JAPANESE ATTITUDES TOWARDS COMMERCIAL AGREEMENTS WITH THE PEOPLE'S REPUBLIC OF CHINA*

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I. INTRODUCTION

Similar Japanese and Chinese attitudes towards contractual agreements are reflected in drafting form and in substantive provisions. This similarity of attitudes stems from the position of compromise as a primary means of dispute resolution in each country's legal system. The primacy of compromise is reflected in simply drafted agreement provisions and the use of the expressions "friendly" and "mutual discussion" as the method by which to settle, for example, payment problems and disputes in the interpretation of a particular agreement. Although arbitration is provided for in all Japan-People's Republic of China (P.R.C.) agreements, the requirement that each party receive the approval of its national government to give full force and effect to an arbitration tribunal's decision underlines the mutual preference for settling disputes by friendly and mutual discussions.[1]

This article intends to demonstrate the similarity of Japanese and Chinese attitudes towards contractual agreements by contrasting Japan-P.R.C. agreements with Japan-United States and Japan-third world agreements. This similarity of attitudes, the structural support framework for bilateral trade, technology, and after-sales service can explain Japan's success in trading with the P.R.C.

Section II will examine Japanese attitudes towards domestic commercial agreements and explain why this domestic model is used in business transactions with the P.R.C. Section III will set out the structural framework of trade between Japan and the P.R.C. prior to and after the establishment of diplomatic relations between the two countries in 1972. This section will thereafter focus on the contrast in content between the Japan-P.R.C. Agreement Concerning Trade[2] and the U.S.-Japan Treaty of Friendship, Commerce, and Navigation.[3] Section IV will examine current forms of Japan-P.R.C. commercial transactions and focus on dif-

1. NI-CHŪ BŌEKI HIKKEI (MANUAL OF JAPAN-CHINA TRADE), 43 JAPAN ASSOCIATION FOR THE PROMOTION OF INTERNATIONAL TRADE (1979).

2. Nippon-koku to chūka-jimmin-kyōwa-koku to no aida no bōeki ni kansuru kyōtei (Agreement Between Japan and the People's Republic of China Concerning Trade), 93 GENKO-HOKI SORAN (ALL EXISTING LAWS AND REGULATIONS) (*Joyaku [Treaties]*), 2171-162 to 2171-163-3 (*effective* Sept. 15, 1974), [hereinafter cited as Japan-P.R.C. Trade Agreement].

3. Treaty of Friendship, Commerce and Navigation Between the United States of America and Japan, *done* April 2, 1953, 4 U.S.T. 2063-2084 T.I.A.S. No. 2863 (*effective* Oct. 30, 1953), [hereinafter cited as U.S.-Japan Treaty].

ferences among selected Japan-P.R.C., Japan-U.S., and Japan-third world commercial agreements.

The Japan-P.R.C. paradigm of commercial agreements is worthy of study by U.S. lawyers and businessmen engaging in commercial transactions with the P.R.C. Although U.S. legal attitudes and Japanese-Chinese attitudes towards the detail of contract provisions differ, the success of Japan in trading with the P.R.C. should give pause to U.S. lawyers and businessmen to rethink the necessity of offering detailed draft proposals to P.R.C. enterprises. Indeed, P.R.C. government officials have stated that Japan-P.R.C. commercial agreements should be studied as model cases by other countries.[4]

II. JAPANESE DOMESTIC MODEL OF CONTRACTS AND WHY THIS MODEL IS USED IN JAPAN-P.R.C. AGREEMENTS

A. Japanese Attitudes Towards Commercial Agreements: Views of Rights and Obligations

Commercial agreements between Japanese and foreign enterprises may be divided into three paradigms, Japan-U.S., Japan-third world, and Japan-P.R.C. Focusing on licensing agreements, for example, a Japan-U.S. agreement where the licensor is a U.S. corporation and the licensee a Japanese corporation will usually contain detailed clauses as to exclusivity, royalty calculation (minimum royalty and periodic payments), the licensee's obligation to protect licensed patents and trademarks against infringement claims, marking of licensed products by the licensee, warranty disclaimer, confidentiality obligation of the licensee, technical assistance, and arbitration in accordance with the U.S.-Japan Trade Arbitration Agreement of September 16, 1952.[5]

4. This statement was made by Ma-Yi, Vice Minister, P.R.C. State Economic Commission and Fang Zhichun and Gan Ziyu, Vice Ministers, P.R.C.-Japan Planning Commission. A. Moroguchi, *Gōben mondai no chugoku-gawa no kangaekata (Chinese Side's Way of Thinking With Respect to Joint Venture Problems)*, 78 Nicchukeizaikyokai (Japan China Association of Economy and Trade Report) 9 (Jan. 1980), [hereinafter cited as *Gōben mondai*].

5. Agreement Between the Japan Commercial Arbitration Association and the American Arbitration Association to Facilitate the Use of Commercial Arbitration in Trade Between Japan and the United States of America, September 15, 1952; CHUSAI-HOKI-SHU (COLLECTION OF ARBITRATION LAWS) at III-1 to III-4, Kokusaishojichusaikyokai (International Commercial Arbitration Association) (1972), [hereinafter cited as Arbitration Agreement].

A Japan-third world agreement with a Japanese licensor and third world licensee will contain detailed clauses in favor of the Japanese party, such as:

> licensor's technical personnel will be dispatched to licensee's plant for technical guidance and licensee's personnel accepted at licensor's Japan plant for three months total each, during the term of the agreement. Expenses will be paid by licensee several weeks in advance of departure of licensor's staff to licensee's plant, or prior to arrival in Japan of licensee's staff.[6]

Japanese corporate personnel and attorneys[7] explain the need for detailed drafting in the Japan-U.S. and Japan-third world models in terms of each party's legal consciousness. In the United States, contract law doctrine, including the statute of frauds and the parol evidence rule, leads to detailed contract provisions.[8] If the Japanese party does not agree on such detailed drafting, generally, the United States side will not conclude the agreement, especially if it is a licensing agreement. With third world agreements, the Japanese party is anxious to protect its confidential know-how and to obtain payment. In those third world countries with a British colonial past, the contract law statute of frauds and the parol evidence rule also demand detailed drafting.[9]

To understand the Japan-P.R.C. paradigm, it is necessary to explain Japanese attitudes towards domestic commercial agreements and why the domestic model is used in transactions with China. Japanese merchants view a contractual relationship as one of cooperation, friendship, and co-reliance.[10] Thus, rights and obligations are not perceived as being limited within the "four corners" of a contract. Rather, there is a tacit understanding between

6. This information was drawn from a number of agreements reviewed by the authors.

7. Interview with Professor M. Young, visiting research scholar, Faculty of Law, University of Tokyo, Tokyo, Japan, April 21, 1980.

8. U.C.C. § 2-201 (Statute of Frauds) provides in pertinent part, "a contract for the sale of goods for the price of $500 or more is not enforceable . . . unless there is some writing . . . ," and § 2-202 (Parol . . . Evidence) provides in pertinent part, "[t]erms . . . in . . . writing intended by the parties as a final expression of their agreement . . . may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement."

9. For the English common law statute of frauds see, *The Statute of Frauds* at 178-96 and for parol evidence see, *The Contents of the Contract* at 113, in M.P. FURMSTON, LAW OF CONTRACT (9th ed. 1976).

10. *Wagakuni ni okeru keiyaku-kan (1) (Views of contracts in Japan (1))*, No. 200 *NBL* at 6-7 (Jan. 1980).

the parties regarding the extent to which contract provisions shall impose an obligation on one party and grant a right to the other party. This tacit understanding stems from lengthy negotiations which invariably precede the conclusion of a complex commercial agreement. In the case of a licensing agreement, the parties will engage in negotiations over a period of months or even years.

The first step in negotiations calls for each side to become well acquainted with members of the other side. To company management the character of the individuals in a prospective licensee's management is important. In addition, good social relations allow for a more relaxed negotiating atmosphere and a deeper understanding of the other side's way of thinking.

At the conference table, each side's understanding of the other theoretically lessens the necessity of drafting detailed contract provisions.[11] Additionally, there are other beliefs underlying the emphasis on tacit understanding. The stipulation of detailed rights and obligations indicates distrust between the parties.[12] Furthermore, detailed provisions cannot foresee future situations. It is preferable to settle problems on a case-by-case basis through friendly discussion and co-reliance. This friendly discussion and co-reliance is possible only when a working relationship of trust has been built between the parties. Finally, the Japanese character is such that it is imperative to consider the other party's position at all times.[13]

Provisions in Japanese domestic commercial agreements often contain such ambiguous expressions as "friendly discussion,"

11. *But see* NIPPON-JIN NO HO-ISHIKI (LEGAL CONSCIOUSNESS OF JAPANESE) at 88 (ed. Nihonbunkakaigi [Japan Cultural Conference] 1973), in which 88.5% of those questioned in a survey expressed a preference for concrete, detailed contracts as opposed to 8.5% who expressed a preference for simple contracts.

12. The following volumes are references stating the Japanese view towards contracts: E. Hoshino, *Gendai ni okeru keiyaku (Contracts in Modern Times)*, MINPO RONSHU (3) (ESSAYS ON THE CIVIL CODE (3)) (1972); T. KAWASHIMA, NIPPON-JIN NO HO-ISHIKI (JAPANESE CONSCIOUSNESS OF LAW) (1967); J. Kamishima, T. Sawaki, K. Tokoro and T. Amaji, *Nippon-jin no keiyaku-kan (Japanese Views of Contracts)*, NIPPON-JIN TO HO (JAPANESE AND LAW) (1978); *Wagakuni ni okeru keiyaku-kan (1)(2)(3)(4) (Views of Contracts in Japan (1)(2)(3)(4))*, Nos. 200 to 203 NBL (Jan. and Feb. 1980); W. Kashiwagi, *Sho-torihiki no jissai to genko-keiyakuho: business-kai ga nozomu keiyakuho no gendaika (Practice of Commercial Transactions and Current Contract Law: Modernization of Contract Law Desired by Business Circles)*, No. 33 NBL at 33-39 (Oct. 1974).

13. Y. Ishida, *Nippon to obei no keiyaku ni tsuite no kangae-kata (Japanese and European-American Views of Contracts)*, Nos. 7-8 KOKUSAI-SHOJI-HOMU (1979).

"cooperate," "sufficient," "necessary" and "mutually acceptable."[14] These ambiguous provisions reflect the mutual trust and tacit understanding which exists between the parties. Ambiguous provisions also permit flexibility in interpretation of agreement clauses in the future.

Domestic commercial agreements, generally, do not contain "whereas," jurisdiction, or arbitration clauses. "Whereas" clauses are viewed as inadequate to express relations between the contracting parties. Jurisdiction clauses are not viewed as necessary for a variety of reasons. First, one party's insistence on the inclusion of a jurisdiction clause would be viewed by the other party as a lack of trust. Second, even though Japanese district courts are generally limited in jurisdiction to the prefecture in which they are located, many Japanese companies have offices in large population centers. Accordingly, it is convenient for one party to travel to the other party's location to bring suit.[15] Arbitration in domestic contracts is not familiar in Japan.[16] Rather, compromise fulfills the function which arbitration performs in U.S. domestic commercial agreements when it is specified in an agreement. A final factor is that Japanese parties often trust public bodies such as courts.[17] A domestic form licensing agreement used in Japan is included in the Appendix as an illustration of the simplicity and brevity of commercial agreements in Japan.

A lawyer's review of domestic contract provisions usually does not occur until a serious dispute has surfaced. As a general rule, Japanese corporate personnel consider the review by a lawyer of a domestic commercial agreement to be a sign of lack of mutual trust between the parties. Also, the limited number of lawyers in Japan[18] and the lawyer's traditional role as essentially a litigator indicate a preference for thorough review of domestic

14. Many Japanese domestic contracts contain such provisions as, "if any problems occur with regard to this contract, the parties shall discuss in good faith." Legally, it may be stated that the parties carry on mutual discussions based on this provision.

15. Distances are short in Japan. For example, from Tokyo to Osaka it is only 545 kilometers.

16. In certain contracts, for example, construction contracts, an arbitration clause must be included. See *Kensetsugyoho (Construction Business Law)*, article 19-11, (1956) as discussed in *Kenchiku no horitsu-sodan* (CONSULTATIONS ON CONSTRUCTION) at 277-281 (1970).

17. NIPPON-JIN NO HO-ISHIKI, *supra* note 11, at 74, 94, 164.

18. At present there are 11,536 licensed attorneys in Japan, *Nippon-bengoshi-rengo-kai kaiin meibo (Register of Japan Federation of Bar Associations)* (July 1, 1979).

commercial agreements before a dispute arises.[19]

In contrast, Japanese lawyers generally review international commercial agreements during the drafting and negotiation stages. However, Japanese lawyers generally do not participate in negotiations between a client and contract party leading to the conclusion of an international agreement. This contrasts with the general practice in the United States of including lawyers in similar contract negotiations.

When disputes arise between parties to a domestic commercial agreement, every effort is made to reach a settlement through friendly discussions. These discussions usually involve the participation of personnel of the respective contracting parties only. If possible, the parties will strive to maintain an amicable relationship between the contracting parties and at the same time avoid a loss of face by either party.[20] This method of agreement is sanctioned by Article 695 of the Civil Code, which provides that, "a compromise becomes effective when the parties have agreed to terminate a dispute between them by mutual concessions."[21]

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19. Professor M. Young has suggested that according to preliminary investigations, Japanese attorneys in Tokyo spend an average of 15%–20% of their time reviewing contracts.

20. *See* Ohta and Hozumi, *Compromise in the Course of Litigation*, 6 LAW IN JAPAN: AN ANNUAL 97, 99-101 (1973).

21. There are two forms of compromise recognized under Japanese law: out-of-court compromise and compromise during the course of litigation. Out-of-court compromise has the same effect as judgment when the parties declare the particulars of their agreement to the court in accordance with the Code of Civil Procedure. Compromise during the course of litigation also has the same effect as a judgment. Compromise provisions are as follows:

CIVIL CODE (Japan, 1896)

(Compromise)

Article 695. A compromise becomes effective when the parties have agreed to terminate a dispute between them by mutual concessions.

(Effect)

Article 698. If, in cases where it has, by a compromise, been admitted that one of the parties possesses the right constituting the object of a dispute or that the other party does not possess such right, it has afterwards been established that the former party did not possess the right or that the other party did possess the same, such right shall be treated as having by virtue of the compromise been transferred to the former party or extinguished as the case may be.

CODE OF CIVIL PROCEDURE (Japan, 1890).

(Attempt of compromise)

Article 136. The court may, whatever stage the suit may be in, attempt to carry out compromise or have a commissioned judge or an entrusted judge try the same.

2. The court, a commissioned judge or an entrusted judge may for compromise

If, subsequent to friendly discussions, one party files a suit in court, compromise during the course of litigation is provided for by Article 136 of the Code of Civil Procedure.[21,1] This article permits a judge to attempt to carry out a compromise at any time during the course of litigation. Compromise negotiations may be commenced at the initiative of either of the parties or by the court. The active position of a judge in the Japanese civil law system, in contrast to the passive role of judges in the United States, facilitates judicial initiative.[22]

The pitfall of agreeing to a judge-initiated compromise is that both parties may feel they have been forced to accept a solution. Parties to a lawsuit in Japan tend to be reluctant to challenge a judge's suggestion, since such challenge tends to result in a decision unfavorable to the party refusing to compromise.[23] In addition, lawsuits in Japan tend to be lengthy, resulting in high litigation fees.[24] Even when a favorable judgment is obtained, enforce-

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order the principal party or his legal representative to appear before court.

(Effect of protocol of compromise, waiver, or admission)

Article 203. In case a compromise, waiver of claim or admission has been entered in a protocol, such entry shall have the same effect as a judgment becoming final and conclusive.

(Compromise prior to institution of complaint)

Article 356. The parties may, regarding a civil controversy, bring a motion for compromise before the summary court located in the place where the general forum of the other party exists by setting forth the purport and ground for claim as well as the actual circumstances of the controversy.

2. On a compromise being arranged, it shall be entered in the protocol.

3. In the event that a compromise is not arranged, the court shall, upon motion of both parties appeared on the date for compromise, order them to forthwith proceed to oral argument of the suit. In this case the movant of compromise shall be deemed to have instituted suit at the time when he made the motion and the expenses for compromise shall be made a part of court costs.

4. In the event that the movant or the other party does not appear on the date for compromise, the court may deem the proposed compromise to be a failure.

21.1 Code of Civil Procedure, *supra* note 21, art. 136.

22. The active role of a Japanese judge aids the in-court compromise process. Issues, e.g., are defined through pleadings and through the judge's questioning of the parties and witnesses. The judge often suggests compromise to the parties and helps to fashion a compromise solution to the issues in dispute. S. Mutō, *Concerning Trial Leadership in Civil Litigation: Focusing on Judge's Inquiry and Compromise* in COMPARATIVE LAW: JAPANESE LAW C-133—C-157 (Y. Nagashima, course materials, Harvard Law School, Fall 1978).

23. *See* Ohta and Hozumi, *Compromise in the Course of Litigation*, *supra* note 20, at 102-106.

24. In one patent infringement case, for example, stamp tax for a 4-½ year trial (March, 1966—September, 1970) amounted to ¥529,000 (@250¥/$US1 = $2,116), lawyers' fees conceivably amounted to ¥5,000,000 ($20,000) on a recovery of ¥30,000,000 ($120,000). *American Cyanamid Co., Inc. v. Nissan Chemical K.K.* (Toyama Dist. Ct. 1970), *reprinted in* K. OGAWA, PATENT SENSŌ (PATENT WAR) at 76-87 (1977).

ment may take up to five years due to various procedural delaying tactics which are available to the losing party.[25]

Compromise may thus be viewed from two perspectives. The first is each party's desire to avoid losing face and to arrive at a solution which will retain the basis for possible future business relations, or at the very least, maintain a good reputation in trade circles. The second is the prohibitive cost of litigation and enforcement, and the hesitancy of the parties to clash with a judge's suggestion.

Even though Japanese corporations draft detailed international commercial agreements, the strong preference for flexibility in interpretation of provisions and the use of compromise to settle disputes remains. At times, this leads to serious disputes. One leading example, the Australian sugar dispute,[26] illustrates the Japanese side's desire for flexibility in a change of commodity market price situation.

In December of 1974 thirty-one Japanese sugar companies and the Colonial Sugar Refinery of Australia agreed on a long-

25. If, for example, plaintiff recovers a ¥10 million judgment against defendant and this decision is affirmed on appeal, plaintiff must undertake a compulsory procedure to recover. Let us assume that the defendant has funds in the bank, land, and goods produced by defendant. Delaying tactics often used by defendant to hinder plaintiff's compulsory execution are: (1) refusal to accept service of decision; (2) plaintiff applies to court for execution against bank deposit and court issues order to bank (which takes two to three weeks). (This delay gives defendant an opportunity to transfer funds as defendant has notice that plaintiff has applied for order); (3) Plaintiff may request the court to sell defendant's land. Defendant may object to granting of order for sale of land and thereafter may object to each procedure of the court. As this is a kind of regular litigation procedure, this process will take up to three years. Even if plaintiff wins, official sales are usually held only once every four months. Also, it is usually difficult to sell the land at the fair market value. Each time the sale fails, ten percent is deducted from the asking price. The sale of land may last up to an additional three years; and (4) in the case of goods, plaintiff must apply for sale of defendant's goods. This is at times difficult to achieve as title to goods is often unclear. As with land, there are several processes: *e.g.*, (1) oppose the plaintiff in obtaining a court order, and (2) object to order on the grounds that goods belong to third party. This process will often last up to three years. M. Ujiie, *Bengoshi kara mita minji-saiban (1) (Civil Trial From A Lawyer's Viewpoint)*, in GENDAI-SHAKAI TO BENGOSHI (CONTEMPORARY SOCIETY AND LAWYERS), at 119-125 (August, 1977).

In response to the amount of time spent in compulsory execution, the Diet (Japanese parliament) passed a completely new compulsory execution law in November, 1979 which will come into force on October 1, 1980. The main purpose of the law is to speed the compulsory execution process. Urano, *Minji-shikkō-hō seitei no keika to igi ni tsuite (Process and Meaning in the Establishment of the Civil Compulsory Law)* 30 JIYŪ TO SEIGI (LIBERTY AND JUSTICE) 2-8 (December 1979).

26. "Nichi-gō keiyaku-kōshō no nokoshita kyōkun" ("Lessons from the Negotiations Between Japan and Australia Regarding Sugar"), in *Wagakuni ni okeru keiyaku-kan (I)*, *supra* note 10, at II, § 2.

term sugar supply contract for the supply of 600,000 tons of sugar per year for five years at a price of 229 pounds sterling per ton. This price was approximately one-half the international market price when the contract was executed. Subsequent to the execution of the contract, the world market price of sugar decreased substantially.

The Japanese side requested a lowering of the contract price based upon the principle of changed circumstances, despite the fact that the contract provisions did not recognize a drop in the market price as justifying a downward adjustment in the contract price. The Japanese side based its reasoning on the notion that compromise in light of changed circumstances was justifiable. This position is often adopted by one side in Japanese domestic contract disputes, and parties often compromise on this basis.

The Australian side refused this request and applied for arbitration. The Japanese side managed to delay the actual arbitration proceedings through negotiations to the point where the Australian side agreed to a downward price adjustment. A compromise agreement was reached in 1976 after two years of negotiations.[26.1]

B. *Application of Japanese Domestic Model to Japan-P.R.C. Agreements and Why the P.R.C. Perceives Japan as a Model*

From the Japanese perspective, a mixture of emotional and practical factors explains the application of simply drafted commercial agreements to agreements with the P.R.C. These include cultural affinity, lingering guilt over World War II, and the view that China is a natural trading partner.

Although vastly different, the adoption by Japan of Chinese language ideographs, Confucian social ethics, Buddhism, and early Chinese administrative legal structures has greatly influenced Japanese respect for Chinese culture. These cultural factors have enabled Japanese businessmen, for example, to feel more at ease when negotiating a commercial agreement with the P.R.C. than with U.S. corporations.

Japanese enterprises are eager to cooperate with the P.R.C. in the development of natural resources. Such development, it is hoped, will provide Japan with a secure supply of raw materials. Also Japanese businessmen are eager to invest in labor intensive

26.1 *Id.*

industries in the P.R.C. as many of these industries, e.g. textiles, have become unprofitable in Japan.

Finally, Japanese businessmen believe that the P.R.C. has a similar attitude towards contracts. P.R.C. draft agreement proposals are also simply drafted. Numerous provisions in such drafts provide for settlement of issues via friendly or mutual discussion, as is the case in Japanese domestic commercial agreements. Japanese businessmen are also aware of the historical primacy of compromise in the Chinese legal system.[27]

From the Chinese perspective, Japan is admired as the only Asian country to have modernized independent of domination by western countries. In addition, the Chinese are aware of the cultural affinity, and believe that Japan is a natural trading partner. Despite differences in political theory, certain Chinese leaders admire the collective spirit of Japanese workers as demonstrated by their loyalty to their employer.[28] This collective spirit and the willingness to work hard are models which the P.R.C. seeks to emulate.

In negotiations leading to the conclusion of commercial agreements, P.R.C. enterprise personnel often spend a good amount of time socializing with their Japanese counterparts. P.R.C. negotiators believe that it is important to become acquainted with the other side's personality and, as a result, ascertain character prior to engaging in serious negotiations.[29]

The P.R.C. is also eager to obtain Japanese know-how in exchange for natural resources and labor intensive products. To the Chinese, Japanese know-how includes technology, quality control techniques, and management systems.[30] Accordingly, Japan-P.R.C. licensing agreements include all three of these items, as further discussed in Section IV.

An additional factor from the Chinese perspective is the primacy of mediation as a form of dispute resolution. Traditionally, the Chinese have avoided litigation wherever possible resort-

27. Lubman, *Mao and Mediation: Politics and Dispute Resolution in Communist China*, 55 CALIF. L. REV. 1284 (1967); Cohen, *Chinese Mediation on the Eve of Modernization* 54 CALIF. L. REV. 1201 (1966); and Marks, *In-Court and Out-of-Court Mediation: A Comparative Study of Taiwan, New York, and Wisconsin* (unpublished seminar paper, State University of New York at Buffalo School of Law, Spring, 1975).

28. *Gōben mondai, supra* note 4.

29. Ching, *China's Prejudices Confront Capitalism*, The Asian Wall Street Journal, April 4, 1980, at 6.

30. *Gōben mondai, supra* note 4.

ing instead to mediation.[31] Subsequent to the founding of the P.R.C. in 1949, the government and the Communist Party emphasized the primacy of mediation as the preferred means of settling disputes. Although cast in the ideological terms of "persuasion by the masses" to achieve "correct thought," the essence of mediation remains the voluntary consent of both disputants to the suggestions of a third party.[32]

At present, civil procedure law provides that, in civil cases, the parties may engage in mediation under the auspices of the mediation committee before proceeding to litigation.[33] While international commercial agreements are not subject to this provision, the obligation of parties to engage in friendly or mutual discussions to solve disputes before proceeding to arbitration demonstrates the applicability of this concept.

III. THE STRUCTURAL FRAMEWORK OF JAPAN-P.R.C. TRADE AND CONTRASTS BETWEEN JAPAN-P.R.C. AND JAPAN-U.S. GOVERNMENT LEVEL AGREEMENTS

A. Pre-1972 Structural Framework

Between 1952 and 1958, trade between the P.R.C. and Japan was based on four consecutive agreements employing the barter system of trade.[34] These agreements were executed between the

31. Cohen, *Chinese Mediation on the Eve of Modernization*, *supra* note 27.

32. Lubman, *Mao and Mediation: Politics and Dispute Resolution in Communist China*, *supra* note 27.

33. FALU CHANGZHI SHOUTSE (HANDBOOK ON LEGAL KNOWLEDGE) 165 (ed. Jin Mo-sheng, 1979); and FALU ZHISHI WENDA (QUESTIONS AND ANSWERS ON LEGAL KNOWLEDGE) 202-203 (ed. Chen Chun-lung, 1979).

34. The four agreements were:

(a) June 1, 1952, executed by Nan Han-chen, chairman of CITPC and two Japanese Diet members, Tomi Koora and Kei Hoashi. The agreement was for one year with a target of £60,000,000 two-way trade; however, only $15,510,000 was achieved.

(b) October 29, 1953, executed by CITPC and the Japanese trade delegation. This agreement was also for one year with a target of £60,000,000 two-way trade; however, only $59,870,800 was achieved.

(c) May 4, 1955, 55 Agreements of the People's Republic of China [C.C.J.C.] 36 (1968), executed by the CITPC, Japan Association for the Promotion of International Trade, Dietmen's League for the Promotion of Trade between Japan and China, and the Japan-China Trade Representative Group. The agreement was for two years, and in addition to trade, provided for the holding of trade exihibitions in the P.R.C. and Japan. In 1956, trade between the P.R.C. and Japan expanded to $150,990,000. Japan exported primarily iron and steel, chemical fertilizers and agricultural chemicals, and imported primarily salt, coal, magnesia, and hides.

China Council for the Promotion of International Trade (CITPC) and trade missions representing Japanese trade organizations. The Korean War, however, inhibited the growth of two-way trade, and the Nagasaki "flag incident" in 1958 caused a suspension of trade until 1960.[35]

Trade resumed in August of 1960 based upon the "three political principles" and "three principles of trade" stipulated by the late Premier Chou En-lai. Based upon his belief in the inseparability of politics and trade, Premier Chou stated that the P.R.C would not conduct business with Japanese companies which did not support the following political principles: (1) terminating any hostile attitude by Japan towards the P.R.C.; (2) not engaging in the scheme to establish two Chinas; and (3) not impeding the process of normalization of relations between the P.R.C. and Japan.[36] The principles of trade included: (1) all agreements were to be government level agreements; (2) individual transactions could be concluded on a friendly private basis; and (3) trade in selected commodities, (for example, lacquer and sweet chestnuts)

(d) July 1957—March 1958, the following agreements were executed:

July, 1957	import (to Japan) agreement relating to magnesia; 120,000 metric tons.
August, 1957	import (to Japan) agreement relating to salt; 1,000,000 metric tons.
December, 1957	export (to P.R.C.) agreement relating to chemical fertilizers; amonium sulfate (400,000 metric tons); and urea (30,000 metric tons).
	import (to Japan) agreement relating to rice; 50,000 metric tons.
February, 1958	export (to P.R.C.) relating to urea; 20,000 metric tons.
	five year barter agreement relating to iron and copper.
March, 1958	import (to Japan) agreement relating to rice; 30,000 metric tons.
	import (to Japan) agreement relating to soybeans; 265,000 metric tons per year.

Y. Miwa, *Sino-Japanese Trade Relations After World War II, 1945-1962*, at 14-32 (May 1974, preliminary draft) (quoted with permission of the author); and H. HIRAI, NI-CHŪ BŌEKI NO KISOCHISHIKI (BASIC KNOWLEDGE OF JAPAN-CHINA TRADE) 183-88, 307-14 (1971).

35. On May 2, 1958, a P.R.C. flag at the site of a P.R.C. trade exhibition in Nagasaki was torn down by a Japanese youth. The police refused to prosecute and the Japanese government declined to apologize to the P.R.C. As a result, the P.R.C. announced a suspension of trade with Japan and cancelled all outstanding contracts. However, underlying this incident was Prime Minister Kishi's cabinet's statement concerning the fourth Sino-Japanese trade agreement of March 1958. This statement clarified that expansion of P.R.C.—Japan trade was based upon the non-recognition of the P.R.C. Government by Japan. Miwa, *supra* note 34, at 38-39.

36. NI-CHŪ BŌEKI HIKKEI, *supra* note 1, at 8.

would be encouraged in order to support small enterprises.[37] The P.R.C. subsequently conceded on the first trade principle, but the absence of relations between the two countries and the restrictions later imposed by the Coordinating Committee for Export Control (COCOM)[38] inhibited the growth of two-way trade.

Pursuant to these political and trade principles, the concept of friendship trade developed, and, thereafter, in 1962, memorandum trade began.[39] Under friendship trade only those trading companies which accepted the above stated principles and which belonged to one of the trade promotion organizations were allowed to do business with the P.R.C.[40] All companies which desired to conduct business with the P.R.C. were obliged to use the services of this select group of trading companies. Major Japanese trading companies established subsidiaries which qualified as friendly trading companies, and by 1971 the number of these subsidiaries had expanded to 238.[41]

The major functions of the friendly trading companies were to: (1) hold trade fairs in the respective countries; (2) dispatch trade and economic representative delegations; (3) promote the exchange of technology; and (4) work for the establishment of correspondent relations between Japanese and P.R.C. banks.[42] Three documents, the Agreement Concerning Promotion of Friendly Trade Between the Japanese and Chinese Peoples (1967), the Record of Discussions (1968), and the Joint Communiqué Between the Japan Association for the Promotion of International Trade and Six Associations and the China Committee for the Promotion

37. *Id.* Trade was renewed on the basis that Japanese companies ordering Chinese products were "direct partners" and middlemen such as trading firms did not make profit. JAPAN EXTERNAL TRADE AND RESEARCH ORGANIZATION (JETRO), HOW TO APPROACH THE CHINA MARKET 75 (1972).

38. *Tōzai bōeki no arikata COCOM-kinyu-list ō-haba-kanwa-saku fukumu* (*The Method of East-West Trade: COCOM Prohibited Export List Eased*), Nipponkogyōshimbun (Japan Industrial Newspaper), Oct. 17, 1978, at 1.

39. In 1961, the Japanese government discarded the principle of dealing with the P.R.C. only under a barter system, and shortly thereafter removed many export items from the COCOM list. Imports from the P.R.C. were subject to Ministry of International Trade and Industry (MITI) approval. In 1962, deferred payments from the P.R.C. for steel and chemical fertilizers were approved. Japan Eximbank loan credits were also made available, but this was cancelled one year later. Miwa, *supra* note 34, at 65-67; and NI-CHŪ BŌEKI KISO-CHISHIKI, *supra* note 34, at 197.

40. Primarily, those companies belonged to the Japan Association for the Promotion of International Trade.

41. NI-CHŪ BŌEKI KISO-CHISHIKI, *supra* note 34, at 188-189.

42. *Id.* at 184.

of International Trade (1970) enumerated in detail the above principles of friendship trade and the direction in which that trade was to proceed.[43]

As a supplement to friendship trade, a memorandum trade agreement (Takahashi-Liao Agreement) was initialed on November 9, 1962 with a five-year term, calling for an annual two-way trade totaling US$100 million over five years. Pursuant to this agreement, liaison offices were established in Peking and Tokyo, manufacturers were divided into groups according to products imported or exported, and the selection of friendly Japanese trading companies was liberalized.[44] This agreement was renewed in 1967, and until the signing of the Japan-China Trade Agreement in 1974 on a governmental level, this agreement served as a second basis of trade between the two countries.[45]

Under the memorandum trade agreements, Japanese makers and users formed the Japan-China General Trade Liaison Conference. Individual companies signed "memorandum trade" agreements for such products as plant exports, which in general had five year deferred-payment provisions, and for exports of chemical fertilizers, steel materials, agricultural products, and machines, each of which included provisions for payment from one to two years after acceptance of delivery.[46] However, in 1965, the Satoh Government in Japan, under pressure from the U.S. government, restricted the use of deferred payment provisions.[47]

Prior to 1972, individual contracts between P.R.C. and Japanese companies reflected the non-governmental nature of P.R.C.-Japan relations. Contracts contained payment, arbitration, and other clauses in favor of the Chinese party. These clauses suggest the absence of formal legal sanctions for enforcement. A typical form purchase agreement drafted by the P.R.C. party is discussed in section IV.

B. Post-1972 Structural Framework and Contrasts in U.S.-P.R.C. Government Agreements

The success of Japan in trading with the P.R.C. subsequent to

43. *Id.* at 184-85.

44. Miwa, *supra* note 34, at 65.

45. NI-CHŪ BŌEKI KISO-CHISHIKI, *supra* note 34, at 186; and JETRO, THE JAPANESE PERSPECTIVE ON CHINA'S OPENING ECONOMY 182 (1979).

46. NI-CHŪ BOEKI KISO-CHISHIKI, *supra* note 34, at 186.

47. *Id.* at 187.

48. Nippon-koku to chūka-jimmin-kyōwa-koku to no aida no bōeki ni kansuru kyōtei, *supra* note 2.

the establishment of diplomatic relations in 1972 is partially attributable to the structural support framework at the governmental, quasi-governmental, and private levels. Important government level agreements are: the Japan-P.R.C. Agreement Concerning Trade (1974),[48] the Japan-P.R.C. Agreement Concerning The Protection of Trademarks (1978),[49] and the direct loan from Japan to the P.R.C.[50] The quasi-governmental agreement is the untied Japan Eximbank Loan.[51] There are two private level agreements, the Long Term Trade Agreement,[52] and a loan agreement between thirty-one Japanese banks and the P.R.C.[53] These agreements are substantially different from comparable United States-Japan agreements as they reflect the Japanese and Chinese preference for friendly discussion and compromise to settle disputes.

The Trade and Trademark Agreements[54] merely outline general principles, leaving details to more specific governmental arrangement and private agreements. Each provision in the Trade and Trademark Agreements is simply drafted, in contrast to the content of the U.S.-Japan Treaty of Friendship, Commerce, and Navigation (United States-Japan Treaty)[55] which is detailed. The latter reflects the United States attitude that it is imperative to define every term and precisely draft an instrument so as to clearly specify each party's rights and obligations. The Trade Agree-

49. Nippon-koku to chūka-jimmin-kyōwa-koku to no aida no shōhyo no hogo ni kansuru kyōtei, *supra* note 2, at 2171-163-4 to 2171-163-5; and Y. KOBAYASHI AND H. GOTO, NI-CHŪ SHŌHYŌ HOGO KYŌTEI: KAISETSU (JAPAN-CHINA AGREEMENT ON PROTECTION OF TRADEMARKS: AN EXPLANATION) (1978).

50. NICCHŪKEIZAIKYŌKAI (JAPAN-CHINA ASSOCIATION ON ECONOMY & TRADE), 79-12 SHIRYO: NI-CHŪ KEIZAI 5 (MATERIALS ON JAPAN-CHINA ECONOMY) (1979).

51. *Tai-chū-yūshi-kōshō ga ketchaku: ni-chū-saidai no ken-an katazuku kam-min tomo chūgoku daihyō-dan to chōin e (Financing Negotiations with China Are Concluded: Japan-China's Largest Pending Questions Are Settled: Officials and Private Companies and China's Negotiation Team Sign)*, Nihonkeizaishimbun (Japan Economic Times) May 15, 1979, at 1 [hereinafter cited as Nikkei].

52. The initial agreement, private in nature, was signed in February, 1978. *Shin-dankai no ni-chū kyōryoku; jo (A New Stage in Japan-China Cooperation; Part I)*, Nikkei, Dec. 2, 1979, at 1.

53. *Tai-chū-yūshi-kōshō ga ketchaku: ni-chū-saidai no kenan katazuku kam-min tomo chūgoku daihyō-dan to chōin e*, Nikkei, *supra* note 51.

54. Nippon-koku to chūka-jimmin-kyōwa-koku to no aida no shōhyō no hogo ni kansuru kyōtei, *supra* note 49. The Trademark Agreement provides for most favored treatment to legal or natural persons of either country who desire to register trademarks or other rights in either country. As with the Trade Agreement, the initial period is three years, and, thereafter, continues automatically unless terminated by thirty days' prior notice by either party.

55. U.S.-Japan Treaty, *supra* note 3.

ment consists of ten articles, in contrast to twenty-five articles in the United States-Japan Treaty.

The preamble of the Trade Agreement affirms respect for the private trade system existing prior to 1972, and proceeds to declare the basing of trade on the principle of mutual equality and friendship.[56] The U.S.-Japan Treaty preamble, on the other hand, states the desire to encourage closer economic and cultural relations and to promote mutually advantageous commercial intercourse, and is based upon unconditionally according national and most favored nation treatment.[57]

The most prominent contrast between the two treaties is in the clauses dealing with dispute resolution. In the Trade Agreement, parties are encouraged to settle disputes by friendly discussion.[58] In cases where no settlement is reached, provisions in individual commercial agreements shall be given effect. Each country shall accord an arbitration judgment effect where requested in accordance with domestic law. Further, each party is encouraged to use the arbitration bodies of each country.[59]

The Trade Agreement dispute settlement provisions clearly demonstrate Japanese and Chinese preference for friendly discussion to settle issues. Even if the parties resort to arbitration, the enforcement of an arbitration tribunal's award is dependent upon the domestic law of each country.[60] This limitation serves to discourage each party from resorting to arbitration. Also, the Trade Agreement states that if arbitration is not stipulated in a commercial agreement between two companies, the contract parties may bind themselves to a separate arbitration agreement.[61] This provision alludes to the practice of excluding an arbitration provision in Japanese domestic agreements. Finally, the Trade Agreement provides for a mixed commission composed of the members of each government to deal with any problems in the execution of this agreement or with any trade problems in general.[62] Again, this provision indicates the Japanese and Chinese

56. Japan-P.R.C. Trade Agreement, *supra* note 2, preamble.
57. U.S.-Japan Treaty, *supra* note 3, preamble.
58. Japan-P.R.C. Trade Agreement, *supra* note 2, article 8(1).
59. *Id.*, article 8(3).
60. *Id.*, article 8(4).
61. *Id.*, article 8(2).
62. *Id.*, article 9.

preference for constant discussion to deal with ongoing trade problems.

The U.S.-Japan Treaty provides two methods for dispute resolution, litigation and arbitration.[63] Court decisions are enforceable in accordance with the principle of equal access to the courts in each country by the aggrieved parties.[64] Arbitration awards rendered outside the United States are enforceable to the "same measure of recognition as awards rendered in other States [of the United States]."[65]

The U.S.-Japan Treaty dispute settlement provisions underline the U.S. legal principles of comity and the opportunity to appear. It is also notable that no provision provides for the settlement of disputes by friendly discussion or negotiation prior to formal legal procedures. However, parties will inevitably attempt to negotiate a settlement before invoking arbitration or litigating. The difference is that the U.S. side will inevitably bring an attorney to such negotiations, whereas in Japanese-Chinese disputes, an attorney is rarely brought into dispute settlement discussions.

Most-favored-nation treatment is another area where the contrast between the two treaties is significant. Articles of the Trade Agreement provide for most-favored-nation treatment covering taxes or duties on import and export articles.[66] Tax exemptions and duty exemptions are provided for goods, catalogues, articles used for demonstration or experimental purposes, articles displayed in trade fairs or exhibitions, tools used in assembling work or equipment installation, containers used in export or import, and articles in transit through either of the signatory parties to third countries.[67]

In contrast, the U.S.-Japan Treaty provides for both national and most-favored-nation treatment to a much greater scope. A total of six articles accord either national or most-favored-nation treatment. National treatment is accorded in a wide variety of circumstances. This treatment includes application of laws and regulations,[68] access to courts and administrative tribunals,[69] pro-

63. U.S.-Japan Treaty, *supra* note 3, article IV(2).
64. *Id.*
65. *Id.*
66. Japan-P.R.C. Trade Agreement, *supra* note 2, article 1.
67. *Id.*, article 2.
68. U.S.-Japan Treaty, *supra* note 3, article III.
69. *Id.*, article IV.

tection of leased or owned property,[70] equal handling of products regarding internal taxation, sale, and distribution,[71] and carrying of products by vessels.[72] Most-favored-nation treatment is accorded for access to courts and administrative tribunals,[73] protection of leased or owned property,[74] entry and departure from the territories of the other party for commercial travelers,[75] application of customs duties on arriving and exported products,[76] and taxation, sales, and distribution conditions for products.[77]

Other provisions in the Trade Agreement are also drafted as principles with the single exception of the clause dealing with currencies of settlement.[78] For example, transaction prices between the two countries are to be based upon international market prices.[79] Additional provisions note that each country is bound to energetically endeavor to promote the flow of industrial technology,[80] and, to the greatest extent possible, encourage the holding of trade exhibitions in each country.[81]

The U.S.-Japan Treaty specifically addresses a number of commercial transaction issues. These issues include the level of exchange restrictions on payments, remittances, and transfers of funds or financial instruments,[82] exchange rate quotations for private commercial agreements,[83] and the absence of restrictions on the import or export of products.[84] The rejection of double taxation is also dealt with at length in the U.S.-Japan Treaty[85] as well as in a separate U.S.-Japan Tax Treaty.[86] No such treaty is in force

70. *Id.*, article VI.
71. *Id.*, article XI.
72. *Id.*, article XIX.
73. *Id.*, article IV.
74. *Id.*, article VI.
75. *Id.*, article XIII.
76. *Id.*, article XIV.
77. *Id.*, article XVI.
78. Japan-P.R.C. Trade Agreement, *supra* note 2, article 4(2).
79. *Id.*, article 5.
80. *Id.*, article 6.
81. *Id.*, article 7.
82. U.S.-Japan Treaty, *supra* note 3.
83. *Id.*, article XII.
84. *Id.*, article XIV.
85. *Id.*, article XI.
86. *Shotoku ni tai suru sozei ni kansuru nijyūkazei no kaihi oyobi datsuzei no bōshi no tame no nipponkoku to amerika-ga sshū-koku to no aida no jōyaku (Treaty between Japan and U.S. on Income Tax with Regard to the Avoidance of Double Taxation and Tax Delinquency)*, 94 GENKO-HOKI SORAN (ALL EXISTING LAWS AND REGULATIONS) 2187-230 to 2188 (June 23, 1972).

between Japan and the P.R.C. Rather, provisions of the Trade Agreement address this issue.[87]

The direct Japan-P.R.C. government loan, the Japan Eximbank loan, the Long Term Trade Agreement, and the private bank loan agreement, provide additional structural support for Japan-P.R.C. trade. The direct Japan to P.R.C. government loan agreement was executed on December 7, 1979, during Prime Minister Ohira's visit to the P.R.C. The loan, in the amount of ¥50 billion (@¥250 = $1, US$200 million), is at the Organization for Economic Cooperation and Development's (OECD's) lowest interest rate guideline and varies in duration according to each of six targeted projects.[88] These projects are:

> (1) Shijiusuo gang jianshe (Shijiusuo harbor construction) (Shantung Province). This project covers the construction of harbor berths for ships carrying coal and iron ore. The berths will be used to facilitate shipment of Chinese coal overseas and to accept iron ore from Australia to supply five ironworks in the Peking vicinity. Construction time is estimated at three years. Of a total project cost of US$322 million, US$220 million will be funded by the loan;
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> (2) Railway construction between Shijiusuo and Yanzhou (Shantung Province). This project involves the construction of a 300-kilometer, one-track line for diesel locomotives in order to transport raw coal from Yanzhou to the port of Shijiusuo and to transport iron ore and general coal shipment inland. Construction time is estimated at three years. Of a total US$296 million cost, funds from the loan will total US$165 million;
>
> (3) Railway construction between Peking and Langwopu. This project includes the construction of a 150-kilometer double track for electric trains. This line will primarily be used to transport coal but will also be incorporated into a trunk line originating in Harbin. The construction period is estimated at three years. Of a total cost of US$642 million, US$375 million will be provided from the loan funds;
>
> (4) Construction and upgrading of the Jingguang railway line between Guangzhou and Hengyang (Guangdong and Hebei Provinces). The Japan Railroad Construction Corporation will dispatch engineers to assist in the construction of tunnels along

87. Japan-P.R.C. Trade Agreement, *supra* note 2, article 3.

88. NICCHŪKEIZAIKYOKAI (JAPAN-CHINA ASSOCIATION ON ECONOMY & TRADE), 1979-12 SHIRYO: NI-CHŪ KEIZAI (MATERIALS ON JAPAN-CHINA ECONOMY) 1-5 (1979).

this line. The line is to be a double track and used for the exchange of general commodities between the interior and the South of the P.R.C. The construction period of this line is estimated to be four years at a total cost of US$1.87 billion. US$106 million of the loan funds will be applied to this project;

(5) Qinhuangdao harbor expansion (Hebei Province). This project consists of the construction of two berths for 50,000 ton class ships. Upon the completion of the project in three years, the harbor will have an annual handling capacity of 300 million tons. Of a total cost of US$161 million, US$104 million will be provided by funds from this loan;

(6) Wuqiangxi water electric works (Hunan Province). This project involves building a dam on the Ruanshui River to generate electricity, prevent flooding, and facilitate irrigation and water transport. The power generating capability of the dam is estimated at an annual 7.1 billion kilowatts. The electricity generated will be transmitted to Wuhan and to tin, lead, zinc, and other non-ferrous metalworks in the Wuhan area. In 1979, 18,000 workers were transported to the project site to begin construction in 1980. Construction is expected to take six years at a total cost of US$803 million with US$330 million to be funded from this loan;

(7) Japan-China People's Friendship Memorial Hospital (Beijing). This 1000-bed capacity hospital is scheduled for completion in two years. The Japan Ministry of Health has provided technical assistance to the P.R.C. physicians' group which will staff the hospital. Of a total cost of US$140 million, US$61 million will be provided as a straight grant.

The Japan Eximbank loan agreement ratified on May 15, 1979 provides for the equivalent of US$2 billion in Japanese yen for resource development. In addition to this agreement, thirty-one private banks have earmarked US$2 billion in long-term funds and US$6 billion in short-term funds, primarily to finance deferred payments for plant exports to China. The Eximbank terms include a 6.25% per annum interest rate, with the financing period for individual projects to be decided on an individual project basis.[89] An average ten-year loan period is predicted by Eximbank sources.[90] Although the loan is untied, Japanese financial and industrial

89. *Tai-chū-yūshi-kōshō ga ketchaku: ni-chū-saidai no kenan katazuku kam-min tomo chugoku daihyō-dan to chōin e*, Nikkei, *supra* note 51.

90. *Id.*

circles have predicted that private bank loans, which are to be tied, will be used to partially finance targeted projects of the Eximbank loan. In addition, it is speculated that the Japanese will use tied loans in conjunction with demonstration techniques and after-sales servicing to give Japanese industrial concerns a competitive advantage over foreign firms in securing natural resource development project orders.[91]

The Long Term Trade Agreement,[92] as revised in March, 1979, extended the original term from 1985 to 1990 and increased the goal of two-way trade from US$10 billion to a range of US$20-$30 billion. The terms of the agreement include a continued emphasis on deferred payments, denominated one-half in Japanese yen and one-half in U.S. dollars, for plant exports from Japan to the P.R.C., and interest rate payments at the OECD guideline.

The terms of the private banks' loan package provide for: (1) an annual interest rate of 0.5% above the Eurodollar rate, for long-term funds of US$2 billion; and (2) an annual interest rate of 0.25% above the Eurodollar rate, for short-term funds of US$6 billion.[93]

In addition to the above structural framework for two-way trade, Japanese-Chinese enterprise group joint projects are currently in the planning process. These projects include a joint venture for insurance,[94] a joint project for the insurance of Chinese central government bonds and Fukien Province bonds in interna-

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91. *See Kaihatsu-sōgaku jū-oku dolu: ni-chū-sekiyu-kaihatsu kyō chōin: yu-gin shikin o shiyō, nippon hambun hikitori* (*Development Amount of $1 Billion: Japan-China Oil Development Agreement Signed Today: Using Eximbank Funds, Japan Obtained One-half of Oil Production*), Nikkei, Dec. 7, 1979, at 1.

92. The revised agreement was drafted and executed by the Japan-China Long-Term Trade Consultative Commission (P.R.C.) and the Yoshihiro Inayama Japan-China Long-Term Trade Consultative Commission (Japan). NICCHŪKEIZAIKYOKAI (JAPAN-CHINA ASSOCIATION ON ECONOMY & TRADE) 1979-5 SHIRYŌ: NI-CHŪ KEIZAI (MATERIALS ON JAPAN-CHINA ECONOMY) 5 (1979).

93. *Tai-chū-yūshi-kōshō ga ketchaku: ni-chū saidai no kenan katazuku kam-min tomo chūgoku daihyō-dan to chōin e*, Nikkei, supra note 51.

94. Types of insurance will be, (1) casualty insurance on freight shipped in import-export transactions as a supplement to marine insurance, (2) ship insurance on vessels used to transport goods/plants and on vessels used in oil exploration, (3) assembly insurance covering materials used in plant construction, and (4) construction insurance on the construction of factories and offices in the P.R.C. *Ni-chū-kyōdō-hoken-kyōtei teiketsu e: hikiuke seppan de, chōki—torikime anken taishō* (*Japan-China Joint Insurance Agreement Progresses Towards Conclusion: Responsibility to be Divided 50/50: Object is Long Term Agreements*), Nikkei, Jan. 16, 1980, at 1; and interview with the Casualty Insurance Association, Tokyo, Japan, Jan. 22, 1980.

tional financial markets,[95] and a joint venture for the leasing of heavy equipment rented in Japan to Chinese industrial concerns.[96]

IV. COMMERCIAL AGREEMENTS

A. Forms of Trade and Problem Areas

"Diversified trade" between Japan and the P.R.C. includes processing, assembly arrangements (including licensing agreements), compensation trade method, and joint ventures, in addition to plant export and purchase-sales agreements. These forms of trade are not unique to Japan-P.R.C. trade and are also employed regularly in Japan-Association of Southeast Asian Nations (ASEAN) trade.[97]

Processing (*itaku kako* [Japanese], *lailiaojiagong* [Chinese]) involves the import of materials or samples from abroad to the P.R.C. The Chinese manufacture or produce finished goods and charge the Japanese supplier a processing fee for the manufacture.[98] Usually a portion of the raw materials is furnished from within the P.R.C.[99]

Assembly arrangements (*nockdown* [Japanese], *laijianzhuangbei* [Chinese]) involve the supply by Japanese companies of samples and equipment to P.R.C. enterprises. At present, Japanese companies in the heavy machinery, electrical appliance, and electronics industries have been the primary suppliers. The P.R.C. company assembles the finished product using supplied items, and, to date, has sold finished products chiefly in the P.R.C. Where a Japanese company has not supplied equipment, the

95. *Chūgoku: kokusai-shijō de shikin-chōtatsu e: yen-date-sai o dashin: shōken ni-sha, sangatsu hō-chū-shi kyōgi (China: To Seek Funds in the International Market: Inquiry as to Yen Denominated Securities: Two Securities Companies to Visit China in March for Discussions)*, Nikkei, Jan. 26, 1980, at 1.

96. *Pekin de lease jigyō: oriento lease gōben kaisha setsuritsu e (Leasing Enterprise in Peking: Oriental Lease to Establish a Joint Venture Company)*, Nikkei, Jan. 31, 1980, at 3.

97. NICCHŪBŌEKISOKUSHINKAI (JAPAN ASSOCIATION FOR THE PROMOTION OF INTERNATIONAL TRADE), NI-CHŪ KEIZAI KŌRYŪ NI OKERU TAYŌKA-BŌEKI (DIVERSIFIED TRADE IN JAPAN-CHINA ECONOMIC COOPERATION) 4, (Mar. 1980).

98. Cohen and Nee point out that the Chinese differentiate between *lailiaojiagong*, the import of raw materials and packaging from abroad for processing and *laiyangjiagong*, the import of samples for processing based upon which the Chinese supply raw materials and manufactured goods. Cohen and Nee, *China: All About Compensation Trade, Part I*, The Asian Wall Street Journal, July 3, 1979, at 4.

99. NI-CHŪ KEIZAI KŌRYŪ NI OKERU TAYŌKA—BŌEKI, *supra* note 97, at 5.

P.R.C. enterprise charges the company an assembly fee. Where equipment has been supplied, the P.R.C. discounts the assembly fee and credits to the Japanese side the portion of the full fee not charged against the installment payments due for the price of the equipment.[100]

In compensation trade (*hoshó-bóeki* [Japanese], *bushang maoyi* [Chinese]) the Japanese side supplies equipment and essential materials to a Chinese enterprise for mining, agricultural, forestry, domestication, or light industry development. Chinese enterprises pay for supplied equipment and materials with the production from these enterprises or with products from different industries. There are two levels of production-sharing: (1) large-scale national projects such as oil and coal development which are based on the Japan-China Long-Term Trade Agreement;[101] and (2) local level (usually provincial level) projects which are small to medium in scale and are not based on any trade agreement.[102]

Payments in production by the Chinese are at a set price for a fixed period. In contrast, payment provisions in each processing agreement have been negotiated on a case-by-case basis. If the Japanese side is displeased with the quality of goods produced by the P.R.C. enterprise, renegotiations will be held on the processing fees stipulated within the agreement. As noted above, Japanese businessmen believe that a change in circumstances justifies a renegotiation of prices stipulated in a contract. Chinese enterprise management has also been willing to renegotiate prices for any processed articles which the Japanese side is reluctant to accept.[103] In light of this renegotiation practice, it would be prudent to draft an automatic price readjustment clause in this type of agreement. This clause would provide for mutual discussions on the readjustment of price in the event processed goods fall below a certain level of quality.

The Japanese government has published a set of guidelines

100. *Id.*

101. *Shin-dankai no ni-chū kyōryoku; jo, supra* note 52.

102. *Id.*

103. In one case, a Japanese purchaser ordered matching blue jeans and denim jackets from a P.R.C. seller, supplying manufacturing specifications. Upon inspection after arrival in Japan, the Japanese purchaser discovered that the blue jeans and denim jackets were different shades of blue. The P.R.C. seller agreed after prolonged negotiations to lower the price of the items. Interview with H. Hirai, Director and Editor, Japan Association for the Promotion of International Trade, Tokyo, Japan, Feb. 23, 1980.

for the handling of these specific trade forms.[104] In the production-sharing method, resource development in the form of large-scale national projects will be recognized. This recognition stems from the Japanese government's policy to secure a stable oil and coal import supply from the P.R.C.

Other forms of trade will be dealt with on a case-by-case basis. However, the Ministry of International Trade and Industry will not approve production-sharing agreements involving the sale of equipment to be paid for by the Chinese side in manufactured goods.[105]

In processing trade, those goods which are not "notably competitive" with domestic goods will be approved on the same basis as is used with goods originating from other countries. This qualification demonstrates the favorable treatment which the Japanese government accords Chinese products. Assembly arrangements and joint ventures in Japan between a Japanese and a P.R.C. enterprise will be handled in the same manner as is presently in force.[106]

There are also numerous pricing and financing problems in diversified trade. In compensation trade, the Chinese enterprise is

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104. *Tai-chū bōeki suishin e seifu hōshin: shigen wa seisanbutsu bunyo: kyūsho-hōshiki wa gensoku mitomezu (Government Policy is to Encourage Trade With China: Natural Resources to be Exchanged for Production: Production Sharing Method Will Not Be Recognized)*, Nikkei, Nov. 30, 1979, at 1.

105. *Id.*; *But see* NI-CHŪ KEIZAI KŌRYŪ NI OKERU TAYŌ-KA-BŌEKI, *supra*, note 97, at 23, which states that the Nikkei, Nov. 30, 1979 article is incorrect in reporting the non-recognition of the production sharing method; rather, MITI does not recognize a barter system of trade without exchange rate calculations.

106. Any joint venture agreement between a Japanese corporation and foreign enterprise involving the establishment of a new company and new shares in a foreign country must be approved by the Ministry of Finance pursuant to the Foreign Exchange Law, Foreign Exchange Regulation, Article 14. If the joint venture is to be established in Japan, approval must be obtained from the Ministry of Finance and other concerned ministries pursuant to the Foreign Investment Law, Article 11. As of December 18, 1980, the Foreign Investment Law will no longer be in effect. However, those intending to establish a joint venture in Japan will still be required to report the contents of the agreement for notification purposes to the Ministry of Finance. *See* Seki, Gaikoku-kawase oyobi gaikoku-bōeki kanri-hō no kaisei ni tsuite: jō; ge (Regarding the Revision of the Foreign Exchange Law, I, II), Nos. 860 and 861 *Shoji-homu* (March 1980).

Those Japanese corporations intending to engage in processing trade must receive approval from MITI pursuant to the Foreign Exchange Law, Export Trade Control Regulation, article 2-1, or article 1-1-2 and Import Trade Control Regulations, article 8-1-2.

Those Japanese corporations intending to dispatch technology to the P.R.C. under a license agreement (including compensation trade) must obtain approval from MITI pursuant to the Foreign Exchange Law, Foreign Exchange Regulation, article 17-1-2.

contractually obliged to remit a fixed quantity of manufactured goods within a set time period to the Japanese party. In processing, however, the possibility exists that a dispute may arise as to processing fees or the price at which manufactured goods are sold to the Japanese enterprise which supplied the materials or parts for processing. In addition, if the manufactured goods are to be sold in Japan, the currency in which payment is made may become problematic.

From the Japanese side, it is essential that P.R.C. labor costs remain competitive and that prices change in accordance with market conditions in Japan. From the Chinese side it may be argued that the availability of higher retail market prices outside Japan should allow the P.R.C. enterprise to raise the processing fee charged to the Japanese party. To date, Japanese corporations have offered extensive technological training at low fees, including quality control training, as a lever in pricing negotiations with P.R.C. enterprises.

Letter-of-credit (L/C) financing of individual commercial transactions is subject to the requirement under Japanese law that separate L/C's be open for export and import. When exporting materials to be processed, for example, Japanese enterprises are required to have the Chinese side pay for raw materials with an L/C. When importing the processed goods from the P.R.C., the Japanese enterprise is required to establish an L/C in favor of the P.R.C. seller.[107] These two requirements complicate the use of an L/C to finance trade.

To overcome this problem, the following arrangement is employed. When exporting materials to the P.R.C., the Japanese side receives an L/C payable at sight on a certain date usually set after expected delivery of the processed goods from the P.R.C. Upon receiving the processed goods, the Japanese side pays with an L/C payable on demand. As the price of the processed goods exceeds the price of materials, the balance in favor of the P.R.C. enterprise is then remitted to the Bank of China.[108]

In the case of compensation trade, the long term between investment of equipment and production from a Chinese factory necessitates the use of financing. Several methods are currently

107. NI-CHŪ KEIZAI KŌRYŪ NI OKERU TAYŌKA-BŌEKI, *supra* note 97, at 18.
108. *Id.* at 19.

used. In the most commonly used method, a Japanese supplier will obtain a supplier's credit from a Japanese bank. The Bank of China will then remit payment to the Japanese bank. This transfer of funds from China to Japan will then be offset by a loan from the Japanese bank to the Bank of China.

B. Contractual Provisions in Japan-P.R.C. Private Commercial Agreements

This section focuses on the differences among Japan-P.R.C., Japan-U.S., and Japan-third world private commercial agreements. In particular, provisions from a form purchase contract drafted by the Chinese buyer[109] and Japan-P.R.C. licensing agreements[110] are compared with Japan-U.S. and Japan-third world sales and licensing agreements.[111]

Arbitration provisions yield the most striking difference between Japan-P.R.C., Japan-U.S. and Japan-third world commercial agreements. In the Japan-P.R.C. sales and licensing agreements, the first sentence of the arbitration clause provides that, "all disputes which arise with relation to this contract or with the execution hereof, shall be solved by the parties through consultation with each other."[112] This wording reflects Japanese and Chinese preferences for reaching a compromise solution that will avoid the loss of face and the expense involved in proceeding to open dispute in the form of arbitration.

The place of arbitration is specified as the place of the party to whom the demand for arbitration has been addressed. If the arbitration is to take place in the P.R.C., the procedure is governed by the arbitration rules and procedures of the Foreign Trade Arbitration Commission of the China Counsel for the Promotion of International Trade. If the arbitration is to take place in Japan, the rules and procedures of the Japan Commercial Arbitration Association are applied.

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109. These contract provisions are from a form purchase contract used by China Metals & Mining Import-Export Company reprinted and discussed in *Ni-chū bōeki ni okeru 'keiyakusho': keiyakusho kisai-rei no kentō ('Contracts' in Japan-China Trade; Examination of Contract Provisions)*, NBL, No. 8 at 36-39 (Jan. 15, 1972).

110. NI-CHŪ BŌEKI HIKKEI, *supra* note 1, at 29, and interviews with C. Kaneda, Japan-China Friendship Association, and H. Hirai, *supra* note 103.

111. Examples of U.S.-Japan sales and licensing agreements and Japan-third world licensing agreements are drawn from the authors' work product.

112. NI-CHŪ BŌEKI HIKKEI, *supra* note 1, at 49.

An interesting problem arises, however, in the case of cross-claims. In one case, a Chinese enterprise served a demand for arbitration on a Japanese corporation. Under the above clause, arbitration was to be held in Japan. The Japanese party cross-claimed, and the Chinese party asserted that the cross-claims must be heard in the P.R.C. The parties finally agreed, after prolonged negotiations, on hearing the whole case in Japan.[113]

Arbitrators are not limited to the names in the register of the Japanese or Chinese association. A third-country national may be chosen as an arbitrator with the agreement of both parties.

The arbitration decision is final and binding upon both parties. However, each association is obliged to obtain the approval of its respective national government to give full force and effect to the decision. Thus, in theory, if one government did not approve of the arbitration decision, the other party to the agreement would be unable to enforce the arbitration award. This possibility serves to pressure the parties into reaching agreement through friendly discussions.

In contrast, a Japan-U.S. agreement rarely places an obligation on the parties to engage in friendly discussions to reach a compromise solution before proceeding to arbitration. Japan-U.S. sales and licensing agreements usually provide for the settlement of disputes in accordance with the U.S.-Japan Trade Arbitration Agreement of September 16, 1952,[114] or with the rules of the Japan Commercial Arbitration Association. Under the U.S.-Japan Arbitration Agreement, the site of arbitration is the place of the party to whom the notice for arbitration has been addressed. Arbitration decisions are also binding subject to enforcement in the courts of either country.

Japan-third world licensing agreements usually provide for arbitration in Tokyo under the rules of the Japan Commercial Arbitration Association. In those agreements where the licensee's government requires application of its own laws, the Japanese licensor usually inserts a provision providing for arbitration in accordance with the rules of the International Chamber of Commerce.

Force majeure clauses in Japan-P.R.C. sales and licensing

113. Interview with M. F. Higgins, attorney at law, Graham & James, Tokyo, Japan, Apr. 19, 1980.

114. *Arbitration Agreement*, *supra* note 5.

115. *Ni-chū bōeki ni okeru 'keiyakusho:' keiyakusho kisai-rei*, *supra* note 109, at 37.

agreements are also different from their counterparts in Japan-U.S. agreements. Prior to the establishment of diplomatic relations between Japan and China in 1972, only war and natural phenomena were included in *force majeure* clauses.[115] In post-1972 provisions, strikes, lockouts, government orders, and other *force majeure* conditions have been added.[116] In the case of Japanese exports to the P.R.C., delay in arrival at the Chinese port of destination due to port congestion is not included within the scope of the *force majeure* provision.[117]

The sales agreement provides that if the *force majeure* condition continues for four weeks or more, the P.R.C. buyer may unilaterally cancel the contract. This right is not specifically accorded to the Japanese seller in the wording of the provision. The Japan-P.R.C. licensing agreements provide that if the *force majeure* condition continues for more than ninety days, the parties will engage in friendly discussions in order to promptly settle the question of the continued effectiveness of the agreement. A typical Japan-U.S. sales agreement, in contrast, lists a number of *force majeure* conditions such as blockade, embargo, mobilization, fire, flood, hurricane, typhoon, and landslide.

Other provisions of interest in the Japan-P.R.C. sales agreement include method of payment, shipment terms, inspection of quality and quantity, warranty, and penalty for delayed performance.

L/C is the sole method of payment, and an L/C is to be initiated subsequent to the receipt, within twenty to thirty days before shipment, of a cable from the Japanese seller which states the prospective date of shipping. L/C's prior to 1972 were established by the P.R.C. purchaser with the Bank of China and were payable only at a friendly Japanese bank. Payment was effected in pounds sterling or French francs (usually the former) via a bank with which both the Bank of China and the friendly Japanese bank had a correspondent agreement.

At present, L/C settlement may be between the Bank of China and any one of thirty-one Japanese banks with whom correspondent agreements have been concluded.[118] More than fifty

116. NI-CHŪ BŌEKI HIKKEI, *supra* note 1, at 39-40.

117. Interview with H. Hirai, *supra* note 103.

118. NI-CHŪ BŌEKI HIKKEI, *supra* note 1, at 77, lists the thirty-one banks which have concluded correspondent agreements with the Bank of China.

percent of the transactions are settled in U.S. dollars with the remainder being settled primarily in Japanese yen or Chinese renminbi. Procedures for settlement are governed by the agreement between Japan's foreign exchange banks and the Bank of China.[119]

Prior to 1972, in cases where products to be sold were on the COCOM list, Japanese sellers were required to send, in a telegram to the Chinese buyer, the approval permit number issued by the Japanese government. While the Japanese seller is still required to telegraph a permit number issued by the Japanese Government for items on the COCOM list, relaxation of COCOM restrictions against the P.R.C. have rendered this requirement a formality in most cases.[120]

Inspection of quality and quantity of each shipment must be performed at the port of origin by an inspector appointed by the P.R.C. or the manufacturer. Final acceptance, however, is subject to inspection at the port of destination by the P.R.C. Products Inspection Bureau. If the inspector discovers a defect, the buyer is required to present a written claim to the Products Inspection

119. The settlement agreement between Japan's foreign exchange banks and the Bank of China provides for:

(1) currency to be used (presently at the buyer's option);
(2) market price (based on the public announcements of the China Foreign Currency Administrative Bureau);
(3) settlement of accounts (settlement in yen account or renminbi account);
(4) procurement of yen/renminbi (purchases of renminbi or yen by each side); and
(5) disposition of balance after settlement (at any time yen/renminbi may be exchanged by banks into U.S. dollars, and remitting of money overseas will be allowed).

With regard to future settlements, the above banks have agreed that:

(1) if future settlement is to be in yen, same will be transacted at a Japanese bank; if future settlement is to be in renminbi, same will be transacted at the Bank of China;
(2) future settlement in yen/renminbi is for a concrete transaction;
(3) future settlement will be limited to six months;
(4) in principle, settlement should take place within one month after the execution of the contract;
(5) it is possible to use future settlement for the export of the Japanese side, together with a note; and
(6) when future settlement is employed, the contract number, product name, and amount will be reported.

NI-CHŪ BŌEKI HIKKEI, *supra* note 1, at 74.

120. COCOM approval is still required for a number of items including aircraft and computers. *See Chūgoku e YX yushutsu keikaku (Plan to Export the YX [Boeing 767] to China)*, Nikkei, Aug. 27, 1979, at 1; and *Hōzan-seitetsujo-yo no densanki: COCOM ga yushutsu shōnin: Hitachi nado yonsha de jūroku-dai (Computer for Baoshan Ironworks: COCOM Approves Export: Hitachi and Four Other Companies, 16 Computers)*, Nikkei, Dec. 21, 1978.

Bureau within ninety days for transmission to the Japanese seller. Thus, the significance of port-of-origin inspection is unclear in terms of interpretation of the purchase agreement.

Warranty periods are from one to five years with the purchaser having the options of repair at no cost or partial or complete replacement by the seller at no charge. It is notable, however, that no provision reserves to the P.R.C. purchaser the right to terminate the agreement and demand damages if defective products frustrate the purpose of the contract. This long warranty period contrasts with the period stipulated in a Japan-U.S. sales agreement. The latter usually specifies a one-year period.

Force majeure is the only condition under which delayed arrival of products in the Chinese port of destination will avoid a penalty assessment. For every two weeks of delayed arrival up to a maximum of ten weeks, a penalty of 1% (a maximum total amount of 5%) of the total contract price is assessed against the seller. After ten weeks, the P.R.C. purchaser acquires the right to terminate the contract. This penalty provision contrasts with drafting in the Japan-U.S. sales agreement where no penalty for late delivery is provided. The buyer only has the option to terminate the whole agreement.

There are a number of provisions in the Japan-P.R.C. licensing agreements which are drafted differently from comparable provisions in the Japan-U.S. and Japan-third world licensing agreements. Those provisions include the preamble, technical assistance, price and payment method, and inventions and improvements.

The preamble in Japan-P.R.C. licensing agreements (P.R.C. agreement) states that parties *A* and *B*, upon the conclusion of friendly discussions, have concluded the following agreement. Preambles in Japan-U.S. licensing agreements (U.S. agreement) merely state that the agreement has been made on a certain date between parties *A* and *B*. In the P.R.C. agreement preamble, the parties are identified by name only, whereas in the U.S. agreement, the state of incorporation and business address are specified.

No "whereas" clauses are used in the P.R.C. agreement. This follows the Japanese belief that "whereas" clauses perform no useful function.[121] In contrast, the U.S. agreement inevitably contains

121. Woodward and Matsuo, *Drafting License Agreements in Japan and in the United States*, in PATENT AND KNOW-HOW LICENSING IN JAPAN AND THE UNITED STATES, 124, 125 (T. Doi, W. Shattuck ed. 1977).

"whereas" clauses. This reflects the belief in the United States that "whereas" clauses are useful in the interpretation of a contract, especially where a merger clause is included in the instrument.[122]

Technical assistance clauses in the P.R.C. agreement are wider in scope than comparable clauses in the U.S. agreement and third world agreement. In the P.R.C. agreement technical assistance usually takes the form of the dispatch of Japanese technicians to the P.R.C. to engage in technical training for manufacture, management techniques, safety, and quality control. In addition, the Japanese side is obliged to guarantee that the supplied technology is the most recent of its kind. This requirement is also reflected in Article 5 of the P.R.C. Law on Chinese and Foreign Enterprises.[123] This article states that, "the technology or equipment contributed by any foreign participant as investment shall be truly advanced and appropriate to the P.R.C.'s needs."[124]

Fees and training periods for the licensee's personnel are not specified in the P.R.C. agreement. Rather, the parties agree to settle these items by friendly and mutual discussions.

The U.S. agreement limits technical assistance to the supply of printed technical information subject to prices charged by the licensor at the time of request. The Japan-third world agreement (third world agreement) limits technical assistance to the supply of printed technical information.

Training is provided for in a limited manner, in contrast to the P.R.C. agreement. Trainees who are dispatched by the licensee are limited to a small number per year and, for a limited period only, receive training at the licensor's factory in Japan. The licensee is required to pay a training fee as charged by the licensor. The licensor will dispatch technicians to licensee upon request for a limited period of time.

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122. A typical merger clause provides:

> There are no verbal agreements, warranties, representations or understandings affecting this Agreement, all previous agreements, or other negotiations, representations and understandings between *A* and *B* are merged herein, and this Agreement supersedes, cancels and annuls all contracts, undertakings or agreements of prior dates relating to the subject matter of this Agreement.

123. *Chū-gai-gōshi-keiei-kigyō-hō* (*Law on Chinese and Foreign Enterprises*), Article 5, states in pertinent part that, "[t]he technology or equipment contributed by any foreign participant as investment shall be truly advanced and appropriate to China's need." NIHONKOKUSAIBŌEKISOKUSHINKYŌKAI (JAPAN ASSOCIATION FOR THE PROMOTION OF INTERNATIONAL TRADE), CHŪGOKU KEIZAI-KANKEI HŌREI-SHŪ (COLLECTION OF LAWS AND REGULATIONS OF CHINA CONCERNING ECONOMIC RELATIONS) 38-40 (1980).

124. *Id.*

The payment method in the P.R.C. agreement is also different. Due to the difficulty of ascertaining the number of manufactured units to be sold by the licensee in the P.R.C., payment consists of a lump sum for the know-how which is supplied by the Japanese licensor. If the licensee exports manufactured units in the future, royalties on these units are to be settled through the friendly discussions and mutual agreement of the parties. The payment currency is divided between U.S. dollars and Japanese yen.

In contrast, the U.S. and third world agreements limit payment to an initial payment, with a minimum royalty to be paid semi-annually, and an additional set percentage royalty on licensee's sales of licensed products. In addition, separate charges are levied on the supply of technical information and training. The Japanese licensor obliges U.S. and third world licensees to supply records documenting sales for royalty purposes. The P.R.C. agreement does not address this matter.

In the P.R.C. agreement, clauses relating to inventions and improvements by the licensee are also different from provisions in the U.S. and third world agreements. The licensee is obliged to notify the licensor of any inventions and improvements covering the licensed products. However, the parties are to engage in friendly discussion to agree on the registration of any patents outside the P.R.C. In addition, the parties are usually obliged to hold conferences on a regular basis to exchange information concerning inventions and improvements.

Finally, a number of provisions found in the U.S. and third world agreements are absent in the P.R.C. agreement. These include sub-licensing rights, warranties of non-infringement on third parties' patents, an assignment clause, and a governing law clause. Other Japan-P.R.C. licensing agreements contain a governing law clause specifying the laws of both the P.R.C. and Japan. The absence of either a governing law clause or a governing law clause referring to two governing laws points to the emphasis which the Japanese and Chinese parties place on the arbitration clause and on the obligation to engage in friendly discussions.

V. CONCLUSION

Emphasis on social harmony is a central theme in Chinese and Japanese society. In the legal systems of both countries emphasis is placed on the social obligations and the future relationship of

the parties over rights and obligations as expressed within the "four corners" of the written document. Thus, the Japanese and Chinese prefer drafting bilateral commercial agreements with ambiguous wording, leaving a formulation of rights and obligations to the social compact of friendly discussion or mediation.

Whether Japanese corporations will, in the long run, be benefited by this drafting approach depends upon the P.R.C.'s continued adherence to the policy of encouraging foreign investment. Yet, in the P.R.C. and Japan, where maintaining mutual trust outweighs rights and obligations, the Japan-P.R.C. model of commercial agreements is instructive to U.S. attorneys in their drafting approaches to U.S.-P.R.C. commercial agreements. If a U.S. corporation is to successfully develop business relations with the P.R.C., it is essential to emphasize mutual trust over rights and obligations.

VI. APPENDIX
DOMESTIC JAPANESE KNOW-HOW LICENSING AGREEMENT

(Stamp Tax)

A Company (hereinafter referred to as *A*) and *B* Company (hereinafter referred to as *B*) have hereby agreed with regard to the supply of *A*'s manufacturing technology (hereinafter referred to as know-how) as follows:

Article 1. Object

A agrees to the manufacture and sale by *B* of *X* machine (hereinafter referred to as *X*) incorporating know-how.

Article 2. Obligation of Notice

2(1) *B* shall inform *A* of the quantity of *X* which *B* manufactures on a case-by-case basis.

2(2) *B* shall inform *A* in writing, in advance, of the identity of purchaser, quantity of *X* sold, price for each order, and delivery date for the sale of *X*, and shall follow *A*'s instructions.

Article 3. Royalty

3(1) In consideration of the grant of know-how, *B* shall pay to *A* ____ percent (%) of the total sales of *X* as royalty.

3(2) Royalty shall be calculated on the last day of each month based upon the amount of *X* sold per month by *B*. Royalty shall be paid in cash by the ____ day of the following month.

3(3) *A* shall not demand additional royalties from *B*, even if *A* registers any right regarding the know-how.

Article 4. Treatment of Improvements

4(1) In case the parties during the term of this Agreement develop improvements based upon which they obtain patent or other rights regarding *X*, *A* and *B* shall at no charge supply technical data and grant patents or other rights to each other.

Article 5. Obligation to Protect Confidentiality

5(1) *B* shall not reveal to others any secrets regarding know-how.

5(2) *A* may terminate this Agreement immediately and de-

mand damages should *B* breach the preceding paragraph of this Article.

Article 6. Prohibition of Assignment

B shall not transfer any rights or obligations granted hereunder to a third party.

Article 7. Term of the Agreement

The term of this Agreement shall be ____ years from the date of the execution hereof. This term shall be automatically renewed for a period of ____ years unless either party submits an objection to the other party ____ months before the expiration of this Agreement.

Article 8. Settlement of Matters not Provided for Hereunder

Matters not provided for hereunder and questions regarding the interpretation of this Agreement shall be settled by mutual discussion between *A* and *B*.

IN WITNESS HEREOF, two originals of this Agreement have been made, *A* and *B* setting their respective seals hereto and each retaining one copy.

_____ (Date)

Address:
A Company
Representative Director
_____ [seal]

B Company
Representative Director
_____ [seal]