

COMMERCIAL LEASING IN CHINA

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Chinese economic policy increasingly is given over to the concept of market operations to direct land investment and usage. It therefore is critical that Chinese law provide a clear basis for the rights of participants in the real estate marketplace. This article will evaluate the Chinese law of commercial leasing as a basis for market development. Necessarily, the article also will provide a basic background of Chinese real estate law.

The lease is a critical tool in the operation of a market economy. Markets thrive when market participants are given flexibility in pricing and subdividing assets. Leasing permits division of the benefits of ownership and control of property among a series of parties, thereby making the property not only more flexible in terms of possible uses, but also more attractive to capital. Through the use of leases, parties intending short-term use of real estate can meet their needs without extensive capital investment. Investors who have a tentative long term interest in property can make a capital investment when opportunities arise, even if their long term uses have not yet become practical, and lease to short term users in the meantime. If owners of real property are permitted to subdivide their property by using leases, then multiple short term users can also make use of a given asset at the same time. As a consequence of this flexibility, capital investors are more likely to fund investments into real estate because the risk is not tied to an individual use for a limited time frame. Capital can be matched to real investment opportunities unhampered by a limited use framework.

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The lease agreements that are the subject of this article are analogous to commercial leases in Western society: transfers of possession for a term in exchange for payment of periodic rent. The authors do not view the Chinese land use right—either an allocated or granted right—as directly analogous to a Western lease, although such interests also involve a use right for a term.¹ Therefore, land use rights will be distinguished from lease rights for the purpose of this article.

The article will discuss the lease as a device for dividing uses, providing economic return, and attracting capital. The article will begin by outlining the impact of civil law concepts on the formation of Chinese lease law. It will then describe the Chinese land use right—the basis of private control of land in China—as the beginning point for evaluating land use and transfer systems. Finally, it will describe the basic elements of Chinese lease law in the commercial arena. There will be some comparison to Chinese residential landlord/tenant law, but as residential lease law in China is a product of social policy that ranges far beyond economic considerations, it is not the primary focus of this article.

1. It is true that some Western leasehold estates are limited in use and that some involve prepaid rent, although it is a rare situation in which would find both these characteristics in a leasehold estate lasting from 50 to 75 years. But a further difference between the Chinese land use right and the Western leasehold estate is in the renewal right. Chinese land use rights in theory are infinitely renewable (upon payment of additional fees) subject to intervention of State priorities. As we are only in the very earliest stages of these rights, and they typically are for long term, there is little known about whether renewal rights will actually exist and under what conditions. But the perpetual renewal concept certainly is not directly analogous to the typical long term lease in Western economies.

Another difference that may be unique to Chinese law is the fact that in a Chinese lease any improvements made by the tenant are regarded as part of the leasehold and belong to the landlord, while improvements made to a land use right are independent of the right itself and belong to the land use right holder. QIAN MINGXING, WU QUAN FA YUAN LI [LEGAL PRINCIPLES OF RIGHTS IN REM] 293 (1994) [hereinafter QIAN].

In common law countries, of course, the doctrine of "tenant fixtures" would give the tenant rights to certain kinds of improvements in a leasehold estate. Further, in a common law country the parties would be able to "sever" other permanent improvements and regard them as having separate existence from the leasehold estate itself, but this severance would have to be established specifically in the contract, and it not part of the standard interpretation of the lease relationship.

Further, in fact Chinese law treats the two concepts of land use right and leasehold right as distinct, and this, of course, is reason enough to differentiate between them.

I. FOUNDATIONS OF CHINESE REAL ESTATE LAW

A. THE IMPACT OF CIVIL LAW CONCEPTS

Chinese scholars and judges view the concepts of the civil law as the basis of Chinese business law.² The historical roots of China's civil law tradition can be traced to the early twentieth century, when the Emperor of the Qing Dynasty designated Shen Jiaben³ to supervise the drawing of new forms⁴ of a civil code, a criminal code, a civil procedure code and a criminal procedure code.⁵ The "Draft of the Civil Code of Qing Dynasty (da qing min lu cao an)"⁶ was finished in 1911. Although the Communist Party, in 1949, revoked all laws, including the civil code of the Kuomintang government,⁷ the ideas of civil law have unavoidably influenced legislators, judges, and scholars in China.

The current civil law in China consists of several separate acts. Among them, the General Principles of Civil Law⁸ is considered the core of civil law. The provisions of the General Principles of Civil Law, such as: the doctrine of equality;⁹ the doctrine of voluntariness, fairness, and compensation of equal value; the doctrine of good faith;¹⁰ the provisions on civil acts;

2. See Wei Zhenying, *Shichang Jingji yu Minfa Guannian* [The Market Economy and the Notion of Civil Law], 5 PEKING UNIV. L.J. 1 (1994) [hereinafter Wei].

3. Shen Jiaben was an important pioneer scholar who introduced new ideas of Western law into China in the early twentieth century.

4. There already existed in China the Great Qing Code, which governed China through all the Qing Dynasty (1644-1911). This Code is a combination of almost every aspect of law, but criminal law was the main component. The Code was in fact a handbook for the administration of the Empire. See THE GREAT QING CODE, (William C. Jones, trans., 1994) [hereinafter QING]. We call the codes drawn under the supervision of Shen Jiaben "new forms" due to the existence of the Great Qing Code.

5. See QIAN, *supra* note 1, at 89.

6. This Draft drew heavily from the German Civil Code and Japanese Civil Code. The Civil Code of Qing Dynasty was only a draft and had not been promulgated and executed officially at the time of the downfall of the Qing Dynasty. Its influence upon the Civil Code of the Northern Warlords' and the Kuomintang government, however, cannot be ignored.

7. See QIAN, *supra* note 1, at 89.

8. These principles were effective as of January 1, 1987. They consist of a "miniature Civil Code" of 156 articles. In addition to several important new instructions reflecting China's economic reform, the principles contain nearly all the elementary concepts and technical terms of a European code. It even contains a chapter on the application of foreign laws to civil matters. For an English translation and analysis of the Principles, see Zhonghua Renmin Gongheguo Minfatongze [General Principles of Civil Law of the P.R.C.] (adopted Apr. 12, 1986) translated in 3 China L. for Foreign Bus.: Bus. Reg. (CCH Int'l) ¶ 19-150 [hereinafter General Principles].

9. Article 3 provides that parties involved in civil legal relationships shall be considered to have equal status. See *id.* art. 3, at 23,805.

10. Article 4 requires the application of the doctrines of voluntariness, fairness, compensation of equal value and good faith to the civil matters. See *id.* art. 4. Revi-

and the provisions on contracts certainly apply to real estate leases. In order to implement the General Principles of Civil Law, which is quite concise, the Supreme People's Court, in 1988, issued a two hundred clause Interpretation of the General Principles of Civil Law.¹¹ This interpretation contains provisions on real estate that are applicable to leases of real estate in China.¹²

In comparison to American common law, the Chinese civil law requires a greater degree of basic fairness between the par-

sions to the 1981 Economic Contract Law in 1993 may have repealed, or at least modified, the application in commercial cases of the Doctrine of Compensation of Equal Value, which provides basically that a court may review the fairness of the economic exchange in any contract. This doctrine has been criticized by Chinese scholars for its inconsistency with the market economy. The 1981 Economic Contract Law provided this doctrine as a general principle for economic contracts, but the 1993 amendment of the Economic Contract Law excluded it. Scholars now conclude that contracts, at least commercial contracts, are no longer required to conform to the doctrine of compensation of equal value. See *Zhonghua Renmin Gongheguo Jingji Hetongfa* [Economic Contract Law of the P.R.C.] (adopted Dec. 13, 1981, amended Sept. 2, 1993), translated in 1 China L. for Foreign Bus.: Bus. Reg. (CCH Int'l) ¶ 5-500 [hereinafter Economic Contract Law].

11. See *Zuigao Renmin Fayuan Guanyu Guance Zhixing Zhonghua Renmin Gongheguo Minfatongze Ruogan Wenti de Yijian* [Opinions of the Supreme People's Court on Issues Concerning the Implementation of the General Principles of Civil Law of the P.R.C.] (adopted Jan. 26, 1988), translated in *Supreme Court Explanations*, 1 China Bus. L. Guide (CCH Int'l) ¶11-110 [hereinafter *Supreme Court Explanations*]. This is a very comprehensive judicial interpretation of the General Principles of Civil Law. It is said that some clauses of this interpretation are not only interpretation of the General Principles of Civil Law, but additions to the law.

Judicial interpretation has played a very important role in China since 1949. In the area of civil law, the first comprehensive judicial interpretation was made in 1963, and later in 1979 and 1984, prior to the 1988 interpretation. In 1949, the new government revoked all the laws and regulations of the Kuomintang government and required the courts at different levels to make decisions in accordance with the Party's policies. During this period the Supreme Court issued a number of judicial pronouncements to interpret the Party's policies. Another active period of the judicial interpretation was in late 1970's and early 1980's, when the newly resumed court system was faced with millions of cases accumulated during the ten-year Cultural Revolution but had access to only a small body of legislation adopted in a hurry. China's rapid political and economic development suggests that we will continue to see judicial interpretations of the civil law provisions due to the constant pressures of transition.

Note, however, that in theory this judicial interpretation is only the interpretation of the statutes. Furthermore, only the Supreme People's Court is entitled to issue binding judicial documents. See *Zuigao Renmin Fayuan Guanyu Difang Geji Renmin Fayuan Buying Zhiding Sifa Jieshixing Wenji de Pifu* [Reply of the Supreme People's Court that the Courts at Local Levels Shall Not Make Judicial Interpretation Themselves (Mar. 31, 1987)] in *Jianmin Fangdichan Shenpan Shouche*, CONCISE HANDBOOK FOR THE TRIAL OF REAL ESTATE CASES 231 (1993) [hereinafter *CONCISE HANDBOOK*].

12. For example, articles 118 and 119 of the Interpretation of the General Principles of Civil Law deal with the lease of private owned houses. See General Principles, *supra* note 8, at 23,861.

ties to arrive at consensual business relationships.¹³ American lease law provides a relatively clear, predictable, albeit somewhat landlord oriented, framework for lease relationships against which the parties can bargain. American lease drafters tend to draft lengthy, meticulous documents outlining many contingencies in order to be certain that they are protected by the contract. They are less likely to trust a subsequent judicial analysis to resolve a dispute satisfactorily. American judges often respond to this level of detail by giving the parties the result they have stipulated. In China, there are a number of "assumed" or "implied" conditions in commercial leases that are more oriented toward a "fair" construction of the lease than in America, and many of these implied provisions cannot be varied by contract.

B. OTHER BASIC CHINESE STATUTES AFFECTING REAL ESTATE

Apart from the General Principles of Civil Law, the Economic Contract Law¹⁴ and the Foreign Economic Contract Law¹⁵

13. In this regard Chinese Civil Law is also distinct from its European Civil Law predecessors. On the question of the relationship between civil law and commercial law, civil law countries can be divided into two categories. In some countries, commercial code is independent from civil code, while in other countries, there is only civil code, with the separate commercial laws as a special subset of the civil code. In both types of systems, however, the transactions between businessmen are regulated by special rules. Generally speaking, the rules governing non-business transactions between normal people do not necessarily apply to transactions between businessmen. The assumption behind this is that businessmen know best where their true interests lie and how to protect themselves.

14. The Economic Contract Law was first adopted in 1981 and later revised in 1993. See Economic Contract Law, *supra* note 10, at 6,401. It deals with contract relationships between domestic entities with or without "legal person" status, contracts between entities and self-employed industrial and commercial individuals, contracts between entities and agricultural collective members, contracts between self-employed industrial and commercial individuals, and contracts between self-employed industrial and commercial individuals and agricultural members. See *id.* art. 2. Economic Contract Law mainly regulates ten contract types: i.e., contracts for purchasing and selling of products (contracts of sale), contracts for construction engineering, contracts for processing work, contracts for carriage (including railroad transportation, highway transportation, and water transportation, with separate regulations for each, contracts for power supply, contracts for storage and custodianship, property leases, loan agreements, property insurance and contracts for scientific and technological collaboration (which later have been addressed by the Technological Contract Law). See *id.* art. 8, at 6,403. The State Council and its subordinate agencies have promulgated many regulations to implement the Economic Contract Law.

15. The Foreign Economic Contract Law, adopted in 1985, is applicable to all foreign-related contracts, whether they involve foreign trade, foreign investment, or technology transfer, with the exception of international transportation contracts. See *Zhonghua Renmin Gongheguo Shewai Jingji Hetongfa* [Foreign Economic Contract Law of the P.R.C.] (adopted Mar. 21, 1985), *translated in* 1 China L. for Foreign Bus.: Bus. Reg. (CCH Int'l) ¶5-550, at 6,621.

may also apply to leases of real estate in China. Lease contracts between domestic entities, or entities and individuals, are governed by the Economic Contract Law, while lease contracts between Chinese parties and foreign parties are regulated by the Foreign Economic Contract Law.¹⁶ Foreign-funded enterprises established in China are considered domestic entities, and thus, contracts with foreign-funded enterprises as contracting parties are still governed by the Economic Contract Law, even if both parties of the contract are wholly foreign-owned enterprises.

Besides these laws of general application, there is special real estate legislation such as the Land Management Law and its implementing regulations,¹⁷ the Law on Urban Real Estate Administration,¹⁸ and the Regulations on the Granting and Transfer of Land Use Rights on State Owned Land for Valuable Consideration in Cities and Towns.¹⁹

C. THE LAND USE RIGHT

For leases to exist, of course, the landlord must have some form of protected interests in property that can be rented. Until

16. On a policy level, these two laws were designed to regulate transactions based upon different rules. The domestic economy at the time defined was a planned socialist economy, characterized by economic planning as having a leading role and marketing regulation as supplementary. Most of the contracts among domestic enterprises were plan-controlled in the early 1980's. Cross-border transactions, however, were viewed as based on market mechanisms, with less influence of planning. Thus, it was then necessary to have separate laws governing domestic contracts and Sino-foreign contracts. With the reduction of the influence of economic planning on the domestic economy, the concept of separate contract laws has proved unnecessary and inconvenient. A draft of a Uniform Contract Law, replacing this multiplicity of overlapping statutes, is now under discussion in China.

17. See *Zhonghua Renmin Gongheguo Tudi Guanli Fa* [Law of the P.R.C. on Land Management] (adopted June 25, 1986, revised Dec. 29, 1988), *translated in* 2 China L. for Foreign Bus.: Bus. Reg. (CCH Int'l) ¶14-715 (1991) [hereinafter Land Management Law]. The implementing regulations of this law were promulgated by the State Council on January 4, 1991. See *Zhonghua Renmin Gongheguo Tudi Guanli Fa Shishi Tiaoli* [Rules for the Implementation of the Law of the P.R.C. on Land Management] (promulgated Jan. 4, 1991), *translated in* 2 China L. for Foreign Bus.: Bus. Reg. (CCH Int'l) ¶14-717 (1991) [hereinafter Land Management Implementation Law].

18. See *Zhonghua Renmin Gongheguo Chengshi Fangdichan Guanli Fa* [Law of the P.R.C. on the Administration of Urban Real Estate] (adopted July 5, 1994), *translated in* 3 China L. for Foreign Bus.: Bus. Reg. (CCH Int'l) ¶19-593 (1994) [hereinafter Urban Real Estate].

19. See *Zhonghua Renmin Gongheguo Chengzheng Guoyoutudi Shiyongquan Churang He Zhuangrang Zhanxing Tiaoli* [Regulations of the P.R.C. on Granting and Transfer of Land Use Rights on State Owned Land for Valuable Consideration in Cities and Towns] (promulgated May 19, 1990), *translated in* GUIDE TO THE LATEST FOREIGN ECONOMIC LAW AND REGULATIONS OF THE P.R.C. 1193 (1995) [hereinafter Regulations of Land Use Rights].

recently, all land in China with few exceptions,²⁰ belonged either to the State Government or to Agricultural Collectives.²¹ Other parties did not have rights in land,²² and there were no leases for land use rights. The State and Agricultural Collectives had created land use rights in certain individuals for agricultural or residential purposes. In addition, the State had issued land use rights to State owned entities, Urban Collectives and various public institutions to carry out their functions. All of these pre-1988 land use rights on State land were referred to as "allocated" rights.²³ The recipients basically paid no consideration for their rights²⁴ which were allocated to them to carry out identified purposes consistent with State interests.

20. Prior to 1982, there was much privately owned housing land in China. Theoretically, in that year the actual ownership of the land constituting these homesteads passed to the State, although the buildings themselves remained with their owners. The homeowners, also theoretically, were entitled to land use rights for the land, although certificates for land use rights were not issued in many cases. Thus, the status of these residential homeowners was uncertain, although they are treated for many purposes as if they held true land use rights in the property on which their homes existed. In 1989, the State Land Administration issued a regulation providing for a National Land Use Right Registration System. Since then, most of these residential users have registered their land use rights and have received certificates.

21. Exclusive ownership of land by the State and Agricultural Collectives was established finally through the declaration of the 1982 Constitution. Article 10 of the 1982 Constitution reads:

Land in the cities is owned by the state.

Land in the rural and suburban areas is owned by collectives except for those portions which belong to the state in accordance with the law; house sites and privately farmed plots of cropland and hilly land are also owned by collectives.

XIANFA [CONSTITUTION] art. 10 (adopted Dec. 4, 1982, amended Apr. 12, 1988), *reprinted in* 1 China L. for Foreign Bus.: Bus. Reg. (CCH Int'l) ¶4-500 [hereinafter CONSTITUTION].

The Law of the P.R.C. on Land Management of 1986 reiterates the same concept of land ownership. Article 2 of the 1986 law declares that the People's Republic of China practices socialist public land ownership (i.e., the state land ownership by the whole people and the collective land ownership by the working people). *See* Land Management Implementation Law art. 2, *supra* note 17, at 18,621.

22. It should be noted however, that State Owned Enterprises and State Owned Institutions (hospitals, universities, etc.) and Collectives and Collective Owned Institutions owned buildings constructed on allocated land use rights, even though they did not "own" the land itself. These buildings could be leased. Of course, in the case of State owned enterprises, the State in fact holds all the ownership rights in the assets of the enterprise. The right of State owned enterprises in these assets (land use rights and building ownership) is described as a "right of management and operation."

23. Although some rights conferred by Agricultural Collectives for domestic gardens and the like were treated as allocated land use rights, in fact most agricultural rights given to individuals were part of the "family contract system," and properly should not be regarded as allocated land use rights. Further, there is some ambiguity over whether a "homestead" conferred by the State should be viewed as an "allocated land use right" or as a separate species of right.

24. The recipients of allocated land use rights might have paid some consideration to the former users of the State owned land or the Agricultural Collectives, if

These allocated land use rights were not transferrable, and perhaps for that reason, there was not much attempt to maintain a registry system for them. In 1986, however, the Land Administration Law provided for the establishment of a registry system, and in 1987, the State Land Administration issued a notice authorizing the creation of a "pilot project" registration system. Following a brief trial period, the State Land Administration promulgated the Rules of Land Registration in 1989;²⁵ these Rules have now been replaced by the Rules of Land Registration,²⁶ which became effective in February 1996.

In 1988, however, as part of a general government program to "commodify" the productive economy and thus establish market transactions, China amended its Constitution²⁷ to provide for the transfer of land use rights.²⁸ The 1988 amendment permits the creation, or "transfer" of new, transferrable land use rights, even though the right of ownership remains in the State and the Collectives. The Chinese character translated as "transfer" connotes the concept of a contract right, but most English language discussions of the land use right have denominated the new land use rights as "granted" land use rights. They should be differentiated from the "allocated" land use rights that had been the earlier practice (and still exist²⁹). The Constitutional language does not draw a distinction between the State and the Agricultural Collectives in conferring the right to create granted land use rights, but presently only the State has obtained legislative authority to do so.³⁰ Subordinate bodies of the State can only transfer such rights as agents of the State.

the State requisitioned the land and then allocated land use rights to the recipients. These payments, however, were only compensation to the former users or the owners of the land, not consideration paid for the land use rights themselves.

25. See discussion of registration of land interests *infra* at text accompanying notes 54 to 69.

26. See Donald C. Clarke & Nicholas C. Howson, *Developing P.R.C. Property and Real Estate Law: Revised Land Registration Rules*, E. ASIAN EXECUTIVE REP., Apr. 15, 1996, at 9, 14-17 (discussing the Land Registration Rules Adopted Dec. 31, 1995, effective Feb. 1, 1996).

27. See CONSTITUTION, *supra* note 21, at 5,301.

28. The amended Article reads: "No organization or individual may appropriate, buy, sell or unlawfully transfer land in other ways. The right to use land may be assigned in accordance with the provisions of the law." *Id.* art. 10 (amended 1988) at 5,313.

29. It is the current policy to attempt to encourage holders of allocated land use rights used for commercial and industrial purposes to "convert" these rights to granted rights by paying consideration and accepting the term limitations that are part of the granted rights.

30. The 1988 Amendments to the Constitution provided for the creation of transferrable land use rights as provided by law, but the Constitution did not specifically identify which entities could create such rights. See CONSTITUTION art. 10 (amended 1988), *supra* note 21, at 5,313. The 1988 Amendments to the Land Man-

Should Agricultural Collectives obtain granted land use rights, they can lease them, but at present they cannot create granted land use rights nor can they lease Collective-owned land for commercial purposes. These restrictions limit collective property to agricultural purposes. But, as will be described below, Agricultural Collectives can enter into leases of buildings located on their lands, which in effect is a lease of the land itself. Further, Agricultural Collectives may "convert" land that they own into granted land use rights and thus make them transferable by first having the State requisition of the Collective land, then having the State grant land use rights in the same land, and finally giving the land back to the Collective. Through these methods, Agricultural Collectives, which own much property on the expanding urban fringes, such as in the Haidian District in Beijing, can use property for non-agricultural purposes either by the Collectives themselves or through their contributions to joint venture enterprises.³¹

II. WHAT CAN BE LEASED?

A. LAND OWNERSHIP ITSELF CANNOT BE THE BASIS OF A LEASE

As stated above, virtually all ownership rights in land in China are vested in the State or in Collectives. These ownership rights themselves cannot be the subject of a lease.³² If the State allows another entity to use the land, it does so through a land use right, and not through a lease.³³ Collectives are not permitted to create granted land use rights, but can create allocated land use rights.³⁴ Allocated rights, however, cannot be the sub-

agement Law did provide for creation of transferrable land use rights both on State and Collective owned land. See Land Management Law art. 2, *supra* note 17, at 18,621. But the Amendments to the Law provided that the method of transfer should be established by the State Council. The State Council has never established procedures by which Agricultural Collectives can create transferrable land use rights. Article 8 of the Law on Urban Real Estate Administration provides that Agricultural Collectives that own land in designated urban areas cannot create land use rights on such land unless the land is requisitioned by the State and is converted to State owned land. See Urban Real Estate art. 8, *supra* note 18, at 25,325. In many recent cases, when this process occurs, the State grants back the requisitioned land to the same Agricultural Collective in the form of a granted land use right.

31. See discussion of this technique *infra*, p. 113.

32. See CONSTITUTION art. 10 (amended 1988), *supra* note 21, at 5,313.

33. Although this statement is the recognized norm in China, and confirmed in many procedures, Article 28 of the most recent Land Registration Rules discusses the registration of leases of land from the State. See *supra* note 26, at 13-17. This may be a misstatement, or may be an indication that direct leases by the State will now be recognized.

34. Agricultural Collectives can create land use rights only in their own members and only for agricultural or residential purposes. Also, there is a complex pro-

ject of a lease. Nevertheless, circumstances have arisen in which the Collectives have themselves obtained granted land use rights in land owned by the State. But any leasehold right in land obtained from a Collective, as opposed to a lease of buildings alone, must necessarily be based upon a granted land use right held by the Collective.³⁵

B. LAND USE RIGHTS

Granted land use rights may be the subject of a lease.³⁶ In order for there to be a technically proper land-use lease, the landlord must be the registered holder of a granted land use right. A transferee of a granted land use right may also lease such right.

Because of the anti-speculation policies contained in the land use right system, the grantee of a granted land use right must actually commence the use identified to the right before leasing the property. Consequently, the grantee must invest at least twenty-five percent of the planned investment amount into the property before undertaking to lease the property to another.³⁷ Obviously, the tenant's use of the property must con-

cess whereby such Collectives can create allocated land use rights as their contributed share in a joint venture project.

35. Although this statement reflects the recognized norm in China, and has been confirmed in many procedures, Article 32 of the most recent Land Registration Rules discusses the possibility of a Collective creating a land use right and contributing it to a joint venture enterprise. *See supra* note 26, at 13-17. In theory, this should only occur after the land use right has been created by the State and retransferred as a granted land use right back to the Collective. It is unclear whether the Article contemplates the direct creation of a land use right by a Collective for purposes of its equity contribution, or whether the Article simply is "blessing" the new development by which Collectives arrange for their land to be requisitioned by the State and then retransferred back to them in the form of a granted land use right, which right the Collectives then could use as an equity contribution to a joint venture project.

36. Article 4 of the Regulations on Granting and Transfer of Land Use Rights on State Owned Land for Valuable Consideration in Cities and Towns, which provides that granted land use rights can be transferred, rented or mortgaged. *See Regulations on Land Use Rights* art. 4, *supra* note 19, at 1193.

37. Article 28 of the Regulations on Granting and Transfer of Land Use Rights On State Owned Land for Valuable Consideration in Cities and Towns prohibits a lease of a land use right before the land is developed and utilized within the fixed term and in line with the stipulations of the granting contract. *See id.*, at 22. In accordance with this provision, some local regulations also impose conditions on the rent of land use rights. For example, The Implementing Measures of Sichuan Province Concerning the Granting and Transfer of Land Use Rights requires the following preconditions on the rent of granted land use right:

- (1) All the fees related to the granting of the land use right have been paid;
- (2) Investment and development have been done in accordance with the provisions prescribed by the granting contract and at least thirty percent of the total investment has been completed;

form to the uses associated with the land use right.³⁸

- (3) The landlord has obtained a Title Certificate for his land use rights and the buildings and other attachments on the land;
- (4) The land is not within the area where the buildings are going to be dismantled for city construction.

Sichuansheng Chengzhen Guoyou Tudi Shiyongquan Churang He Zhuanrang Shishi Banfa [The Implementing Measures of Sicuan Province Concerning the Granting and Transfer of Land Use Rights], in ZUIXIN FANGDICHAN FAGUI ZHENGCE HUIBIAN [THE LATEST REAL ESTATE LEGISLATION AND POLICIES] 313 (Municipal Real Estate Administration of Chengdu City ed. 1993).

The 1994 Law of the P.R.C. on the Administration of Urban Real Estate only provides for the leasing of buildings and makes no provision for the leasing of a land use right. See Urban Real Estate art. 2, *supra* note 18, at 25,323. Article 38 of this law, however, does require the completion of a certain proportion of the total investment before the granted land use right can be transferred, i.e., twenty-five percent of the total investment for housing construction projects. For development of whole large tracts of land, it requires that the land has been available for the construction of industrial or other projects. See *id.* Perhaps due to the influence of this provision, in practice, landlords are not allowed to pre-lease real estate before 25% of the whole investment has been completed.

There is no direct provision about whether the landlord herself must complete the development, rather than the tenant. However, the language of Article 2 of the the Provisional Regulations Governing Development and Operation of Tracts of Land with Foreign Investment contains a suggestion that the landlord should finish the construction herself. Weishang Tuozhi Kaifa Jingying Chengpianudi Zhangxing Guanli Banfa [Provisional Regulations Governing Development and Operation of Tracts of Land with Foreign Investment] art. 2 (May 19, 1990), *translated in* GUIDE TO THE LATEST FOREIGN ECONOMIC LAW AND REGULATIONS OF THE P.R.C. 1202 (1995) [hereinafter Provisional Regulations]. Otherwise, a land use right holder can transfer the land use right, but not lease it. In describing the type of development that a recipient of a land use right must carry out, this article states two models: in the first model, the grantee builds infrastructure, "making the land usable for industry and other constructions," and then may transfer (or, by extension, lease) the land use right for further development; in the second model, the developer builds the complete project before transfer or leasing. This Article reads:

The development of tracts of land as referred to in these regulations denote in accordance with plans of the tracts of land after a state-owned land use right is obtained, levelling the land and construction of public facilities such as water supply, sewage, electricity and heat supply, roads and telecommunications, making the land usable for industry and other constructions and then the transfer of the land use right and operations of the public facilities, or construction of universal factory premises and auxiliary production and services facilities and transfer or leasing of the buildings on the ground.

38. The tenant can only change its use of the land upon the approval of the government authorities.

If a land user needs to change the purpose of the land as specified in the contract for transfer of the right to use land, the land user must obtain the consent of the transferor and the urban planning department of the municipal or county People's Government. Upon approval, an agreement on amendment to the contract for transfer of the right to use land or a new contract for the transfer of the right to use land shall be concluded, and a fee for the transfer of the right to use land shall be readjusted accordingly.

Urban Real Estate art. 17, *supra* note 18, at 25,329.

Thus the "land user" should be able to change the use of the land in accordance with this Article. But the language is not clear whether the "land user" is the holder

Allocated land use rights cannot be leased *per se*,³⁹ although it is possible to "convert" an allocated land use right into a granted right by entering into a new arrangement with the appropriate granting authority⁴⁰ and by paying the appropriate fees commensurate with paying value for the land. There is a vague provision in the Law on Urban Real Estate Administration⁴¹ which provides that if an owner leases buildings on an allocated land use right, that owner must pay over to the state a portion of the rent attributable to the land. Of course, if the allocated land use right is not leasable, then no portion of the rent could be attributable to it. Therefore, the provision is technically inconsistent with the rules of leasing. It does, however, reflect the reality that the lease of a building necessarily must, as a practical matter, carry with it some right to make use of the land under and around that building.

The current legislation is not very clear about whether a land use right can be rented out alone with no buildings or other attachments to the land. Article Nine of the Provisional Measures Concerning the Administration of Allocated Land Use Rights⁴² describes the lease of a land use right as a device by which the holder of the right leases the land with or without the buildings or other attachments on the land. The Provisional Regulations on the Granting and Transfer of the Land Use Rights on the State Owned Land in Cities or Towns, however, provide that land use rights shall be rented out along with the buildings or other attachments on the land. And the Law on Urban Real Estate Administration only provides for the leasing of buildings. Taking into consideration the various preconditions on leases of land use right described above, we can at least conclude that

of the land use right (the landlord) or the actual possessor of the land (the tenant). Therefore, it is not clear that the tenant can change the identified purpose of the land use right without the collaboration of the landlord.

39. Under the Constitution, land itself cannot be transferred, mortgaged or leased. See CONSTITUTION art. 10, *supra* note 21, at 5,313. But land use rights may be transferred, mortgaged or leased in accordance with the law. See generally Urban Real Estate arts. 7-11, *supra* note 18, at 25,325-27; Regulations on Land Use Rights art. 2, *supra* note 19, at 1193. Article 44 of the Regulations on Land Use Rights prohibits the transfer, leasing or mortgaging of allocated land use rights except as otherwise provided by law. See Regulations on Land Use Rights art. 44, *supra* note 19, at 1198.

40. See Regulations on Land Use Rights art. 45, *supra* note 19, at 1198. See also Huabo Tudi Shiyong Quanli Zhangxing Banfa [Provisional Measures Concerning the Administration of Allocated Land Use Rights] (promulgated Mar. 8, 1992), reprinted in ZHONGHUA RENMIN GONGHEGUO FANGDICHAN ZHENGCHEFAGUI DAGUAN [COMPLETE COLLECTION OF REAL ESTATE POLICIES AND LEGISLATION OF THE P.R.C.] 649-52 (Huang Shu Hai & Zhuang Mu eds. 1993) [hereinafter COMPLETE COLLECTION]

41. See Urban Real Estate art. 55, *supra* note 18, at 25,343.

42. See COMPLETE COLLECTION, *supra* note 40, at 649.

leases of land use rights to vacant land are not common now in China.

C. BUILDINGS

Buildings and free standing improvements⁴³ have a separate identity in Chinese law. A building on State land, Collective land⁴⁴ or on an allocated land use right, can be the subject of a lease, even though the underlying interest in the ground cannot. The question of how the lessee has the right to enter on the property without any interest in the ground is a question that is unanswered in available Chinese law. Obviously, there must be some implicit right transferred to the lessee. Chances are that the implied permission to use the ground would be recognized as a Civil Law "neighborhood right"—the basic privilege of the owner of a right in one parcel to make reasonable use of neighboring parcels to obtain access to his own parcel.⁴⁵ Thus, at present, parties to leases of buildings in China see little purpose in attempting to create access rights or other rights in the ground itself. A lease of the building is a sufficient and complete transfer of use rights to the ground on which the building exists.⁴⁶

Agricultural Collectives can lease buildings on their land. Often, such leases are in effect leases of the land as well. Legally, however, because the interest being leased is only the building, a building must exist. There are examples of leases being entered into where the building is essentially "vestigial," where only a suggestion of the improvements actually planned for the prop-

43. Improvements constituting infrastructure, such as roads, paved parking lots, etc., can in many cases be sufficient "buildings" to be the subject of a lease, even when the land or land use right itself cannot. For example, leases of a "site" by an agricultural collective or a lease of a "mine" or "quarry" where there has been little more done on the land than moving or excavating dirt. The parties to these leases and the government officials involved in reviewing them concluded that there was a sufficient difference between the subject of these leases and the raw land to warrant the conclusion that the land use right itself was not being leased.

44. "Collective land" in this context may include an allocated land use right that has been contributed to a joint venture. The joint venture controls the land pursuant to the transfer from the Collective, but cannot transfer the interest in the land, since the interest is a non-transferrable land use right. In theory, the actual ownership of the land must be viewed as remaining in the ownership of the Collective. Nevertheless, because the joint venture, as a separate entity, has control over the land, it will be viewed as the "owner" of the buildings, and can lease them. Possession and control of land, under the Civil Code principle of "inherent right," gives a right of ownership to improvements constructed on them.

45. See General Principles art. 83, *supra* note 8, at 23,845. See also Supreme Court Explanations arts. 99-100, *supra* note 11, at 12,204-12,301.

46. It is probably possible to create easements or other "subordinate rights" in land that is the subject of a "non-transferrable" land use right such as an allocated land use right. But there is little experience of this type of transaction in China at present.

erty exist. In such cases, the lease may require the tenant to develop a more elaborate building (the building, regardless of who pays for it, will belong to the landlord during and after the lease). But the theory would not condone the creation of a lease where there was no building at all.

D. BUILDINGS THAT CANNOT BE LEASED

A regulation⁴⁷ of the Ministry of Construction places limits on the kinds of buildings that can be the subject of a lease.⁴⁸ Buildings that have been condemned, closed by the government,⁴⁹ or closed by judicial decree⁵⁰ cannot be leased. Generally, properties whose ownership is in dispute in a legal proceeding, such as a proceeding to determine ownership following the death of an owner, cannot be leased.⁵¹ A court, however, may approve leases that are in the best interests of all disputants. The regulation also requires that all co-owners of a building concur in a lease. Another important provision is that the mortgagee of the building must approve the lease. Note that this regulation appears to apply whether or not the mortgagee has reserved in the mortgage the right to approve the lease. Furthermore, buildings that involve heavy public use (e.g., hotels and restaurants) and buildings with special safety concerns (e.g., factories) may be subject to regulation and permit requirements by various special agencies. Such regulations prohibit leases of such buildings if the necessary permits have not been secured.

47. See Chengshi Fangwu Zuren Guanli Banfa [Measures for the Administration of Urban Building Leasing] art. 6 (June 1, 1991) [hereinafter *Urban Building Leasing*], reprinted in BEIJINGSHI FANGDECHEN KAIFA JINGYING CHENGSHU JI XIANGGUAN SHUIFEI [PROCEDURES AND RELATED TAXES AND FEES CONCERNING THE REAL ESTATE DEVELOPMENT AND OPERATION IN BEIJING] 776-81 (Municipal Real Estate Administration of Beijing ed. 1993) [hereinafter *REAL ESTATE, BEIJING*].

48. The first rule, that the landlord must have a certificate of ownership for the building, virtually goes without saying. Credentials are everything in China. See *id.*

49. Buildings may be closed because they are unsafe or built in violation of building or land use codes, as in Western countries. But Chinese prosecutors also have broad powers to close buildings that are known to harbor criminal activity. See *id.*

50. Creditors with security interests in real property who are seeking to recover a debt in a legal proceeding may obtain court orders restricting further leasing or transferring of the property by the debtor. See *id.*

51. A lease entered into prior to the death of the landlord would bind the landlord's estate and those taking from it. See *id.*

III. DETAILS OF THE LEASE AGREEMENT

A. REQUIREMENT OF A WRITING

Several Chinese statutes contain the requirement that contracts involving real estate interests on State-owned land, including sale agreements, mortgages and leases, must be in writing and registered.⁵²

As for the leases of buildings owned by Agricultural Collectives, there is no special requirement that they be in writing. But there is a strong argument, nevertheless, that such instruments must be written. An Agricultural Collective is a legal person under Chinese Law, and contracts with a legal person as a party must be in written form.⁵³

Residential leases in the countryside, however, might be an exception to the requirement of written form. The farmers are allowed to rent their houses out, and there is no provision that leases of privately-owned houses in rural areas should be in writing, although in fact most long-term leases of housing are in written form.

B. REQUIREMENT OF REGISTRATION

Registration is more than a notice system in China. Registration, in fact, is the formal creation of the interest. During the discussions preceding the adoption of the 1994 Laws on Urban Real Estate Administration, there was considerable debate as to whether registration should be regarded as the only basis for state protection of a real estate interest, as had been the case in the past.⁵⁴ Some authorities argue that where the parties actually intended a transfer, even without registration, the transfer should be regarded as binding upon them and others with notice of it. The debate was never fully resolved, and the Law is silent on the

52. See Regulations on Land Use Rights arts. 7, 8, 16, 20, 25, 29, 31, 34, and 35, *supra* note 19, at 1193-94, 1195-97; Urban Real Estate arts. 14, 35, 40, 48, 49, and 53, *supra* note 18, at 25,327, 25,337-43. These provisions require written land use right granting contracts, land use right transfer contracts, land use right lease contracts, and land use right mortgage contracts on State-owned land in cities or towns, and written agreements for the transfer, lease or mortgage of buildings and other attachments on the land.

53. See Economic Contract Law art. 3, *supra* note 10, at 6,403. This provision is subject to an exception for contracts calling for immediate performance.

54. See Chengshi Fangwu Chanquan Chanji Guanli Zhangxing Banfa [Provisional Measures for the Administration of the Ownership of Urban Buildings] art. 18 (Dec. 31, 1990) *reprinted in* COMPLETE COLLECTION, *supra* note 40, at 146-48 (reprinting a regulation of the Ministry of Construction). See also Tudi Dengji Guize [Regulations for Land Registration] art. 25, (Nov. 18, 1989), *reprinted in*, COMPLETE COLLECTION, *supra* note 40, at 591-96.

issue.⁵⁵ A party who has contracted to receive a right that has not been registered might have a contract claim, or a "credit right" against the transferor.⁵⁶

1. Registration System

The current method for registration of real estate interests consists of two separate systems. The first is the land registration system, which was first established in accordance with the Land Management Law.⁵⁷ Land administrations at or above the county level are in charge of the registration and certificate issuance for land use rights. The second is the registration system for ownership interests in buildings, including ownership, leasehold interests, mortgages or other security interests.⁵⁸ The Real Estate Administrations at or above the county level are in charge of the registration and certificate issuance for ownership of buildings.⁵⁹

When an applicant delivers to the registry the necessary documentation for establishment of a land use right or a lease or mortgage of a land use right, the registry will provide public notice of the pending application for registration. Following a comment period, if the papers are in order and if no objections have been filed, the registry will proceed to grant the registration. Unfortunately, the available legislation does not set forth the method of notice or length of the notice period required prior to

55. UNDERSTANDING THE INTERPRETATION OF THE LAW ON URBAN REAL ESTATE ADMINISTRATION OF THE P.R.C. 171-175 (Fang Weilian ed., Publishing House of People's Court 1994).

56. See discussion of credit rights *infra*, notes 125-131 and accompanying text.

57. For some provisions on the legislation of the granting and transfer of land use rights, see Regulations of Land Use Rights, *supra* note 19, at 1193. In order to implement these provisions and the provisions in the Land Management Law, the State Land Administration has promulgated a series of regulations, such as the Rules on Land Registration and Several Opinions on Issues Concerning Land Titles.

58. This system was first established under the 1983 Regulations Concerning the Administration of the Urban Private-owned Buildings. Guowuyuan Guanyu Fabu Chengshi Siyou Fangwu Guanli Tiaoli De Tongzhi [1983 Regulations Concerning the Administration of the Urban Private-Owned Buildings] (Dec. 7, 1983), *reprinted in* COMPLETE COLLECTION, *supra* note 40, at 128-131 [hereinafter Urban Private-Owned Buildings]. After being designated by the State Council to take the responsibility of the Building Property Administration, the Ministry of Construction has issued a series of regulations and rules since 1987, such as Guanyu Banfa Fangwu Suoyouquan Zhengshi Yangji Fangwu Suoyouquan Dengji Fazheng Gong Zuode Tongzhi [Notice on the Issuance of the Form of the Building Ownership Certificate and the Development of the Building Registration on the Issuance of the Title Certificate] (Jan. 11, 1987), *reprinted in* COMPLETE COLLECTION, *supra* note 40, at 169-70 and the Chengzhen Fangwu Suoyouquan Dengji Zhanxing Banfa [Provisional Measures on the Registration of the Building Ownership in Cities and Towns].

59. The Chinese character for "housing" is the same as the character for "building," and we have here translated it as "building" since the jurisdiction of these Acts and these agencies appears to go beyond residential property.

registration. This is particularly difficult because the comment period may be the only opportunity that parties with interests in land may have to identify conflicting claimants. Following registration, the current Rules provide that parties wishing to inspect the registration records must apply for permission. It is not clear that permission will be granted, particularly to foreigners. Further, the Rules are not clear as to the exact location where registry records will be maintained. The Rules stipulate that the registry will be at the county level or above, without clarifying what interests are to be recorded where. Thus, checking at the county level may not reveal competing interests recorded at the Provincial level and vice-versa.⁶⁰

Chapter Five of the 1994 Law on Urban Real Estate Administration confirmed the existence of the two separate systems for land use rights and building ownership, and at the same time authorized the provincial governments to unify the registration and certificate issuance system within their jurisdictions. In some areas, such as in Shanghai and Shenzhen, one government agency issues a uniform certificate for both interests.⁶¹

Upon registration, the registry office provides a certificate of registration to the interest holder and prepares a registration card that is maintained in the registry office. The card, and not the certificate, constitutes the official evidence of registration. Consequently, it is not safe to rely only upon the existence of the transferor's certificate in documenting transfers of land use rights or transfers of subordinate interest in them such as leases or mortgages.⁶² Until the transfer documents have been delivered and accepted for an amended registration, one cannot be certain that the transferor truly has the rights in question.

Until very recently, there has been some doubt as to the completeness, accuracy or even existence of land use registries outside of major developed areas. To complicate matters even

60. See Clarke & Howson, *supra* note 26, at 13-17.

61. See Urban Real Estate, *supra* note 18, at 25,345-47. For a general discussion of the authorization of consolidated registrations systems, see UNDERSTANDING THE INTERPRETATION OF THE LAW ON URBAN REAL ESTATE ADMINISTRATION, *supra* note 55, at 175-177.

62. Note that this discussion pertains only to transfers of interest that have already been created. A lease or a mortgage of a land use right would be the subject of an original registration, but the transfer of such interests would require an amended registration.

more, the latest Rules depart from the pre-existing policy⁶³ that land registries were open to public inspection.⁶⁴

2. *Registration of Leases of Land Use Rights*

Until very recently, there had been some doubt as to whether leases of land use rights should be registered independently of the registration of the leases of the buildings on those rights. It should be noted that a lease of a pure land use right is not common in China, so typically land and building leases are part of the same transaction. The earlier Law on Urban Land Administration⁶⁵ only provided for the leasing of buildings, and required that the lessor and lessee go through registration procedures to record a building lease with the Real Estate Administration.⁶⁶ But under the latest Rules⁶⁷ relating to the registration of real estate interests, it is clear that leases of land use rights must also be registered.⁶⁸ Nevertheless, such transactions will require two separate registrations, one for the land use right and one for the building. In some areas, where there has been consolidation of the registries,⁶⁹ the lease would be registered in only one office.

63. See Regulations on Land Use Rights art. 7, *supra* note 19, at 1193-94. In any event, this policy may have been more theoretical than real in many areas. Even prior to the recent changes, Western practitioners had reported difficulty in obtaining access to land registries.

64. For an excellent exposition of the new Rules and problem areas associated with them, see Clarke & Howson *supra* note 26, at 13-17.

65. See Urban Real Estate art. 53, *supra* note 18, at 25,343.

66. In order to implement the provisions of the Law on Urban Real Estate Administration, the Ministry of Construction promulgated the Measures for the Administration on Urban Building Leasing on April 28, 1995. See Urban Building Leasing, *supra* note 47, at 776-81.

67. See Regulations for Land Registration, *supra* note 54, at 591-96.

68. Even prior to the 1995 Regulations, certain provisions of the Regulations of the P.R.C. on the Granting and Transfer of Land Use Rights for Valuable Consideration in Cities and Towns stated a process whereby a lease of a land use right would be registered. Article 7 provides, "[t]he granting, transfer, renting, mortgaging and termination of the land use rights and the registration of related buildings and their auxiliary facilities on the ground are handled by land administrative and house property management departments according to law and relevant regulations by the State Council." Regulations on Land Use Rights art. 7, *supra* note 19, at 1193-94. Also, Article 31 reads, "[w]hen the land use right and the buildings and their auxiliary facilities on it are rented out, the lessor must go through registration formalities." *Id.* art. 31, at 1196-97.

69. In most places, the separate registries would be the Land Administration office and the Real Estate Administration Office. In Shanghai and Shenzhen the registries have been consolidated, and leases and other transfers of both land use rights and buildings would be registered in the same location—at the Real Estate Administration Bureau. See *Shanghai Shishi Fangdichan Dengji Tiaoli* [Shanghai is Implementing Real Estate Registration Regulations], BEIJING EVENING PAPER Mar. 4, 1996 (reporting on regulations entitled *Shanghaishi Fangdichan Dengji Tiaoli*) [Regulations of Real Estate Registration of Shanghai City] (Mar. 1, 1996);

Registration is a condition of validity. The registration requirements of the new Rules apply retroactively, so holders of leases of land use rights who had not registered those rights in the past must register them immediately.

3. *Registration of Leases of Buildings*

In addition to the registration requirements of building leases described above, a special regulation on urban buildings⁷⁰ requires that parties engaged in the leasing of such buildings record their interests with the Real Estate Administration at the City or County level when they execute or revise any lease contract. Recordation must occur within thirty days of signing the contract. A written lease contract is required for recording.⁷¹ Upon recordation, the tenant receives an occupancy certificate that is sufficient to establish legal domicile. The regulation, however, is vague as to the impact of non-recording on the validity of the lease.⁷²

It is likely that recordation is necessary to establish rights against others who might attempt to lease the property. If a tenant has not recorded his lease within thirty days and a subsequent party without notice of the first lease should take a lease on the property and record it, the recordation would validate the second lease as against the first tenant. If, however, the first tenant has taken possession, then that possession would not only establish notice to the second party but would also move the first tenant's rights closer to "in rem" status, as opposed to simple "credit right" status. Rights in rem always have priority over simple credit rights. However, because leases are not *clearly* in rem rights, we cannot say with certainty that the tenant under an unrecorded prior lease would have automatic priority over a *bona fide* tenant under a second lease. But leases in which occu-

Shengzhen Jingji Tequ Fangdichan Dengji Tiaoli [1992 Regulations for Real Estate Registration of Shenzhen Special Economic Zone] (effective July 1, 1993), *reprinted in* COMPILATION OF LAWS AND REGULATIONS OF SHENZHEN SPECIAL ECONOMIC ZONE 9-25.

70. See Urban Building Leasing arts. 13-18, *supra* note 47, at 778-79.

71. Other required documents include the landlord's title certificate for the building (which is distinct in most areas from the land use certificate), the identification card or business license for the tenant, and such other documents as the City or County government might require.

72. The regulation provides that the certificate received by the tenant is evidence of the "validation and effectiveness" of the contract, but does not state that absent recordation the lease is not valid or effective. Further, the regulation provides that if the landlord and tenant do not record, they may be fined. The existence of this sanction language suggests the greater sanction of invalidation was not intended. See Urban Building Leasing art. 32, *supra* note 47, at 781.

pancy has begun are more than simple credit rights and likely deserve the in rem protection in this instance.⁷³

C. MAIN CLAUSES OF A LEASE CONTRACT

The concept of "main clauses" is one of the most important in Chinese contract law. If the parties cannot reach an agreement on the main clauses of a certain type contract, they will not be viewed as forming that contract, although the law may impose some alternative form of legal relationship upon them.⁷⁴ The Economic Contract Law and its implementing regulations have listed main clauses for each type of contract regulated by the Economic Contract Law, including contracts for property leases.

The Law on Urban Real Estate Administration⁷⁵ and the Measures for the Administration of Urban Building Leasing⁷⁶ have listed the main clauses for the lease of urban buildings, which include, but are not limited to:⁷⁷

- (1) names and addresses of the parties to the contract;
- (2) the location, size, and situation of the premises;
- (3) use of the premises;
- (4) lease term;
- (5) rent and its method of payment;
- (6) repair liability;
- (7) sub-lease;
- (8) alteration and termination of the contract.

Contracting parties can obtain access to forms containing all these main clauses from their local real estate administrations. Theoretically, the parties are entitled to make additions or alterations to the clauses in the form when preparing a residential lease; however, it is necessary to implement the leasing policy stipulated by the State and the city government.⁷⁸ The parties to commercial leases appear to have more freedom.⁷⁹

73. See discussion of credit rights and in rem rights *infra* notes 125 to 131 and accompanying text.

74. See Economic Contract Law art. 9, *supra* note 10, at 6,405.

75. See Urban Real Estate art. 53, *supra* note 18, at 25,343.

76. See Urban Building Leasing art. 9, *supra* note 47, at 777.

77. The parties to a contract may identify other clauses as the "main clauses."

78. See Urban Real Estate art. 54, *supra* note 18, at 25,343; Urban Building Leasing art. 7, *supra* note 47, at 776-77.

79. When leasing a building for production or commercial use, the parties shall determine the rental and other terms of the lease through consultation. See Urban Real Estate art. 54, *supra* note 18, at 25,343; Urban Building Leasing art. 7, *supra* note 47, at 776-77.

D. IDENTITY OF TENANTS

Individual Chinese citizens are prohibited from directly holding land use rights for other than agricultural⁸⁰ or residential purposes. But, they may establish themselves as business entities and, in theory, acquire or lease land use rights in that capacity.⁸¹ Furthermore, foreign individuals, foreign business entities, joint ventures, and other business entities in China also can be tenants under a lease.

Government agencies, public societies, military forces, state-owned or collective enterprises, and state-owned or collective institutions are not permitted to rent urban privately-owned buildings unless approved by the people's government at or above the county level.⁸²

E. LEASE TERM

Leases are not necessarily limited by the fixed term limits that apply to granted land use rights, although obviously a lease on premises that is subject to a granted land use right could not last longer than the land use right itself.⁸³ The law does require that there be some fixed term for the lease, and it is likely that Chinese law would not countenance a lease for an extraordinarily long period of time—such as beyond the useful life of the

80. In the past, only members of an Agricultural Collective have been able to obtain land use rights for agricultural purposes. This has been part of the "family responsibility system," a means of contracting for agricultural production between peasants and Agricultural Collectives. But a recent Communist Party proclamation stated that it is permissible for non-Collective members, and even urban residents, to obtain land use rights on Agricultural Collective land for agricultural purposes. The change in policy is an attempt to turn back the surging tide of migration from rural to urban areas and to encourage greater agricultural productivity. The "family responsibility system" is described in general terms both in the Constitution and in the General Principles of Civil Law, and there is such limited detail in these formal provisions that the Party proclamation probably is sufficient to make changes in the system. See CONSTITUTION art. 8, *supra* note 21, at 5,311; General Principles art. 74, *supra* note 8, at 23,837, 23,841.

81. In China, natural persons are not allowed to go into business directly. They must register themselves as either self-employed "industrial and commercial individuals" or incorporate a private-owned enterprise before they can go into business. A self-employed industrial and commercial individuals or a private-owned enterprise can, at least theoretically, hold a land use right or lease a land use right for its commercial purposes.

82. See Urban Private-owned Buildings art. 22, *supra* note 58, at 130.

83. A lease written for longer than the term of the underlying land use right would probably still be valid for the balance of the term, but would not automatically extend to the renewal term, should the landlord renew the right. The parties could provide in the lease that the lease would extend longer in the event that the land use right is renewed, but absent such provision, agreeing to a longer lease term than the land use right would probably result in a "partially void" contract. If the tenant is unaware that the land use right does not extend for the length of the lease, then the landlord would be liable for such partial invalidity.

improvements. This would certainly be true for leases in which the primary subject of the lease is the building itself.⁸⁴

Local governments with jurisdiction over Collective property in urban areas can regulate the use of that property, and may restrict the lease term.⁸⁵

The lease instrument must set forth clearly the date that the lease begins. Chinese courts have determined that if there is no specified date that the lease begins, the rent commences from the time that possession occurs. If the lease is vague as to when possession begins, then either party can provide reasonable notice to the other in order to trigger commencement of possession and rent.⁸⁶

Chinese law permits both leases for a fixed term as well as "periodic" tenancies which continue on the established terms until one of the parties gives notice of termination one period in advance. Civil law concepts of fairness likely will limit the ability of the parties to truncate too dramatically the notice periods applicable to periodic tenancies, particularly when residential rights are at stake.

F. RENT

Rent typically is paid in advance.⁸⁷ The rent period is set by contract. Three to six months advance rent is common for residential leases. In commercial leases, which frequently provide

84. If there is no fixed leasing term, then either party can provide reasonable notice to the other in order to terminate the contract. For residential leases, however, a certain period of time must be given to the tenant to find alternative accommodations. See Supreme Court Explanations art. 19, *supra* note 11, at 12,303. Even if there is a fixed period, the landlord of a residential lease is required to extend the leasing term when the tenant cannot find alternative accommodations upon the expiration of the leasing term. See Urban Private-Owned Buildings art. 20, *supra* note 58, at 130.

85. By hearsay, the authors understand that Beijing has adopted a regulation limiting the term of Collective leases to 30 years.

86. Each party to a contract can provide reasonable preparation time to the other in order to trigger the performance of the contract if there is no definite deadline for performance in the contract and the parties cannot reach an agreement about it. See General Principles art. 88(ii), *supra* note 8, at 23,847.

87. Advance rent is not the case in certain common non-market arrangements that are not the central focus of this Article. Employees usually rent apartments from their employers (called "work units"). If city or town residents have no work units or their work units can't supply their accommodations, they can rent an apartment or rooms from the local real estate administration. The real estate administrations are not only in charge of the management of the state-owned residential buildings, but also in charge of the management of the state-owned buildings for other purposes than residential purposes. They can also lease buildings to individuals or entities for commercial purposes. In all the above-mentioned leases, the rent is usually paid monthly, and seldom in advance. Although these kinds of leases account for a large proportion to all the real estate leases in China, they are more administrative acts than civil matters.

for lengthier terms, rent typically is paid in advance for periods of one, two, or even five years. It is not unusual for the prepaid rent to be used to pay for the construction of the buildings that are the primary subject of the lease. There is no rent control on commercial leases⁸⁸ to the authors' knowledge.⁸⁹

IV. IMPLIED WARRANTIES OF A LANDLORD

As in America, implied in every Chinese lease is a landlord's covenant of quiet enjoyment. The landlord represents that the landlord has the legal capacity to vest a possession right in the tenant pursuant to the lease. Should the landlord later prove not to have such legal authority (e.g., if the landlord in fact has no land use right) then the lease would be considered void. The tenant would be able to recover all monies paid under the lease and damages for loss of future possession under the lease.⁹⁰ Chinese law follows what is known in America as the "English Rule"⁹¹ on the question of the landlord's duty to provide actual possession at the outset of the lease. The landlord has the responsibility to clear the premises of inconsistent possessions and is liable to the tenant if unable to provide free occupancy at the outset of the lease, even if the occupant is a holdover tenant.

An important difference between the "standard" construction of Chinese lease relationships as compared to those in America is the absence in China of the "*caveat lessee*" concept.

88. Everywhere in China, residential rent is subject to some form of rent control. Article 16 of the Regulations on the Administration of Urban Privately-owned Buildings requires that the parties should determine rent through consultation subject to local standards. If there are no local standards, the rent should be determined fairly and reasonably in light of actual local rents. Usually the authorities will set tolerances which residential rents cannot exceed. The size, location, condition, age and other factors of the rental units may have an impact on the question of applicable rent. See, e.g., Guanyu Jiaqiang Chengshi Shiyong Fangwu Maimai Jiage He Danwei Shiyong Shiyong Fangwu Zhujing Guanli De Guiding [Interim Provisions Concerning the Administration of the Sale Price and Rent of Privately Owned Buildings] (June 1, 1986), reprinted in REAL ESTATE, BEIJING, *supra* note 47, at 730-34.

89. See Urban Real Estate art. 54, *supra* note 18, at 25,343; Urban Building Leasing, art. 7, *supra* note 47, at 776-77. Under these articles, when leasing a building for production or commercial use, the parties may determine the rental and other terms of lease through consultation.

90. See General Principles art. 61, *supra* note 8. It is probable that Chinese law would not permit the tenant to recover all the rent if the tenant has enjoyed significant occupancy under the invalid lease. General principles of fairness under the civil law would limit the tenant's recovery by crediting the landlord with the value of the occupancy that the tenant has received.

91. The landlord must insure that the tenant is able to occupy the premises at the agreed upon time and that the premises are fit for the use described by the contract. The "English Rule" in fact probably states the position adopted by a majority of American jurisdictions as well.

The Chinese landlord, from the outset of the lease through the entire term of the lease, is responsible for providing a premises in good order and repair.⁹² The landlord must conduct all maintenance responsibilities and bears the risk of loss in the contract if the premises are destroyed by fire not caused by the tenant.⁹³ In commercial leases, at least, the parties can and sometimes do shift these responsibilities by contract,⁹⁴ although the landlord probably would not be able to escape the duty to comply with safety regulations adopted by the Building Ministry or other government agencies. In America, if the lease agreement is silent, the landlord can avoid many maintenance duties (with a general exception for those imposed by public regulation), but the Chinese landlord would be well advised to carefully delineate the exact scope of its maintenance responsibilities and to provide specifically that it has no others.

V. DUTIES OF A TENANT

Tenants have the basic responsibility to take reasonable care of the premises.⁹⁵ Further, as continued use for the permitted purpose is necessary to preserve the landlord's land use right, tenants have the obligation to use the premises continuously for the identified use as defined in the land use right. Tenants cannot abandon the premises.⁹⁶ Of course, the parties could describe the use the Tenant must undertake more narrowly than

92. The tenant is entitled to claim any damages due to the landlord's delay in repairing the premises. If the landlord does not repair, the tenant can undertake the repairs herself. The money the tenant uses for the maintenance and repair shall be considered to be advance rent, or the landlord may have to pay the money back. See Urban Private-Owned Buildings art. 19, *supra* note 82; Urban Building Leasing art. 21, *supra* note 47, at 779.

93. The landlord's responsibility is subject to a broad *force majeure* exception that the Civil Code reads into all private contracts. See General Principles art. 107, *supra* note 8. The example in the text assumes fire caused not by lightening or other "act of God," but by the negligence of the landlord or third parties, known or unknown. In such cases, *force majeure* likely would not apply and the landlord would be liable to rebuild or to pay damages. In American law, the tenant, and not the landlord, would bear the risk of destruction by a fire caused by third parties or of unknown origin.

94. See Urban Building Leasing art. 21 §2, *supra* note 47, at 779.

95. See Urban Building Leasing art. 23, *supra* note 47, at 779.

96. Should the lease be of a building located on an allocated land use right, there is a danger that failure to occupy the premises for a period of two years could result in forfeiture of the land use right itself, and the tenant would have a clear duty to protect the landlord from such an event. On the other hand, the rules regarding granted land use rights require only that the property be put to use within two years of grant; the rules say nothing about continued use. Under these circumstances, the tenant's abandonment might create a danger of waste, but would not necessarily jeopardize the land use right. The authors are not prepared to state conclusively that there is an implied continuous occupancy duty for leases on granted land use rights.

that set forth in the land use right. If this is the case, the Landlord should make certain that the lease clearly delineates any continuous use expectations at that level.

The law provides that if a Tenant changes the structure of use of the premises without proper authorization, the landlord is entitled to terminate the lease and to make a claim for damages.⁹⁷

VI. TENANT'S RIGHTS TO TRANSFER INTERESTS IN THE LEASED PREMISES

Unlike American law, Chinese law does not assume that the tenant's interest in a lease can be assigned or sublet. Tenants who wish to assign or sublet must negotiate for such language in the lease. Such provisions are not unusual in Chinese commercial leases. The landlord, of course, can condition any permission with specific or general restrictions or reservations.⁹⁸

Further, unlike American law, Chinese law would view an assignment of a lease by a tenant as a novation, with the assignor being relieved of further liability.⁹⁹ Typically, the landlord would execute a new lease with the new tenant.

Subleases are recognized in Chinese law as well. Tenants who have permission in the lease to sublet remain liable on the lease unless the parties agree otherwise.¹⁰⁰ The subtenant has no contractual liability to the landlord, but has duties under Civil Law as an occupant of land subject to a land use right owned by another. These duties include a duty not to injure the land or improvements and a duty to continue the permitted uses.

A recent provision is likely to cause difficulty for subleasing transactions. Article Thirty-One of the Measures for Administration of the Urban Building Leasing reads: "During the lease term of a sublet, the sublet contract shall be altered, rescinded or terminated correspondingly when the original lease contract is altered, rescinded or terminated."

97. See Urban Building Leasing art. 24, *supra* note 47, at 779-80.

98. See Urban Building Leasing arts. 26-28, *supra* note 47, at 780. In accordance with these provisions, if there is no general authorization in the contract, a written authorization from the landlord is necessary for a sublet. The sublet contract must be in written form and go through procedures for recordation just as the lease contract. One thing new in this recently promulgated Measure might be the public declaration that the original tenant is entitled to benefit from the sublet, which may legalize market transactions in sublet real estate.

99. Discussions of Chinese legal theory have identified a distinction between novation and assignment, but in practice the system has not yet identified the distinction.

100. See Urban Building Leasing art. 30, *supra* note 47, at 780.

The negative influence on the interests of subtenants is obvious. The provision would appear to give the parties to the original lease the power to alter or even terminate the sublease without the sublessee having any right to object to or control such action. Even though such power likely would be subject to the overall Civil Law duty of good faith and fair dealing, so that the parties to the original lease likely would have to take the interests of the sublessee into account, the simple vesting in two parties the power to alter a contract between one of them and another party is an obstacle to good market operation. One explanation for the provision is that the lease agreement is "primary" and the sublease agreement "subordinate," a concept recognized by the Civil Law in certain other areas.¹⁰¹ If this is the basis for the rule announced in Article Thirty-One, however, it has been misapplied in this case.

VII. REFUSAL RIGHT

The Civil Law recognizes a "Refusal Right," a right of first refusal in a tenant as to both resale and reletting of leased property.¹⁰² The Refusal Right need not be set forth in the lease agreement to exist. The Civil Law might regard a lease contract that does not include such a right as inherently unfair. The *Supreme Court Interpretations* commentary recognizing this right does not differentiate between commercial and residential leases, so we must assume that it applies to both, although it is possible that subsequent interpretations may narrow the application.

At the end of the lease term, the Refusal Right gives the tenant the right, within three months of receiving notice,¹⁰³ to match any other offer to lease the premises for a succeeding term. The tenant must match "the same conditions" as the competing offer. It is not clear whether this language requires the tenant to have the same credit standing as the competing lessee. Most likely the tenant must have credit reasonably sufficient to perform under the new terms, but need not be as strong economically as the competitor.

101. For instance, we would view a debt obligation as "primary" and a security agreement relating to that obligation as "secondary."

102. Although the Supreme Court commentary discusses the refusal right as applicable only to leases of buildings, it necessarily would apply to the land use rights associated with those buildings. See Supreme Court Explanations art. 118, *supra* note 11, at 12,303.

103. The parties may change the notice period by contract to another period that is reasonable, in light of all the facts and circumstances.

Furthermore, if the landlord seeks to sell the premises,¹⁰⁴ the tenant also has the right to match a competing sales offer.

VIII. REMEDIES FOR BREACH OF LEASE

Chinese statutes provide that the landlord has no right to seek default remedies until the default is six months in arrears.¹⁰⁵ The parties may be able to change this rule by contract to a shorter, but still reasonable, period.

Following notice,¹⁰⁶ a landlord has the right to terminate the lease upon default by the tenant whether or not the right appears in the lease. Upon termination, the landlord may seek a court eviction. Peaceable "self help" eviction (e.g., changing locks) is also recognized, following a notice of default and a reasonable opportunity to vacate.¹⁰⁷

Most often, the landlord will elect to seek a remedy through a legal proceeding in the district where the leased premises are located.¹⁰⁸ The legal proceeding will be in the Civil Division of the Court. The usual jurisdiction is in the Basic Court,¹⁰⁹ but claims for larger amounts and major claims involving foreign entities or individuals¹¹⁰ as either tenants or landlords may be

104. Again, it appears that "premises" includes the land use right as well as the building itself. This definition would present some interesting anomalies where the proposed new user would conduct a different use on the premises. The old tenant would have to match the price, but presumably not have to demonstrate that it qualified to conduct the new land use. It could continue the old use.

105. The landlord might be able to go to court earlier than six months after the first default and seek a judgment for back rent and an order terminating the lease. But the lease will terminate automatically (upon notice) after six month's default has occurred. See Urban Building Leasing art.24, *supra* note 47, at 779-80.

106. There is no fixed time for the notice of default, although presumably the parties could fix the notice period by contract. The default notice period can run concurrently with the six month arrears period.

107. The notice of default could also include a demand to vacate.

108. Zuigao Renmin Fayuan Guanyu Fangdichan Anjian Shouli Wenti De Tongzhi [Notice of the Supreme People's Court Concerning the Jurisdiction of the Cases Concerning Real Property Interests] (Nov. 25, 1992), in *CONCISE HANDBOOK*, *supra* note 11, at 92.

109. In China's court system, the courts at the county, city, and municipal district levels are called "Basic Courts." See Zhonghua Renmin Gongheguo Mingshi Susong Fa [Code of Civil Procedure of the P.R.C.] arts. 18-21 (Apr. 9, 1991), *translated in* 3 China L. for Foreign Bus.: Bus. Reg. (CCH Int'l) ¶19-201 at 23,899-901 [hereinafter Code of Civil Procedure].

110. "Foreign entities or individuals" in this context would not include joint venture entities or wholly owned foreign enterprises in China. See, e.g., Zuigao Renmin Fayuan Guanyu Shiyong Shewai Jingji Hetongfa Ruoguan Wenti De Jieda [Answers of Supreme People's Courts to Issues Concerning the Implementation of the Foreign Economic Contract Law] (Oct. 19, 1987), *reprinted in* Quanguo Lushi Zige Kaoshi Bidu Falu Fagui Huiban [COMPILATION OF LAWS AND REGULATIONS FOR THE NATIONAL LAWYER QUALIFICATION EXAMINATION] 1245 (Zhang Geng ed. 1995).

heard by the Intermediate Court.¹¹¹ The action may or may not include a demand for possession as well as damages. If litigation is carried out in the Basic Court, the procedure may be a "summary procedure"¹¹² completed within three months,¹¹³ or a regular procedure which typically must be completed within six months.¹¹⁴

If a party refuses to accept the first judgment of a local People's Court, either the Basic Court or an Intermediate Court, then that party is entitled to file an appeal with the People's Court at the next higher level¹¹⁵ within fifteen days after the date on which the written judgement was served.¹¹⁶ The People's Court will generally conclude the case within three months after docketing.¹¹⁷ The judgment of a court of second instance shall be final.¹¹⁸

If the landlord's only claim is for unpaid rent, a simpler procedure is available—the "procedure for hastening debt recovery." Assuming that there are no other debt disputes between the landlord and the tenant, the landlord may apply to the Basic People's Court for an order of payment and must assure the court that the tenant is physically available to receive such an order.¹¹⁹ The court will inform the landlord within five days whether it accepts the application.¹²⁰ If the court finds that the rights and obligations between the landlord and the tenant are clear and legitimate, it will issue an order of payment to the tenant within fifteen days. This order will require the tenant to pay the debt or submit his dissent to the court in writing. If the tenant has neither dissented nor complied with the order of payment within the period specified by the order, the landlord may apply to the People's Court for its execution.¹²¹ If the tenant files a

111. See Code of Civil Procedure art. 18-19, *supra* note 109, at 23,899-901.

112. Such proceedings involve only one judge and somewhat reduced formality with regard to pleadings and evidence. See *id.* art. 142. Summary proceedings are held only in the Basic Courts. See *id.* The longest time allowed for a summary procedure is three months. See *id.* arts. 142-146.

113. *Id.* art. 146.

114. See *id.* art. 135. To extend the time for this procedure, a trial court must seek permission from the court at the next highest level. *Id.*

115. The court at the next higher level for an intermediate court is the Higher People's Court. There is a High People's Court in each province, autonomous region or municipality subject directly to the central government.

116. Code of Civil Procedure art. 147, *supra* note 111, at 23,941.

117. *Id.* art. 159, at 23,959.

118. *Id.* art. 158.

119. *Id.* art. 189, at 23,971-72.

120. *Id.* art. 190, at 23,972.

121. *Id.* art. 191.

dissent, however, the court will dismiss the procedure. Then the landlord may bring an action in the court.¹²²

In addition to rent default, the landlord can also seek default remedies in the following circumstances:¹²³

- (1) the tenant sublet the premises without authorization;
- (2) the tenant "loaned or exchanged" the premises with another without authorization;
- (3) the tenant changed the structure or uses of the premises without authorization;
- (4) the tenant deliberately caused significant damage to the premises;
- (5) the tenant used the premises for illegal purposes.

Even if a residential tenant is in default and an order of eviction is issued, the order will not be enforced until the residential tenant has been given a reasonable opportunity to seek alternative accommodations.

The landlord can collect contract damages for unpaid rent and for loss of lease benefits upon tenant default. The landlord, however, has the duty to mitigate by reletting the premises following eviction. The general practice is that the court will not project the contract damages for more than one year from the time of termination. If the landlord expects a longer projected term for contract damages purposes, the landlord should provide for such an extended term in the lease as Chinese law does not recognize a landlord's lien.¹²⁴

IX. STATUS OF LEASE AS A "CREDIT RIGHT," RATHER THAN A RIGHT "IN REM"

Generally speaking, property rights under the Chinese Civil Law can be divided into two types: (1) "credit rights" which include obligations owed to others under contracts,¹²⁵ and (2)

122. *Id.* art. 192.

123. *See* Urban Building Leasing art. 24, *supra* note 47, at 779-80.

124. The lien under Chinese Civil Law is comparatively narrower than the common law landlord's lien. In accordance with article 89 of the General Principles of Civil Law, the creditor can only lien the debtor's property when the creditor already has lawfully occupied the premises in accordance with the contract. *See* General Principles art. 89, *supra* note 8, at 23,851.

125. Contract rights are identified as creditors' rights. *See id.* arts. 84-85, at 23,845. Other types of credit rights include a claim for unjust enrichment. *See id.* art. 92, at 23,851. Tort claims are not listed as credit rights in the General Principles, but scholars tend to view them as credit rights as a matter of theory.

There is another form of credit right recognized for "object management:" benefits in the form of avoidance of loss or injury conferred upon a person by another person who has no legal obligation to provide such benefit, but the circumstances are such that it would be unfair for the benefitted party to receive the benefit without compensating the benefactor for the costs incurred. *See id.* art. 93, at 23,851-53. As an example of the latter right, consider the following example:

"rights in rem" which are equivalent to ownership rights as conceived in the Civil Law.¹²⁶ There is also a provision for special rights in intellectual property. There is a rough correspondence between the in rem concept and legal title, or ownership, as well as a similar rough correspondence between the credit right concept and the common law concept of the "equitable right."

An in rem right is entitled to protection by the State against interference from all the world. If the State interferes with it, it must compensate the owner.¹²⁷ An in rem right generally inheres in something tangible, like a parcel of land or a building, but such a right can exist in both moveable and immovable property. The holder of an in rem right has a right to protect the thing in which the right inheres, and has a claim for damages if that thing is damaged or injured. An in rem right may not be taken or transferred away from an owner without the owner's consent. An in rem right in a land use right arises only upon registration. The in rem right is mortgageable, and the mortgage interest itself is an in rem right.

Scholarly opinion is that a right in rem can exist in a tangible embodiment of an intangible right, such as a bond or a share of stock.¹²⁸ For instance, a share interest in a foreign joint venture embodied in a formal publicly tradeable share probably can form the basis for an in rem right. A lease right, however, is a mere contract right, and is not in rem. The same is true of a Chinese

A farmer is away from his farm and a storm endangers the wheat crop. The farmer's neighbor hires laborers to harvest the wheat crop, thereby rescuing it from destruction. The farmer owes his neighbor the cost of the laborer's wages, but need not compensate the neighbor for anything more than the neighbor's costs.

126. "Property Ownership and Related Property Rights" is the title of §1, Chapter 5 of the General Principles of Civil Law. *See id.*, at 23,837. Besides ownership, including State ownership, collective ownership, and individual ownership, the General Principles of Civil Law provides for the right of succession, land use rights, natural resources use rights on State owned natural resources, mineral rights on state-owned mineral resources, management rights of State-owned enterprises, and neighborhood rights. *See id.* arts. 73-76, 80-83, at 23,837-41, 23,843-45. Although the General Principles of Civil Law does not use the term "rights in rem," it is well accepted among Chinese scholars that the rights provided in General Principles of Civil Law under the title "Property Ownership and Other Property Rights Related to Property Ownership" are part of the rights in rem. *See* QIAN, *supra* note 1, at 126.

127. If the State revokes a granted land use right before its expiration, it would be obligated to compensate the land user. *See* Urban Real Estate art. 19, *supra* note 18, at 25,329. The State can only revoke the right for reasons grounded in "[social] public interest." Compensation will be based upon the time of usage and the user's investment. *Id.*

128. Furthermore, money orders, checks, cashier's checks, securities, deposit receipts, warehouse receipts, bills of lading, shares and share of certificates that are transferable according to law can be used in hypothecation. *See* Zhonghua Renmin Gongheguo Dan Baofa [Guarantee Law of the P.R.C.] (June 30, 1995) [hereinafter *Guarantee Law*].

"judgment lien," the right to have a debtor's property applied in satisfaction of a debt. The contract right of a purchaser under a land sale contract is also not an in rem right. China does not indulge in the "equitable conversion" concept that is sometimes applied in the Common Law.

A credit right is a right against an individual party. It states a relationship of a given party with certain other specific parties, and does not enjoy protection against all the world. A simple contract right, for instance, is a credit right. If the party who owes the credit right is somehow disabled from performing it by actions of a third party, the holder of the right has no action against the third party. The only claim is against the obligor.¹²⁹

A lease contract itself is a credit right and not a right in rem under Chinese Civil Law. The occupancy under the lease may be an in rem right and entitled to protection by application of certain in rem concepts, such as "first in time, first in right." But the fact that the contract is simply a credit right has an important consequence for the status of the lease as a commercial tool.

It is commonly stated in Chinese legal texts that credit rights cannot be mortgaged. It is commonly believed that a Chinese court would not enforce a security interest in a credit right, including a tenant's leasehold mortgage. American real estate development, particularly in the area of shopping center financing, depends heavily upon the device of the tenant's, or even the subtenant's, leasehold mortgage. The critical feature of the leasehold mortgage from a financing standpoint is that the landlord is able to establish a priority claim in a real estate project, and the tenant and the tenant's mortgagee (frequently a construction lender) agree that the landlord will be paid first. This enables shopping center developers to induce land owners to provide land on a "time payment" arrangement for a relatively long lease term. Apparently such devices are not possible in China, at least not in the form used in America.

Chinese Civil Law texts have not considered the concept of leasehold mortgage. They have discussed only the theoretical classification of lease contracts in general as credit rights. In the future, it may be possible to convince Chinese legal authorities to recognize the validity of security interests in tenant's leasehold estates.

Similarly, there is some ambiguity about the impact of a mortgage on the landlord's interest. The landlord's interest, if it is a land use right, is a right in rem and can be mortgaged. But does the mortgagee obtain an interest that has priority over sub-

129. For a more detailed discussion of rights in rem and credit rights, see *supra* note 126, at 9-38.

sequent leases by the mortgagor? In America, absent special contractual arrangements, the mortgagee would be able to "fore-close away" burdensome leases that arise subsequent to the mortgage. Chinese foreclosure law and lease law are unclear on this point. The standard rule is that a sale of the landlord's interest does not terminate a lease.¹³⁰ This, of course, is also the rule in America, but the American mortgagee is not the same as an ordinary buyer where the mortgagee's rights arose prior to the lease. If China does not recognize the priority interest of the mortgagee in this circumstance, it will sacrifice another important potential financing option of real estate developers.¹³¹

X. ECONOMIC ANALYSIS OF THE CHINESE COMMERCIAL LEASE

As a general proposition, Chinese law imposes on the contracting parties a greater number of implied provisions based upon general fairness. Some are variable by contract, others are not. In cases where legal conditions may be varied by contract, lawmakers need only be sure that the implied conditions may be reasonably anticipated by parties, so that the parties will know when bargaining is appropriate, and that the implied conditions are clear. Such provisions are rarely an impediment to an efficient market.

But non-waivable implied conditions may constitute a significant market impediment. Real estate arrangements constitute an allocation of risk and opportunity among the contracting parties. Non-waivable contract provisions interfere with the free bargaining of the parties and can seriously impede market efficiency. The parties may bargain to seek alternative methods of meeting their risk management or opportunity goals. Such alternatives may be more difficult to negotiate or to price, and the overall cost of reaching a bargain will be higher, even if the bargain is made. Moreover, in some cases, bargains that might be desirable from the standpoint of the public interest or marketplace functions will not be made.

Some might find it a contradiction to argue that the imposition of a non-waivable contract provision, which one assumes fulfills some public policy objective, would in fact result in the loss of a desirable contract from the standpoint of the public interest. They would contend that the public would not be served by a contract that does not include this provision. There are two responses to this contention.

130. See Urban Building Leasing art. 11, *supra* note 47, at 777-78.

131. Unfortunately, the Guarantee Law does not provide for a priority interest of the mortgagee in this circumstance. See Guarantee Law, *supra* note 128.

First, the implied provision may be applicable to a large variety of contracts, but not equally beneficial to the public interest in all of them. Therefore, courts or legislatures over time will learn to distinguish those contracts in which the provision provides relatively minor benefit from those in which it is crucial. As to those contracts in which the benefit is minor, it may be appropriate to reevaluate whether the public cost is justified. Of course, the best example of this type of problem is an implied lease provision that is conceived at a time when the primary focus of the law is residential or agricultural leases. The fact that the tenants in such cases have relatively less sophistication than landlords, and relatively more to lose from severe default penalties, might lead lawmakers to restrict the ability of the parties to establish by contract default remedies that do not meet a standard "soft" model. But in commercial contracts, where the parties are more balanced in terms of power and sophistication, landlords may be concerned that tenants would abuse soft default remedies. Landlords would worry that the risk of loss from such abuse is such that landlords will limit their selection of tenants or their selection of investment properties so that the market will have fewer participants and, therefore, the danger of higher prices and less flexibility.

Second, the parties may attempt to avoid an undesirable implied provision by inventing an elaborate non-standard legal relationship that leads to greater costs in its creation, maintenance and perhaps enforcement than the more standard relationship. An example of an implied lease provision in Chinese law that many commercial landlords would find to be an anathema is the right of refusal, particularly as applied to sale of the property. Such rights seriously interfere with the ability of a landlord to market property. Potential buyers will not enter into serious negotiations when they are aware that, after committing to a deal following protracted and expensive bargaining, they would lose the opportunity to a tenant who merely "sat on the sidelines," permitting the potential buyer to craft a deal that the tenant can seize. Consequently, the owner of a building or land use right who is interested in finding someone to operate a business on the property in exchange for a fixed return may try to seek another relationship that would not interfere with the landlord's ability to transfer the property to third parties. It is difficult to guess what form this alternative might take, perhaps some kind of partnership or conditional sale. But if what the parties really had in mind is the kind of relationship traditionally identified as a landlord/tenant relationship, such alternative arrangements usually will be costly and inefficient precisely because the parties must take pains to avoid characterization of the relationship as a lease.

The two contract rules mentioned above are the two Chinese lease rules that likely would cause the most difficulty for Western-style bargaining. To reiterate, the first problem rule is in fact a set of rules dealing with default remedies. Landlords frequently do not want tenants on their property when the tenant is breaching the lease. A rule forcing the landlord to wait six months before invoking lease remedies would be a major disincentive to entry into the Chinese leasing market. Similarly, a rule that significantly limits the ability of a landlord to forecast damages over the life of the lease also would present a landlord with a greater potential risk of loss on default. Needless to say, any rule that would prevent a landlord from having rapid access to the property after a court has established the existence of a default also would be undesirable. Reasonable notice requirements, on the other hand, are more appropriate and would frequently avoid misunderstanding and needless loss.

The second "problem" rule is the concept of the right of refusal. Again, this rule shifts away from the parties the ability to negotiate over the potential long term value of the property. From the standpoint of an anti-speculation economic planner, the result may at first appear desirable, since the landlord should not count on being able to capitalize on increases in market value. But the speculative possibility in such cases does not disappear; it merely shifts to the tenant. If there is significant demand for the property in question, the tenant will find that its refusal right is a valuable asset from which it can profit, whether or not it actually exercises the right. It can charge a high price not to exercise the right. This is speculation of another kind, and is no more consistent with socialist values than the landlord's sale of the property at a profit. The shift to a market based economy demands some shift away from anti-speculation policies, and there appears to be scant value in preserving the refusal right for this reason in any event.

Another issue needing resolution in Chinese law is the position of the subtenant when the parties to the main lease negotiate a change in the main lease. As discussed above, there is some authority to the effect that any changes in the main lease would automatically modify the provisions of the sublease. If this authority means that the master landlord cannot be limited by arrangements that the tenant makes with a subtenant, then the concept presents little difficulty. The subtenant should be aware that there is a main lease and that the subtenant's rights necessarily are dependent upon it. But if the provision means that the sublandlord could reach an agreement with the main landlord that would modify the contract rights of the subtenant, leaving the subtenant with a weaker lease and no recourse even in dam-

ages, Chinese law again would raise an impediment to flexibility in the lease marketplace. The sublandlord should be bound by the sublease and should have no power to amend its terms without the consent of the subtenant. Otherwise, the subtenant really has no protected property interest at all, and serious investors will neither contract for nor invest in a subtenancy arrangement.

As to other major differences between Chinese lease law and American law, most are not likely to create significant concerns for Western investors.¹³² It is true that the complexity of land use right or building lease analysis that must be undertaken at the outset of the leasing relationship will add costs to every transaction, and also may contribute to a risk of uncertainty and confusion which will themselves add costs. But they may be necessary elements of a socialist-based land distribution system, and probably can be worked through. Then there are the other departures from the Western model: the imposition of greater maintenance burdens on the landlord and the preservation of the landlord's right to approve sublessees and assignees. These features probably are neutral factors from the standpoint of commercial leasing since they can be priced in the rent computation and can be reworked through bargaining.

Finally, there is the concept of the lease as a non-mortgageable "credit right." This single feature of Chinese lease law probably presents the greatest difficulty, because it removes significant elements of the investment picture from the credit market. The market of tenants is reduced dramatically to those who can secure financing for their improvement and operation costs with assets other than their principle business lease. Consequently, the number of properties available for lease also shrinks with the reduced demand, leading to less flexibility in the land investment model. If China is seriously interested in using commercial leases as a means of marketing land uses to parties with the capital and talent to make the most of those rights, then financeable leases ought to play a significant role in the legal investment picture.

XI. CONCLUSION

Market systems will function well with a legal framework that provides predicable rules and adequate flexibility for market

132. Not mentioned in this catalogue of potential problems is the possibility, discussed in *supra* notes 63-64, and accompanying text, that under the new registration laws interested parties may be denied access to the public registry. Access is now by application, rather than generally open to the public. Clearly denial of access to the only certain means of proving ownership of real estate interests would prove to be a major impediment to market functions.

decisions to operate. The American legal system certainly is not the only model for the Chinese system. In fact it may not be the best, since the division of the American system into fifty-one separate sets of common law rules complicates the efficiency of the American system from a market standpoint. Nevertheless, the Chinese can learn from the American system in designing their own legal framework for commercial leasing.

Chinese lawmakers face special problems that those in the more developed Western economies do not have to address. Chinese real estate law reflects the conflict present in all of Chinese economic law between those law makers who favor a market driven system and those who see a need for planning and control to preserve critical values in the economy. China must wrestle with the political reality that military interests and Agricultural Collectives have become important players in the market based economy even though their origins reflect an entirely distinct purpose. Chinese judges must leaven the harsh substance of regulations with Civil Law interpretations, even when these judges lack the training and sophistication to understand the consequences of their decisions upon the confidence and security of market participants. With all of these obstacles, it is indeed a wonder that the Chinese have done as well as they have in designing law that channels China's superheated economy into any kind of orderly performance.

The final judgment as to the success of the Chinese legal system in providing a foundation for the marketplace will be, of course, the performance of that marketplace. This article has suggested some discrete changes that the Chinese might consider that would assist the marketplace for commercial leases. These suggestions may be helpful not because they track an American model, but because they reflect the experience of two centuries of a free market economy in commercial real estate. In a properly functioning market, real estate transfer is an intricate game with untold numbers of players, voluntary and involuntary. For each player to function properly, that player must know the rules and the rules must be consistent and workable. For the game to work best, the rules also must be sufficiently complex to reflect the many and varied patterns in the interactions of the players. In the area of commercial leasing, the Chinese have accomplished much, but further improvements will insure continued success as the Chinese economy continues its rush to prosperity.