induced by fraud or duress, thereby harming the interests of the state; (ii) the parties colluded in bad faith, thereby harming the interests of the state, the collective, or any third party; (iii) the parties intended to conceal an illegal purpose under the guise of a legitimate transaction; (iv) the contract harms public interests; or, (v) the contract violates a mandatory provision of any law or administrative regulation. In Article 14 of its second judicial interpretation, the Supreme People's Court restricts the application of the last ground for invalidity. It explains that the mandatory provision must expressly provide that failure to comply with it will render the contract invalid.

Article 53 CCL provides that the following exculpatory provisions are invalid: (i) where a party excludes liability for personal injury caused to the other party; or, (ii) where a party excludes liability for property loss caused to the other party by intentional misconduct or gross negligence. Standard terms which fall within the scope of these provisions are void, even if the supplier has notified the other party of their inclusion in the contract.[140]

Article 40 CCL also provides three further grounds for invalidating a standard term. First, a standard term that excludes the liability of the party supplying such term is void. There is obviously tension here between the freedom of contract of parties to include exemption clauses in their contract, and thus adjust the risks inherent in a particular transaction, and the fairness of such a term, in particular when it is presented as a standard term, because the exemption clause tends to alter the balance of the parties' interests. Does this mean that all provisions that exclude the liability of the user of the standard term are void? LING suggests that this rule should be construed restrictively to mean that only terms that exclude the user's liability which have not been notified to the other party in accordance with Article 39(1) are void.[141] Where the exemption clause has been notified, it can be challenged under Article 54(1)(2) CCL (unconscionability review), and invalidated if it causes a 'flagrant disequilibrium' between the rights and duties of the parties.

Secondly, Article 40 CCL provides that a standard term that increases the liabilities of the other party is void. This provision is formulated so broadly that it would appear to suggest that a standard term that leads to liability that is more onerous than liability under the general

[139] Ibid., p. 192. Compare EU Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts which renders a standard term that, 'contrary to the requirement of good faith, […]causes a significant imbalance in the parties' rights and obligations arising under the contract, unfair; Article 4:110 PECL; §307 BGB.
[140] Ibid., p. 112.
[141] Ibid., p. 112.

law of contract or tort would be void. Such a rule would seem to be too far reaching, since the recipient may have received a price discount or the increased liability may be compensated elsewhere in the contract. It is important not to read individual standard terms in isolation, but to establish whether there is an unfair disequilibrium between the rights and duties of the parties based on an analysis of the contract as a whole. LING explains that the provision applies in particular to liquidated damages clauses, forfeiture clauses and termination clauses.[142] Thus, the user of the standard term cannot rely on a liquidated damages clause that exceeds the actual loss sustained by him, or a termination clause that would not entitle him to terminate under the general law. Where the liability of both parties is increased, however, Article 40 CCL does not apply. It only applies where the standard term increases the liability of the other party in a disproportionate and unfair manner.

Thirdly, a standard term that deprives the other party of any of its material rights is, according to Article 40 CCL, void. 'Material rights' is not defined in the CCL, but would seem to refer to 'major duties or increases the other party's responsibilities',[143] or 'rights the party normally will have in the kind of contract'.[144] LING explains that 'the deprived right is one that the other party would have had, but for the standard term'.[145] Examples include: (i) terms that exclude or limit a party's contractual defences; (ii) terms that provide for the forfeiture of a party's property; (iii) terms that restrict a party's freedom to contract with others; and, (iv) arbitration clauses (which exclude the parties' access to the court).[146]

8. Final Remarks

In a market economy, where competition and economic efficiency is promoted if businesses are free to enter into voluntary exchanges (subject to mandatory law), the principle of freedom of contract plays a vital role. Particular attention was given in this article to the question whether freedom of contract is recognized in Chinese contract law. It was seen that the CCL does not expressly include freedom of contract as an underlying principle of contract law. Nevertheless, it appears to have been incorporated in substance in various general principles in the CCL. The CCL recognizes the principle of equality between contracting parties, the right to voluntarily enter into contracts, and the principle of *pacta sunt servanda*. In essence, these principles, read in combination, recognize that individuals are free to decide whether or not to contract, with whom, on what terms and in what form. Whereas this is inherently reflected in a simple reference to freedom of contract in European legal systems, the drafters of the CCL seem to have chosen to spell out the constituent elements of freedom of contract, and in particular to emphasize respect for party autonomy and rejection of unlawful (governmental) interference.

Although the letter of the law seems to recognize what European legal systems regard as freedom of contract, whether it is truly recognized in Chinese law will depend on how these principles are applied in practice and the nature and extent of restrictions placed by the law on individuals' ability to benefit from this freedom. In particular, administrative supervision, mandatory plans, lawful interference, the requirement of governmental approval and the open norms contained in Article 7 CCL, which introduce a broad discretion to subject the

[142] Ibid., pp. 112-113.
[143] Wang Kui Hua, *Chinese Commercial Law* (Oxford New York Melbourne: Oxford University Press, 2000), p. 62.
[144] Zhang, *Chinese Contract Law. Theory and Practice*, *supra* note 2, p. 139.
[145] Ling, *Contract Law in China*, *supra* note 2, p. 113.
[146] Ibid., pp. 113-114.

individual rights and interests of the contracting parties to the collective interest, raise potentially far-reaching restrictions to the freedom of contract under Chinese law.

Having concluded that the CCL nevertheless offers greater freedom to conclude contracts than its predecessors, this article then addressed how contracts are formed. The overview of the rules on contract formation, which were newly introduced into Chinese contract law by the CCL, demonstrated that the drafters of the CCL appear to have been greatly influenced by international practice, in particular the CISG and the UPICC. Many of the rules on contract formation will be familiar to continental lawyers. A particularly difficult issue in the context of contract formation, which can also play an important role in international business transactions, is the battle of forms. In Europe, a variety of approaches (last shot, first shot, knock out) are adopted to solve the problems of whether a contract has been concluded, and if so, on what terms, when parties transact by exchanging divergent standard form contracts. The solution to this problem adopted by the CCL has clearly been influenced by the CISG, which adopts a modified 'last shot' approach. By adopting this approach, the terms of one party are imposed on the other party. Most businesses do not become acquainted with the other party's standard form and are therefore rarely aware that by starting to perform their side of the bargain, they are in fact accepting, through conduct, the other party's terms. In view of the influence of the UPICC on the drafters of the CCL, it is unfortunate that the 'knock out' approach contained in Article 2.1.22 UPICC was not adopted in the CCL as this approach appears more favourable to establishing a meeting of minds.

The negative consequences of the 'last shot' approach to the battle of forms could be mitigated to a certain extent, however, by the duty to notify the other party of standard terms that exclude or limit its user's liability. In this way, the party who, ignorant of the discrepancies in the standard forms, is about to accept through conduct is made aware of the material alteration to the liability term and is able to take appropriate action. Furthermore, although the other party (the original offeror) may be bound to standard terms he did not actually intend to govern the contract through his acceptance by conduct, he is protected by the fairness principle in the sense that the user of standard terms may not impose terms that are evidently unfair. Having said that, a far-reaching judicial control of standard terms is not always desirable and could impose restrictions on the parties' freedom of contract. This would particularly be the case if every exemption or limitation of liability would be held invalid. Whether a particular standard term is deemed unfair and therefore invalid, should ultimately be based on an assessment of the fairness of the term in light of all of the terms of the contract read as a whole, the nature and purpose of the contract, the relative bargaining power of the parties, and the circumstances of the individual case. The question remains whether the Chinese courts and arbitration institutions will approach the application of the fairness principle in this manner.

In a globalising world, contracts form the backbone of international economic transactions and contract law provides the legal framework for the formation, performance and enforcement of those contracts. The provisions laid down in the CCL appear to be a step towards a modern law of contract that can promote its objectives to foster international economic, trade and technological cooperation. However, the CCL only provides the legal framework for understanding how contracts and contract law function in China. The actual implementation and enforcement of the law takes place within a broader context in which the cultural and legal heritage and traditions and the politico-economic environment play an

important role. In addition to the legal analysis provided in this article, it is necessary to also take these factors into account in any endeavour to understand Chinese contract law.

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