

Rule of Law in China: Chinese Law and Business

Courts as Legislators: Supreme People's Court Interpretations and Procedural Reforms

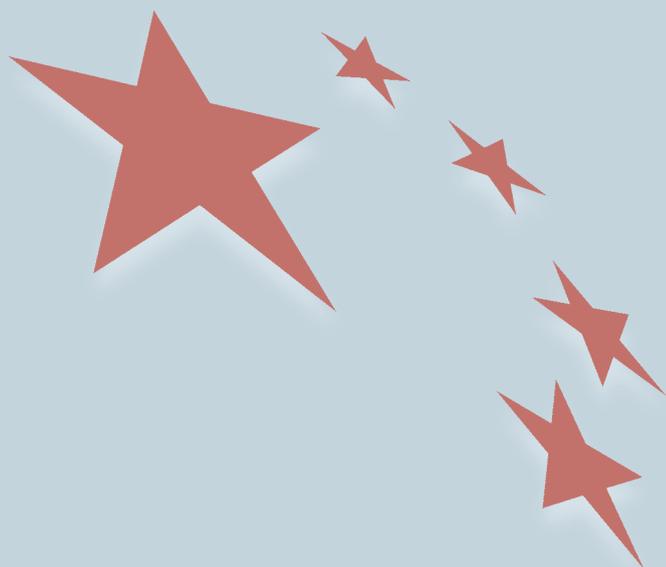
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Executive Summary

- Courts in China today often act like legislative bodies, making law by issuing interpretations of laws that are binding on the courts. The general trend in China has been towards more transparency and greater public participation in legislative law-making and administrative rule-making processes. In contrast, the judicial interpretation process is less transparent, with significantly less room for public participation.
- Every year the Supreme People's Court (SPC) issues a variety of interpretations, regulations, notices, replies, opinions and policy statements (collectively, 'interpretations'). Most are binding on the courts; others are highly persuasive and likely to be followed by the courts. Sometimes they are rather general; other times they are very specific and issued in response to an inquiry from a lower court in regard to a particular case pending before the court.
- SPC interpretations play a valuable role in the legal system. Existing laws and regulations are often too vague or fail to address many of the issues that arise in practice and frequently make their way to the courts. While in theory the courts should be able to seek guidance from the issuing entity, the National People's Congress (NPC) Standing Committee and other bodies have been too busy drafting new laws and regulations to issue interpretations clarifying existing laws. SPC interpretations therefore provide timely and specific responses to concrete issues.
- Nevertheless, the various SPC interpretations raise a number of concerns, including that the SPC lacks the authority to issue interpretations, and that the legislative role of the SPC is at odds with the proper role of courts in a civil law system.
- The biggest concern however is that the SPC is acting like a legislative body, and yet is not adhering to recent reforms of law-making and rule-making processes to increase transparency and public participation. The failure to adopt such reforms undermines the legitimacy of the SPC interpretations, and in some cases leads to decisions that are not well-considered or consistent with existing laws and regulations.
- On the positive side, the SPC is aware of the need to improve the process. The SPC has begun to solicit public comments on some interpretations. In addition, the SPC's Second Five-Year Agenda, released in December 2005, promises further reforms to the procedures for drafting interpretations and to improve their quality.
- The SPC should give teeth to the general reform recommendations in the Second Five-Year Agenda by promulgating detailed rules for hearings and a notice and comment system that provide the general public with a greater say in the drafting of interpretations and other quasi-legislative documents.
- These reforms are within the power of the court, and thus more readily implemented. In contrast, the problem of SPC interpretations being inconsistent with the constitution, NPC laws or the regulations of other state organs highlights the need for a constitutional review body. The SPC is in effect making the law. It cannot review its own law for constitutionality or consistency with other laws and regulations. Nor can the SPC decide where SPC regulations rank in the legislative hierarchy.
- The need for a constitutional review body has been much debated in China. The creation of such a body is not within the power of the SPC. Nor is it likely to occur in the near future. Nevertheless, there is growing pressure to address the issue.

Courts as Legislators: Supreme People's Court Interpretations and Procedural Reforms

Courts in China today often act like legislative bodies, making law by issuing interpretations of laws that are binding on the courts. The general trend in China has been towards more transparency and greater public participation in the legislative law-making and administrative rule-making processes. In contrast, the judicial interpretation process is less transparent with significantly less room for public participation.

The nature of SPC interpretations

China's legal system is based on a civil law system imported from Germany via Japan, although it is now a mixed system with elements of common law, socialist law and traditional law. In comparison to courts in common law systems, Chinese courts have little or no power to 'make law'. Their role is to apply law to the facts. If the laws or regulations are unclear, the courts are supposed to seek guidance and clarification from the entities that promulgated the laws or regulations.

In practice of course, the situation is somewhat more complicated and fluid. Courts inevitably must interpret laws in deciding cases. They no doubt sometimes interpret them in ways that are not consistent with the intent of the promulgating bodies, thus 'making law' in this limited sense. Yet this is no different to the operation of courts in any system of civil law, and is consistent with the general principle that courts apply laws made by legislative entities and regulations made by administrative agencies.

What is distinctive about China's legal system is that the Supreme People's Court (SPC) makes law in a much more direct and highly visible way. Every year the SPC issues a variety of interpretations, regulations, notices, replies, opinions and policy

statements (collectively, 'interpretations').¹ Most are binding on the courts; others are highly persuasive and likely to be followed by the courts. Sometimes they are rather general; other times they are very specific and issued in response to an inquiry from a lower court in regard to a particular case pending before the court.

For example, the SPC has issued interpretations of laws passed by the National People's Congress (NPC) or its Standing Committee, including the Contract Law, Marriage Law, Security Law, Civil Procedure Law, Criminal Law and most other major laws. These interpretations, which may include more articles than the original law itself, clarify terms, fill in lacunae or operationalize ideas in the original law.

Take the issue of whether American or Chinese law would apply if an airplane made in America crashes in China because of a defective engine. The *General Principles of Civil Law* states that the law of the place 'where an infringing act occurred' shall apply in handling compensation claims for any damage caused by the act. But is that where the faulty engine was made, or where the plane crashed? The Supreme Court's interpretation of the law clarified the general issue, stating that 'the place where an infringing act occurred' includes the place where the act was committed *and* where the consequences of the act occurred. Where the two are different, the court may choose the governing law of either place.

1. The Supreme Court's 1997 regulation on judicial interpretations creates three general categories of interpretation: interpretations, regulations and replies. Interpretations in the narrow sense address general issues, in contrast to replies which are responses to specific inquiries from courts. Regulations refer to opinion and general standards. The same regulations also state that judicial interpretations will be legally effective and can be cited by courts in their judgments.

In addition to interpretations of laws, the SPC promulgates regulations regarding the work of the courts. For instance, in early 2000, the SPC issued the *Regulations of the Supreme Court Concerning Several Issues Related to the Unified Administration of Enforcement Work by the High People's Courts*. The regulation sought to improve enforcement of court judgments and arbitral awards by, among other things, allowing higher level courts to intervene when lower level courts were encountering difficulties in enforcement.

The SPC also issues policy statements, such as *Opinions on Utilizing Fully the Role of Adjudication to Provide Judicial Protection and Legal Services for Economic Development*. Such measures are almost always in response to policies first announced by the Chinese Communist Party, the NPC or central level government ministries.

The SPC will also issue replies to inquiries from lower courts on specific issues that arise in the course of litigation. Thus, the SPC replied to the Sichuan High Court that People's Republic of China (PRC) courts may accept cases seeking to enforce a Taiwanese mediation agreement when the agreement was the result of court-sponsored mediation, but not when the mediation was conducted by other civil organizations.

In addition, the SPC publishes leading cases that have a quasi-precedential value. The cases may be edited to bring the factual and legal cases more clearly into focus.

Finally, the SPC sometimes participates in the NPC law-drafting process, as it did for the Judges Law and Lawyers Law.

The valuable role played by SPC interpretations

SPC interpretations play a valuable role in the legal system. China had to construct a legal system virtually from scratch when it embarked on market reforms in 1978. At the time, China lacked even the most basic laws such as a comprehensive criminal

code, civil law or contract law. The response has been a legislative onslaught the pace and breadth of which has been astounding. Between 1976 and 1998, the NPC and its Standing Committee passed more than 337 laws, and local people's congresses and governments issued more than 6000 regulations.

Nevertheless, existing laws and regulations are often too vague or fail to address many of the issues that arise in practice and frequently make their way to the courts. While, in theory, the courts should be able to seek guidance from the issuing entity, the NPC Standing Committee and other bodies have been too busy drafting new laws and regulations to issue interpretations clarifying existing laws.

SPC interpretations therefore provide timely and specific responses to concrete issues. Without SPC interpretations, the legal system would grind to a halt. Business people would have to wait for years for the legislative bodies to respond to inquiries before the courts could decide cases.

Problems and concerns

The various SPC interpretations raise a number of concerns, including that the SPC lacks the authority to issue interpretations, and that the legislative role of the SPC is at odds with the proper role of courts in a civil law system.

The constitution does not provide a clear basis for SPC interpretation. Rather, the SPC relies primarily on a delegation from the NPC to issue interpretations regarding the application of laws to specific issues arising in the course of trials. Nevertheless, doubts remain about whether the scope of the delegation is sufficiently broad to authorize general interpretations of law.

Supporters hoped the Law on Legislation would expressly authorize the SPC to issue interpretations. However, the Supreme People's Procuratorate (SPP) opposed the suggestion on the grounds that the SPP's right to issue interpretation should also be recognized.

The SPP's right to issue interpretations is even more controversial. The SPC and SPP have clashed in their interpretation of key provisions of the Criminal Procedure Law and Criminal Law, mainly because the SPP tends to take a more conservative position on many law and order issues. Not surprisingly, many legal reformers and scholars opposed the SPP's attempt to have its right to interpretation written into the Law on Legislation.

The final result was a compromise: the Law on Legislation did not authorize either the SPC or the SPP to issue interpretations, leaving the issue of authority unresolved. Even assuming the SPC has the right to issue interpretations, the scope would appear to be more limited than the current wide range of interpretations, opinions and regulations.

Another issue is how much deference lower courts must give to broad policy statements such as the need to consider macroeconomic factors in deciding cases, or to remain diligent in the campaign to 'strike hard' at crime. Some commentators have argued that such statements are inconsistent with the rule of law and an independent judiciary. Courts are to apply the law to the facts in the case before them, rather than to engage in social engineering based on vague policy objectives that have not been passed into law. If government leaders want to change the law to reflect macroeconomic concerns or to increase the penalties for criminals, they may do so. But until they do, judges may only apply the law as it exists.

This view understates the amount of discretion often given to judges in the existing laws, and the role of policy considerations in judging. For instance, judges may opt for heavier or lighter punishments within a range set out in law. Similarly, many factors may influence a decision in a particular case, including public policy arguments about whether deciding a case in a certain way will lead to economically efficient or welfare enhancing results.

Nevertheless, at times, broad policy statements may create a conflict in particular cases where the law is clear, but at odds with the SPC's latest policy objectives.

The practice of higher courts issuing replies in specific cases has been criticized for depriving the litigant of the right to appeal, since the higher court will already have decided key issues, albeit in the absence of a complete record and without the parties having had the opportunity to present their case.

Perhaps the biggest concern, however, is that the SPC is acting like a legislative body, and yet is not adhering to recent reforms of the law-making and rule-making processes to increase transparency and public participation. The failure to adopt such reforms undermines the legitimacy of the SPC interpretations, and in some cases leads to decisions that are not well considered or consistent with existing laws and regulations. A recently issued interpretation illustrates the problems.

The SPC Commercial and Maritime Meeting Minutes

In November 2005, over 200 senior judges including court presidents and the heads of the maritime and foreign-related litigation divisions met in Nanjing. SPC President Xiao Yang delivered the keynote speech, and on 26 December, the SPC issued the *Second National Foreign-related Commercial and Maritime Trial Work Meeting Minutes*. The SPC expressly instructed lower courts to follow the Minutes' 153 articles, reporting back to the Court if they encountered any problems in the process of implementation.

In general, the Minutes are very professional, with much that foreign investors will welcome. They clarify a host of litigation issues, including jurisdictional issues in cases involving foreign-invested enterprises and the recognition, enforcement and the setting aside of arbitral awards.

The Minutes also strengthen the hand of companies in combating fraudulent conveyance by providing that if one party transfers all or part of its assets to a third party, the arbitration agreement is still valid unless the parties agree otherwise, or the third party did not know about the arbitration agreement at the time of transfer.

In the past, a number of regulations dealt with the procedures for serving process on foreign parties. Yet many issues were unresolved, including the relationship of the various regulations to the 1965 Hague Convention on the Service Abroad of Judicial and Extrajudicial Documents in Civil and Commercial Matters, of which China is a member. In clarifying many of these points, the Minutes generally adopt a practical approach. For example, the court may now make a public announcement on a special website for foreign and maritime litigation along with publishing an announcement in domestic or overseas newspapers. The Minutes also allow for service by fax or email if the notifying party receives a return confirmation.

While welcome in many respects, the Minutes take a controversial position on some issues, and are sure to give rise to complaints of runaway judicial activism and usurpation of legislative authority.

The Minutes take an aggressive position on the jurisdictional reach of PRC courts, providing that PRC courts may still hear a case even if foreign courts have already accepted or even decided a case. Furthermore, the Minutes give the courts considerable leeway, simply stating that PRC courts will decide based on the particular circumstances of the case.

Similarly, the Minutes break new ground in introducing a *forum non conveniens* mechanism that would allow parties to argue that Chinese courts should not hear a case if there is a more appropriate forum in another country. However, the standards for obtaining dismissal are unduly restrictive. PRC courts may dismiss a case if it does not affect the interests of a Chinese citizen, legal person or other organization. In addition, the court will dismiss the case only if the main facts of the case did not occur in China, the applicable law is not PRC law and PRC courts would have trouble determining the facts and applying the law.

In other words, PRC courts will only dismiss the highly unusual case involving only foreign parties who decide to bring suit in China even though the dispute arose elsewhere and is governed by foreign law.

The Minutes also take an aggressive position on applicable law, siding in favour of Chinese law when in doubt. PRC law must now govern the equity transfer agreements of shareholders to joint ventures and wholly owned foreign enterprises if a PRC party is involved. This arguably conflicts with *Several Regulations Regarding Alterations to the Equity Interests of Investors in Foreign Invested Enterprises*, issued by the Ministry of Foreign Trade and Economic Cooperation (now the Ministry of Commerce) and the State Administration of Industry and Commerce in 1997.

Such conflicts directly raise the issue of the authority of SPC's interpretations and their place in the legislative hierarchy. These are exactly the sorts of issues that parties hoped the NPC would address when it passed the Law on Legislation.

The Minutes also provide that if the parties' choice of foreign governing law circumvents mandatory or restrictive provisions of PRC laws or administrative regulations, or violates basic principles of PRC law or public interest, then the foreign law will not apply.

This could spell trouble for foreign technology transferors given that PRC law provides that the party that improves the technology owns the improvements. If parties choose foreign governing law in a technology licence agreement, which provides that all improvements belong to the licensor or requires the licensee to assign the rights to all improvements to the licensor for some nominal fee, would PRC courts then apply PRC law and invalidate those provisions?

Similarly, many contracts would require approval under Chinese law from PRC approval authorities, including loan agreements that are regularly governed by English or New York law. If such contracts are governed by foreign law, and no approval is obtained, would the courts then refuse to apply the law chosen by the parties?

The Minutes also attempt to deal with the practical issue of how Chinese judges are to determine what the applicable foreign law is. The Minutes provide

that parties may rely on expert witnesses, law firms and other legal service organizations, as well as international organizations. The parties or their representatives or experts may cite statutory law, case law and legal commentaries. The parties may also ask the courts for assistance if need be.

So far, so good. However, problems arise if there is a dispute as to what the applicable law is on a particular issue. If the parties disagree about the law or there is a difference of opinion among experts, as will no doubt often be the case, then the court will conduct its own investigation. When the court is unable to ascertain what the relevant law is, the court will apply PRC law.

This provision itself requires further interpretation. However, if it means that PRC courts can decide that the foreign law is unclear on the particular issue based on conflicting expert testimony and then apply PRC law, the courts will have tremendous discretion. They will often end up applying PRC law, frustrating the intent of the parties and most likely aiding one of the parties at the expense of the other.

By far the most controversial aspect of the Minutes, however, is the prevention of foreign citizens or nationals from leaving China. Chinese courts may prevent a party or the party's legal representative or 'responsible person' from leaving the country before a case is completed if there is the possibility of avoiding litigation or failing to fulfill one's legal duties, and the person's departure would make it difficult to hear the case or enforce the judgment. The court can order the confiscation of the person's travel documents. The person will be released if a valid guarantee is provided equal to the amount in controversy.

The Minutes do not contemplate an interlocutory procedure where the person detained could argue that the case has been brought simply for harassment purposes. Nor do the Minutes address which party bears the burden of proof, or what the standards will be for showing that there is a risk that a party will not return for the trial or will not fulfill his or her legal duties.

Chinese companies involved in disputes with their trading partners or their joint venture partners might now be able to sue a foreign party, ask for an absurdly high amount of damages, and then demand that the foreign party or their key management personnel be prevented from leaving China.

The SPC cites a 1987 regulation from the early years of the reform period as the basis for their decision. However, the constitution, the 1996 Administrative Punishment Law and the 2000 Law on Legislation require any restriction of personal freedom be based on a law (*falü*) passed by the NPC or its Standing Committee. Preventing a person from leaving China would seem to be a limitation of personal freedom. Thus, the SPC would not appear to have the authority to impose a limitation on its own, and the 1987 regulation is not a law.

Policy implications: the need for more transparency and public participation

The SPC is acting like a legislative body, and yet it has not taken steps to keep up with the reforms that have made the law-making and administrative rule-making processes more transparent and open to public participation.

The Law on Legislation required that drafters consider opinions on all laws by holding conferences, discussion meetings, evidentiary hearings and so on. Most draft laws are distributed to relevant entities, organizations and experts. The drafts of important laws are now also made available for public comment by government entities, interest groups and citizens.

China does not yet have a comprehensive administrative procedure law, although the NPC is currently drafting one. However, there are various central level regulations that contain provisions regarding procedures for administrative rule-making. As is often the case, local governments have also gone ahead and passed their own procedural laws.

Hearings for NPC laws and administrative rules have become more common in recent years. The State Environmental Protection Agency, for instance,

recently issued regulations enhancing the role of public participation in the environmental impact assessment process. Developers and EPA officials are now required to disclose information at various stages in the process.

There are currently numerous projects and experiments that seek to address a range of practical issues such as when hearings should be held, how the public is to be notified, who should be able to attend and speak at the hearings (especially if the number of people wishing to attend the hearing and speak is very large), how hearings should be conducted, and how the government should respond to inquiries or recommendations from the public.

When acceding to the World Trade Organization, China also agreed to establish an official journal dedicated to the publication of all trade-related laws, regulations and other measures, and to provide a reasonable period for comment before such laws, regulations and measures are enforced. Unfortunately, there is no requirement that interested parties be allowed to comment before the acts are promulgated. However, in practice, groups such as the US-China Business Council or various international chambers of commerce are often asked for their input.

In keeping with the general trend toward more openness, the State Council and NPC are considering a national freedom of information law. More than 20 provincial and municipal governments have already passed open government information regulations. Most government agencies now also have websites where regulations and other information are available to the public.

The government has also experimented with citizen committees to supervise and advise on government work. Beginning in October 2003, the procuracy established citizen supervision committees in ten provinces. The system is now used by 86 per cent of procuratorates nationwide. The committee is charged

with conducting independent appraisals of cases the procuracy placed on file for investigation but later decided to withdraw or terminate prosecution.

The SPC, for its part, also solicits expert opinion, and carries out considerable research on the various topics, including research of how other legal systems handle similar issues, before issuing major interpretations. The SPC also solicits public comments on some draft interpretations. However, the SPC does not hold hearings open to the public, or solicit comments from the general public on all of the various forms of interpretations, opinions, minutes and other quasi-legislative pronouncements.

On the positive side, the SPC is aware of the need to improve the process. The SPC's Second Five-Year Agenda, released in December 2005, promised reforms to the procedures for drafting interpretations and to improve their quality. The Court will regularly amend, abolish and compile interpretations, and regularize the system of filing interpretations with the NPC Standing Committee.

The SPC also sought to address concerns about the practice of issuing replies to lower level courts. The Second Five-Year Agenda recommends that lower courts submit cases that involve generally applicable legal issues to the higher court directly for hearing, rather than seeking advice. This would eliminate the problem of the higher court deciding issues in cases that it does not hear, and also preserve the integrity of the appeal process.

These reforms are within the power of the court, and thus more readily implemented. In contrast, the problem of SPC interpretations being inconsistent with the constitution, NPC laws or the regulations of other state organs highlights the need for a constitutional review body. The SPC is, in effect, making the law. It cannot review its own law for constitutionality or consistency with other laws and regulations. Nor can the SPC decide where SPC regulations rank in the legislative hierarchy.

Conclusion and recommendations

The need for a constitutional review body has been much debated in China. Some commentators suggest the SPC should be given the authority to conduct constitutional review. Some commentators feel the NPC Standing Committee should conduct constitutional review, as the constitution currently provides for. Most commentators feel that a separate constitutional review body is required. Most likely, such a body would be answerable to the NPC, on a similar level to the SPC, State Council and the SPP.

The creation of such a body is not within the power of the SPC. Nor is it likely to occur in the near future. Nevertheless, there is growing pressure to address the issue. In the meantime, more modest reforms to increase transparency and public participation are needed. The SPC should give teeth to the general reform recommendations in the Second Five-Year Agenda by promulgating detailed

rules for hearings and a notice and comment system that provide the general public with a greater say in the drafting of interpretations and other quasi-legislative documents.

The SPC might also consider establishing consultative committees similar to those established by the SPP. The committees, which would include legal scholars as well as citizens, would monitor the drafting process, providing input where appropriate.

In addition, the committees could monitor other aspects of the work of the courts. They could be charged, for example, with conducting independent appraisals of cases where there have been allegations of impropriety. They could also investigate complaints about cases not being accepted or being delayed, look into allegations of torture or reliance on tainted evidence in criminal cases, and monitor disciplinary actions against judges charged with wrongdoing.



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