FOREIGN TRADE CONTRACTS BETWEEN WEST GERMAN COMPANIES AND THE PEOPLE’S REPUBLIC OF CHINA: A CASE-STUDY

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ROBERT HEUSER

I. INTRODUCTION

Throughout the nineteenth and twentieth centuries, businessmen in the West have had high expectations for developing the market potential of China. Those hopes have never been realized — neither in the colonial nineteenth century nor in the years preceding or following the Communist accession to power. Explanations for that failure have varied, but the hopes of “selling ‘oil for the lamps of China’ [are] no less intoxicating today than they were in 1937,” when U.S. businessman Carl Crowe first published his book, 400 Million Customers. After the eleventh edition, Crowe succeeded in proving only that the United States remains an excellent market for literature promising a utopian future; the China-market remained illusory.

The years since 1972 have brought substantial changes in the Chinese approach to foreign trade. The polarity between the precept of self-reliance and the economic concept of participation

Abbreviations: AJIL = American Journal of International Law; AHD = Aubenhandelsdienst (of the German Chambers of Commerce); RIW = Recht der Internationalen Wirtschaft (Heidelberg); Ch.a. = China aktuell (Hamburg); BGBI = Bundesgesetzblatt; FGHB = Pagu-Huibian (Collection of laws of the PRC); Hamburger Vertragssammlung = Institut für Asienkunde (ed.), Die Verträge der VR China mit anderen Staaten; NZZ = Neue Zürcher Zeitung; P.R. = Peking Rundschau/Peking Review; USCBR = US-China Business Review (Washington, D. C.).


in the international division of labor was reduced in the Chinese communist ideology. In foreign trade, as in other spheres of Chinese policy, the principal concern is to find adequate methods, within the Chinese ideological framework, for modernizing a technologically underdeveloped China. During China's first ten years under Mao Tse-tung, the response to this concern consisted of a continuation of the pre-communist approach, with the parties appropriately changed. Thus "yi-bian-dao," "to lean on one side," indicated cooperation with the Soviet Union and the Peoples' Democracies rather than, as before, with the western capitalist countries. Mao was explicit: "Of course, we want to have trade" — but not with the foreign reactionaries, the imperialists, who do not care about the principles of "equality" and "mutual benefit."\(^5\) Mao's leaning on one side, however, was ill-repaid: the Soviet Union, as its capitalist predecessors in trade, "ripped up the contracts."\(^6\) Never before had a Chinese government felt so despised. After all, "the alliance with Soviet Russia [was] the first deliberately chosen alliance in Chinese history."\(^7\) Following this treatment, China turned inward. It was felt that Chinese national pride could only be regained and developed through "confidence in one's own resources." It was some time before Chinese foreign trade took on substantial dimensions. This hiatus in trade is mirrored in the publication history of the Chinese periodical *Foreign Trade.* First published in 1956, the journal published an article in its November 1966 issue entitled, "The Great Victory of the Principle of Self-Reliance." With this issue, *Foreign Trade* stopped publication until 1974. China, the "pupil of the West" and "small brother of the Soviet Union," began its program of modernization. It can hardly be disputed, for example, that China made an important contribution to the theory and practice of development among the countries of the Third World.\(^8\)

Even under Mao, however, efforts of the collective will and the mobilization of the masses have not been able to bring about the massive industrialization program presented by Chou En-lai at the fourth National Peoples' Congress in January 1975.\(^9\)

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6. An often used expression in Chinese publications.
9. See Documents of the first session of the IVth National People's Congress of the PRC, Peking 1975 (German edition at 59 f.).
decision of the Chinese government to accept larger and longer-
termed credits than had been accepted at any time since the
Cultural Revolution can be regarded as the most important
expression of a new orientation in the sphere of foreign trade.\textsuperscript{10}
This measure weakened one of the basic tenets of the precept of
"self-reliance," and was necessitated by the growth of China's
transactions with Japanese, U.S. and West European firms.
Nevertheless, the forms of these transactions — primarily
licensing, planning, supply and installation of complete plants,
particularly in the fields of chemicals and steel — indicates that
China has not altogether foresworn self-reliance: China has
continued to seek those sorts of transactions over which she can
maintain the greatest control and which she can use to enhance
"confidence in one's own resources." These transactions with
capitalist companies have increased steadily since 1972. In 1971,
China's foreign trade amounted to U.S. $4.5 billion; in just two
years, by 1973, China's trade volume had more than doubled, to
U.S. $9.9 billion.\textsuperscript{11} Of that trade, Japan takes the largest part,
followed by the states of the EEC. Among the latter, the Federal
Republic of Germany (FRG) has the largest part, U.S. $599 million
(1974 figures). France follows with U.S. $366 million, then Great
Britain with U.S. $339 million and Italy with U.S. $222 million
(1974 figures). According to the opinion of the Ministry for
Economic Affairs of the FRG, the trade exchange between China
and the FRG might double or even triple by 1980.\textsuperscript{12}

This expansion of foreign trade with the PRC has necessi-
tated an increasing scrutiny of the Chinese legal system. For
example, a delegation of the National Council for U.S.-China
Trade issued a "Peking Report" in which it was said that "[b]oth
sides acknowledge an awareness of the importance of certain legal
issues in the general facilitation of trade. These relate to matters
of copyright, trademark, patent protection, dispute settlement
procedure, varying contract forms and clauses, insurance, trade
documentation, [and] contractual arrangements for major tran-

\textsuperscript{10} Such a decision is mentioned by A. Donnithorne in "China's Foreign Trade
trends, see Current Scene Sept. 1976 (China's Foreign Trade in 1975).
\textsuperscript{11} This is in accordance with a world-wide trend, partly characterized by
inflation. The structural marginal role of the Chinese foreign trade should not be
forgotten. China's foreign trade represented never more than 5% of her GNP, and
the share of this country in world-trade is less than 1%.
\textsuperscript{12} See "Die Welt" (Bonn), No. 263, of 11.11.1975, at 10.
The Chinese have been reluctant to create a formalized domestic legal system. They did, however, establish within the China Council for the Promotion of Foreign Trade a legal department which may be consulted by foreign trade companies. That there is an interest in the legal aspects of foreign trade is also evidenced by the *Primer on International Trade* that was prepared by the foreign trade department of the Liaoning Finance Institute.

### Table 1

<table>
<thead>
<tr>
<th></th>
<th>Exports to China</th>
<th>Imports from China</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1971 (Million U.S. $)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td>577.1</td>
<td>332.1</td>
<td>899.7</td>
</tr>
<tr>
<td>Hongkong</td>
<td>10.3</td>
<td>549.6</td>
<td>559.6</td>
</tr>
<tr>
<td>USA (1972)</td>
<td>63.5</td>
<td>33</td>
<td>96.15</td>
</tr>
<tr>
<td>EEC</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>FRG</td>
<td>175</td>
<td>140</td>
<td>315</td>
</tr>
<tr>
<td>1974 (Million U.S. $)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td>1987</td>
<td>1305</td>
<td>3292</td>
</tr>
<tr>
<td>Hongkong</td>
<td>20</td>
<td>1123</td>
<td>1143</td>
</tr>
<tr>
<td>USA</td>
<td>690</td>
<td>64</td>
<td>754</td>
</tr>
<tr>
<td>EEC</td>
<td>959</td>
<td>838</td>
<td>1797</td>
</tr>
<tr>
<td>FRG</td>
<td>409</td>
<td>190</td>
<td>599</td>
</tr>
</tbody>
</table>

The present paper illustrates the Chinese approach to some of the above mentioned legal issues using the experiences of West German participants in the China trade. Before proceeding to an analysis of actual contract terms, it will be instructive to outline the state-to-state relationship of the two countries in regard to international trade.

## II. DEVELOPMENT OF FRG-PRC TRADE

In the period following World War II, trade between the FRG and the PRC was impeded by obstacles arising from trade policies and from politics in general. The FRG consented to the embargo.

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imposed by the United Nations, under pressure of the United States, during the Korean War; the FRG applied the embargo to deliveries for which China had already paid. Another obstacle was the 1953 "Special List-China," which precluded exportation of the very goods that, in fact or potentially, made up the main part of German-Chinese trade, for example, steel products, machinery and optical instruments. In the mid-1950s, however, a relaxation developed gradually, until on September 27, 1957, a trade agreement was executed between the Eastern Committee of the Association of the German Economy and the China Committee for the Promotion of International Trade.\textsuperscript{16} In 1958 the mutual trade between the two countries amounted to DM927.5 million (681.9 million German exports). The agreement was concluded for only one year and was not renewed. The Chinese side, however, was now eager to negotiate on a governmental level.

Governmental-level negotiations became possible only after diplomatic relations were established on October 11, 1972.\textsuperscript{17} Eight months later the first trade agreement on a governmental level was signed.\textsuperscript{18} Because the competence of the EEC countries to conclude treaties was transferred to the European Community (on January 1, 1975) this agreement could only have a short term. The relationship between the two countries, however, had developed very satisfactorily during this short time, and it is expected that the regulations of the 1973 agreement will serve as basis for the deepening of the mutual trade in the future. Regarding the legal aspects of foreign trade the following provisions of the agreement may be emphasized: the mutual allowance of the most favored nation treatment (art. 2), carrying out the transfers in German Mark and Renmin-bi or another freely convertible currency agreed upon (art. 4), and the establishment of a "Mixed Commission" for the promotion of mutual trade (art. 5).\textsuperscript{19} During the two years after normalization, the trade between the two countries had nearly doubled compared with the year before normalization. The


\textsuperscript{17} By a joint communiqué; Chinese and German text in: Ch.a. October 1972, at 48.

\textsuperscript{18} BGBl. II, at 974.

Chinese exhibition in June 1975 in Cologne\textsuperscript{20} and the German exhibition in September of the same year in Peking\textsuperscript{21} had in fact deepened the insight into the capacities of the supply and need of the partner country. According to the desire of the Chinese, more than 150 symposia and lectures were scheduled to present modern German technology. This makes it clear once again that the Chinese have a strong will to learn as much as possible from other countries.

After extensive negotiations, an exchange of notes concerning the mutual registration of trademarks took place at August 8, 1975\textsuperscript{22}. Finally, shipping and air-traffic agreements were concluded in October 1975\textsuperscript{23}.

\section*{III. THE FOREIGN TRADE CONTRACT}

In contrast to the institutional framework in which China's foreign trade is executed\textsuperscript{24}, the concrete features of trade relations with partners in capitalistic states are rather poorly known. This is not surprising. On the one hand, the bilateral trade agreements with capitalist states are usually very cursory\textsuperscript{25}, while on the other

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\textsuperscript{20} See Yu-Hsi Nieh, Chinesische Nationalausstellung in Köln, Ch.a. July 1975, at 373.

\textsuperscript{21} See H. Dohmen, Technogerma — ins Ungewisse gesät, in Ch.a. Oct. 1975, at 630. The catalogue of the German exhibition in Peking names more than 300 exhibitors of complicated machinery.

\textsuperscript{22} BGBl. I, at 2561.

\textsuperscript{23} Not yet published. The shipping agreement is based on the principle of nondiscrimination of ships and contains provisions concerning exemption of double-taxation.


hand, the contracts concluded with western companies have been analyzed only in some individual cases\(^\text{26}\) and have almost never been published.\(^\text{27}\) However, it is in the contract that the exchange of goods finds its legal expression.

In a textbook concerning legal and economic aspects of foreign trade,\(^\text{28}\) the foreign trade contract (ftc) is defined in general terms:

Commercial contracts are negotiated agreements signed in order to determine the mutual rights and responsibilities of both buyer and seller in an exchange of certain goods. Once the contract is signed, the two sides agree to consider it a commitment with all the actual force of a legal agreement.

After a reference to the general use of standard form contracts in international trade, the Primer goes on:

The “London Contract” is one of these. This contract is clearly of a class nature. For instance, the “London Contract” includes clauses that call for the determination of the quality and weight of goods on arrival and for London arbitration based on English law as the final method of settling any disputes . . . It is a tool of the British monopoly capitalists use to plunder and exploit the developing nations . . . When our nation signs a contract with a foreign export-import company, it resolutely adheres to the Principle of reciprocity based on equality and rejects any one-sided clauses . . . In the process of carrying out a contract we adhere from beginning to end to the principle of “honoring the contract and keeping one’s word” and thus help the development of our foreign trade relations.

How such general formulated principles of the ftc are developed in the specific contact with West German trading partners is shown in this paper, using fifteen contracts concluded between German firms and Chinese foreign trade companies as a


\(^{27}\) Three contracts with Japanese companies are printed as an annex to G.T. Hsiao, Communist China’s Foreign Trade Contracts and Means of Settling Disputes, in: Vanderbilt Law Review, vol. 22 (1968/69), at 503.

\(^{28}\) See supra note 14 (subsequently referred to as “Primer”).
basis. All but three of these transactions were agreed upon after 1971. They contain a considerable volume of supply. The so-called traditional business, i.e., delivery of semifinished and finished products, is increasingly supplemented by the sale of complete plants. Furthermore, whereas the former have usually been carried out through standard form contracts of the respective foreign trade company, the latter transactions are negotiated in detail. It is clear that the legal problems are primarily involved in this latter sphere.

a. Contract Negotiations

Contract negotiations concerning the sale of complete plants usually follow after a bid of a Chinese foreign trade company reaches a German firm. Thereupon, the German firm responds by submitting an ample offer, consisting of a technical and a commercial part, whereafter the Chinese side extends an invitation to the German firm. All negotiations are held in Peking, so that the necessary check-backs of the Chinese delegates to their superiors can be done quickly at their home capital.

Contract negotiations are divided into a technical and a commercial-legal part. Only after the technical questions (documentation, method and technique, guarantees, etc.) have largely been made clear do the commercial-legal negotiations begin. Both parts of the negotiations are described by German business men and technical personnel as “hard and difficult, but proceeding in an agreeable atmosphere.” The Chinese act as self-conscious buyers, who are using their strong negotiating position; they are, however, somewhat more flexible than their Soviet counterparts. The extent of the flexibility of the Chinese negotiators undermines the assertion that trading contracts with the PRC are, in fact, merely "dictated contracts." The composition of the Chinese

29. I am grateful to the German executives for their friendly cooperation during my interviews with them.
30. Mostly during the Canton Fairs, but also by telegraph. Here contract negotiations are more or less reduced to negotiations about prices. All the other contract clauses are not debateable.
31. The firstly fixed commitment to the offer runs usually up to three months.
32. See O. Weggel, op. cit., at 119. It is to be understood that such an appreciation has to be seen in the light of respective conditions of competition and the interest of the Chinese buyer for the products involved. Regarding the "tributary" tendencies (so called according to the traditional Chinese concept of international relations) in Chinese foreign trade behavior some observations may be mentioned: The seller of bigger objects has to travel to Peking to negotiate personally; he has to adjust himself to the procedure of the Chinese (agenda,
negotiating team is relatively constant. Both at the technical and the commercial level, the negotiations take place under the supervision of a leader; the commercial one appears to be superior. The leader is introduced as such or as “speaker”; it also happens on occasion that the leader’s position only becomes apparent in the course of the negotiations. This leadership position is often occupied by a woman. The leader possesses both professional and ideological competence. Sometimes, however, the ideological element is incorporated in the person of a so-called “people’s engineer.” According to a corporation having negotiations in spring 1974 (at a time when the principle of “self-reliance” was again stressed strongly), the long monologs of the leader of the negotiating team were hampering the pace of the negotiations. Delay was also caused by the fact that some members of the Chinese team had to participate simultaneously in ideological classes and could not regularly take part in the commercial proceedings. Sometimes the ideological element cannot be identified with one particular team member but is only represented by the usual polit-language which quite often articulates only generally understood circumstances in its own peculiar way. When, e.g., a German firm proposed to send a certain number of its assemblers to the construction site, the Chinese remarked that one would “mobilize the masses” and therefore would not need so many German personnel. It may also occur that German negotiators are told that they do not know the Chinese people sufficiently, otherwise they would not insist on the incorporation of such and such a clause into the contract. The other members of the Chinese team are — as far as the technical side is concerned — always to be recognized as specialists. They come partly from the negotiating foreign trade company (i.e., China National Machinery Import and Export Corporation and China National Technical Import Corporation), and partly from the eventual buyer and from advisory institutes. In the commercial-legal sphere, an allocation of functions is not always identifiable. Specialists for problems

change of topics, pace of the negotiations) and to stay so long as the Chinese consider it adequate. A contract draft brought along is ignored by the Chinese. In other socialist states the seller is expected to take the pains of working out such a draft. It appears that the Chinese are not unwilling to accept small and practical presents.

33. Here a problem is seen insofar as the Chinese handicap the German contractor in his development dictated by technical considerations and needs, on the other side; however, they are not prepared to take the risk of such interference. In other words: the clauses concerning liability cannot be adapted to the “self-reliance”-pride which became incorporated into the contract.
concerning banking or shipping are rarely recognizable. Furthermore, the Chinese negotiate without jurists, and this may lead to misunderstandings. "Warranty," "limitation of liability," "patent liability," etc. are discussed and regulated, but the German partner frequently has the impression that the Chinese negotiators do not fully grasp the meaning and the relevance of these legal institutions, and that they do not share the importance given to these questions by German firms.34

Although the structural composition of the Chinese negotiating team seems to remain constant, individual negotiators are frequently exchanged. This necessitates verbal repetitions by the German team and reflects, on the Chinese side, the desire to use the opportunity to learn as much as possible concerning German trading tactics and practices. During negotiations, the sole function of several members of the Chinese team is to keep the minutes of the negotiations as complete as possible. These records serve as a kind of seismograph for the statements of the selling side in order to be able to pin down the latter to their own words, if this should be necessary.

The competence of the Chinese team to make decisions is presumably very limited in the technical sphere as well as in the field of commercial-legal negotiations. The Chinese negotiators very often have to check with their superior authority even on such matters as packaging. This permanently moving vertical structure of the Chinese decision-making process is the main reason for the relatively long negotiations that take place in Peking. Direct contact by the German delegates with superior offices is not at all possible. The president or vice-president of the

34. That they are not always informed about the legal structure of capitalistic organized companies — they doubt, e.g., the legal personality of subsidiaries — may be remarked in passing. On the other side the Chinese appear occasionally to withhold legal knowledge. Up till now the most voluminous German-Chinese transaction was offered by a consortium. The Chinese were not at all familiar with this institution. After being informed accordingly at the beginning of the negotiations they again asked at the conclusion of the negotiations (after months) whether they really have to sign the contract together with the consortium instead with the negotiating company. The next day they showed up with the following contract clause which suggests their complete understanding of the legal implications: "The representatives of the Seller — A and B — shall assume jointly and/or individually full responsibilities for the Buyer in respect to the execution of the contractual stipulations and the Seller's obligations. It shall be considered as equally authentic to the Seller that either the Buyer gets in touch with any one of the above mentioned Companies or both of them as a whole in regard to the fulfillment of the Contract."
relevant Chinese corporation appears only when the contract is finally ready to be signed.

The conclusion of the contract in the case of extensive bilateral negotiations creates no legal problems in China. The contract comes into force either after the realization of a condition\textsuperscript{35} (\textit{ex nunc} or \textit{ex tunc}) or without any condition through the signature only (for instance, ". . . shall come into force with its signature by both parties\textquotedblright).

\textbf{b. Conditions of Payment, Documents and Shipping}

It is nearly proverbial that the Chinese generally pay in cash. This does not mean that there are no negotiations about long-term payment. In such a case the Chinese make it clear that they are not willing to accept the current rate of interest common in Germany; they are only prepared to consider 6 to 6.5\% (fixed) interest. In one specific case both sides had already agreed to include in the price of the contract plant the difference between the actual German rate of interest (which, as the Chinese are aware, the German supplier has to take into account) and the rate officially accepted by the Chinese. The long-term loan arrangement finally failed because the parties could not agree upon the modalities of its execution. Instead, however, the Chinese offered cash payment. In such case payment\textsuperscript{36} is done in successive steps: installment, delivery rate, fulfillment of the guarantee of process, and fulfillment of the mechanical guarantee. Possible repayable advance payments are secured by a bank guarantee. Security of the contract price is obtained by a guarantee of the Bank of China.

Recently it has become possible again to agree upon a so-called "deferred payment"\textsuperscript{37} with a term generally of five years

\begin{footnotesize}
\begin{enumerate}
\item[35.] For instance: Presentation of the export certificate of the government. The realization of the condition(s) is communicated by telegram. The date of the last dispatched telegram is regarded as the moment on which the contract comes into force. This date must then be mutually confirmed.
\item[36.] Always in German Mark. Exports from China are since 1972 always in Renmin-Bi. For the Chinese currency see USCBR vol. 1, no. 1 (Jan.-Feb. 1974), at 50 and ibid., no. 3 (May-June 1974), at 33. Shortly after the Cultural Revolution the Chinese also insisted on a Renmin-Bi base in regard to import-contracts; see AHD 1970, at 421, 611.
\item[37.] Before 1967 it was usually and plainly called a "loan agreement." At that time as well as now a first installment, delivery rate and the guarantee rates are followed by half-year installments. After delivery is executed to a certain degree the supplier presents a certain number of drafts which the customer must accept and will present with the respective installment.
\end{enumerate}
\end{footnotesize}
following the date on which the contract plant has begun to function. Payment is always made by irrevocable letters of credit after the documents have been checked. Thus far the Chinese have not accepted that a trustee-bank abroad may check the documents after which payment may occur.

For a contract to enter into force, it is necessary that the seller present an exporting license or a certificate expressing that such a license is not needed. Regarding shipping documents the Chinese request the following: one full set Clean On Board Ocean Bills of Lading marked “Freight to Collect” and made out to order, blank endorsed; several copies of invoice, indicating contract number and shipping marks; two copies of a packing list with the indication of shipping weight; two copies of a certificate of quality and quantity issued by the manufacturers; a certified copy of a cable to the Buyers advising shipment immediately after the shipment has been made; a full set of technical documentation.

The reference to “Incoterms 1953” in the contract is objected to by the Chinese with the explanation that China is not a party to this agreement. However, the Chinese do accept relevant definitions such as f.o.b. and c.i.f. Exports to China are always f.o.b. German port package included. The ship is provided for by the buyer, who also concludes insurance through the Chinese People’s Insurance Company. Recently the Chinese have also

38. The Chinese formula: “After having received the following documents and found them in order . . .” was considered by the German partner as too subjective and replaced by “having checked the conformity . . . .” The L/C is opened by the Bank of China in Peking (also Shanghai, Canton) shortly before the date of shipment. It is payable in China, always irrevocable, but unconfirmed; the German bank communicating the documents takes no guarantees. The first installment or payment in general occurs usually within four weeks after shipping, thus before arrival of the goods which needs six to eight weeks.

39. For instance: “The prices are for delivering f.o.b. north sea port including packing, not stowing.” In the standard contract of the China National Machinery Import and Export Corporation “f.o.b.” as such is not mentioned. The contract’s “terms of shipment,” however, contain the incoterms-definition and in addition an extension of the buyer’s risk regarding the functioning of the tackle (“. . . and is released from the tackle”). For the Shanghai Branch of the same foreign trade company it suffices that “. . . the goods have effectively passed the ship’s rails.”

40. For the principal sources of ships used for the Chinese maritime transport, see “Primer,” at 27.

41. For maritime transport insurance, see “Primer” at 28. The effective “Maritime Transport Goods Insurance Clause” contains three types of insurance: “total damage insurance, basic insurance, and multipurpose insurance.” This new clause “not only adheres to the principle of independence, equality, and mutual benefit, but embodies the spirit of our nation’s opposition to the imperialist policies of aggression and war.” In the “new war damage clause” it is made clear that “if
insisted on “f.o.b. and stowing,” which has long been a common feature in trade with other state trading countries.

c. Inspection, Tax and Duties

In contrast to the traditional trade regarding delivery of individual goods, the Chinese Import Commodity Inspection Office\(^{42}\) is not involved in the trade concerning the sale of complete plants. An inspection of the machines and equipment determined for shipment to China is sometimes undertaken in the seller's factory by a Chinese delegation. A transfer of risk is not associated with such an inspection. After arrival in China the materials are immediately brought to the construction site and checked by the Chinese in the presence of a representative of the seller. There is nothing like an inspection fee.

Concerning possible resulting tax and duty payments the following regulation is common in the contracts:

All taxes and/or duties of any kind whatsoever in connection with the performance of the Contract imposed by the authorities of the Buyer's country shall be borne by the Buyer, and all taxes and/or duties of any kind whatsoever in connection with the performance of the Contract imposed by the authorities of the Seller's country shall be borne by the Seller.

d. Force Majeur and Penalties

Different clauses concerning force majeur are to be found in the contracts. This notion always includes “natural disasters,” such as typhoon, fire, flood, heavy snow, and earthquake. Sometimes the following formulation is also added: “including other cases recognized as force majeure, and which cannot be controlled by both parties. . . .” Sometimes “war” and “civil war” are also included. The broader formula (which was already used in China's trade with western countries), “including reasons beyond the control of either Party and reasons unforeseen, which may occur during the process of manufacturing or in the course of testing and shipment . . . ,” could not be written in the contracts

the insured goods are used by imperialists to carry out wars of aggression, at the outbreak of such a war of aggression our responsibility for the insurance automatically ends.”

analyzed in this paper. In spite of the strong efforts of German negotiators, who were mainly concerned with possible stoppages of their sub-suppliers as well as with possible problems regarding supply of raw materials, the Chinese refused to allow such a broad formulation of force majeure. In the Chinese standard contracts, however, one finds more extensive force majeur clauses.\textsuperscript{43} If this is mentioned during negotiation sessions, the Chinese only point out that there are other products involved. It is obvious that the Chinese want to control the cases of application of force majeur. This also results from the following Chinese proposal of a clause: “or by other causes beyond the parties' control and agreed upon by the parties.”\textsuperscript{44} It is to be emphasized, however, that the Chinese apply force majeur clauses more liberally than do the Germans. Thus a German firm that was not able to supply at due time because of a strike of metal workers (in the middle of the 1960s) was regarded as not responsible because of force majeur although “strike” was not included in the relevant contract clause. It has also occurred that defects of materials, if they are regarded as unavoidable — this is the case concerning defects of castings, for example — are dealt with as force majeur. It is important, however, that the buyer be informed as soon as possible concerning such circumstances. If those circumstances continue longer than a certain number of months (three or six), “friendly negotiations” have to take place in order to reach an agreement about the continuation of the execution of the contract. Sometimes the relevant clause provides that when it is impossible to reach an agreement the matter has to be handled by arbitration. It is very rare that the buyer gets the right to cancel the contract (for instance: “In case the accident lasts for more than 12 weeks the Buyers shall have the right to cancel the contract”). Being aware of Chinese reluctance towards arbitration procedures, the German merchant rather tries to succeed with a right of action instead of a right of withdrawal. One then ensures that there will be further negotiations and a chance to continue with the fulfilment of the contract, or, should this not be possible, one is at least certain that

\textsuperscript{43} In the “Purchase Contract of the China National Chemicals Import and Export Corporation” the “generally recognized 'Force Majeur' clauses” are dealt with. Sometimes “Force Majeur” is only mentioned as such without being further defined. It may be added that in one case it was difficult to explain to the Chinese the distinction between Force Majeur and distribution of risk as it would become relevant should the “f.o.b.-ship” sink because of a typhoon.

\textsuperscript{44} For the Chinese it seems to be essential not to recognize expressis verbis strike and want of raw materials as “Force Majeur.”
a notice (or withdrawal) is only effective when expressed (e.g., by an arbitration tribunal).

During arbitration procedures, the execution of the contract must usually be continued. A termination of the whole project in due time is of highest priority in planned economies. In one contract, however, it is made clear that further execution is only to be carried through "as the performance of the contract is not effected by the questions and problems submitted to arbitration."

Penalties are stipulated concerning default and performance not in accordance with the contract. The penalty of default does not exceed 5% of the value of the supply that is in default. Sometimes, however, the whole contract price is taken as a basis. Regarding performance not in accordance with the contract, the seller has the duty to improve his performance. The quality of the product is seen as an absolute guarantee; deviations are always defined as non-performance. The same is true for, say, 95% of the guaranteed capacity. For the other 5% the payment of a penalty is stipulated (for instance, for each percentage of deviation, 0.5% of the contract price). Another penalty is stipulated concerning deviations of guaranteed consumptions (raw materials and utilities). Here it is agreed upon that the amount by which guaranteed expenses are higher in a specific year must be paid as a penalty.

e. Clauses Concerning Patents and Know-How

It is in accordance with the usage in foreign trade that, in the case of the sale of technical methods for use in the sold plant, the buyer must ascertain whether rights of third persons in his country are interfered with by the transaction. Such a practice has no material basis in China today. There is no patent law and no patent office. During the sixties an invention could bring some financial advantages to the inventor, but also in those days the state received the ownership rights. Since the Cultural Revolution, however, even such awards are regarded as expressions of "bourgeois law." The elimination of such financial advantages serves the "limitation of the bourgeois rights" (which cannot completely be abolished during the socialist phase).

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The foreign trading partner is thus confronted with the need of a case-to-case regulation.\(^{47}\) Therefore, the following expressions of patent liability are often found in contracts: Oppositions made within China are dealt with by the Chinese; claims from outside of China (i.e., based upon rights which were applied for outside of China) are handled by the German seller. The Chinese side requests a list of all registered patents owned by the licensors.

As far as the problems of transfer of know-how are concerned, the Chinese adjust themselves only slowly. The efforts of the sellers to include relevant clauses in the contracts meet with the opposition of the Chinese ("You don't know the Chinese people, otherwise you would not insist on such or such a clause"). From case to case in a different attitude, influenced by the particular plant and the general bargaining power, the Chinese declare that they are prepared to use the received technical informations only for their own operation and not to reproduce the plant without the consent of the seller. A typical clause reads, "The license, the know-how, technical documentation and other information are to be used only for the construction, operation and maintenance of the contract plant." Such a clause is valid without temporal limitation. A period of concealment of ten to twelve years (from the date of the coming into force of the contract) only exists concerning third persons; the scope of license is not effected thereby.\(^{48}\)

Transfer of know-how to the buyer is carried through in several ways: by the training of Chinese technicians in a factory of the seller which is similar or identical to the contract plant; by instructions given by the seller's assemblers to their Chinese colleagues at the construction site; finally by the transfer of documentation and other information "regarding know-how and license applied in production, operation, and maintenance. . . ."

The licenses are conceded for a fixed capacity and are so confined; each extension has to be the object of new license negotiations. The Chinese are not prepared to agree to an exchange of know-how. Thus they have objected to the proposal of a licensor, on a basis of mutual advantage, to exchange

\(^{47}\) In contrast to the protection of trademarks, see R. Heuser, in RIW vol. 20 (1974), at 462. See also A. Smith, Chinese Trademarks in Hong Kong, in USCBR vol. 1, no. 6 (Nov.-Dec. 1974), at 4.

\(^{48}\) The Chinese do not always understand this easily. Therefore it is to be recommended to distinguish licensing and concealment-duty in different contract clauses. In one contract it was additionally stressed that both concepts may not be considered together!
experiences regarding the improvement of the technical process five years after completion of the contract plant. The Chinese argue that they are not yet in a position for such cooperation. Instead, there exists the following clause concerning a one-sided duty to make subsequent experiences known:

Within five years after signing the present Contract whenever there is any improvement or innovation made by the Seller on the license and know-how relating to the Contract Plant, the Seller shall provide the Buyer with detailed information free of charge and the Buyer is entitled to use it.

The license fees may be contained in the contract price or set out separately.

f. Limitation of Liability

For every supplier it is of utmost importance to stipulate the limitations of his liability in the contract. The Chinese are, of course, familiar with the concepts of responsibility and liability, i.e., with the general principle that responsibility is combined with a generally unlimited liability of property.\(^49\) On the other hand, it seems quite difficult to convince the Chinese that this lapidary principle of “who is responsible is also liable” has to be modified in favor of a limitation of liability.\(^50\) In accordance with their understanding, the Chinese attempt to succeed in an unlimited liability concerning defects in planning and instruction. The German partners, however, succeeded mostly in stipulating a certain maximum limit of liability. Regarding bodily injury culpably caused, however, the foreign partner has to be liable without any limitation.\(^51\) Attempts to introduce a maximum limit also in this sphere are objected to by the Chinese. “Friendly negotiations” are considered to be the proper framework for the

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49. See for instance: Basic Principles of the Civil Law of the PRC, English translation by U.S. Joint Publication Research Service, 4879 (Aug. 15, 1961), at 182, 325ff. (This is the most important source of Chinese civil law.)

50. The Chinese conceive the claim for damages based upon civil liability primarily under the aspect of penalty; see ibid., at 326. With regard to such a concept the disintegration of responsibility and liability must appear to be immoral.

51. When this duty should become part of the contract. There is, however, on the Chinese side a tendency to “repress” those questions during the negotiations. Legally only what became part of the contract can be invoked; there is, therefore, sometimes no liability at all.
adjustment of damages. It is self-evident that a liability for consequential damages is generally excluded. Although this is in accordance with the international standard, the Chinese must sometimes first be convinced about the necessity of this kind of exemption from liability.

IV. DISPUTE SETTLEMENT

It is in accordance with traditional Chinese thinking\(^52\) that when arbitration clauses are contained in commercial agreements and in individual contracts, and when disputes arise concerning the execution of the contract, an attempt should first of all be made to solve these disputes by “friendly negotiations”\(^53\) as a preferred means of settlement. Only after the failure of these friendly negotiations as a means of settlement should the way be opened for a method of settlement by participation of a third institution, \textit{viz.}, the arbitration process. The Chinese “Primer” points out, “Foreign Trade arbitration occurs when, in the course of carrying out a contract, the two sides . . . have a dispute and cannot reach an agreement even after negotiation.” And further, “. . . our country’s foreign trade arbitration system relies on a spirit of cooperation between arbitration and mediation. We try whenever possible to solve disputes through mediation, doing everything we can to help the two sides to reach an agreement through the principle of negotiation and voluntarism. . . .”\(^54\) This evaluation of judicial procedure with its binding decisions as an \textit{ulimum remedium} may, as V. Li points out,\(^55\) result from the Confucian as well as Marxist view about the (good) nature of men—that reasonable persons are in a position to settle their disputes among themselves. This is, however, quite consistent with the general practice of foreign trade as such. Bilateral negotiations and mediation always precede formal arbitration procedures. Typical for the Chinese is the degree of informality in mediation

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\(^53\). A similar reference was contained, e.g., in the standard contract concerning the order of cotton as used in the commerce between Chinese and British merchants; see Chow Kwong-Shu, A Handbook of Chinese Trade Customs, Shanghai 1933, at 25.

\(^54\). Op. cit., at 32 f. Similarly, the short statement of the director of the legal department of the China Council for the Promotion of International Trade, Mr. Jen Tsien-hsin, in: China’s Foreign Trade 1975, no. 3, at 50 f.

\(^55\). Conflict on Contracts and Why Things are What They are in China, in: Worldwide P & I Planning, 1972.
and the eventual success of "friendly negotiations." It is indeed noticeable that arbitration clauses, which are hereinafter described, are almost never invoked.

a. Stipulation of an Arbitration Clause

The experience with the practice of dispute settlement in FRG-PRC trade does not avoid lengthy negotiations about arbitration questions. The Chinese no longer attempt to circumscribe the jurisdiction of their own foreign trade arbitration into a contract concerning a complete equipment sale. The jurisdiction of the

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56. A German-American merchant, referred to as "probably the most experienced China trader alive," pointed out: "Forget about going to arbitration. You will find the Chinese to be the fairest and most ingenious conciliators in the world of commerce." See USCBR vol. 1, no. 5 (Sept.-Oct. 1974), at 3, 4.

57. This in contrast to the trade with the Soviet union. The foreign trade arbitration committee in Moscow published several thousand of pages with decisions; see H. Berman and G. Bustin, The Soviet System of Foreign Trade, in: R. Starr (ed.), Business Transactions in the U.S.S.R., 1975, at 49, footnote 80. Contrary to this, Chinese authorities have published up to now only one case (which was pending at the Maritime Arbitration Tribunal in Peking). It is characteristic that this case was mediated; see The Bureau of Salvage Work of Shanghai v. Valdemar Skogland A/S of Norway in: Foreign Trade (Peking) 1963, no. 3, at 4.

58. The often mentioned study of H. Fellhauer, Die Aussenhandelschiedsgerichtsbarkeit in der Volksrepublik China (The Foreign Trade Arbitration of the PRC), in: Recht im Aussenhandel, vol. 6 (1960), at 7 f. does not contain any reference to the pending of a case of a German company at the Peking foreign trade arbitration. And also Cohen (op. cit., supra, note 52) remarks more generally that he does not know of any case before the Peking arbitration tribunals "that has been disposed of by arbitration rather than mediation" (p. 1204).

59. In execution of relevant decisions of the State Council (government) the China Council for the Promotion of International Trade established a foreign trade arbitration commission in 1956 and a maritime arbitration commission in 1959. The respective arbitration statutes contain concise rules of procedure regarding initiating the action up to the eventual award. There is no need to rely on any further legal sources, for example, a code of civil procedure. The procedural rules are almost identical with those of permanent arbitration courts in the West. They grant both parties a claim to a due process of law, avoid any discrimination against the foreign party and contain almost no limitation worth mentioning of the giving of evidence. It is unusual, however, that the court sessions are public ("Primer," at 32: "Cases conducted within the arbitration system of capitalist countries were usually not public") and that the chairman has the competence to order the safeguarding of the claim involved if applied for by the party. With regard to the U.S.S.R. the independence of the foreign trade arbitration court has been and is still questioned. Doubts in this direction, however, are only justified concerning the structure of the court as well as the whole foreign trade organization in general. On account of its practice, however, the Soviet foreign trade arbitration tribunal has acquired an excellent reputation.
arbitration tribunal of the International Chamber of Commerce (Paris), often sought by the German merchants, has up to now always been opposed by the Chinese. An agreement is often reached by declaring Stockholm, Sweden as the seat of the arbitration tribunal. A typical arbitration clause reads as follows:

All disputes in connection with the contract shall be settled by friendly consultation between both parties. In case no agreement can be reached, the disputes shall be submitted to arbitration.

The arbitration shall be conducted in Stockholm, Sweden, according to Swedish Arbitration Procedures.

Sometimes it is added:

An arbitration committee, consisting of three persons, shall be formed by one each from both the Buyer and the Seller as well as one third nationality who is agreed upon by both parties.

Sometimes the nationality of the third person is already stipulated in the contract (usually Swedish).

b. Substantive Law to be Applied

With an agreement about the venue of the arbitration committee, the question concerning the relevant substantive law is not thereby answered eo ipso. The Chinese "Primer" points out correctly that "fixing the place of arbitration is relatively important because it can determine just what laws and regulations will govern the proceedings."61 This is the case if the contract does not stipulate a specific legal order as applicable, and when the determination of the law to be applied is left to the rules of private international law of the country in which arbitration takes place. In only one of the contracts taken in account here was a specific legal order stipulated to be applicable. There was no agreement concerning the application both of Chinese and German law, nor was it possible to declare "generally acknowl-

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60. Seen from the Chinese point of view this regulation cannot be recommended either by conflict-of-law considerations or by the often mentioned fact that Swedish civil and commercial law is particularly favorable to the buyer. According to the present writer's opinion Swedish law would not be applicable.

edged usages” or “principles of commercial experiences” as a basis for an arbitration decision. Thus the Swedish practice concerning conflict of law gains importance. According to Swedish practice, the starting point is no longer the *lex loci contractus* but the law of the country with which the contract is most closely connected. The criterion for this is the domicile of the seller. This means that according to the Swedish conflict-of-law practice German law has to be applied, and hence the unresolvable problem of ascertaining the contents of Chinese civil and commercial law would not emerge.

One contract, for instance, had the following stipulation (as suggested by the Chinese side): In the event that the German partner appeals to the (Swedish) arbitration tribunal, Chinese law applies; otherwise German law is to be applied.

The question concerning the contents of Chinese law also has application in another field. In all the contracts whose execution implies services of German fitters at the construction site it is pointed out:

The Sellers technical personnel and their families shall observe the laws and regulations of the People's Republic of China and the rules and regulations of the plant-site during their stay in China.

The problem of ascertaining those laws and regulations is usually answered by the statement that there is nothing in written form

62. For a long time this was the general practice. See e.g. H. Batiffol, Droit International Privé, 4th ed., Paris 1967, at 635: “La majorité des auteurs penchent traditionnellement en faveur du lien de conclusion . . . .” However, this practice is no longer used; see A. Schnitzer, Handbuch des internationalen Privatrechts, 4th ed. (1957), vol. I, at 129. This also includes eastern European countries; see, e.g., J. Jakubowski, The Settlement of Foreign Trade Disputes in Poland, in: International and Comparative Law Quarterly, vol. 11 (1962), at 814. The most comprehensive study of a PRC author regarding international private law (Ni Zheng-ao, Problems of Judicial Jurisdiction in Public International Law, Peking 1964) is also evidence of this development but does not deal in particular with the Chinese practice (see especially pp. 71 ff.).

63. H. Eck, The Swedish Conflicts of Laws, Stockholm 1965, at 266. See also H. Nial, American-Swedish Private International Law, New York 1965, at 51 ff. Here the focus is on the “center of gravity.”

64. Such a complicated situation mentioned by Smith (supra note 26) will not emerge in the German-Chinese trade. Smith: “. . . in the case of the Sale to the PRC of Canadian wheat, f.o.b. Vancouver, the contract having been concluded in Hong Kong between China Resources and the Canadian Wheat Board and with a provision for arbitration in Switzerland.”
and that they can only be communicated by oral instructions.\textsuperscript{65} The lack of compilations concerning the relevant legal sources makes the following clause necessary:

The Buyer shall explain to the Seller's technical personnel the laws, regulations and rules which are to be observed by them after they arrive at the plant-site.

Oral instructions are given as a kind of educational contribution to the "guests of the country." Proper behavior at the construction site, in traffic and transportation and toward women are its main objects. To one German supplier written rules concerning duty on importation\textsuperscript{66} and safety and "local rules" will be prescribed.\textsuperscript{67} The incompleteness of those regulations leads to the consequence that the sphere of movement of the foreign personnel is very limited; the development of legally relevant facts shall be restricted as far as possible.\textsuperscript{68}

A German firm felt it necessary to have the following stipulation written in the contract: "The Buyer agrees that the Seller's personnel remain always in possession of their passports." This was done in view of experiences during the Cultural Revolution. Cohen warned, "Although the worst excesses of the Cultural Revolution seem to have ended, foreigners engaged in trade with China cannot yet feel secure against arbitrary interference with their personal freedom. . . ."\textsuperscript{69}

\textsuperscript{65} This may only apply to regulations concerning foreigners. The proposal of the chief of a Chinese negotiation delegation to hand to him a German code in order to write at the margin the rules deviating in China may be mentioned as a curiosity.

\textsuperscript{66} Between the Chinese Foreign Trade Companies and the Board of Customs exists an agreement concerning preferential tariffs of foreign technical personnel.

\textsuperscript{67} In the "Gongzuo Riji" (The Working Daily) which is kept at a construction site it is pointed out: "The Seller's personnel has been given 'Regulations governing the entry, exit, transit, residence and travel of aliens' by the Buyer. Special law in China has not been explained."

\textsuperscript{68} In the service contracts questions of lodging, holidays and transportation are dealt with in detail. G. Crespi Righizzi's statement (op. cit., supra note 24) concerning the need of a study about Chinese civil law "in order to know the rights and the obligations of the Western trade representations, delegates and technical personnel who are living in China, bargaining with the Chinese and assisting them in setting up their new plants . . ." is bound both to liberal ideas of western consuming societies and to the legalistic concept of western social systems, (at 86, footnote 1).

\textsuperscript{69} Cohen, op. cit. (supra note 42), at 146.