return to AMPLA 2003 Table of Contents

Managing Legal Risks in Contractual Disputes with China: Application of the Vienna Convention as the Governing Law in Australia-China Trade Contracts

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SUMMARY

This paper seeks to assist practitioners drafting international contracts with China in how and why to select and elect or opt out of various transnational laws regarding choice of law. There are four sections in this paper. Firstly, contracting with China (including contracting in China) will be viewed within the transnational legal framework governing commercial transactions between Australian and Chinese entities. Secondly, the relationship between the United Nations Convention on Contracts for the International Sale of Goods 1980 (CIGS) and Australian domestic laws and their application in Australia will be examined. Thirdly, the paper will explain the Chinese legal framework governing foreign related joint ventures in China that are relevant to Australian investors. Fourthly, a comparison of selected areas of Australian contract law with corresponding provisions of CIGS and Chinese Contract Law 1999 will be analysed and explained.

INTRODUCTION

Doing business with China involves risks that should be identified and managed. Ideally, Australian corporations contracting with China should be able to manage their transnational contractual disputes risks, where an Australian domestic law governs the sale contract with a Chinese party, and the contract has a "closest and most real connexion"[1] with Australian jurisdiction. This would mean that an Australian court is competent to adjudicate the dispute in the event of a breach by the Chinese party, and an Australian court judgment could be enforced

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[1] *Bonython v Commonwealth* [1951] AC 201 at 219.

in China where the Chinese party has assets. If so, Australian businesses will have a greater control of the cross-border dispute resolution process as the disputes are heard and decided by Australian courts in which Australian corporations have confidence and knowledge. Accordingly, the risks and costs of doing business with China will be significantly reduced as the rule of law is observed.

This paper will address the practical issues of the choice of law and the choice of jurisdiction within the transnational law context of cross-border trade between Australia and China. It will explore the feasibility of whether the 1980 United Nations Convention on Contracts for International Sale of Goods (the Vienna Convention) can be applied as a framework for bilateral trade between Australia and China to manage dispute risks and to facilitate trade. The paper will address the following questions:

1. Is there an Australian domestic law applicable to the common contracts of sale of goods with China which is not objectionable to Chinese parties?
2. How should the parties choose and draft the choice of law clause?
3. How can we ensure such contracts have the closest and most real connection with Australia so that Australian courts will be competent to adjudicate any contractual dispute?
4. Can Australian court judgments be enforced in China?

Emphasis will focus on how and why to choose and then elect or opt out of the various transnational laws governing choice of law issues when drafting international contracts dealing with China.

The paper will suggest that the drafting of international contracts should go beyond the exercise of transplanting domestic contract precedents with variation of choice of law clauses. In the context of globalisation of commercial activities, a better understanding of recent legal developments and fundamental differences in international legal systems regarding the applicable law and jurisdiction is required as well as an understanding of substantive law issues.

Background of Australia-China Trade

China is the world's sixth biggest economy and third largest trading partner of Australia, with an official annual GDP growth rate of 8% over the past decade. Of the A$8.368 billion Australian exports to China in 2002, the top five major Australian exports are all commodities, namely, iron ore, wool, crude petroleum, coal and aluminium, amounting to 45 per cent of Australian exports.[2] In the meantime, more and more Australian companies are venturing into China, establishing businesses, entering joint ventures or tendering for special projects.

[2] Australian Trade Commission information: http://www.austrade.gov.au. Furthermore, the Chinese Academy of Social Science expects that China will continue its economic development and industrial transformation at a rate of 8% in 2003 despite of the disruption of SARS (as reported in the *People's Daily*, 8 July, 2003).

The rapid expansion of Australia-China bilateral trade has seen an acceleration of commercial transactions with China in the past two decades. Although the experience accumulated in such transactions has greatly reduced the obstacles posed by cultural and linguistic differences, the question is no longer: "Is it worthwhile to take the risk of doing business with China?" but is instead: "How to manage the risk in dealing with China?"

Managing the Risks and Costs of Contracting with China

Business executives assessing the feasibility and profitibility of overseas business opportunities must take account of the economic and legal environment, in particular, they must consider the availability of sound and predictable dispute resolution procedures. In the case of doing business with China, Australian business executives should, as with any other transaction in which they are involved, regard contracts as a way of understanding and limiting potential costs, transactional uncertainties and allocation of the risks involved.

Due to the significant cultural, political and legal differences existing between Australia and China there is an urgent need to address issues of legal uncertainty. A better understanding of the determination of the dispute mechanism and the laws governing contracts with China, in particular, the contracts relating to the international sale of goods to China and the choice of law matters, is warranted.

Given the transnational nature of commercial transactions with China, three issues should be of particular interest to lawyers: choice of law; jurisdiction and enforcement of foreign judgments.

In order to better appreciate the transnational law issues in contracting with China, a good starting point is to examine the current Australian legal practice in advising on foreign and China-related matters and the decided cases which may expose the mishaps and oversight lawyers have made in the past.

Current Australian Practice of Advising on Foreign or China Related Matters

Australian lawyers are well regarded internationally for their legal skills and competence. Many Australian law firms have followed, and, in many cases, led their clients in their commercial ventures into China. Generally they have used their well-drawn and tested domestic contract precedents for similar transactions as a template and incorporated other special conditions as the situation demands. However, this practice will largely depend upon the relevance, correctness or currency of domestic precedents.

In terms of the choice of law and choice of forum provisions, practitioners have, not surprisingly, demonstrated a strong bias against Chinese in favour of Australian law and jurisdiction.

Australian Law as the Choice of Law

Choosing Australian law to govern the contract has a multitude of benefits for Australian companies. The most important are certainty and reliability. In most cases, Australian law is relatively definitive, certain and settled, compared to Chinese law. Secondly, Australian lawyers and business executives are familiar with Australian law and the procedures for dispute resolution. Thirdly, it goes without saying that there would be a significant cost saving in the legal fees involved.

This phenomenon can be explained from two perspectives. Firstly, Australian lawyers tend to have a pragmatic approach to problems. This is largely due to their legal training and practice in the common law precedent tradition. It is natural and logical that a definitive and workable law like that of Australia has become the preferred choice of law. Secondly, it could be the mere lack of information and understanding of this area of law which contributes to the suspicion and reluctance among practitioners to accept and apply transnational law in practice.

Costly and Humiliating Errors

In August 2000, the case of *Perry Engineering Pty Ltd (Receiver and administrator appointed) v Bernold AG*[3] in the Supreme Court in South Australia unfortunately highlighted the lack of knowledge about the law of international sale of goods among the relevant practitioners. The plaintiff, Perry Engineering Pty Ltd was an Australian company contracted with a German defendant company, Bernold AG, for the supply of heavy construction engineering material. The governing law of the contract was, by default, the law of South Australia. In default of appearance by the German defendant, liability was deemed to be admitted and the Australian plaintiff succeeded in obtaining an interlocutory judgment for breach of contract in its favour. However, the lawyers for the Australian plaintiff pleaded the wrong legislation governing the contract as they failed to plead the relevant provisions of the *Sale of Goods (Vienna Convention) Act* 1986 (SA) in the statement of claim, with the result that the judge declined to proceed to make an assessment of damages.[4]

The Vienna Convention has been part of Australian domestic law governing international contracts of sale by the operation of the Sale of Goods (Vienna Convention) Acts enacted by the States and Territories in Australia between 1985 and 1986. It is an example of where the governing law of the contract being an Australian law which is actually an international convention, the Vienna Convention.

[3] *Perry Engineering Pty Ltd (Receiver and administrator appointed) v Bernold AG* No SCFRG99-1063 [2001] SASC 15, February 2001.

[4] *Perry Engineering Pty Ltd (Receiver and administrator appointed) v Bernold AG* No SCFRG99-1063 [2001] SASC 15, February 2001.

In April 2003 in the Supreme Court of Victoria, the case *Playcorp Pty Ltd v Taiyo Kogyo Ltd*[5] involved an international contract of sale of goods between a Victorian distributor and a Singaporean supplier. The law of Victoria as the governing law of the contract was a contentious issue in the case. It was found that the solicitors from an Australian firm, acting for the overseas supplier, neither pleaded nor proved the application or content of the governing law of the contract. The solicitors simply contended that Australian law was not the governing law of the contract in question. It was decided that the *Sale of Goods (Vienna Convention) Act* 1986 (Vic) applied in the case and a judgment was made in favour of the Australian plaintiff.[6]

The surprises and costs to the law firms and companies concerned in these two cases have demonstrated a lack of knowledge of transnational law governing international contracts, especially the Vienna Convention. This lack of information is not unique to Australia but is common across the western common law jurisdictions.

As every contract must be made by reference to some system of law that indicates the legal consequences of the parties' agreement and their conduct in respect of that agreement,[7] it is important to address the above questions in the context of transnational commercial law.

LEGAL FRAMEWORK ON TRANSNATIONAL CONTRACTING

The WTO/GATT international trading system under the multilateral treaty provides the rules and principles governing international trade and implementation and dispute resolution mechanism cases in which the parties are member states.[8] It generally covers general trade dispute issues between the states.

International commercial transactions like the sale of goods contracts between businesses in different states are governed by both the national laws of the states and international conventions like the Vienna Convention. As a result, transnational law governing international contracting is partly international law, and partly national law of the states concerned.[9]

Private international law seeks to determine the issue of applicable law by applying rules of the conflict of laws. The issue of the choice of law is all about which law should properly be the system of law governing the contract, namely the substantive domestic laws of a state that are applicable to resolving disputes and determining the validity and remedies of the contract.[10]

5 *Playcorp Pty Ltd v Taiyo Kogyo Ltd* [2003] VSC 108 (24 April 2003).
6 *Playcorp Pty Ltd v Taiyo Kogyo Ltd* [2003] VSC 108 (24 April 2003).
7 M Tilbury, G Davis and B Opeskin, *Conflict of Laws in Australia*, 2002, 726.
8 Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 (Antidumping), April 15, 1999 WTO Agreement, Annex 1A.
9 J Mo, *International Commercial Law* (2nd), 2000.
10 M Tilbury, G Davis and B Opeskin, *Conflict of Laws in Australia*, 2002, 726.

As each legal system has developed its own private law, the resultant differences between states provide little legal certainty to contracting parties as to the interpretation and dispute resolution of a contract should a dispute arise.[11] In Australia, conflict of laws rules do little to address such practical difficulties.[12] The conflict of laws rules in China are, not surprisingly, very brief.[13]

So, rather than leaving the choice of law issue to be decided by the cumbersome process of the rules of conflict of laws by an unknown court in either state, it is prudent to make a choice of law for the contract by a valid agreement of the parties. Generally courts both in Australia and China respect the parties' choice of law due to the respect and observation of the principle of freedom of contract, except in exceptional circumstances like mandatory application or evasion of law.[14]

Chinese trading partners have traditionally been suspicious of and have resented the practice of the dictation of the term where a foreign law governs the contract, in spite of their reluctant acceptance on many occasions. With the Chinese parties rapidly accumulating more international business negotiation experience and a narrowing gap in the parties' relative bargaining positions, this will continue to be a thorny issue in Australia-China trade causing greater frictions and tensions in the future. This choice of law problem should not be ignored for it represents a serious opportunity cost to all Australian corporations with an international business component.

"Do not impose upon others something you do not want to be imposed upon you." Observation of this Chinese proverb would lead to the application of a law acceptable to both parties in China and Australia. There are the following options:

1. Australian law.
2. Chinese law.
3. The law of a third country acceptable to both parties.
4. A neutral law like a uniform international convention ratified by both countries.

Unfamiliarity with laws other than their own and the costs involved with seeking and providing legal advice make the selection of a foreign law a difficult hurdle for business and advisers. The solution to the question: "Is there an Australian domestic law applicable to the common contracts of sale of goods to China which is not objectionable to Chinese parties?" is the Vienna Convention.

[11] Hans van Houtte, *The Law of International Trade*, 2nd (2002), 16.
[12] M Tilbury, G Davis and B Opeskin, *Conflict of Laws in Australia*, 2002, 23.
[13] G Zhu, Inter-regional Conflict of Laws Under "One Country, Two Systems": Revisiting Chinese Legal Theories and Chinese and Kong Kong Law, with special reference to judicial assistance, Hong Kong Law Journal, 2003, 633.
[14] *Akai Pty Ltd v The People's Insurance Co Ltd* (1996) 188 CLR 418.

What is the Vienna Convention?

The United Nations Convention on Contracts for the International Sale of Goods was concluded in Vienna in 1980. This international law on the contract of sale was designed to replace the diverse domestic laws with one uniform law applicable to all parties in the contracting states.[15] So far 62 states have ratified the Vienna Convention including all major international trading nations except Japan and the United Kingdom. Australia and China are both the signatories to the Convention.

Application of the Vienna Convention in Australia and China

Australia

Australia acceded to the 1980 Vienna Convention on 26 March 1986, and by agreement between all States and Territories and the Commonwealth, the Vienna Convention became a self-executing domestic law in all States and Territories by the passage of the Sale of Goods (Vienna Convention) Acts in 1986 and 1987. Through the operation of Art 1(a), the Vienna Convention applies to contracts of sale of goods between parties whose places of business are in different states when the states are contracting states of the Vienna Convention.

The Convention is not to be treated as a foreign law

The Vienna Convention is in fact the law in Australia governing all international sale of goods contracts unless the parties have opted out of it by agreement. As the Vienna Convention is adopted and legislated as an Australian domestic law governing international sale of goods transactions, other Australian laws like the *Sale of Goods Act* and common law become the residual applicable law. Australian cases have affirmed that the meaning of the Vienna Convention and its application to the facts is to be determined by Australian courts.[16] There have been six Australian cases where the Vienna Convention has been applied as the paramount law overwriting any inconsistency of State law.[17]

China

China signed the Vienna Convention on 30 September 1981 and ratified it on 11 December 1986. Article 142(2) of the *General Principles of Civil Law* 1991 (the

[15] J O Honnold, *Uniform Law for International Sales*, 1999, 17.

[16] *Roder Zelt-UND Hallenkonstruktionen GMBH v Rosedown Park Pty Ltd* (1995) 17 ACSR 153.

[17] *Perry Engineering Pty Ltd (Receiver and administrator appointed) v Bernold AG* No SCFRG99-1063 [2001] SASC 15, February 2001, *Roder Zelt-UND Hallenkonstruktionen GMBH v Rosedown Park Pty Ltd* (1995) 17 ACSR 153; *Downs Investments Pty Ltd v Perwaja Steel SDN BHD* [2000] QSC 421, at November 17, 2000; *Playcorp Pty Ltd v Taiyo Kogyo Ltd* [2003] VSC 108 at April 24, 2003; *Ginza Pte Ltd v Vista Corporation Pty Ltd* [2003] WASC 11 at February 17, 2003; *Olex Focas Pty Ltd v Skodaexport Co Ltd* [1998] VR 380.

GPCL) states that: "If any international treaty concluded or acceded to by the PRC contains provisions different from those in the civil laws of the PRC, the provisions of the international treaty shall apply, except if the provisions are ones on which the PRC has made reservations". Chinese *Contract Law* 1999 is part of the Chinese civil law system. By virtue of Art 142(2) of the GPCL, the Vienna Convention can be directly applied in China to govern international sale of goods contracts; it will prevail over Chinese *Contract Law* 1999 and other domestic laws to the extent of any inconsistency.

Accordingly, when a governing law clause in a contract for sale of goods with China stipulates "The Law of Victoria applies" or "The Law of People's Republic of China applies", it actually means "the Vienna Convention applies". The Vienna Convention governs all international sale of goods contracts in all States and Territories of Australia unless the parties have opted out.[18] The same also applies in China.[19] Therefore, unless an Australian Corporation has previously decided to opt out of the Vienna Convention, it is unwise and insensitive to proceed with tough negotiations to insist on the application of Australian law.

The scope of the application of the Vienna Convention

Cross-border contract

The contract of sale of goods must be international by nature. The focus is on the identities of the parties as to their place of business rather than nationality. Article 1(a) stipulates that the contracting parties must have places of business in the different contracting states, in this context, China and Australia, which are both signatories to the Vienna Convention. For multinational corporations, Art 10(a) further makes a stipulation as to "the closest relationship to the contract and its performance" requirement for a party which may have multiple places of business.

Contracts involving "goods"

The Vienna Convention applies only to contracts of sale of "goods". By virtue of Arts 2 and 3, "goods" is not defined by the Convention but can be ascertained by the exclusion. In general most tangible and corporeal things except ships and aircraft are goods but general household consumer goods are excluded.[20]

The Vienna Convention will therefore be applicable to most of the contracts covering trade between in Australia and China as it is mostly based on the export of commodities to China and the import of manufactured goods to Australia. Note however that the transfer of intellectual property rights such as patent rights,

[18] See Declaration of the United Nations Convention on Contracts for the International Sale of Goods, Vienna, 1980 at http://untreaty.un.org/ENGLISH/bible/englishinternetbible/partI/chapterX/treaty20.asp.

[19] See Declaration of the United Nations Convention on Contracts for the International Sale of Goods, Vienna, 1980 at http://untreaty.un.org/ENGLISH/bible/englishinternetbible/partI/chapterX/treaty20.asp.

[20] Article 2(a).

copyrights, trademarks and know-how are not considered as goods and are therefore not governed by the Vienna Convention due to this exclusion.

Declarations/reservations by Australia and China

None of the declarations made by Australia or China gives rise to any issue of concern in the bilateral trade.[21] For practical purposes, in the declaration made by China on accession, it refuses to recognise the validity of an oral contract and the admissibility of oral evidence as it disallows contracts not formed in writing regarding Art 11, as well as the provisions in the Convention relating to the content of Art 11. It is important to note that oral contracts are recognised under Chinese *Contract Law* 1999,[22] over which the Vienna Convention prevails unless it is opted out by agreement.[23]

Incompleteness of the Vienna Convention

The Vienna Convention is however not a complete set of law on international contracts of sale of goods.[24] It does not cover the issues of transfer of title, the existence of agency relationship and the choice of forum, etc. So to the extent which the Vienna Convention does not cover, the parties may choose to agree to be bound by any relevant national law or international convention as a gap filling residual.

Opting out option in the Vienna Convention

As the Vienna Convention makes the provision for freedom to contract in Art 6, the parties are at liberty to select the parts of the Vienna Convention to which they agree to be bound, if any at all.

The legal environment of foreign related trading and investing in China

Since the implementation of the "Open door" policy in the late 1970s, China has worked diligently to develop an economic and legal infrastructure that promotes foreign investment and trade.[25] The amount of effort and the scale of improvement made in the last two decades by the Chinese government has been less acknowledged and publicised in the West. With China's accession to the World Trade Organisation (WTO) and its undertaking to observe the rule of law in international trade, more measures will be implemented to provide a greater degree of certainty and protection of foreign businesses engaging in trade activities with China.

[21] Declarations of the participants, United Nations Convention on Contracts for the International Sale of Goods, Vienna, 11 April 1980.
[22] Article 10 of Chinese *Contract Law* 1999.
[23] Article 6 of the Vienna Convention.
[24] Article 7(2) of the Vienna Convention.
[25] R E Reyes, Jr, "The Enforcement of Foreign Court Judgments in the People's Republic of China: What the American lawyer needs to know" (1997) 23 *Brooklyn Journal of International Law* 241.

Freedom of contract in China

If contracts have a foreign element involved, the parties to the contract may choose a law other than Chinese law to govern the contract. Article 145(1) of the *General Principle of Civil Law* (GPCL) states: "The parties to a contract involving foreign elements may choose the law to be applied to settlement of the disputes arising from the contract, except as otherwise stipulated by law." Article 126(1) of Chinese *Contract Law* 1999 further states that: "The parties to a foreign-related contract may choose those laws applicable to the settlement of contract disputes, unless stipulated otherwise by law. If the parties to a foreign-related contract fail to make such choice, the state laws most closely related to the contract shall apply." Accordingly, it is permissible for the parties to choose a law of their choice to govern the settlement of contract disputes.

Status and acceptance of foreign law and international convention

In general, China has adopted the prevailing practice of private international law. It is largely deposited in the GPCL. The eagerness of the Chinese desire to adopt international law and practice can be found in Art 142(2) of the GPCL, which states: "If any international treaty concluded or acceded to by the PRC contains provisions differing from those in the civil laws of the PRC, the provisions of the international treaty shall apply, unless the provisions are ones on which the PRC has announced reservations."

Furthermore, it also binds itself to adhere to the international practice where "international practice may be applied to matters for which neither the law of the PRC nor any international treaty concluded or acceded to by the PRC has any provisions" as stipulated in Art 142(2) and (3) of the GPCL. This rule is applicable to foreign-related contract matters. From a comparative perspective the Chinese undertaking to conform with international law practice is quite admirable.

Article 144 of the GPCL states that: "In determining the ownership of immovable property, the law of the place where the property is located applies." This is compatible with international practice.

CHOICE OF LAW ISSUE IN CONTRACTING WITH CHINA

In order to better appreciate the intricacies of the legal framework for Australian businesses contracting with China, it is important to make a distinction between the following two situations:

1. Contracts relating to Australian exports of goods to China:
   (a) Where the parties have not selected the applicable law
   (b) Where the parties have selected the applicable law
2. Contracts relating to Australian companies doing business in China:

(a) Where Australian companies make direct investment in China

(b) Where Australian companies directly participate in special projects in China

Situation 1: Contracts Relating to Export of Australian Goods to China

(a) *Where the parties have not selected the applicable law:*
It would be very rare for an Australian export of goods contract with a party in China not to contain a choice of law clause. In the event of such rare incidents, which could well be deliberate or due to the failure of the negotiation, should the case go through a Chinese court or an Australian court, through the conflict of law process, either of the national laws of China and Australia will apply. As such, the Vienna Convention will be applied as the national law of both countries which have adopted the Convention to govern international contracts of sale, provided that the businesses of the two parties are located separately in China and Australia.[26]

In a case where the parties have chosen the Vienna Convention, as to the incompleteness of the Vienna Convention there will be two scenarios:

(a) Where a gap filling law is chosen as the residual law.

(b) Where a gap filling law is not chosen as the residual law.

Should (a) position be adopted, the Vienna Convention will be the governing law of the contract with a law of choice agreed by the parties to be residual law. It poses no problems in either court in Australia or in China. Should (b) position be adopted, the residual law will likely be the law of the competent jurisdiction with which the contract has the closest and most real connection would be implied should the case be heard in Australia,[27] and so is China.[28]

(b) *Where the parties have selected the applicable law:*
There are three possible situations where the parties have selected the applicable law in a contract:

- The Vienna Convention.
- The national law of China or Australia.
- The national law of a third or neutral state or other international uniform contract law and principles like UNIDROIT Principles.

In the case where the parties have chosen the Vienna Convention, the above Situation 1(a) will apply.

In the case where the parties have chosen the national law of China or Australia, whether it will trigger the automatic application of the Vienna

[26] In Victoria, Australia, by the operation of the Art 1 of Sched 1 to the *Sale of Goods (Vienna Convention) Act* 1987 (Vic). In China, by the virtue of Art 142(2) of the *General Principles of Civil Law of the People's Republic of China* 1991.

[27] *Bonython v Commonwealth* [1951] AC 201 at 219.

[28] Article 16(1) of Chinese *Contract Law* 1999.

Convention under the laws of China and Australia[29] depends on whether the parties have effectively opted out of the Vienna Convention by agreement.[30]

Opting out of the Vienna Convention

As the Vienna Convention makes the provision for freedom to contract in Art 6, the parties are at liberty to select the parts of the Vienna Convention to which they agree to be bound, if any at all. Therefore, should the parties agree that Australian law be adopted as the governing law of the contract, firstly, the parties have to agree to exclude the operation of the Vienna Convention over their contract; secondly, they have to choose Australian law (or Chinese law) as the governing law, thirdly, it is prudent to exclude the application of the Chinese law (or Australian law). This opting out exercise is dependent on a valid exclusion clause regarding application of the Vienna Convention and one of the national laws of China and Australia.

If no effective exclusion of the Vienna Convention clause is made or accepted by the court, the Vienna Convention will nevertheless apply to a contract with a choice of law clause being either Chinese law or Australian law. That will repeat the scenario where "the Law of Victoria will apply" in the choice of law clause in fact means "the Vienna Convention will apply". This would constitute a failure of drafting which may have a detrimental effect on the client, at least to the extent of potential loss of a better bargain.

In the case where the parties have chosen the national law of a third or neutral state or other international uniform contract law and principles like the UNIDROIT Principles of International Commercial Contracts, as stated above, provided that valid opting out clauses regarding the Vienna Convention and both the Chinese and Australian laws are in place, such a choice of law can be validly made by the parties.

As such, in Situation 1, unless the parties have effectively opted out, the Vienna Convention will be the governing law of the contract. The issue of the residual law governing the contract should also be addressed. It would then be a matter of securing the competency of an Australian court as to the jurisdiction.

Situation 2: Contracts Relating to Australian Companies Doing Business in China

(a) *Where Australian companies make direct investment in China:*
It is a prudent practice to partner with a local business overseas to establish a foothold in an unfamiliar business environment as many Australian businesses have done in China. Chambers summarised the joint venture position under Australian law as a vehicle not only to provide a convenient

[29] In Victoria, Australia, by the operation of the Art 1 of Sched 1 to the *Sale of Goods (Vienna Convention) Act* 1987 (Vic). In China, by the virtue of Art 142(2) of the *General Principles of Civil Law of the People's Republic of China* 1991.

[30] Article 6 of the Vienna Convention.

> structure for bringing together capital and expertise to a common endeavour, but also to achieve a satisfactory position under Australian tax and trade laws. Joint ventures generally take one of two forms: equity joint venture or contractual joint venture. Equity joint venture is established by incorporation of a separate company under Australian corporations law while the latter is created under general contract law where no separate legal entity is constituted.[31]

Under Chinese law, foreign businesses may engage in business activities in the following three forms under three different legislations:

- Wholly foreign owned enterprises:

  Law of the People's Republic of China on Wholly Foreign-Owned Enterprises (Amended) 2000

- Contractual (Co-operative) joint venture:

  Law of the People's Republic of China on Chinese-Foreign Contractual Joint Venture 2000

- Equity joint venture:

  Law of the People's Republic of China on Chinese-Foreign Equity Joint Ventures (Amended) 2001

Should an Australian company establish itself in China under this legal regime, it will usually acquire a "legal person" status in China and a "place of business" in China, provided that the compliance procedures are met. A further distinction should be made here regarding the business activities of foreign invested enterprises (FIEs):

1. Domestic trade by the FIEs within China.
2. International trade by the FIEs from China.

Domestic trading activities by the FIEs within China

All three laws deal with foreign invested enterprises. They all make clear provision that the formation of contracts and business activities conducted by any business entity in any of the above forms are governed by Chinese laws and regulations.[32]

In the situation where the parties have not selected the applicable law in a contract, the contract will be governed by the Chinese law by the operation of Art

[31] R H Chambers, "Joint Venture Under Australian Law: With a brief comparison of the joint venture laws in China" (Paper presented at the Sino-Australian Conference on Taxation and Investment in Beijing, April 1989).

[32] Article 3 of *Law of the People's Republic of China on Chinese-Foreign Contractual Joint Venture*, Art 2 of *Law of the People's Republic of China on Chinese-Foreign Equity Joint Ventures (Amended)* 2000 and Art 4 of *Law of the People's Republic of China on Wholly Foreign-Owned Enterprises*.

145(2) of the GPCL and Art 126(1) of the *Contract Law* 1999 based on the principle that is the closest connection with the contract.

As Art 126(2) of Chinese *Contract Law* 1999 states: "The contracts for Chinese-foreign equity joint ventures, for Chinese-foreign contractual joint ventures and for Chinese-foreign co-operative exploration and development of natural resources to be performed within the territory of the PRC shall apply the laws of the PRC." Therefore, the contracting parties have no choice but to choose Chinese law as the governing law. As such, the domestic trading activities by the FIEs within China are governed by the relevant Chinese laws and under the jurisdiction of the people's courts in China.

A note of caution: In the event that a Chinese contracting party takes a dispute arising out of a contract involving an Australian corporation to a Chinese court, and a Chinese court finds the dispute falling within its jurisdiction, if the Australian corporation wishes to take this dispute to Australian courts, it should first object to the competence of Chinese court jurisdiction. Failure to do so will trigger the deeming provisions referred to above[33] trapping the Australian corporation and its legal advisers in the territory of the Chinese judicial system which could be a very costly and troublesome exercise.

International trade by the FIEs from China

An abundant supply of low cost, skilled labour is one of the most appealing comparative advantages of China which has become the "factory for the world". Many FIEs have been engaged in the process and assembly trade business, where the orders for manufactured goods are made overseas, the orders together with the supply of the substantial part of the materials necessary for such manufacture or production are sent to China for manufacturing for later export overseas.[34] This practice is particularly common for FIEs with Japanese, American, Taiwanese and Hong Kong interests as they control access to lucrative overseas consumer markets.

According to Art 3, the Vienna Convention will not apply to those contracts where the buyer who agrees to purchase the manufactured or produced goods undertakes to supply a substantial part of the materials necessary for such manufacture or production. In such a case, the Vienna Convention will not apply to a contract of export of manufactured goods nor a contract for supplying the necessary materials for processing by Chinese labour, even though there may be a change of ownership of the materials supplied.[35]

[33] Article 245 of the *General Principles of Civil Law of the People's Republic of China* states: "If in a civil action in respect of a case involving foreign element, the defendant raises no objection to the jurisdiction of a people's court and responds to the action by making his defence, he shall be deemed to have accepted that this people's court has jurisdiction over the case".

[34] Article 3 of the Vienna Convention.

[35] Article 3(1) of the Vienna Convention.

However, should the FIEs be engaged with an international contract for the sale of goods other than simply the assembly and processing of goods, as the FIEs have acquired a place of business in China, the scenarios listed in Situation 1 will apply. The competency of jurisdiction of Australian courts remains.

(b) *Where Australian companies directly bid and participate in special projects in China on a project by project basis, especially in the energy and resources sectors:*

China's rapid economic development has been hindered by the lack of the corresponding infrastructure development in the past. Under China's 10th Five-year Plan, China will make heavy investment to improve its domestic infrastructures in the areas of highways, ports, railway, telecommunication, trans-China gas pipeline, power plants, municipal utilities like water treatment and sewerage plants and other large industrial projects. According to Li, China will continue to co-operate with foreign corporations to develop oil and gas exploration, construction of transmission pipelines and downstream utilisation projects.[36]

The planned development will create further opportunities on a project by project basis for Australian companies which do not wish to tie their fortune to China but have the special expertise and equipment China needs.

Under Chinese law, the bidding and procurement of the contracts for foreign companies are governed by the following main legislation:

- *Law of the People's Republic of China on Bid Invitation and Bidding* 1999.
- *Measures on Bid Invitation and Bidding for Commencement of Special Construction Projects* 2003.
- *Regulations of the People's Republic of China on the Exploration of Offshore Petroleum Resources in Cooperation with Foreign Enterprises* 1982.
- *Regulations of the People's Republic of China on the Exploitation of On-shore Petroleum Resources in Cooperation with Foreign Enterprises* 1993.
- *Notice on Printing and Issuing the Interim Provisions on Regulating Foreign Invested Rare Earth Industry* 2002.
- *Interim Rules of the State Council of the People's Republic of China on Preferences for the Construction of Ports and Piers with Chinese and Foreign Joint Investment* 1985.

Contract of special project involving supply of goods and services under the Vienna Convention

Should Australian companies succeed in winning special project contracts after going through the bidding process under Chinese law, a formal commercial

[36] Li Yanmen, Director-General, Department of Basic Industries, China's Energy Policies During the 10th Five Year Plan Period, September 11, 2001.

contract will have to be made for delivery and performance. Such a contract will fall within the category of the Contract of Supply of Goods and Services. This poses the question: Is the Vienna Convention confined to the supply of goods in exclusion of service?

According to Honnold, when the parties deal with goods and services in a single contract, the Vienna Convention will apply by virtue of Art 3(2).[37] Therefore, in drafting such a contract, naming of the contract and the determination of the value of components of the goods and services in the contract are important considerations.

Australian Jurisdiction and Contracts with China

For practical purposes, the choice of forum is about the determination of the jurisdiction of the courts hearing the disputes. Should the Vienna Convention be adopted as the governing law of a contract with China, Australian corporations need to ensure the contract has a real and close connection with Australia so that Australian courts will be competent to adjudicate a contractual dispute should it arise.

Due to the complexity and technicality of the rules of private international law, it is the writer's opinion that despite the selection of the choice of law and choice of forum in the contract, it is prudent to ensure that a close and real relationship between the choice of law and the contract can be established and proved in order to ensure the court will honour the selection stipulated in the contract. As demonstrated in the case of *Akai Pty Ltd v The People's Insurance Co Ltd,*[38] the place of payment, the place of negotiations, the place of execution and the currency are all important factors determining the competence of the jurisdiction and the choice of law.

Lessons for an exporter from an importer

In the case of *Lewis Construction Co Pty Ltd v M Tichauer SA,*[39] Lewis Construction, a Victorian company, purchased a crane for construction purposes from a French company. While in use, parts of it broke away and crashed onto the site, killing three workers and injuring five others. Lewis commenced legal proceedings in the Supreme Court of Victoria against the French company for breach of terms of contract and the tort of negligence. It was found that although the contract was made in Victoria and the law of Victoria was applicable, the court found the case falling outside its jurisdiction because of the lack of "the closest and most real connexion" required with Australia.[40] The court made the following important findings:

[37] J O Honnold, *Uniform Law for International Sales*, 1999, 58.
[38] (1996) 188 CLR 418.
[39] [1966] VR 341.
[40] [1966] VR 341.

- As the correspondence containing acceptance to the offer was made in Victoria, the time of formation of the contract was the time of that communication made.
- As the contract between the parties agreed that any litigation would be adjudicated upon in the Commercial Court of Lyon, it could be implied that French law would govern the contract.
- As the sale was on CIF terms, the French exporter's obligation was performed when it shipped the crane and forwarded to the buyer an effective bill of lading and insurance policy. As such, if the crane shipped was not in accordance with the contract, the breach took place in France rather than in Victoria.

For Australian exporters of commodity goods to China, it would be important to monitor their conduct in the following three areas stipulated by Tilbury[41] as they may have a significant impact on the court's determination whether the court has competency of jurisdiction over the matter.

Where parties have expressed an intention about the proper jurisdiction

The court in determining whether it has jurisdiction over the matter in dispute will first ascertain if the parties have expressed an intention about in which jurisdiction a contractual dispute should be adjudicated. Therefore, it is important to have a clause dealing with choice of forum where any litigation would be adjudicated.

Where the breach of contract occurs

An international contract should not only stipulate expressly when the performance of the parties' obligations are due, but also where the performance is to take place. The contract of sale should be on FOB terms but no more than CIF terms where Australian exporters can discharge their entire obligations in Australia.

Where and when is the contract made?

A contract is made where the last act necessary to create a binding contract takes place – the acceptance of an offer. The place and time of the formation of the contract is when and where the last acceptance of the final offer is made.[42] The drawn-out process of a "battle of forms" is a common occurrence in international contracts. It is therefore important to ensure Australian exporters "fire the last shot" in the formation of the contract. The mode of communication by which the contract was made is also important as it relates to different applications of the postal acceptance rule, or other rules of non-instantaneous communication and email communication. Business executives are often preoccupied with reaching a deal by constantly sending offers and counter offers without sufficient awareness of the legal significance on the timing, mode and place of the final act of acceptance.

[41] M Tilbury, G Davis and B Opeskin, *Conflict of Laws in Australia*, 2002.
[42] *Brinkibon Ltd v Stahag Stahl and Stahlwarenhandelsgesellschaft mbH* [1983] 2 AC 34.

Choice of jurisdiction for export of goods contracts

In contracts for export of goods, Australian companies should insist on Australian courts in the choice of jurisdiction clause for such contracts would have the closest and most real connection with Australia; formation, performance and/or the discharge of the contract are all likely to take place in Australia.[43]

Traditionally, lawyers have only been engaged in the drafting of contracts, advising and litigation at the dispute resolution stages, to facilitate cross-border transactions. With the progress of globalisation and the complexity of interaction of state systems of law, more and more participation by lawyers in the initial stages of business negotiations and later management and execution of contracts can be expected. The way business is conducted is directly relevant to the determination of the choice of law and choice of jurisdiction matters in the court.

ENFORCEMENT OF AUSTRALIAN COURT JUDGMENTS IN CHINA

The final issue to be discussed is perhaps the most critical in a commercial sense. A judgment is not worth the paper it is written on if it cannot be enforced. Enforcement involves two issues, recognition of the validity of the judgment and an effective enforcement system.

Internationally the enforcement of foreign court judgments largely rest on the strong political will between states and mutual respect between the courts concerned based on the principles of reciprocity.

Under Art 268 of the GPCL[44] unless the enforcement of a foreign court judgment is in contravention of the basic principles of Chinese law, or against the national interests of China, a Chinese court will give effect to such foreign court judgment by recognising it and enforcing it according to the procedures set out by Chinese law.

There are two possible avenues through which a foreign court judgment can be recognised and enforced in China according to Art 268 of the GPCL. Firstly, there is direct enforcement under the international treaties China has signed, like the

[43] *Lewis Construction Co Pty Ltd v Tichauer SA* [1966] VR 341.

[44] Article 268 of the GPCL states that: "In the case of an application or request for recognition and enforcement of a legally effective judgment or written order of a foreign court, the people's court shall, after examining it in accordance with the international treaties concluded or acceded to by the People's Republic of China or with the principle of reciprocity and arriving at the conclusion that it does not contradict the basic principles of the law of the People's Republic of China nor violates State sovereignty, security and social and public interest of the country, recognize the validity of the judgment or written order, and, if required, issue a writ of execution to enforce it in accordance with the relevant provisions of this Law; if the application or request contradicts the basic principles of the law of the People's Republic of China or violates State sovereignty, security and social and public interest of the country, the people's court shall not recognize and enforce it".

bilateral judicial assistance accords in civil and commercial matters, where a foreign court may make a request of recognition and enforcement of its judgment to the Intermediate People's Court in China. Secondly, a foreign party may directly apply for the recognition and enforcement of a foreign court judgment to the People's Court and it is up to the court to decide based on the principle of reciprocity.[45]

As China has only entered into the accords of mutual judicial assistance in civil and commercial matters with the countries comprising of mainly the small developing countries, with the exception of France and Argentina, the avenue of the enforcement of Australian court judgments have been seriously restricted. To the author's knowledge, there are no case precedents where Australian court judgments have been enforced in China. Therefore, it only leaves the final stage of the strategy of the enforcement of Australian judgments in China as a theoretical possibility. The Australian business and legal profession should view it as a window of opportunity to a possible improvement in the future. They should work towards securing future bilateral judicial assistance accord with China, at least to the extent covering the specialised commodity trade by engaging in active political lobby. This view is shared by some American lawyers.[46]

From a practical point of view, it may be worthwhile to insert a contract clause which requires the parties to recognise the validity of the jurisdiction and validity of the court judgment and to accept the enforcement of a competent court's judgment and not to obstruct such enforcement proceedings.

CONCLUSION

Adoption of the Vienna Convention as the Governing Law of Contracts with China

Choice of law in negotiation

Choosing the appropriate governing law will have a significant impact on the bargaining positions of the parties. In international business negotiation, where trust and confidence between two commercial parties from different countries is usually wanting, it is desirable that no hard line approach of "my law or no deal" is

[45] Article 267 of the GPCL, which states: "If a legally effective judgment or written order made by a foreign court requires recognition and enforcement by a people's court of the People's Republic of China, the party concerned may directly apply for recognition and enforcement to the intermediate people's court of the People's Republic of China which has jurisdiction. The foreign court may also, in accordance with the provisions of the international treaties concluded or acceded to by that foreign country and the People's Republic of China or with the principle of reciprocity, request recognition and enforcement by a people's court."

[46] R E Reyes, Jr, "The Enforcement of Foreign Court Judgments in the People's Republic of China: What the American lawyer needs to know" (1997) 23 *Brooklyn Journal of International Law* 251.

unreasonably or unnecessarily insisted upon, which may have an adverse effect on the commercial negotiations.

The feasibility of implementing this transnational dispute risks management strategy

As the Vienna Convention is a mutually acceptable law for Australia and China as the choice of law governing international contracts for the sale of goods, it will facilitate the business deal-making process and minimise the opportunity costs accordingly. By the nature of the transactional process of export of goods contracts, should the conclusion of contracts be well executed with adequate legal assistance, it will likely ensure contracts have the closest and most real connection with a court jurisdiction in Australia. This method of choosing the jurisdiction is not objectionable to Chinese parties and goes some way towards ensuring a proven and fair judicial process enhances the management of businesses. Finally, the Chinese legal system at least leaves a theoretical avenue open for the enforcement of Australian court judgments in China. Therefore it is feasible.

The costs of drafting and litigating contracts applying the Vienna Convention may be higher in the short term as lawyers, their clients and even the courts have to develop expertise in that area of law. But in the long run, harmonisation of laws in international trade would likely reduce the transaction costs and opportunity costs as the application of a mutually acceptable international convention would increase trust and facilitate economic co-operation for the mutual benefits to the parties concerned. Most importantly, choosing the appropriate law for a contract with a Chinese party may assist risk management and facilitate the deal-making of the business, as it ensures Australian business dealing with China operates within a pre-empted framework and procedures without compromising the chances of striking deals for mutual commercial benefits.

The future of the choice of law in contracting with China

It was reported that the London-based commodity trading houses were reluctant to adopt the Vienna Convention in their contracts as it might introduce uncertain elements into contract governed by existing English law.[47] With the growing awareness of the Vienna Convention and decided cases, it is anticipated that the Vienna Convention will be chosen more frequently as the governing law of contracts in the globalisation of commercial activities. Major international trading countries along with Australia and China, like the United States, Germany, France and Canada have all ratified the Vienna Convention and adopted it as part of their domestic law. This provides a solid foundation for the application of the Vienna Convention in international contracts of sale of goods, including the trade between Australia and China.

[47] Michael Bridge, "The UK Sale of Goods Act, The Vienna Convention and The UNIDROIT Principles", in Petar Sarcevic and Paul Volken (eds), *The International Sale of Goods Revisited*, 2001, 116.

return to AMPLA 2003 Table of Contents