
Todd R. Benson†

I. INTRODUCTION .............................................. 184
   A. Overview and Objectives ...................................... 184
   B. Analytic Framework ........................................ 185

II. THE CHINESE LEGAL SYSTEM .................................... 188
   A. Formal Law and Developing Civil Law ......................... 188
   B. Law and Practice: The Primacy of Policy .................... 190
   C. Historical and Cultural Influences .......................... 193
      1. The Imperial Legacy .................................... 193
      2. Maoist Influences .................................... 195

III. CREATING SECURITY IN CHINA ................................ 195
   A. Published Laws and Regulations Setting Forth Security .... 196
   B. Security Law in Practice .................................... 197
      1. Creating a Security Interest ............................... 198
         a. Mandatory Registration .................................. 198
         b. Third Party Consent .................................... 200
         c. Property Issues ........................................ 202
      2. Giving Notice to Third Parties .............................. 204
         a. Optional Registration .................................... 205
            (1) Place of Registration ............................... 205
            (2) Maintaining Registration ............................ 206
            (3) Searching the Register ............................. 207
         b. Possession ........................................... 208

IV. ENFORCING SECURITY INTERESTS ................................ 209
   A. Against Debtors ........................................... 210
      1. Self Help ........................................... 210
      2. Chinese Methods ....................................... 211
      3. Formal Proceedings ..................................... 213
   B. Third Parties ............................................ 218
   C. The Government ............................................ 222

V. LIQUIDATING THE SECURITY AFTER ENFORCEMENT ............... 223

VI. CONCLUSION .............................................. 225


The author is deeply indebted to Professors Lynn M. LoPucki and William C. Jones of Washington University for their helpful insights, suggestions, and advice without which this Article would not have been possible. The author is also indebted to Edward Epstein, Elizabeth Owen, Gao Peiji, Philip Rapp, Stuart Valentine, and Wang Wai Li of Clifford Chance in Hong Kong, Shanghai, and London, Zheng Shujun and Chen Jianlong of C & C Law Office in Beijing, and John Kuzmick of White & Case in Hong Kong for their kind advice, practical experience, and excellent insights into taking security in China.
I. INTRODUCTION

A. Overview and Objectives

The crucial importance of security in China has been heightened by the phenomenal growth of foreign investment in China, much of which has been preceded and accompanied by the adoption of the styles of foreign law into the Chinese legal system. In examining the functioning of security in China's legal system, this Article should appeal both to legal practitioners interested in the intricacies of security in China and to readers interested in China's legal system as a whole. Academics interested in the applications and extensions of functional or systems theory should also find the empirical research and the conclusions of this Article interesting.

"Taking security" in this context means the ability of one person to obtain an enforceable interest in the property of another in order to secure the performance of an obligation. Taking security thus refers not only to the contractual ability to create a security interest, but also to the ability to enforce the security interest. If the contractual obligation cannot be enforced in practice, then one can only create security — a worthless exercise. If one can enforce the contractual obligation but one receives a worthless piece of property, then the ability to take security is also essentially meaningless (other than perhaps for symbolic reasons). Taking security thus involves the ability to liquidate the security or the ability to exchange the security for something of value. In its function as a mechanism for encouraging performance of contractual obligations and for ensuring a supply of credit, the ability to take security is an important component of a market system.

Two important developments in China over the past several years have been the growth of local legislation facilitating the ability of both domestic and foreign entities to take security in China and the very recent enactment of a national law on security. This law, anticipated when this article was first written, is placed in context at the end of this article.

1. See Marc A. Sobel & Danian Zhang, The Evolution of Foreign Secured Lending in China: Socialism and Property, 52 LAW & CONTEMP. PROBS. 185, 185 (1989) (placing start of China's economic transformation at 1978 when Deng Xiaoping declared that "modernization would replace Chairman Mao's concept of political and class struggle as China's main objective. . . . Since that time, the world has witnessed great changes in China, including the development of private entities, Sino-foreign joint ventures, and the introduction of Western capital, science and technology.").

2. See William C. Jones et al., Law of the PRC iii (Dec. 28, 1993) (unpublished manuscript, on file with author) ("What has not received so much attention is the establishment of a new legal system formed on western models whose first overt step was the promulgation of six statutes in 1979.").

3. Christopher G. Oechsli, The Developing Law of Mortgages and Secured Transactions in the People's Republic of China, 5 CHINA L. REP. 1, 1 (1988). For more recent developments, see discussion infra Section III. The recent legislation has generally been enacted in Special Economic Zones (SEZs) and coastal cities encouraging foreign investment. Important reasons for the growth in such regulation are China's need for foreign capital, including loans from banks and the need of commercial banks and other entities to secure their loans with collateral. See Sobel & Zhang, supra note 1, at 185, 213.

The security legislation has generated many questions. How does one take security in China? How does one (if one can) enforce a security interest? How does the approach to security in China differ from that in the United States? The answers to these questions go to such basic issues as the status of property rights and the enforcement of contractual obligations in general, and provide insight into China’s legal system as a whole. Many casual observers tend either to condemn or to praise the Chinese legal system; reactions often depend on oversimplified points of view. By focusing on how the system actually functions as opposed to merely considering printed rules or foreign press reports, one can develop a more sophisticated understanding of the Chinese legal system.

In Section II on the Chinese legal system, I attempt to provide some understanding of larger patterns in Chinese legal culture and the backdrop against which the taking and enforcing of security has developed and takes place. That section also provides a sense of historical progression without engaging the reader in exhaustive historical analysis. The remainder of the Article focuses quite specifically on the intricacies of creating, enforcing, and liquidating security in China. The objective here is not to plunge the reader into tedious, intricate details (although such details constitute increasingly valuable information). Rather, by focusing on the specifics, the reader will obtain a clearer picture of security in China and China’s legal system as a whole as it operates in practice.

I do not attempt in this Article to engage in profound analysis of United States secured transactions law. As with the section on the Chinese legal system, this feature of the Article is only intended to provide an important backdrop against which to present Chinese secured transactions law. This Article also does not go to great lengths to explicate Chinese regulations (although local rules and regulations, where appropriate, are cited rather extensively). The explication approach has been taken by other commentators, but says very little about China’s legal system as it actually functions.

B. Analytic Framework

The approach used in this Article for analyzing Chinese secured transactions law was developed by Lynn LoPucki and George Triantis in the context of bankruptcy reorganizations. Essentially, their method focuses on

5. Some observers question the extent to which recent Chinese legislation should be taken seriously. As Jones states:

Although on paper modern China has all of the apparatus of a western legal system, it is a country that is still heavily influenced by tradition, and any study of Chinese law that concentrates solely on the statutes and institutions copied from the West is bound to come to wrong conclusions. There still has to be a search for the elements of a legal system quite unlike ours.

Jones et al., supra note 2, at 2.

6. In fairness to other commentators, this approach will probably prove more valid over time as China’s market economy progresses.

7. Lynn M. LoPucki & George G. Triantis, A Systems Approach to Comparing U.S. and Canadian Reorganization of Financially Distressed Companies, 35 HARV. INT’L L.J. 267 (1994). This approach focuses on the actual functions of mechanisms within a legal system itself rather than on legal doctrines or legal constructs. Id. at 269-74. This approach is founded on the mainstream conception of systems as
problems in a given area of the law (such as bankruptcy reorganization) and describes the ways in which different legal systems deal with these problems. The underlying theory is that two different legal systems will probably deal with similar problems in similar ways. LoPucki and Triantis offer a unique starting point for approaching similarities and differences among legal cultures and understanding the methods these cultures use to deal with particular problems such as security.

The approach taken in this Article touches on the ways in which environmental or systemic factors affect the development of the law. Law does not exist in a vacuum; much of the law takes its shape from environmental factors. It is often true, however, that the law appears to contradict certain elements of its surrounding environment. For example, commercial or industrial practices may develop and exist by themselves quite apart from written regulations. In the development of customary practices and of law itself, historical, cultural, and political factors play an important role. This Article, in its focus on functioning systems instead of on form, anticipates distinctions between formal law and law in practice as well as the powerful interaction between written law and its broadly understood surrounding environment.

A functional or systems approach to the law is inherently empirical in nature, as one cannot (particularly in the Chinese context) rely solely upon arguments, theories, or written rules to describe the law. In keeping with this approach, I have attempted to obtain as much empirical data as possible. The greatest problem with analyzing the Chinese legal system in this way is discovering empirical data such as actual cases of enforcement. One problem is that there is very little published information concerning Chinese court proceedings. Much of what is published arguably is published selectively for the benefit of foreigners, or to highlight the progress China is making toward a modern legal system. From the statements of those closely involved with China's legal system, it is evident that security is protected at


This comparative approach differs from the traditional approach to comparative law. See Alan Watson, Legal Change: Sources of Law and Legal Culture, 131 U. PA. L. REV. 1121, 1122 (1983) (“Traditional comparative law [which focuses on doctrinal law] does not seek systematically to explain differences and similarities between legal rules and approaches to law in various systems.”) (emphasis added).

8. See Luhmann, supra note 7, at 1419.


10. See id.

11. See Stanley B. Lubman, Emerging Functions of Formal Legal Institutions in China's Modernization, 2 CHINA L. REP. 195, 209 (1983) (“Selective publicity of cases, especially during the proceedings before the outcome is formally known, raises obvious questions to the foreign observer about the fairness of the trial and the distance between law and policy . . . .”).

12. See, e.g., id. at 210. “[T]he Chinese leadership has been sensitive to foreign criticisms.” The article goes on to note that Fei Xiaotong, a leading Chinese sociologist and a member of a special tribunal hearing a celebrated criminal case, was quoted as saying: “It would be improper to measure the case against the criteria of Western laws or any other foreign laws or for others to try to pick holes in China’s legal proceedings.” (quoting Jurist Fei Xiaotong Comments on Trial, FBIS, Feb. 2, 1981, at L9).
Taking Security in China

At some level. However, no matter how developed the system appears on paper, enforcement depends to a great extent on local, national, practical, and political considerations.

Empirical data for this Article were collected through interviews with Chinese lawyers and materials examined in Hong Kong during the summers of 1993 and 1994. This approach has proven helpful in other contexts where there are few published sources or the primary source of legal culture is oral tradition. This approach is especially well tailored for analysis of the Chinese legal system, where the actual functioning of the system often differs substantially from what one would expect from an examination of published sources, and where in many cases there are few published sources dealing with these issues.

I have not neglected citations to written Chinese sources where such sources are available. However, as indicated above, some of the best information on Chinese law in practice lies in unwritten sources. Citation to written sources is helpful for understanding China’s efforts to put in place all the trappings of a Western legal system. Written sources also provide an important context for understanding how things actually work in China compared to how one might suppose they would work after reading the published rules and regulations.

Finally, I have adopted a comparative approach throughout this Article. No one will be surprised to learn that China’s legal system is not yet as developed as that of the United States. What may be surprising is the rapidity with which China’s legal system has developed and is beginning, both in practice and on paper, to resemble more closely that of the United States.

The brief presentation of United States law is also given from a functional perspective, and provides a helpful background for readers without substantial grounding in United States secured transactions law. The drawback to this approach is that the search for and presentation of equivalent mechanisms in different systems can result in a somewhat distorted view of one or both systems. I caution the reader in this regard because the comparison of United States law with developing Chinese law in this Article results in the highly developed United States law appearing somehow equivalent to Chinese law,

13. See, e.g., Walter Otto Weyrauch & Maureen Anne Bell, Autonomous Lawmaking: The Case of the Gypsies, 103 YALE L.J. 323 (1993). Weyrauch and Bell examine the functioning of the legal system of the Romani people, otherwise known as Gypsies, whose system is, surprisingly to some, complex and well developed. The authors glean information on the Gypsy legal system from anthropological studies, noting the lack of legal scholarship on this issue. Id. at 339-40.

14. This way of looking at overlapping systems coexisting within a larger societal context is not entirely new. See, e.g., William C. Jones, Some Questions Regarding the Significance of the General Provisions of the Civil Law of the People’s Republic of China, 28 HARV. INT’L L.J. 309, 318 (1987) [hereinafter Jones, Questions] (“But the process just described is not, of course, the only legal system operating in China. Every large country has more or less informal legal systems that function apart from the formal legal system.”); see also William C. Jones, An Inquiry into the History of the Adjudication of Mercantile Disputes in Great Britain and the United States, 25 U. CHI. L. REV. 445 (1958) (demonstrating that Anglo-American formal commercial law since Middle Ages has often been overshadowed by extrajudicial dispute resolution measures). A similar approach to gathering empirical data about the informal Chinese legal system (or the system as it functions) is taken in Tahirih V. Lee, Risky Business: Courts, Culture, and the Marketplace, 47 U. MIAMI L. REV. 1335 (1993). Lee examines the court system in pre-Communist China using interviews of Chinese lawyers as one source of empirical data.
which is not the case.\textsuperscript{15}

\section*{II. THE CHINESE LEGAL SYSTEM}

In order to compare United States and Chinese systems of taking security, it is first necessary to obtain some perspective on the Chinese legal system as a whole as it functions in practice. As others have said, any attempt to describe the Chinese legal system merely in terms of recent legislation or legal institutions overlooks important elements of the system.\textsuperscript{16} In keeping, this section presents an overview of the political, historical, and cultural context within which the functioning of security has developed and is taking place in China.

\subsection*{A. Formal Law and Developing Civil Law}

Whatever "law" in China really means, most would agree that a dichotomy exists between "paper law," or the law in published regulations, and the law in action.\textsuperscript{17} To some extent, this point is merely the expression of a general understanding of law in any place.\textsuperscript{18} However, the dichotomy seems more exaggerated in China than in other countries.\textsuperscript{19}

To accommodate the needs of foreigners and to attract foreign investment, the Chinese government has been adopting "foreign style" law at an accelerated pace.\textsuperscript{20} Much of the resulting legislation is clearly based on

\begin{itemize}
  \item \textsuperscript{15} Cf. \textit{George Jamieson, Chinese Family and Commercial Law} 4-8 (1921) (noting close similarity between Chinese family law and law of "primitive communities of Indo-European stock," but warning that important differences also exist).
  \item \textsuperscript{16} See Jones et al., \textit{supra} note 2, at iii; see also Liang, \textit{supra} note 9, at 55, 91 ("Law is an inadequate translation of the underlying culture in China where law is not even conceptualized as the basic organizing norm for society.").
  \item \textsuperscript{17} See, e.g., Yu Xingzhong, Comment, \textit{Legal Pragmatism in the People's Republic of China}, 3 J. CHINESE L. 29, 30 (1989). Yu argues that Chinese pragmatism is reflected in China's present legal system. This is seen in the resort to ad hoc legal measures, separation of legal doctrine from practice, overemphasis on instrumental facets of laws, and the placement of policy before the law.
  \item \textsuperscript{18} See LoPucki & Triantis, \textit{supra} note 7, at 270.
  \item \textsuperscript{19} William Alford, \textit{Chinese Living Law: An Interview with Professor William Alford}, 7 ARIZ. J. INT'L & COMP. L. 135, 136 (1989) ("I think that in every society, including our own, there is a distance between formal and actual law. This distance may be especially obvious in the People's Republic of China . . . .").
  \item \textsuperscript{20} See Sobel & Zhang, \textit{supra} note 1, at 202 ("[L]ocal laws and regulations have been enacted to accommodate the special circumstances and needs of these locales and to attract foreign investors and lenders who wish to pursue collateralization of their loans."). The problem with characterizing China's civil legislation as "foreign-style" is evident in the context of Weyrauch and Bell's "state" versus "private" dichotomy. Weyrauch & Bell, \textit{supra} note 13, at 398. Civil legislation is promulgated by the Chinese government and as such constitutes the "official" law of China, or "state" law for purposes of the Weyrauch and Bell analysis. However, this legislation is not based on traditional Chinese legislative models, arguably has little relevance to Chinese social and economic realities or connection to practice, and appears to be enacted primarily in an effort to attract (and appease) foreigners. Even so, it is having some effect on China's legal system. The resolution is a perfect illustration of the dynamic principle inherent in Weyrauch and Bell's thesis that autonomous systems also have powerful influence in shaping state law. Just as oral traditions and unarticulated cultural norms may play a great role in determining the outcome of disputes in the formal justice system of the state, values in autonomous systems may gradually shape the very substance of state law.
\end{itemize}
foreign law models.21

It is unclear to what extent recent legislation reflects customary practice in China. It is probably safe to say that most Chinese formal law, including the recent "civil law" legislation, does not generally reflect customary practice22 and has not been developed with an eye to existing social realities.23 Certainly it has not been enacted to preserve the status quo. More likely, recent legislation is viewed as an agent of social change in China or at least as a statement of central government policy.24 Although officially enacted, the recent legislation does not yet represent actual practice in China — the law in action.25

Even though some Chinese regulations are increasingly complex and comprehensive, large areas of civil life remain essentially unregulated.26 It can be argued that even certain "regulated" areas are unregulated in practice. This state of affairs virtually guarantees the continuing development of customary practices in commercial matters outside of official channels.

Since the ascendency in 1978 of Deng Xiaoping and other leaders favoring market policies, political and practical necessities27 have contributed to an ever-expanding and detailed body of Chinese legislation devoted entirely to civil matters.28 The effects of the new legislation on commercial life in China remain to be seen. It is probable that this legislation will further encourage private commercial and economic activity.

21. See Jones et al., supra note 2, at 186-90. The Civil Code is one example of the ongoing process in China of incorporating styles of foreign law into the Chinese legal system; see also id. at iii. Other examples of the areas in which foreign law has influenced the development of Chinese law include civil procedure, criminal law, and criminal procedure.

22. See Jones et al., supra note 2, at 166.

23. Roscoe Pound argued that the "Chinese should experiment with Chinese materials to solve Chinese problems" instead of importing foreign legal doctrines and institutions. Yu, supra note 17, at 34. Pound was a major proponent of American pragmatism, which began as an attack on legal formalism. It takes as its basic premise the concept that the "truth, meaning, or value of ideas must be judged by their practical consequences." Id. at 31.

24. See BARRETT L. McCORMICK, POLITICAL REFORM IN POST-MAO CHINA 125 (1990) (law in China has remained a tool of state power used to enforce the Chinese Communist Party's (CCP) will and to maintain strict public security).

25. This phrase is attributable to Roscoe Pound, Law in Books and Law in Action, 44 AM. L. REV. 12 (1910) (discussing divergence of laws as administered from formal laws).

26. See Jones et al., supra note 2, at v ("There is, however, a significant area of Chinese life . . . in which there is no effective day-to-day control by the center. This is the economic activity being carried on primarily by private individuals and local governing units of different types . . . ."); see also Sobel & Zhang, supra note 1, at 201-02 ("Notwithstanding the fact that China still lacks encompassing national legislation in these respects, mortgage loan transactions have often been conducted in China, especially in Special Economic Zones and coastal open cities.").

27. See Sobel & Zhang, supra note 1, at 185. Such necessities undoubtedly include China's need for foreign investment and capital. Serious questions remain as to the extent to which the new legislation reflects social realities in China. It is highly probable that the Chinese government has merely "discovered" civil law as a precision instrument for reaching economic and perhaps social goals.

28. See Jones et al., supra note 2, at 166-74, 185-217. Deng Xiaoping came to power in 1978 after the death of Mao Zedong. The progress toward a market economy has been nothing short of phenomenal since that time. The amount of new civil regulation each year is enormous. It remains to be seen what effect, if any, the new legislation will have on Chinese law in action. Except in transactions involving foreign parties, in which the impact of regulation is felt relatively quickly, it is doubtful that customary practice between domestic Chinese parties has been significantly affected.
B. **Law and Practice: The Primacy of Policy**

To comprehend the complex Chinese legal system, it is essential to grasp some of the differences between the law in the books and the law in action. It is critical to understand that policy is an essential component of Chinese law and the legal system.29

In China’s bureaucratic system, policy itself is law; or more precisely, law is a tool of policy.30 This may have something to do with China’s Confucian tradition “wherein everyone in the empire owes a duty to the Emperor whose word is law.”31 This may also have to do with the Stalinist or Leninist system imposed on Chinese society by Mao Zedong in 1949.32 Mao repeatedly asserted the pre-eminence of policy.33

The importance of policy in China is inherent in its political structure, a hierarchical bureaucracy that administers itself from top to bottom.34 The Chinese political structure in practice, however, is not exactly a structurally coherent, self-contained, and polished monolith. A complex web of informal personal connections (guanxi) runs throughout35 and beyond the formal structure.

China’s political structure influences the dispute resolution process.

---

29. See, e.g., 2 THE PEOPLE’S DEMOCRATIC LEGAL SYSTEM, CHINESE LAW AND GOVERNMENT 153 (1969) (“The Policy of the Communist Party is the Soul of the People’s Democratic Legal System; The People’s Democratic Legal System is the Tactic by Which the Policy of the Party is Realized.”).


31. In many ways, Mao Zedong was the archetypal Chinese Emperor, and the modern Chinese bureaucracy continues traditional Confucian Chinese government. As Stuart Schram states:  

   [If] Mao saw in politics the ‘leading thread’ which always had priority over economics, and ultimately shaped the pattern of social change, he was following in this not only Lenin, but also the monistic and state-centered vision of the social order which had prevailed in China for two thousand years.  


32. Although Mao Zedong certainly imposed a communist ideology on Chinese culture, the resulting power structure arguably differed little from that of traditional China under other autocratic rulers.

33. Mao Zedong made one of the earliest statements on the pre-eminence of policy before 1949 in the Yenan period. See SELECTED READINGS FROM THE WORKS OF MAO TSETUNG 271 (1971) (at Yenan Forum on Literature and Art, May 23, 1942: “If everyone [agrees] on the fundamental policy, it should be adhered to by all our workers, all our schools, publications, organizations . . . . It is wrong to depart from this policy and anything at variance with it must be duly corrected.”). Similarly, Schram quotes a speech Mao gave at a Peitahe meeting on August 21, 1958:

   You can’t rely on law to rule the majority of the people; for the majority of the people you have to rely on cultivating [the right] habits . . . . Every one of our [party] resolutions is a law; when we hold a meeting, that’s law too. . . . We do not rely on civil or criminal law to maintain order. The National People’s Congress and the State Council have their stuff (ta-men na-i-t’ao), while we have this stuff of ours.

   **SCHRAM, supra** note 31, at 90, 143.

34. See Epstein, supra note 30, at 42-45.

35. This network has outlasted a variety of government institutions. Lubman describes its survival:

   The success of Chinese Communism in focusing the allegiance and loyalty of hundreds of millions of Chinese on the Chinese Communist Party and on the nation which the Party has created has sometimes served to obscure the persistence of the smaller loyalties, the little networks of personal influence, that preceded Communist rule and continue to exist in China today. Mao recognized the extremes and dangers of such smaller loyalties within and despite the Communist Party, and all but destroyed the Party trying to reform it.

   **Lubman, supra** note 11, at 260.
Indeed, law in China may be viewed as the decisions of officials with respect to administrative decisionmaking. This is partly because dispute resolution in China is such an integral part of the decisionmaking process; there is no independent judiciary in China. Judicial decisionmakers often consult with supervisory administrators in seemingly unrelated government departments or with other individuals holding no ascertainable government office. Judicial decisions are often made with reference to Chinese policy. Dispute resolution in China is, in effect, a function of the entire administrative and bureaucratic process.

Internal regulations, known as neibu, are an important part of the Chinese legal system. The distinguishing characteristic of these regulations is that they are almost entirely directed to government officials, not to the public. By controlling government officials, the government is able to influence private commercial activity. For example, the government can regulate administrative approval processes. These are essentially administrative acts directed or administered by policy.

It appears that changes occurring in internal and published regulations,
whether national, regional, or local in scope, are often coordinated by the central government. Subject to administrative guidance and molded by bureaucratic policy, the changing set of internal regulations, guidelines, and directives governing such administrative matters as approval processes constitute a crucial part of China's legal system and its law in action.

The study of law in China must account for the importance of policy and other unique elements inherent in the Chinese legal system. An analysis of the differences between published law and law in practice in China facilitates understanding. However, locating and gathering empirical data about the Chinese legal system in operation is often difficult. Foreigners, as well as many Chinese, often cannot easily gain access to internal regulations governing administrative decisions. An investigation seeking to find ordering principles must also in some way account for confusing phenomena such as corruption and localism. Despite such obstacles, Chinese methods demonstrate some general regularity. Perhaps legal principles can be derived from observation of the Chinese legal system from a Chinese perspective.

If law is to be defined as "the decisions of officials," then "law" in China means something much different than it does in the United States. An understanding of policy in China gives new meaning to the analysis of China's paper law, which may be viewed as the crystallization or

---


As a result of the rapid growth of the Chinese economy in recent years, the more prosperous provinces and special economic zones have implemented regulations and measures on subjects such as secured loans and, in particular, real estate mortgages, to fill the gap in national legislation. Such fragmented developments form part of the not unfamiliar "incremental" legislative approach in China whereby the central government evaluates the experience of local legislatures on a subject before deciding on whether and, if so, how to legislate at the national level. In the case of the Security Law, the gestation period is longer than usual in view of the importance and scope of the subject matter as well as the need to balance different interests. Id.

46. See Jones, Questions, supra note 14, at 331 ("[The Chinese] would have free access to the materials on the basis of which such a study could be made; it is doubtful that outsiders ever will.").

47. See Jones et al., supra note 2, at 47. These consist of central government "statutes," "directives," "regulations," and local regulations.

48. See Judicial Agencies Should Take the Lead in Fighting Corruption and Encouraging Clean Administration, LEGAL DAILY, Oct. 11, 1993, at 1, reprinted in FBIS-CHI-93-204, Oct. 25, 1993, at 21. Significantly, this Chinese publication actually admits to the corruption problem's existence. See also Kevin Murphy, China's 'Stir-fry' Begins to Cool, BUS. REV. WLY., Oct. 1, 1993, at 45, available in LEXIS, Asia & Pacific Rim Library, Asia/Pacific News File ("Cosy relationships between bank officials and government officials . . . are just one target of a new national campaign against corruption, which Beijing admits is at its worst since the 1949 revolution.").


50. See generally Jones et al., supra note 2. Professor Jones analyzes the Chinese legal system by attempting to identify the elements that the Chinese themselves see as significant.
embodiment of policy, but which may have particular significance and permanence in the form of actual published legislation. The statements of government officials are also important, as they may contain important clues to present policy. Even the Chinese courts may look to such statements as a judge looks to case precedent in the United States.

C. Historical and Cultural Influences

1. The Imperial Legacy

It is possible to view the modern Chinese bureaucratic state as continuing in the mode of the traditional Chinese Empire. Essentially, the central government is more concerned with obtaining bureaucratic compliance with its policies than with controlling individual decisionmakers in the economy. The central government promulgates rules primarily to control the vast Chinese bureaucracy. The implementation of central government rules depends upon local and provincial bureaucrats. The implication of this unique regulatory orientation is that large areas of civil life in China have remained relatively free from direct government intervention.

The Chinese regulatory approach has shifted in recent years to direct regulation of private economic actors. Historically, however, because the Emperor was concerned primarily with maintaining order, his attention, and likewise the attention of local bureaucrats, was only incidentally drawn to

---

51. See Jones et al., supra note 2, at 191-99.
52. See Jones, Questions, supra note 14. Professor Jones explains that the promulgation of a Western-style Civil Code may cause the entrenchment of Western concepts of rights in Chinese society. Potentially, increased reliance on such rules will influence law in action and cause the Chinese legal system to become somewhat more rigid.

Perhaps a concern with this possible permanence motivates the Chinese regulatory authorities to designate all new laws and regulations as "interim" or "provisional." They seemingly could provide for future amendments in another way. Yet they continue to appear wary of introducing permanent changes into Chinese law. Clearly, they still view law as a tool of social policy in China (as are most other things), which may be removed when it outlives its usefulness.

53. See Epstein, supra note 30, at 43-44; see, e.g., Central News Agency, Peking Averse to Honor Guarantees of State Enterprises, July 9, 1990, available in LEXIS, Asia & Pacific Rim Library, Asia/Pacific News File (administrative agencies refused to honor loan guarantees to foreign banks citing reforms of recent years (bankruptcy laws) which made Chinese enterprises responsible for their own profits and losses); see also Ku Ch' uan-t' ieh, RENMIN RIBAO [PEOPLE'S DAILY], Nov. 7, 1978, at 3, translated in 1144 CHINA NEWS ANALYSIS, Dec. 22, 1978, at 3, 3 ("Our laws are inadequate. The naming of crimes is not [consistent]; sanctions are uncertain. . . . The practice of the courts over many years has shown that the courts have only the Party Line, Directive and Party Policy, but no laws for following these out.").
54. See Jones et al., supra note 2, at v ("What seems to exist at the present time is, in the first place, what one might describe as the national legal system. It contains elements of the imperial system in that it is essentially the legal system of a centralized bureaucracy.").
55. See generally Jones et al., supra note 2, at 9 ("Consequently the imperial law took note of human activity only as it was perceived to affect imperial policies. It was natural that the primary focus of attention would be the activities of bureaucrats in the performance of their duties, not the activities of ordinary human beings in their private lives.").
56. See Sobel & Zhang, supra note 1, at 188 ("[T]he laws in China are promulgated by . . . the National People's Congress and [more importantly] its Standing Committee. . . . [Most importantly] the State Council, a central governmental bureau, can enact detailed regulations to implement the relevant foreign investment laws adopted in the National People's Congress.").
57. See Jones et al., supra note 2, at 174-82.
what would be called civil matters today.\textsuperscript{58} Formal Chinese law in the early
codes reflects this view.\textsuperscript{59} Most of these codes focused on punishment for
administrative breaches of bureaucratic procedure or for conduct considered
disruptive of social order.\textsuperscript{60} The codes touched on civil law matters primarily
only when relevant to tax collection.\textsuperscript{61}

One area in which the central government retains direct or indirect control
over civil life is in that of civil disputes.\textsuperscript{62} One reason for this control is that
the Chinese courts have always been a functional arm of the Chinese
bureaucracy,\textsuperscript{63} a bureaucracy possessing no apparent concept of "checks and
balances" or "separation of powers."\textsuperscript{64}

One of the major criticisms of the present Chinese court system is that its
decisionmaking processes are not insulated from political influence and, in
fact, may be subject to direct political and economic influences.\textsuperscript{65}

Most civil disputes in traditional China were not handled by the courts but
by town leaders, clan leaders, or guilds.\textsuperscript{66} Likewise, at present, most civil
disputes are handled through such channels as mediation committees.\textsuperscript{67} It is
clear that even such "informal" dispute resolution mechanisms have not been

\textsuperscript{58}. Jones et al., supra note 2, at 9; see also William C. Jones, \textit{Reflections on the Modern Chinese
("[T]he state took little interest in large areas of society, notably the areas of contract and commercial law;
sales, loans, and banking. These areas could be regulated, and were if any state interest became
involved."); Jones et al., supra note 2, at 10 ("Law was concerned with enforcement of government
policy.").

\textsuperscript{59}. \textit{See JAMIESON, supra note 15}.

\textsuperscript{60}. \textit{See JAMIESON, supra note 15}; Jones et al., supra note 2, at 10 ("Over half the [Ching] Code
is devoted to the regulation of the official activities of government officials.").

\textsuperscript{61}. Jones et al., supra note 58, at 12-16.

\textsuperscript{62}. This is truest for larger and more complicated civil disputes because at the lowest level the
magistrate sits at the county or district level (jurisdictions encompassing more than 100,000 people).
Jurisdictions at higher levels encompass even more people. \textit{See Lubman, supra note 11, at 205}. Continued
central government control over civil disputes is consistent with the central government's traditional
concern with conduct considered disruptive of social order. \textit{See Yu, supra note 17}.

\textsuperscript{63}. This is clearly true in criminal cases where the court's function is merely to try cases. Criminal
cases that reach the courts are actually decided before they are ever tried. \textit{See Jones et al., supra note 2,
at 41-42}.

\textsuperscript{64}. Because of this deficiency, the outcomes of decisions are likely to be influenced or even dictated
by the judge's superiors. \textit{See Jones et al., supra note 2, at 229-30}. The judge's official role has always
been to promote the policies of the central government. As Jones states:

The Chinese courts were also very conscious of the possible implications for society of
particular behavior . . . . In other words, the work of the court was an aspect of the work of
government in achieving its purposes. . . . [T]he court [was not] in any sense a neutral
adjudicator. It was very much a part of the process. The judges were government officials who
carried out its policies.

\textit{Id. at 181} (emphasis added).

\textsuperscript{65}. \textit{See, e.g., Carl Goldstein, China Develops Business Law by Looking to Guangdong, PAR E.
ECON. REV., Nov. 1993, at 71, 72} ("Who occupied the judge's chair mattered little more than any other
menial role in the judicial system: all simply followed party orders. Major judicial decisions were (and are)
taken in closed party cell meetings, not in open court.").

\textsuperscript{66}. \textit{See Lubman, supra note 11, at 201}.

\textsuperscript{67}. Because this situation exists, the Chinese Communist Party is likely to have some influence on
the outcome of civil disputes. \textit{See Lubman, supra note }?, at 224, 226 ("[In 1980], depending on the
specific locale, the number of disputes resolved through mediation was greater than the number of cases
heard through the judicial system by a factor of five to several ten-fold."). The use of mediation as well
as arbitration reflects "the Chinese cultural preference for resolving disputes in a non-confrontational
manner." Sobel \& Zhang, supra note 1, at 212.
free from government influence because, in recent times, the Chinese Communist Party has directly organized and overseen mediation committees as tools of social control.\footnote{\textsuperscript{68}}

2. 

\textit{Maoist Influences}

This subsection is intended only to point out the existence of certain Maoist elements in the Chinese legal system, especially in relation to the importance of policy. Although a detailed analysis would be intriguing and insightful, it is impossible here. The Chinese legal system clearly retains significant elements of socialism, including strong emphases on social and economic planning.\footnote{\textsuperscript{69}}

The central actor in this model is the Chinese Communist Party ("CCP"), which has maintained strict control of most elements of Chinese society, including the functioning of the legal system. The CCP continues to promote its policies through such quintessentially Maoist techniques as mass campaigns, criticism meetings, propaganda, and staged trials.\footnote{\textsuperscript{70}} Although its political power appears to be waning, and its ideological underpinnings weakening, the CCP maintains significant and pervasive organizational control of the Chinese government bureaucracy and state industry at all levels.\footnote{\textsuperscript{71}} Once again, this analysis points out the importance of policy in China's legal system.

III. \textbf{CREATING SECURITY IN CHINA}

This section discusses the extent to which security is recognized in published Chinese rules and regulations and then examines in detail the functional aspects of taking security. The practices of creating security in China, which must be distinguished from enforcing security, resemble practices in the United States ever more closely. Both foreign and domestic lenders have been entering into security arrangements in China for some time.\footnote{\textsuperscript{72}} These security arrangements have included very advanced

\footnote{\textsuperscript{68}} See Lubman, supra note 11, at 226 ("Once again, mediation has been mustered into the service of economic discipline.").

\footnote{\textsuperscript{69}} See Jones et al., supra note 2, at 29-37 (detailing Maoist foundations of Chinese law); see also Sobel & Zhang, supra note 1, at 186 ("The current legal system of the People's Republic of China has evolved from a foundation of traditional Chinese values tempered by a heady dose of Maoist and Marxist philosophy.").

\footnote{\textsuperscript{70}} See Jones et al., supra note 2, at 37-46, 170-73 ("The campaign (\textit{yon dong}) is essentially a mass technique designed to achieve political ends, which may be anything from eradicating flies to eliminating spiritual corruption. Staged by the CCP, campaigns include heavy propaganda and 'criticism meetings' from the local level to the top levels of government."); see also Lubman, supra note 11, at 202 ("Peer group pressure was used to augment scarce governmental resources in punishing and deterring violators of social order.").

\footnote{\textsuperscript{71}} See generally Jones et al., supra note 2, at 66-73 (discussing power of CCP and other Chinese political institutions).

\footnote{\textsuperscript{72}} See Sobel & Zhang, supra note 1, at 193 ("The first widely used method for collateralizing foreign loans in China was project finance. \ldots [which] has its roots in the aftermath of the mid-1970s oil crisis and recession."); Graham Morrison, Taking Security: An Introduction, in \textit{ASIA LAW AND PRACTICE, TAKING AND ENFORCING SECURITY IN CHINA} 1, 1 (Graham Morrison et al. eds., 1993) ("[S]ecurity interests in the nature of mortgages or charges have frequently been granted in favor of
practices.\textsuperscript{73} After first mentioning published laws and regulations recognizing security in China, this section proceeds to examine functional factors distinguishing the process of taking security in China from that in the United States.

A. Published Laws and Regulations Setting Forth Security

As an initial matter, it is interesting and helpful to note the extent to which the concept of security is set forth in published Chinese laws and regulations.\textsuperscript{74} Clearly, the Chinese authorities both at the central level and in the localities have been interested in security for some time now.\textsuperscript{75} The Civil Code,\textsuperscript{76} which was intended as the foundation for the new Chinese civil law legislation,\textsuperscript{77} contains several provisions relating to security.\textsuperscript{78} Other national legislation recognizing the concept of security should be noted as

\textsuperscript{73} Interview with Zheng Shujun, Chinese lawyer with C & C Law Office, Beijing, in Hong Kong (July 19, 1994) [hereinafter Zheng Interview (July 19, 1994)]. This experienced Chinese lawyer indicated that upper level Chinese courts are aware of such practices as taking floating charges over inventories, and are inching toward officially recognizing them. She had recently spoken with one of the more influential members of the Supreme People’s Court who told her that although he would personally oppose floating charges at present - on the grounds that such a practice was too advanced for China — other members of the Court would not.

\textsuperscript{74} See Oechsli, supra note 3, at 26 (“Chinese laws, which, while not comprehensive, offer useful guidance as to the permissible scope and practical implementation of such contractually created rights and remedies.”).

\textsuperscript{75} I am using the term “security interests” generally rather than specifically to identify transactions involving personal (movable) property.


\textsuperscript{77} See Jones et al., supra note 2, at 217.

\textsuperscript{78} Some of these provisions are:

The following kinds of guarantees of performance of obligations may be selected in accordance with the provisions of law or the agreement of the parties:

1) [This provision relates to guarantees which, strictly speaking, are not considered security];

2) The obligor or a third party may tender designated property as collateral. If the obligor does not perform the obligation, the obligee has a priority right to obtain compensation according to the provisions of the law from the value of the collateral converted into money or out of the proceeds received from selling off the collateral;

3) One party may give the other party a deposit within the scope provided by law. After the obligor performs, the deposit will either be deducted from the price or returned. When the party that has given the deposit does not perform the obligation, he has no right to demand the return of the deposit. When the one receiving the deposit does not perform, he must return double the deposit;

4) When, according to the contract, one party occupies the other’s property and the other party does not pay the agreed-upon sum within the time agreed upon, the party in possession has a lien on the said property, and, according to the provisions of law, has a priority right to be compensated out of the value of the liened property converted into money or out of the amount received when the liened property is sold off.

General Civil Law, supra note 76, art. 89.
well, including several "opinions" issued by the Supreme People’s Court.\textsuperscript{79} The recent issuance of a national security law by the Standing Committee of the National People’s Congress\textsuperscript{80} has elevated the status of security in China considerably.

Before enactment of the national security law, authorities in some of the more economically progressive provinces, special economic zones, and cities had already issued secured transactions regulations.\textsuperscript{81} Some of these localities have included, among others, Guangdong Province, Fujian Province, Shenzhen Special Economic Zone, Tianjin Special Economic Zone, Guangzhou, Beijing, and Shanghai. Until the national security law was enacted, local regulations dealing with security were much more detailed than national laws. It appears clear from the published regulations that the more progressive developments in Chinese secured transactions law were tried first in regional and municipal mortgage regulation.\textsuperscript{82}

B. Security Law in Practice

This section focuses on actual practices involved in creating a security interest in China. The focus is on function as opposed to form. The discussion proceeds from practices involved in the creation of a security interest to the

\begin{itemize}
\item \textsuperscript{79} See, e.g., Opinion of July 14, 1992 (Civil Procedure Law), Zuigao Renmin Fayuan [Supreme People’s Court], \textit{reprinted and translated} in \textsc{Taking and Enforcing Security in China}, supra note 72, at 89, 89, art. 241; Opinion of Nov. 7, 1991 (Enterprise Insolvency Law (Trial Implementation)), Zuigao Renmin Fayuan [Supreme People’s Court], \textit{reprinted and translated} in \textsc{Taking and Enforcing Security in China}, supra note 72, at 110, 111, art. 4(3); Opinion of Aug. 13, 1991 (Handling of Loan Cases by People’s Courts), Zuigao Renmin Fayuan [Supreme People’s Court], \textit{reprinted and translated} in \textsc{Taking and Enforcing Security in China}, supra note 72, at 123, 126, art. 18; Opinion of Jan. 26, 1988 (Civil Law General Principles), Zuigao Renmin Fayuan [Supreme People’s Court], \textit{reprinted and translated} in \textsc{Taking and Enforcing Security in China}, supra note 72, at 19-201, 7th Nat’l People’s Cong., 4th Sess. (Apr. 9, 1991) [hereinafter Civil Procedure Law], \textit{reprinted in} \textsc{China Laws} for For. Bus. (1992); State Enterprise Insolvency Law (for Trial Implementation) (1986) [hereinafter State Enterprise Insolvency Law] (a peculiarity of the Chinese legal system is the role of the Supreme People’s Court as a legislative body; instead of being limited to a judicial role as we are accustomed in the United States, the Supreme People’s Court routinely issues pronouncements in legislative form).

\item \textsuperscript{80} Security Law, supra note 4.

\item \textsuperscript{81} See, e.g., Beijing Municipality Measures for the Administration of Real Estate Mortgages (Apr. 20, 1994); Liquidation of Foreign Investment Enterprise Procedures, Beijing Municipality (June 1, 1992), \textit{reprinted and translated} in \textsc{Taking and Enforcing Security in China}, supra note 72, at 127; Secured Loans Circular, Dongguan Municipality (Aug. 28, 1992), \textit{reprinted and translated} in \textsc{Taking and Enforcing Security in China}, supra note 72, at 32; Secured Loan Regulations, Fujian Province (May 1, 1991) [hereinafter Fujian Secured Loans], \textit{reprinted and translated} in \textsc{Taking and Enforcing Security in China}, supra note 72, at 44; Administration of Secured Loan Regulations, Guangdong Province (Dec. 20, 1992) [hereinafter Guangdong Secured Loans], \textit{reprinted and translated} in \textsc{Taking and Enforcing Security in China}, supra note 72, at 3; Administration of Real Property Mortgage Procedures, Guangzhou Municipality (June 6, 1990) [hereinafter Guangzhou Property Mortgages], \textit{reprinted and translated} in \textsc{Taking and Enforcing Security in China}, supra note 72, at 11; Shanghai Municipality Regulations for the Liquidation of Foreign Investment Enterprises (Aug. 16, 1991) (effective Oct. 1, 1991); Provisional Regulations of Renminbi Loan Administration, Shanghai Municipality (June 9, 1998) [hereinafter Shanghai Mortgage Loans], \textit{reprinted and translated} in \textsc{Taking and Enforcing Security in China}, supra note 72, at 127; Administration for Real Property Mortgage Loan Procedures, Tianjin Economic and Technical Development Zone (1991) [hereinafter Tianjin Mortgage Loan Procedures], \textit{reprinted and translated} in \textsc{Taking and Enforcing Security in China}, supra note 72, at 35.

\item \textsuperscript{82} See Clifford Chance, supra note 45; see also Oechsli, supra note 3, at 1.
\end{itemize}
functional purposes served by creating security. The primary focus is on Chinese practices as compared with practices in the United States.

1. Creating a Security Interest

This section discusses what distinguishes the process of creating a security interest in China from that in the United States. Both Chinese and U.S. law usually require a writing in order to create a valid security interest. In the United States, this requirement is specific to the creation of a security interest. In China, however, the requirement is common to all "economic contracts," not just to security agreements. In this regard, however, the writing requirement may sometimes be softened to a greater extent in China. As a purely practical matter, Chinese and U.S. practices do not greatly differ; the differences are essentially matters of legal form.

There are other minor and location-specific formalities that should be carefully observed in China. For example, as in some states in the United States, land mortgages generally must be signed by a local notary. It is also a prudent practice to have the mortgagor stamp the mortgage document with its official stamp in addition to having the mortgagor's legal representative sign the document. Beyond such contractual and formal legal elements, several important functional factors distinguish the process in China from that in the United States.

a. Mandatory Registration

This section discusses one of the most important ways in which the taking of security in China differs from that in the United States: mandatory
Registration is mandatory in certain circumstances in China even to create a security interest.\footnote{For instance, Morrison discusses registration in the context of mortgages: The regulations generally require the registration of mortgages, but different procedures are specified in relation to mortgages over different types of asset[s] . . . . In addition to the mortgage regulations which apply in the relevant location, it may be necessary to refer to certain other PRC laws and regulations . . . . This will depend on the nature of the mortgagor. For example, the Detailed Implementing Rules of the [PRC] on Wholly Foreign Owned Enterprises contain a requirement for approval from the relevant government authority for mortgages to be created by wholly foreign owned enterprises. Morrison, supra note 72, at 2.} In the United States, filing, which may reasonably be equated with Chinese registration as a matter of procedure, is generally necessary only to perfect a security interest and is not mandatory.

Registration is mandatory — not optional — in numerous settings. In some localities, failure to register invalidates the entire transaction and the heretofore secured party suddenly becomes unsecured.\footnote{See, e.g., Beijing Municipality Measures for the Administration of Real Estate Mortgages art. 35 (Apr. 20, 1994) ("For real estate mortgages for which registration is not handled with the registration department, the mortgage is invalid . . . .").} This may happen up to thirty days after the security agreement has been executed and sometimes longer. Registration is mandatory for real estate mortgages and properties originally subject to property registration. Registration is also mandatory for patents, trademarks, and guarantees.\footnote{Wang, supra note 87, at 12. "[P]roperties which are originally subject to registration" can cover quite a range of possible properties in China. Id.} In the case of mortgages over land use rights, failure to register results in invalidity and the inability to enforce the mortgage.\footnote{See David Dall Liu & Mark Reed, Taking and Enforcing Security in the People's Republic of China 5 (Jan. 1, 1994) (unpublished manuscript, on file with author).} Buildings and fixtures are normally mortgaged together with the underlying land use rights.\footnote{Id. at 6. Nevertheless, in practice these should be registered with a different authority. Registration of land use rights is normally with the Land Administration. However, buildings and fixtures should normally be registered with the Real Estate Authority. The two authorities are distinct government entities in China. Id.} Mortgages over shares in a company or over an equity share in an enterprise wholly owned by a foreign investor must be registered with the relevant authority.\footnote{Id. In Shanghai, the relevant authority is the State Administration of Exchange Control (SAEC). In Guangdong, it is the State Administration of Industry and Commerce (SAIC).} The practice of requiring registration for the creation of a valid security interest is strikingly different from U.S. practice and is a good illustration of the Chinese tendency to assert governmental supervisory authority in civil matters. Other related requirements also appear onerous compared with the United States. Document submission requirements for mandatory registration can be quite detailed.\footnote{See, e.g., Fujian Secured Loans, supra note 81, art. 30. This law states: When parties to a secured loan contract handle secured loan registration, the following documents must be submitted to the registration authority: (1) the registration application; (2) the secured loan contract; (3) proof of ownership of or proof of usage rights to the property securing the loan; and (4) certification of examination and approval by the relevant department or the consent of other parties regarding the establishment of the security, as required by the Regulations. Id.} Generally speaking, registration must occur within thirty days of execution of the mortgage contract, as compared with sixty days
in other countries where registration of security interests is mandatory.\(^9\)

In practice, registration may not always be necessary for the creation of a valid security interest.\(^9\) This may be true even in localities with regulations declaring that such a deficiency invalidates the transaction.\(^9\) Certain Chinese lawyers believe that registration serves purely as the basis for "priority" and the enforcement of security interests against third party mortgagees.\(^9\) As Professor Jones has stated, what Chinese lawyers think the law means may have significance in and of itself.\(^10\) Regardless of what the paper law says, China's law in action is a function of such factors.

b. Third Party Consent

This section discusses an additional important way in which the Chinese process of creating security differs from that in the United States, i.e., the legal requirement that the debtor obtain the approval of interested third parties. This requirement creates an additional burden when viewed from a U.S. perspective. However, from a Chinese perspective, the requirement serves the dual purposes of avoiding inappropriate transfers of property and, more basically, avoiding disputes between interested parties.

In the United States, parties enter security agreements at will by private contract. There is generally no legal requirement for the creation of a valid security agreement that a debtor obtain approval from any third party. This is true even if such approval is required by the security agreement between the parties.\(^10\) However, in China, generally speaking, before the parties can legally create a security interest they must obtain the approval of any third party that has a property interest in the security (or anyone with a "regulatory" or "administrative" interest in the transaction).\(^10\) In some instances, notification is sufficient and the third party's approval is

---

\(^9\) Kevin Ching, Address at the Debt Recovery in China Seminar (Feb. 19, 1992) (outline available in library of Clifford Chance, Hong Kong).

\(^9\) Interview with Chen Jianlong, Chinese lawyer with C & C Law Office, Beijing, in Hong Kong (July 9, 1994) [hereinafter Chen Interview (July 9, 1994)].

\(^9\) Id.

\(^9\) Id.

\(^10\) See generally Jones et al., supra note 2, at 166-217 (discussing development of Chinese civil law).

\(^10\) See U.C.C. § 9-311 (1994) ("The debtor's rights in collateral may be voluntarily or involuntarily transferred (by way of sale, creation of a security interest, attachment, levy, garnishment or other judicial process) notwithstanding a provision in the security agreement prohibiting any transfer or making the transfer constitute a default." (emphasis added)). Thus, in the United States, the ability to dispose of one's property (or to create a security interest in it) is valued even over contractual obligations.

\(^10\) This is the case when the property over which the security interest is to be granted is jointly owned by the mortgagor and one or more persons. In this case, the written consent of all joint owners must be obtained. When the prospective mortgagor is a joint venture or shareholding enterprise, it is necessary to obtain approval of the board of directors by board resolution. This is also true for leased property, although, in addition, the Fujian regulations require the mortgagor to enter into a written undertaking with the lessee as to the performance of the secured loan contract. Where there are several mortgagees, consent of each of the mortgagees must be obtained prior to mortgaging again. In the case of real estate mortgages in which the prospective mortgagee is outside of China, prospective non-joint venture mortgagors must apply to the foreign exchange authorities for approval. Joint ventures need only notify the authorities.
unnecessary. Significantly, all local Chinese regulations enacted to date require the approval of the first mortgagee before additional mortgages may be created in the mortgaged property.

Despite the paper requirements, in practice domestic Chinese parties generally do not obtain approvals. There are a number of possible reasons for this. The parties may believe that approvals are extraneous and bothersome and may prefer to avoid the bureaucracy. They may simply be unaware of the paper requirements which are commonly understood as primarily for the benefit of foreigners. When aware of paper requirements, parties may feel that they have sufficient power relative to other interested parties such that they can successfully get away with violating the paper law. Not to be overlooked, parties may simply be lazy. Whatever the reasons may be in a given case, the Chinese practice clearly exemplifies the gap between China's paper civil law and actual commercial practice.

The practical implications of requiring registration and approvals involve the difficulties associated with locating interested parties, obtaining their approvals, locating appropriate government departments, and obtaining access to appropriate officials. As in the United States, although to a greater degree, none of these tasks is easy in the Chinese legal system. Interested parties may be difficult or impossible to find, and once found may prove unwilling to give approval. Locating appropriate government departments can be a daunting experience to the uninitiated, especially when multiple government departments have a connection to the transaction. Obtaining access to appropriate government bureaucrats can also be an extremely frustrating and time consuming experience. The practical implications of requiring registration and approvals thus involve the systemic difficulties that presently exist in the developing Chinese legal system.

As a related matter, problems sometimes arise in relation to Chinese or other parties (official and unofficial) who are not so concerned with observing the formalities of Chinese paper law. In negotiation, Chinese parties sometimes will state (correctly or incorrectly) that they are restricted from a particular course by Chinese law or by neibu, or internal, restrictions. Often, however, this is no more than a preferred negotiation position. Foreign parties are presented with a choice whether to follow formal legal

103. See, e.g., Wang, supra note 87, at 10. This is the case when each of the joint owners owns a distinct part of the security. Then the prospective mortgagor only needs to give 30 days prior written notification to the other co-owners.

104. Liu & Reed, supra note 92, at 10.

105. Use of the term "paper law" or "paper requirements" is meant to convey the sense that what is written in published Chinese rules and regulations is often not reflective of actual practice, or the law in fact. This usage is similar to that in Pound, supra note 25 (law in action versus law in books); see also Jones, Questions, supra note 14, at 331 (use of term "real legal system" distinguishing law in fact from newly enacted legislation).

106. Interview with Chen Jianlong, Chinese lawyer with C & C Law Office, Beijing, in Hong Kong (July 7, 1994) [hereinafter Chen Interview (July 7, 1994)]. It seems that even when they have been aware of legal requirements, Chinese parties have sometimes ignored the details. There is a feeling that the substance of the transaction is sufficient to be enforceable, that the parties can work out the details as a project progresses, or that even if there is a legal flaw, another party will be unable to obtain or enforce a judgment.

107. Interview with Stuart Valentine, Lawyer with Clifford Chance, Hong Kong, in Hong Kong (Nov. 6, 1995) (thirteen years of experience negotiating with Chinese parties).
requirements or commercial expediencies. Aside from the ethical dilemmas presented (foreign parties may play an important role in the development of commercial practices in China, including respect for the rule of law), the choice to yield to commercial expediencies may also subject foreign parties to unreasonable commercial risk (including the risk that heretofore cooperative government officials may suddenly decide to apply the written rules).

Even with an understanding of commercial practice, it is still advisable to obtain approvals, as failure to do so will result in an invalid and perhaps unenforceable security interest under Chinese paper law. Security taken by foreign enterprises in China should always be approved by the appropriate investment authorities as well as the State Administration of Industry and Commerce. Security taken over land use rights should be approved by the State Land Bureau. Until commercial practices come to mirror the paper law, or vice versa, those taking security in China should follow the paper law. Foreigners can deal with pressure to bend the rules by clearly understanding Chinese rules of law before engaging in important negotiations and by holding firm in the face of pressure to bend the rules.

c. Property Issues

This section highlights the importance of determining what property may be the subject of a security interest in China as compared with the United States. Determining what property may legally be made the subject of a security interest is not an exceedingly important issue in the United States. The situation is very different in China, where, although many types of property may now be charged or mortgaged, many others are partially or absolutely restricted and may not be made the subject of a security interest at all.

A number of complexities exist in this area that may surprise the unwary. This is especially true in the case of land, which is theoretically

108. See Wang, supra note 87, at 10-11.
109. See Liu & Reed, supra note 92, at 7.
110. Liu & Reed, supra note 92, at 5-6.
111. Barbara Mok, Victor Chu & Co., Hong Kong, Speech at China Law and Practice Seminar “Taking and Enforcing Security in China” (Nov. 25, 1993) (transcript outline available in Clifford Chance library in Hong Kong) (properties that may presently be mortgaged or in which a valid security interest may legally be created include: “land use rights, including superstructures; other tangible assets such as machinery and equipment, raw materials, semi-finished and end products, motor vehicles and vessels[;] . . . intellectual property rights including patents [and] trademarks . . . [;] shares and other transferable rights and interests”).
112. Id. Restricted properties include:
land[;] land use rights for which compensation to the State has not been paid and [for which] the prescribed transfer process has not been completed[;] natural resources and assets the trading of which is prohibited by law[;] assets the ownership of which is in dispute[;] assets which have been confiscated pursuant to judicial process[;] and] public welfare facilities[,] e.g.[,] schools [and] hospitals.
Id.
113. It is important to note that only land use rights that were originally granted for valuable consideration may be mortgaged. Land use rights allocated by the Chinese government without the payment of a land use premium may not subsequently be mortgaged unless a land use fee is paid and a transfer contract executed. See, e.g., Law of the People’s Republic of China on the Administration of Real Estate in Mainland Cities and Municipalities, 8th Nat’l People’s Cong., 8th Sess. art. 50 (1994) (effective
impossible to transfer or mortgage because it is owned by the "whole people."\textsuperscript{114} The Chinese authorities have gotten around this difficulty by permitting long term leases on "land use rights," which may be mortgaged.\textsuperscript{115} Buildings that have not yet been constructed, known as "pre-sold real property," may be mortgaged as security.\textsuperscript{116} In practice, Chinese parties may now mortgage essentially every type of property they can "own" — a highly loaded and restricted term in the Chinese context — and they do.\textsuperscript{117}

In China, close attention should be paid to the rules and accepted practices relative to particular types of property. Presently, the assignment of contractual rights as security is allowed under the Foreign Economic Contract Law, subject to the approval of other contracting parties and the original approving authority.\textsuperscript{118} Contractual rights that may be assigned and that have been assigned in practice include interests in construction contracts; bonds, guarantees, sales contracts, accounts, insurance, licenses, deposit receipts, shares, patents, trademarks, and copyrights.\textsuperscript{119} The mortgage of a joint venture partner's share in the registered capital of a joint venture is also permissible.\textsuperscript{120} Less clear, although apparently possible in practice, is the ability to take security in inventories and the proceeds of inventories.\textsuperscript{121} Although it is legally possible to take security in the stock of a company,\textsuperscript{122} in practice such security is rarely taken.\textsuperscript{123}

\textsuperscript{114} See generally Sobel & Zhang, \textit{supra} note 1, at 203-10. Ownership of land and other property in China has a varied history. In 1953, Mao Zedong took land from landlords and redistributed the land in equal shares to peasants. Two years later, land was taken from individuals and turned over to collectives. Land came to be owned by the whole people. Due to the influence of socialism, which continues today, it is politically impossible to transfer a "fee simple" interest in land to nonstate entities or individuals.

\textsuperscript{115} Depending on the nature of land use, land use rights may be granted for periods of up to 70 years. See Provisional Regulations of the People's Republic of China concerning the Grant and Assignment of Land Use Rights to State Land in Urban Areas, State Council ch. II, art. 12 (May 24, 1990).

\textsuperscript{116} See Liu & Reed, \textit{supra} note 92, at 6. However, the use of pre-sold real property for security is "subject to the mortgagor completing its obligations under the pre-sale agreement." Id.

\textsuperscript{117} Interview with Chen Jianlong, Chinese lawyer with C & C Law Office, Beijing, in Hong Kong (July 14, 1994). It is true, of course, that not all types of property may be privately owned.


\textsuperscript{119} See, e.g., Mok, \textit{supra} note 111, at 1; see also, e.g., Elizabeth Owen, \textit{Enforcing Security in China: Law and Practice}, in \textit{TAKING AND ENFORCING SECURITY IN CHINA}, \textit{supra} note 72, at 71, 73.

\textsuperscript{120} Owen, \textit{supra} note 119, at 73; see also Wang, \textit{supra} note 87, at 10-11 ("If the shareholder of such an enterprise wishes to create security over its shareholding, it will have to obtain the written consents of the other shareholders and the approval of the board of directors."). Approval of the original approval authority is also necessary. Id.

\textsuperscript{121} The practice known in some circles as "floating charges" has been utilized in several projects throughout China, particularly in localities without any secured transactions legislation. See Zheng Interview (July 19, 1994), \textit{supra} note 73. \textit{But see} Liu & Reed, \textit{supra} note 92, at 8 ("However, such an agreement would need to be drafted very carefully because, under existing local security legislation, if a mortgagor disposes of the mortgaged property without the consent of the foreign mortgagee, such disposal would be void.").

\textsuperscript{122} See Liu & Reed, \textit{supra} note 92, at 8-9.

\textsuperscript{123} See Still no Champaign for Panco, \textit{ASIAMONEY}, Nov. 1993, at 31. This is perhaps for a good reason. In December of 1992, the Shenzhen Intermediate People's Court declared that a share transaction that had been fully authorized two years earlier was illegal. Champaign's majority shareholder, Panco, had secured six bank loans by mortgaging shares in Champaign listed on the Shenzhen and Shanghai stock exchanges. The mortgages had been fully approved, mortgage contracts executed, public notices published, mortgages registered, and the shares placed in the possession of the lender. The Shenzhen Intermediate
2. Giving Notice to Third Parties

This section illustrates the extent to which such processes as placing security interests on record in a public register or taking physical possession of collateral serve similar purposes in China as in the United States. In the United States, an important purpose of filing is to place a record in a filing system where third parties can find it. Physical possession can also serve such a notice function by alerting third parties that the collateral is secured. Notice to third parties serves as a rational basis for enforcement against them, and, thus, the legal effect of filing and physical possession in the United States is perfection, which serves as the legal basis for enforcement against third parties. Unfortunately, as discussed below, the filing system does not perform the notice function very well either in the United States or in China, and physical possession of collateral in China may not have a notice function at all. In fact, a notice function may only be beginning to emerge in China.

Filing in the United States is not necessary for creating a valid security interest; it is only necessary for perfecting an already valid security interest. In several Chinese localities registration is likewise necessary only for perfection — to make the security interest enforceable against third parties. In these localities, failure to register does not invalidate the security interest; as in the United States, the still valid security interest is simply not perfected. Hereinafter, I have termed this kind of registration “optional registration.”

The different legal effects of registration are interesting, as they seem to reflect a certain ambivalence in China between views favoring market based Western approaches to secured transactions (and civil and commercial law in general) and views favoring holding to a system that reserves an important

---

People's Court determined that the security was illegal and confiscated the shares. On appeal, the Guangdong Higher People's Court reversed the Shenzhen court's ruling, but the shares were never returned.

The true basis for the ruling may have been an upward valuation of Champaign's shares of Rmb 27.5 million and a subsequent distribution of the valuation gain to shareholders. A State company, Xinye, was one of the shareholders that had, one month prior to the revaluation, converted its shares into "non-preference" shares, which in effect capped its dividends. Panco made a windfall gain of Rmb 24.6 million on the revaluation, dwarfing Xinye's Rmb 400,000. The restructuring committee set up by the Shenzhen People's Government reported that "[i]t is this action of revaluation followed by distribution of the excess resulted in an injury to the State." Id.

124. Lynn M. LoPucki, Computerization of the Article 9 Filing System: Thoughts on Building the Electronic Highway, 55 LAW & CONTEMP. PROBS. 5, 5 (1992) ("An important purpose of the [article 9 filing] system is to communicate the existence of filed financing statements to those who search the records. If a filing was made, a searcher should be able to find it.").


126. LoPucki & Warren, supra note 125, ch 19.

127. See, e.g., Fujian Provincial Secured Loan Regulations, art. 29 (May 1, 1991) ("When property that is required to be registered has not been registered, a bona fide third party may not be opposed."). Thus, it appears from the text that failure to register does not affect the validity of the transaction itself but only enforcement against third parties. This matches the filing requirement for perfection in the United States.

128. This may be the case because the paper law does not require it. See infra Part III.B.2.a. This may also be the case because local practice does not require it. See supra note 144.
and pervasive (and some would say an intrusive and hindering) role for
government control over private commercial activity. If China were to move
entirely to a nonadministrative model, the registration requirement would
be optional, as the filing requirement is in the United States. When this is the
case, the only penalty for not registering is an unperfected security interest
and the inability to enforce the security interest against some third parties.
The United States itself does not have such a system, as filing is practically
required in real estate transactions to prevent the prior owner from transferring
good title to another purchaser, who could then avoid the transaction.

129. If China were to move entirely to a nonadministrative model, the registration requirement would
be optional, as the filing requirement is in the United States. When this is the case, the only penalty for
not registering is an unperfected security interest and the inability to enforce the security interest against
some third parties. The United States itself does not have such a system, as filing is practically required
in real estate transactions to prevent the prior owner from transferring good title to another purchaser, who
could then avoid the transaction.

130. Chen Interview (July 9, 1994), supra note 97.

131. Again, some confusion is inherent in the terminology used in the Chinese regulations. The term
dengji used in the regulations is ambiguous because it refers both to the creation of a valid security interest
in what is referred to here as mandatory registration and to the perfection of a security interest in what
is here referred to as optional registration. This essential translational bifurcation highlights the different
legal effects and functional problems that are presently part of the Chinese system.

132. Interview with Chen Jianlong, Chinese lawyer with C & C Law Office, Beijing, in Hong Kong
(July 21, 1994). One such bureau is apparently located in Shanghai and may in fact be the registration
department established by the State Administration of Exchange Control. Another likely location is
Shenzhen.

133. Id.
Optional registration fulfills essentially the same function in China as it does in the United States. Optional registration is not yet as commonplace in China as filing is in the United States, and is clearly not yet as firmly entrenched in practice.

Although in the United States a secured party technically needs to file in only one location, depending on the nature of the collateral, he or she in practice must often file in multiple locations to ensure that the security interest will be perfected. Filings for personal property take place in the office of the Secretary of State or in the county Uniform Commercial Code (U.C.C.) filings office. Real estate filings occur in different locations. Filings are often required in both state and county offices.

The place of optional registration in China, likewise, depends on the nature of the collateral. As in the United States, optional registration may occur in more than one location or government bureau, depending on the locality and type of collateral being secured. Examples of relevant authorities potentially include local offices of the State Administration of State Assets, the State Administration of Exchange Control (SAEC), and multiple land administration bureaus.

In the United States, there is a location for the filing and perfection of almost any security interest in any kind of collateral. This is not true in China where there has often been no place to record and perfect security interests in certain kinds of collateral. This is generally true where the collateral is not property for which government regulations require mandatory registration.

This important deficiency will be remedied by implementation of the long anticipated national law governing secured transactions. Shanghai Municipality has already taken steps in this direction by requiring the registration of all security interests in real and personal property collateral for foreign exchange and renminbi mortgages and by establishing a location for the recording of all such security interests.

(2) Maintaining Registration

Filings in the Chinese registration system require less effort to maintain

---

134. See LoPucki & Warren, supra note 125, ch. 19. Multiple filings are often necessary because of uncertainty as to the proper place of filing.

135. LoPucki & Warren, supra note 125, ch. 19.


138. See Allen & Overy, supra note 137, at 1.

139. See Cheng & Leung, supra note 137, at 6.

140. It is often the case that government regulations do not require mandatory registration for personal property. But see sources cited supra notes 132, 137. Shanghai has for some time provided for the filing of all security interests.

141. Chen Interview (July 9, 1994), supra note 97. A draft of this law was reportedly in circulation at the time of the interview. See also Cheng & Leung, supra note 137, at 6.

142. Interview with Gao Feiji, Lawyer with Clifford Chance, Hong Kong, in Hong Kong (July 21, 1994) [hereinafter Gao Interview (July 21, 1994)].
than they do in the United States. In the United States, a filing in the U.C.C. personal property filing system must be updated every five years.\textsuperscript{143} This mechanism serves the purposes of cleansing the system of stale security interests and, more importantly, of encouraging diligence on the part of parties to secured transactions. In China, once registration of any security interest has been accomplished, there is no need to update the recording.\textsuperscript{144} The registration expires only upon the expiration of the underlying security interest.\textsuperscript{145}

(3) Searching the Register

This section indicates the difference between, and the common difficulties experienced in, the Chinese and United States systems with respect to searching for security interests. In many ways, the Chinese and U.S. systems are widely divergent with respect to searching. Interested parties in the United States can search the system at will (subject, perhaps, to cost constraints) in the attempt to locate information on potentially encumbered property.\textsuperscript{146} In some filing offices, searchers are even able to rummage through files themselves.\textsuperscript{147}

Although few Chinese regulations explicitly allow inspection of the register,\textsuperscript{148} Chinese lawyers insist that in practice anyone can inquire about specific pieces of property at the place of registration to see if they have already been secured.\textsuperscript{149} However, the same lawyers concede that in some instances it may be necessary to have a lawyer, a public security official, or another person with a special letter of introduction inquire at the place of registration.\textsuperscript{150} Only in the case of land administration bureaus is it clear that a search may be performed.\textsuperscript{151}

Title searches for government or state owned goods and property in China are, in theory, not too problematic. Mortgages over such goods are subject to the approval of the Administration for State Assets, and careful records are supposedly kept on file by that authority.\textsuperscript{152} Title searches for non–state

\begin{footnotes}
\textsuperscript{143} See LOPUCKI \& WARREN, supra note 125, ch. 24. As for security interests in real estate, once filed, a filing need never be updated.

\textsuperscript{144} Chen Interview (July 9, 1994), supra note 97.

\textsuperscript{145} Gao Interview (July 21, 1994), supra note 142.

\textsuperscript{146} See LOPUCKI \& WARREN, supra note 125, ch. 19.

\textsuperscript{147} See LOPUCKI \& WARREN, supra note 125, ch. 19.

\textsuperscript{148} But see, e.g., Fujian Secured Loans, supra note 81, art. 33 ("Any natural person, legal person or other organization may look up and make copies of the registration card, index and contract of the security at the registration authority."); Regulations of the People's Republic of China for the Registration of Vessels, State Council art. 22 (June 2, 1994) (effective Jan. 1, 1995) (stating that vessel registration authority shall allow public to inquire about registration status of vessel mortgage rights).

\textsuperscript{149} Gao Interview (July 21, 1994), supra note 142; Chen Interview (July 9, 1994), supra note 97 (no regulations prohibit inspection).

\textsuperscript{150} Gao Interview (July 21, 1994), supra note 142; Chen Interview (July 9, 1994), supra note 97.

\textsuperscript{151} Owen, supra note 119, at 4.

\textsuperscript{152} See Liu \& Reed, supra note 92, at 8 ("In practice this check is not very difficult for goods owned by state-owned enterprises, as the mortgage is subject to the approval of the Administration for State Assets;[;] the equipment and stock-in-trade list can be checked with that authority.").
\end{footnotes}
owned goods and property are another problem entirely. As discussed above, some types of such property are not subject to registration. This is typically the case for property termed personal property or chattels in the United States. Where government regulations do not require registration of security interests, it may be next to impossible to discover the existence of such an interest.

Identifying particular property when searching a register can present an additional overwhelming problem in China. This problem is not unique to China; however, it is not difficult to imagine the problems of identifying secured property in China, where the ownership of property is unclear. The easiest method of identifying particular property is obtaining the registration number from the mortgagor. Where this is not feasible, the difficulties in discovering encumbrances on property will be largely of the same type as those experienced in the United States, and perhaps more severe.

b. Possession

This section illustrates the gap between Chinese and United States practices with respect to the purposes served by physical possession of the secured property. Perfection may be accomplished in the United States without filing, where the mortgagee takes possession of the property or otherwise by operation of law. Possession has similar legal significance in China. Where Chinese parties can take actual physical possession of the collateral, there may be no necessity to register.

The actual physical possession of collateral in China, where enforcement is notoriously difficult, may have fundamentally different purposes compared with the United States. Instead of serving as the basis of perfection and enforcement against third parties as it does in the United States, possession may often simply serve the basic purpose in China of allowing a mortgagee to enforce a mortgage contract against the mortgagor.

Parties in China may enforce when they have taken collateral into their possession at the inception of a contract, as in the case of certificates over

---

153. See Liu & Reed, supra note 92, at 8 ("Due to the difficulties in obtaining the necessary information, taking security over the goods of non-state-owned business entities is not as straightforward.").
154. See supra text accompanying note 97.
155. Interview with Chen Jianlong, Chinese lawyer with C & C Law Office, Beijing, in Hong Kong (July 22, 1994).
156. Shanghai has made some movement in the direction of remedying this problem by the development of a general registration office for foreign exchange and renminbi mortgages.
157. See generally LoPucki, supra note 124 (detailing failings of Article 9 filing system).
158. See Jones et al., supra note 2, at 299-317.
159. Gao Interview (July 21, 1994), supra note 142.
160. U.C.C. §§ 9-302(1)(a), 9-305 (1994) (perfection may be accomplished according to this article by taking possession of "letters of credit, goods, instruments (other than certificated securities), money, negotiable documents or chattel paper" either by mortgagee or by agent of mortgagee).
162. Gao Interview (July 21, 1994), supra note 142.
164. This assertion may be somewhat simplified. Actual physical possession in the United States also serves this function in some respects.
bank accounts, insurance contracts, performance bonds, or land use rights. Chinese courts have upheld self-enforcement where a mortgagee retains the investment certificate to a joint venture. Thus, although the examples are far from extensive, possession in China appears to serve the rudimentary functions of creation and enforcement at the most basic level instead of notice and perfection as it does in the United States.

There are other mechanisms for providing notice in China in addition to registration and physical possession. For example, it is possible to perfect in China by posting an actual notice on each item of collateral. In one particular leasing case, the foreign party welded a notice stating the name of the lessor of the equipment to give notice of the existence of a mortgage and took photographs of the exact location of the welds in case these identification markers were removed. The ability to perfect in several different ways illustrates a certain flexibility in the Chinese system with respect to giving notice to third parties.

IV. ENFORCING SECURITY INTERESTS

This part analyzes the problem of enforcement functionally from the perspective of processes designed to result in a remedy against debtors, third parties, and the government. After all, a security agreement is little more than paper if it is unenforceable. The general consensus among non-Chinese lawyers is that the “jury is still out” on the ability to enforce security agreements in China. Chinese lawyers appear to feel cautiously optimistic that Chinese courts are increasingly likely to enforce security agreements.

165. Interview with Zheng Shujun, Chinese lawyer with C & C Law Office, Beijing, in Hong Kong (July 21, 1994) [hereinafter Zheng Interview (July 21, 1994)]. According to Zheng, retaining possession of the collateral allows the mortgagee to exert leverage otherwise impossible. The mortgagee may retain the land use rights certificate, and transfer of ownership may be impossible without the cooperation of the mortgagor. The transfer of ownership in land use rights requires approval by several administrative bureaus, a change of registration, and even the payment of a land use fee. It is unlikely that a mortgagee could perform this unilaterally. Therefore, it is important to include such contingencies in the mortgage agreement.

166. Interview with Gao Peiji, Lawyer with Clifford Chance, Hong Kong, in Hong Kong (July 13, 1994) [hereinafter Gao Interview (July 13, 1994)].

167. Id.

168. Interview with John Kuzmick, Lawyer with White & Case, Hong Kong, in Hong Kong (July 26, 1994).

169. Indeed, Roscoe Pound argued that “[t]he life of the law is in its enforcement.” Roscoe Pound, Mechanical Jurisprudence, 8 COLUM. L. REV. 605, 619 (1908). It is of course true that a security or mortgage agreement, even if unenforceable, may provide some level of comfort and a modicum of bargaining leverage to the creditor.

170. See Morrison, supra note 72, at 2 (“[T]here are instances where mortgages have been successfully enforced without undue complication, especially over smaller properties, but the experience is too limited to draw any firm conclusions at the present time.”); see also Owen, supra note 119, at 72 (suggesting that security agreement is unlikely to be enforced literally).

171. Interview with Gao Peiji, Lawyer with Clifford Chance, Hong Kong, in Hong Kong (Aug. 12, 1994). After reading a draft of this article, which in substance matches the present Article, Gao (a very experienced Chinese commercial lawyer trained in the United States) kindly suggested that my analysis perhaps presented the Chinese system in too negative a light. He suggested that it would be more reflective of Chinese realities if I first made a general statement that Chinese courts are likely to enforce security agreements and then discussed problems present in the system. But see Jones et al., supra note 2, at 227-37. According to Professor Jones, the Chinese judiciary suffers from lack of education, lack of legal
There are systemic factors in China that increase the likelihood that a security agreement will be enforced. The involvement of government officials or a powerful patron can help to resolve a dispute by ensuring that a particular cause is heard, that the formal legal processes such as the courts work properly, or that "extraofficial" or informal processes bring pressure to bear in the right places. It is unknown to what extent such processes are considered legitimate by the Chinese government. The recent anticorruption campaign suggests that informal processes will be discouraged. Still, the very existence of the campaign suggests the present pervasive nature of informal practices. Such factors are probably not considered an important part of the legal system in the United States. In China, however, such informal factors may constitute the very essence of the current legal system.

A. Against Debtors

This section develops the enforcement of security agreements in China with respect to debtors. Special emphasis is placed on methods of enforcement such as aspects of "self help" and more formal proceedings, which, while playing a significant role in the United States, are emphasized differently in China. This section also describes elements of enforcement unique to China's legal system. Though none of these issues is discussed at great length, they provide insight into developing and existing enforcement processes relating to security.

As for enforcement practices related to third parties and the Chinese government, Chinese paper law and practice are at such an early stage that there is very little to describe. Therefore, although relevant to enforcement against third parties and the government, the descriptions of self help, elements of enforcement unique to China's legal system, and more formal proceedings belong appropriately in this discussion of enforcement against debtors.

1. Self Help

In the United States, self help is a regular feature of the system for enforcing security interests. The lender, whether secured or unsecured, has the option of repossession by self help if doing so can be accomplished.
taking Security in China

without breaching the peace. The scope of the self help remedy is limited by law, circumstances of the case, and the nature of the collateral.

The Chinese paper law says nothing about self help. Therefore, by negative implication, security interests theoretically may be enforced by self help. However, in practice, enforcement is almost entirely through the courts or through arbitration tribunals. It is true, however, that parties in China are in practice engaging in very limited self help at the present time. In the Chinese context, however, self help merely means that parties are enforcing carefully drafted self help provisions in agreements between the parties. Thus, it appears that there is no explicitly recognized right to self help in China.

Parties often consult with a local court before engaging in self help. In one case involving substantial economic interests, the court told the enforcing party to “please just do it yourself.” The security at issue was the certificate to a foreign party’s share in a joint venture which was in the possession of the guarantor lending institution. The guarantor enforced the security agreement simply by informing the other party that it was enforcing the security agreement.

2. Chinese Methods

An additional de facto self help remedy exists in China which might be better understood if the “self” in self help is understood as “social self.” Aggrieved parties in China have traditionally resorted to extrajudicial social
pressure tactics to push aggrieving parties into compliance. Historically, village headmen and clan or family leaders were sometimes called upon to assert authority and to exert pressure on aggrieving parties. These individuals could sometimes exert enormous pressure on a party to a dispute. Failure to comply with obligations could result in social stigmatization or an inability to function effectively in commercial matters.

These types of social pressure tactics still exist in China and can affect foreign investors for good or ill, depending on the circumstances. For example, creditors can pressure a noncomplying debtor (or any party to a contract) to comply with the terms of the security agreement. The involvement of third parties has proven helpful by preventing direct confrontation between adversaries. Direct confrontation may cause one or both of the parties to "lose face," resulting in one or both of the parties digging in their heels and refusing to cooperate. The involvement of third parties thus prevents escalation of disputes while providing opportunities for neutral parties to broker a resolution. Third parties successfully playing this "face saving" role have included Chinese partners, shareholders, and local government officials such as local planning or economic commissions, mayors, vice-mayors, and representatives.

During the Maoist era, the CCP extensively used such social control techniques as criticism meetings and campaigns to obtain social compliance. These techniques could be used to deal with such matters as land ownership and crime, which those in the United States generally regard as legal matters, and were sometimes used to pressure individuals to give

184. See, e.g., GEOFFREY MACCORMACK, TRADITIONAL CHINESE PENAL LAW 157 (1990). Shame and humiliation were considered just as important for regulating official conduct as were financial and social consequences during the Tang and Qing periods.

185. See JAMIESON, supra note 15, at 68, 72 ("He is at once the peace officer and the Tribune of the people — a terror to evil doers and the spokesman on behalf of the oppressed."). In other cases, the aggrieved party might force his way onto the other party’s property and refuse to leave until paid.

One individual informed me of a friend who once sought to obtain the repayment of a loan in China by enlisting friends in the security administration to threaten a nonpaying debtor with an investigation and possible punishment. This was illegal because the security administration is supposed to investigate criminal cases only, not civil cases. The debtor could have successfully resisted these efforts and refused to repay the debt. The debtor paid.

186. See JAMIESON, supra note 15, at 69 ("Whenever any individual wishes to do anything out of the ordinary he must produce a kan chieh. . . . It is simply a document where the neighbours voluntarily, freely, frankly (kan) pledge or bind (chieh) themselves by their personal knowledge, for the respectability of the individual and his good faith . . . . "). To my knowledge, this practice is now obsolete.

187. See Patrick P. Hebert, Security in China: The Leasing Case, in TAKING AND ENFORCING SECURITY IN CHINA, supra note 72, at 74, 77.

188. See Patrick P. Hebert, Security in China: The Leasing Case, in TAKING AND ENFORCING SECURITY IN CHINA, supra note 72, at 77. The concept of face is really no different than pride or honor in the United States, and the consequences of causing one to lose face in an oriental culture may be quite similar. However, the concept may be more important in Chinese culture compared with that of the United States, and the corresponding results from causing a loss of face may likewise seem more exaggerated.

189. See Patrick P. Hebert, Security in China: The Leasing Case, in TAKING AND ENFORCING SECURITY IN CHINA, supra note 72, at 77.

190. See Jones et al., supra note 2, at 37-46. Criticism meetings were orchestrated by village groups or work teams. Campaigns were orchestrated from the top levels of government and included criticism meetings from the top levels of government to the bottom levels in the peasantry. Id. at 44-46.

191. See Jones et al., supra note 2, at 37 ("Both can be and were used to accomplish purposes that we would not recognize as legal, such as backing national policies like [o]pposing the United States and [a]lling Korea or eliminating pests such as flies.").
Taking Security in China

up "selfishness" and "bourgeois capitalist tendencies." Both brought intense social pressure to bear either on an accused or on the public in general. In criticism meetings, the accused usually admits faults or wrongdoing and pledges to rectify bad behavior.

Criticism meetings have waned in importance in recent years as Maoist social pressure techniques have gone out of style in China. On the other hand, "education" and "persuasion" are still advocated as the primary means of obtaining compliance with desired policies, rules, outcomes of disputes, or other desired behavioral norms. Clearly, social pressure and control remain important in China. Campaigns (including the present and continuing campaign to encourage foreign investment) are regular features of the current system. As discussed previously, a powerful governmental or economic contact in China can still be invaluable for facilitating enforcement in formal channels, mediating disputes, or exerting influence in informal channels.

3. Formal Proceedings

This subsection briefly discusses the kinds of formal proceedings in China to which one may resort in the event other methods of enforcement fail or seem inappropriate. As discussed below, formal proceedings in China are of several different types, including mediation, conciliation, arbitration, and litigation. Less drastic forms of dispute resolution are preferred in China. Other authors have discussed more completely the content of dispute resolution processes in the PRC. This subsection primarily discusses judicial processes with relation to the enforcement of security. However,

192. In the words of one historian:
[All campaigns in Maoist China] followed this model more or less. That is, a policy is determined by the central authority and is implemented by means of educating groups of leaders at further and further removes from the top until the masses themselves are induced to participate by intensive persuasion. The teaching is always by means of discussion. Everyone has to participate and prove that he understands the policy. If there is any resistance, it should be externalized and then eliminated. The most important part of the method is the directed discussion so that everyone agrees verbally with the result — frequently after criticizing his own previous resistance.

See Jones et al., supra note 2, at 45.

193. See Jones et al., supra note 2, at 41-42. Criticism meetings and campaigns attempt to change the very minds and consciousness of society. In meetings themselves, an accused would be brought before a group of peers to be accused and interrogated (and sometimes beaten). If confession was forthcoming, the penalty was meted out and usually softened.

194. See Jones et al., supra note 2, at 45.

195. See Epstein, supra note 30, at 40.

196. See Epstein, supra note 30, at 40.

197. There is some feeling that the recent corruption campaigns have been targeted in part at inappropriate peddling of influence and abuse of position. See David R. Schweisberg, Anti-Corruption Campaign Hits Top Levels, UPI, Oct. 15, 1988, available in LEXIS, International Library, Asia Pacific File (indicating that recent campaign against corruption is aimed to stem nepotism, influence trading; and strong arm tactics tied to profiteering now rampant in China).

198. See Lubman, Mao and Mediation, supra note 37, at 325 ("Mediation is the universally favored mode of dispute resolution . . . .").

199. See, e.g., Lee, supra note 14; Lubman, supra note 11, at 224-26; Lubman; Mao and Mediation, supra note 37, at 1345-75 (outlining proliferation of mediation in settling disputes in China).

200. One reason for the limitation here is the limited number of reported cases. The few reported cases in existence all involve judicial proceedings.
other formal dispute resolution mechanisms are involved.

In the United States, as in China, where self help fails to meet the needs of an aggrieved lender, the lender may resort to formal channels of enforcement. Lenders and other holders of security interests in the United States resort to the courts as a matter of course. Foreclosure proceedings are very common in the United States. After a favorable decision, collateral is auctioned.\footnote{201}

As in the United States, it is the secured party in China who initiates enforcement proceedings.\footnote{202} After consideration of the matter, the court may issue a decision immediately or conduct mediation between the parties.\footnote{203} After the court's decision or agreement, the parties may appeal or may implement the decision or agreement voluntarily; if a party does neither, the secured party may file an application for enforcement.\footnote{204}

At this point, the zhixing ting (enforcement department)\footnote{205} of the court may become involved and exert pressure on the other party to fulfill its obligations.\footnote{206} If a party continues to fail to cooperate, the court may issue a "writ of assistance,"\footnote{207} notice of execution, or notice of enforcement.\footnote{208} The court may also seek to compel enforcement by issuing search warrants and by sending enforcement personnel of the court to search for and seize the secured property.\footnote{209} The court may impose fines, garnishment of wages and

\begin{footnotes}
\footnote{201} See LoPucki & Warren, supra note 125, ch. 2.
\footnote{203} See id.; Court Orders Enforcement of Mortgage Agreements, CHINA L. & PRAC., Apr. 9, 1992, at 21. ("The Bank instituted proceedings in the Huangshi Municipal Intermediate People's Court . . . which conducted mediation between the Factory and the Bank.").
\footnote{204} See Property Confiscated in Loan Enforcement, supra note 202, at 25 ("None of the parties involved appealed following the decision at first instance. After the decision came into effect, it was not implemented by the parties, with [one] exception . . . . On 17 April 1990, Guangzhuang Credit Society filed an application for enforcement."); see also Court Orders Enforcement of Mortgage Agreements, supra note 203 ("[T]he following agreement was reached: the Factory agreed to mortgage its factory buildings and production equipment . . . and to repay its loans with interest in installments."). After the factory failed to comply with the agreement, the bank applied to the court for execution and the court issued a notice of execution. Court Orders Enforcement of Mortgage Agreements, supra note 203.
\footnote{205} Literally, this means "court of enforcement" or "court of implementation." As its function relates to enforcing and implementing the decisions of other court departments, it seems reasonable at a functional level to equate this with the sheriff. According to Oechsli, supra note 3, at 5, these enforcement personnel include the 'execution officer and the court clerk,' with the assistance of bailiffs in 'important' proceedings.\footnote{206} See, e.g., Property Confiscated in Loan Enforcement, supra note 202, at 25 (describing case in which, after court applied repeated pressure, three of four parties performed part of obligation). See also Zheng Interview.(July 21, 1994), supra note 165.
\footnote{206} Oechsli, supra note 3, at 5 (quoting Civil Procedure Law arts. 164, 171).
\footnote{207} In the case cited supra note 206, the court then "issued a Notice of Enforcement to the parties, in accordance with Article 170 of the PRC Civil Procedure Law (Trial Implementation)." Upon receipt of the notice, three parties implemented plans for performance, though the fourth (Li Wentong) continued in his recalcitrance. Property Confiscated in Loan Enforcement, supra note 202, at 25.
\footnote{208} . . . The court in the case cited supra notes 202, 204, and 206 eventually had to resort to such measures to compel the fourth party, Li Wentong, to perform:

[In accordance with Article 172 of the Civil Procedure Law (Trial Implementation) and with the approval of its President, the court sealed a portion of Li Wentong's property . . . and appointed Li Wentong responsible for custody of the sealed property. Li Wentong was notified that he would be permitted to use such property but not to sell or transfer it during the custody period. However, not only did Li Wentong fail to perform his obligations under the Notice of Enforcement, he also sold the sealed property and concealed the money he received in}
savings, or detention on those refusing to cooperate.\textsuperscript{210} 

The enforcement of security through Chinese courts is occurring in actual practice.\textsuperscript{211} However, it is impossible to determine what percentage of cases requiring enforcement are referred to the courts, and of these, what percentage are successful. Since the purpose of this Article is to analyze the Chinese system of taking and enforcing security, a review of some practical problems to enforcement is instructive and provides essential insight into the function of China’s legal system.

Court orders are often disregarded in practice\textsuperscript{212} or are only grudgingly obeyed.\textsuperscript{213} One of the few reported cases involving the enforcement of a mortgage, here a mortgage on a factory building and equipment, illustrates the problems faced by the Chinese courts. In this case, a factory manager attempted to assign all of the mortgaged property for consideration to a third party after the court had issued a notice of execution to the factory.\textsuperscript{214} Upon learning of this, the court ordered that the factory and property be sealed. After the sealing of the property by replacing the lock, the deputy director of the factory directed ten factory workers to break the lock on the factory door and transfer the remaining materials to another factory. The court’s execution personnel attempted to stop this occurrence but were attacked by the deputy director and the workers, and all of the moveable property that had been sealed was moved. The court, with the approval of the president of the court, imposed a fine and fifteen days detention on certain key individuals who soon thereafter admitted their errors and repaid all loans to the bank, thus resolving the conflict.\textsuperscript{215}
One of the biggest problems of enforcement is localism within the courts themselves. It occurs in part because of the structure of China's judicial system, in which the courts are not independent from politics, the general administrative structure of the government, or the CCP. The courts are also not isolated from local interests and may even be used as tools to promote national and local policies and purposes.

The CCP sets short and long term goals and directives for the courts. Administrative positions of the courts and administrative organizations often overlap with positions in the CCP. In some cases, a judicial committee makes decisions for the court after consultation with individuals, officials, and party members outside of the court. It is not difficult to imagine the dilemma a Chinese judge could face. Regardless of the equities of a given case, a Chinese judge may have little choice but to succumb to any of a number of political pressures that may be exerted from any direction. Party members and others engaging in "bureaucratism" exacerbate the

---

216. For my definition of localism see supra note 49.
217. Gao Interview (July 21, 1994), supra note 142 (describing case in which local company speaks with local government which speaks with court, and court rules against any non-local party). Chinese courts may treat domestic Chinese and foreign parties equally because although domestic and local bias is likely to exist, present policies favor the encouragement of foreign investment in China. Interview with Gao Peiji, Lawyer with Clifford Chance, Hong Kong, in Hong Kong (Aug. 5, 1994) (claiming that courts are likely to treat foreign and Chinese parties equally). This result is furthered by judicial decisions which do not manifestly disfavor foreigners. Although this may be true, I have no direct proof that this is the case.
218. See Jones et al., supra note 2, at 49-54. As Lubman points out, "[a]lthough on paper the judiciary was formally distinct from other state organizations and the Party, in practice it remained essentially undifferentiated from the administrative apparatus of the state." Lubman, supra note 11, at 201. Lubman further states:

"The leadership seems to expect the formal legal system to do considerably more than help maintain order. A greater activism is required by the courts, judges are expected to be responsive to current policies such as punishing criminals guilty of disrupting social order and economic criminals such as venal officials. The courts are expected to march in step with the rest of China's officialdom to carry out whatever policies are viewed as necessary to stimulate further progress toward modernization.

Id. at 255.
219. Gao Interview (July 21, 1994), supra note 142; see Lubman, supra note 11, at 245 ("Unlike the Anglo-American model in which courts are theoretically impartial agencies for adjudicating conflicts, Chinese courts under the Communist Party have been seen and used as active participants in the implementation of Party and state policies."); see also Allen & Overy, supra note 137, at 1 ("Enforcement is subject to the same wide administrative discretion, pressure to compromise and local bias that affect other governmental and judicial actions in the PRC.").
220. See Lubman, supra note 11, at 246-47.
221. See Lubman, supra note 11, at 246-47 ("[S]ome blurring of the line between activities of the courts and of the Party continues to exist, reflected in the continued side-by-side existence of trials and administrative punishments.").
222. See Jones et al., supra note 2, at 49-54.
223. Lubman describes "bureaucratism" in this way:

The term is used to describe major abuses of power by State and Party officials, including the tendency to treat one's area of jurisdiction as a private domain; feeling superior to others of lesser rank; insistence on special privileges; feeling responsibility only to superiors in rank, whose favors are pursued, often by flattery and extravagant measures; corruption, embezzlement of public funds, misappropriation of state property, accepting and giving bribes; and interceding on behalf of relatives and friends. Media accounts abound with this type of conduct, often engaged in by cadres over long periods of time and on a large scale before they were apprehended and punished.

Lubman, supra note 11, at 241.
Another peculiarity of the Chinese legal system that adds to the unpredictability of enforcement is the strong preference for settlement by mediation or conciliation instead of deliberating, making, and enforcing a judgment, as is more common in the United States. The preference for settling disputes through methods of compromise is stronger in China than in the West. The implication for security is that the holder of a security interest is less likely to be secure. It is unlikely that a court will give an entirely favorable decision to one of the parties to a dispute. Compromise judgments, wherein the secured party receives only a portion of the remedy sought, are likely to prevail even where the other party was clearly in the wrong. Where a court is interested in preserving face between parties, it is unlikely to enforce a security interest as readily as a U.S. court would in the same situation.

A peculiar aspect of Chinese law practice is that Chinese lawyers spend much of their time seeking to establish better connections than the opposing counsel. With historic antecedents, the practice constitutes an interesting (and, for foreigners, unsettling) element of China's legal system. Litigation practice in China becomes a guanxi competition wherein good Chinese counsel are best identified by their connections or their ability to establish good connections. These connections and related abilities best identify the winners.

---

224. See Owen, supra note 119, at 72 ("[C]ourts will sometimes refuse to give judgment on a case and insist instead that the parties first endeavour to settle their differences through mediation.").

225. See Lubman, supra note 11, at 224-27. For example, Lubman reports that "Chinese factory officials have told this author and other foreigners interested in economic dispute resolution that they would strongly prefer to reach a compromise in a dispute rather than take the matter to a court." Id. at 227.

226. Interview with Gao Peiji, Lawyer with Clifford Chance, Hong Kong, in Hong Kong (Aug. 13, 1994) [hereinafter Gao Interview (Aug. 13, 1994)] ("Some lawyers prefer not to become litigators — unless for large foreign firms — for this very reason.").

227. See Lee, supra note 14, at 1358-59. Lee discusses the role mediators played in the early part of the century:

As conduits, legal brokers, or middlemen, lawyers made the courts more accessible to the Chinese merchant. Attorneys of various nationalities who had emigrated to China founded their own local bar associations in Shanghai, and some were particularly skilled at petitioning judges to view their clients' cases favorably. At first foreign, and later Chinese, lawyers cultivated their ties with the courts and used their influence to gain strategic advantages for their clients. After 1926, factions of Chinese lawyers developed around certain judges with whom they cultivated ties, often based on the law school they had both attended.

Id.

228. See supra note 35; see also Gene Linn, UPI, Dec. 20, 1992 available in LEXIS, Nexis Library, UPI File ("Without a democratic and accountable government and without the rule of law, Hong Kong will experience a surge in corruption and guanxi (dependence on connections) that is endemic across the border and the international business community will lose confidence . . .").

The social phenomenon of guanxi as an element of Chinese society is well documented. See, e.g., Joyce Barnathan et al., China: Is Prosperity Creating a Freer Society?, BUS. WEEK, June 6, 1994, at 94, 96 ("[China is] a country where the rule of law has long been subordinate to guanxi, or personal connections. . ."); Lucian Pye, China: Erratic State, Frustrated Society, FOREIGN AFF., Fall 1990, at 56, 64-65; John A. Reeder, When West Meets East, BUS. HORIZONS, Jan.-Feb. 1987, at 69.

229. See Lee, supra note 14, at 1359 ("It appears that the closer the relationship between the lawyer and the judge, the higher the fee the lawyer could charge.").

230. Guanxi, which may also be referred to as kinship or friendship ties, is a social phenomenon not limited to China. See, e.g., Edward T. Hall, The Silent Language in Overseas Business, HARV. BUS.
present the most compelling legal arguments but rather wins the *guanxi* battle and has more powerful people supporting its cause.\textsuperscript{231} As a result, enforceability of security agreements is less predictable in China than it is in the United States.\textsuperscript{232} Decisions will usually favor economically or otherwise more powerful individuals or organizations.\textsuperscript{233}

Some of the unpredictability of enforcement in Chinese court proceedings can be avoided by undergoing *wei jiaiwude gongzheng* (special notarization of debts) of the security agreement.\textsuperscript{234} Although notarization of the security agreement is an essential step to enforcement by any Chinese court,\textsuperscript{235} special notarization has the added benefit of providing an avenue for the secured party to avoid completely formal court proceedings by directly commencing enforcement proceedings in the enforcement department of the court.\textsuperscript{236} Special notarization is only available, however, when the underlying obligation is in the “nature of a liability.”\textsuperscript{237} Even when special notarization is possible, practical problems to enforcement remain.\textsuperscript{238}

B. Third Parties

This section discusses the state of enforcement in China with relation to third parties as compared to the state of enforcement in the United States, and reviews Chinese law with respect to “priority.” “Priority” is a key feature in U.S. secured transactions law that may one day become significant in China as well. “Priority,” as understood in the United States, is not a widely understood concept in China. Accordingly, the ability to enforce a security agreement against third parties appears negligible in China when compared with the United States.

In the United States, the ability of a party to enforce its security interest against third parties is an essential feature of secured transactions law. By creating a security interest, the party obtains priority in the collateral over unsecured claimants.\textsuperscript{239} By perfecting the security interest, the party obtains

\textsuperscript{231} Gao Interview (July 21, 1994), supra note 142.
\textsuperscript{232} Gao Interview (July 21, 1994), supra note 142. Two potential ways around these difficulties may include retaining different Chinese law firms that may have connections at strategic locations, and for some issues, taking the case to a higher court if it is possible to resolve the jurisdiction issue. Id.
\textsuperscript{233} Gao Interview (July 21, 1994), supra note 142.
\textsuperscript{234} Zheng Interview (July 19, 1994), supra note 73.
\textsuperscript{235} Zheng Interview (July 19, 1994), supra note 73.
\textsuperscript{236} Zheng Interview (July 19, 1994), supra note 73. As special notarization involves the enforcement department of the courts, the procedure is analogous to a confession of judgment in the United States. The special notarization takes place as part of the initial transaction rather than after a default has occurred. Hence, the procedure is also analogous to a power of sale clause or a deed of trust executed in the real estate setting to avoid the necessity of formal foreclosure proceedings.
\textsuperscript{237} Zheng Interview (Aug. 4, 1994), supra note 212.
\textsuperscript{238} Even if the courts cooperate, which may be a questionable assumption, there is no guarantee that the debtor will cooperate with the creditor or the enforcement department of the court by giving up the collateral.
\textsuperscript{239} See, e.g., U.C.C. § 9-201 (1994).
priority over subsequently secured parties. In essence, the secured party with priority may enforce its preferred claim against unsecured parties if the secured party obtains possession of the collateral or against subsequently perfected secured parties, even if those parties have enforced their security interest in the collateral and have taken possession. The secured creditor is assured the right to obtain possession of the collateral itself or the cash equivalent of its interest in the collateral.

Although Chinese law is beginning to recognize the concept of priority on paper, in practice it is unlikely that the holder of a security interest will be able to enforce this interest against another interest holder that has already enforced its interest. This will be the case even when the secured party has completed all required procedures, including notarization and registration.

One reason for this state of affairs is that the Chinese courts have not yet recognized the concept of priority. Another reason is that some Chinese courts still lack the sophistication to understand such a complex legal doctrine. There are perhaps more fundamental reasons related to enforcement that would explain why the Chinese courts have not begun to recognize the ability of a secured party to enforce its interests against third parties.

The same enforcement problems preventing the enforcement of security interests against third parties on the basis of priority also prevent the enforcement of security in analogous situations. The Chinese courts are likely, and in some cases may be required, to take a lenient view of debtors. The Chinese courts are unlikely to allow a secured party to enforce its security against an unsecured third party that has enforced a claim against the grantor of the security interest and taken possession of the collateral.

---

240. See U.C.C. § 9-312(5)(a) (1994) (“Conflicting security interests rank according to priority in time of filing or perfection. Priority dates from the time a filing is first made covering the collateral or the time the security interest is first perfected, whichever is earlier . . . .”).

241. This analysis ignores the presence of lien holders in the collateral. However, these are treated in a similar fashion. With some exceptions, the first to come into existence, the lien or the perfected security interest, will determine the priority of the relative interests in competitions between lien holders and secured parties. See id; U.C.C. § 9-301 (1994); LOPUCKI & WARREN, supra note 125, ch. 2.

242. See LOPUCKI & WARREN, supra note 125, ch. 2.

243. Interview with Zheng Shujun, Lawyer with C & C Law Office, Beijing, in Hong Kong (July 23, 1994) [hereinafter Zheng Interview (July 23, 1994)].

244. Id.

245. See id. (noting that Supreme People’s Court is probably prepared to recognize concept of priority).

246. See Jones et al., supra note 2, at 227 (“[J]udges may simply lack the education necessary to do the job competently.”).

247. As Oechsli points out:

Equally troublesome are the [Civil Procedure Law’s] provisions that the court shall grant a stay of execution upon presentation of a “reasonable objection” by a person not a party to the action or where the person against whom execution is enforced does not have the financial means to pay off his debts within a short time.

Oechsli, supra note 3, at 6 (quoting Civil Procedure Law art. 182(3)). A stay may also be granted “where the court determines that a stay is appropriate.” Civil Procedure Law, supra note 79, at art. 182.

248. Zheng Interview (July 23, 1994), supra note 243. This opinion is supported by the rather unclear provision of article 182 of the Civil Procedure Law, which “suggests that a nonparty to an execution proceeding could have a priority claim (e.g., because it is a wage claim) to proceeds even if its claim were unsecured.” Oechsli, supra note 3, at 6.
courts, as in the United States, are also unlikely to require a bona fide third party purchaser of the security to return the collateral.249

Essentially, a secured party in China is only secure to the extent that possession of the security can be prevented from passing into the hands of third parties. Thus, in practice, China has no concept of security against third parties — except to the extent just mentioned — and the concept of priority is likewise nonexistent in practice.250

Priority as a legal doctrine in China is in its infancy in many respects. The Civil Code mentions priority but says nothing about what priority means.251 For example, it says nothing about how to handle disputes between creditors with security interests in the same collateral. Priority is explained more completely in the Civil Procedure Law,252 in the liquidation setting,253 and perhaps most significantly, in the real estate mortgage setting.254 According to at least one Chinese lawyer, priority has a place in China.255

In the United States, priority generally depends upon the date of filing or perfection.256 In China, the date the security interest is registered establishes priority (the "date of priority").257 Because mandatory registration creates a valid security interest, the date of priority often coincides with the creation of a valid security interest.258 This is true for land use rights259 as well as

249. E.g., Fujian Province Secured Loan Regulations art. 29 (May 1, 1991) ("When property that is required to be registered has not been registered, a bona fide third party may not be opposed.").
250. See Zheng Interview (July 23, 1994), supra note 243. Some Chinese lawyers advise dealing with the problem by including a covenant to pay in the security agreement. However, such a mechanism may only be effective if the owner of the security is solvent and the courts are willing to enforce the contractual arrangement; the latter may be unlikely. See Owen, supra note 119, at 72 (noting that Chinese courts will overlook terms of contracts, for example, in order to reach equitable solution to dispute).
251. Civil Code, supra note 76, at arts. 84, 85. If the debtor fails to discharge its debt according to the contract terms, the creditor shall have the right to "receive priority in payment" by converting the security to its value or by selling the secured assets.
252. According to that law:

Where charged property is used as security for bank loans of other credit or used as other guarantee, the bank or other creditor shall have priority in receiving repayment with respect to such guarantee . . . . After priority payment of the insolvency expenses from the property of the insolvent enterprise, the remaining property shall be applied to repayment in the following order: 1) wages of staff and workers and labor insurance premiums owed by the insolvent enterprise; 2) taxes owed by the insolvent enterprise; and 3) insolvency claims. If the assets available for distribution is insufficient to repay all the debts within the same order or priority, it shall be distributed on a pro-rata basis.

Civil Procedure Law, supra note 79, at arts. 203-04.
254. Law of China for the Administration of Real Estate in Mainland Cities and Municipalities art. 50 (July 5, 1994) (effective Jan. 1, 1995) ("For land use rights in which a mortgage has been created and which have been obtained through allocation by the Chinese government, after paying the appropriate land use rights transfer fee out of the price obtained for the auctioned land, the mortgagee may have priority in obtaining compensation.").
255. See Zheng Interview (July 19, 1994), supra note 73.
256. See LOPUCKI & WARREN, supra note 125, ch. 19.
257. Chen Interview (July 7, 1994), supra note 106.
258. Guangdong Secured Loans, supra note 81, art. 18 ("The date of registration of the above security shall be the date on which the security is established. From the date of registration the security shall be legally effective."); Beijing Municipality Measures for the Administration of Real Estate Mortgages arts. 27, 30 (Apr. 20, 1994) (section III entitled "Formation and Administration of Mortgage
for other types of property, but as in the United States, is not true under optional registration. Unregistered security interests in land use rights and in other property required to be registered are invalid under the regulations and therefore can have no priority. It is unknown how unrecorded security interests not required to be registered will rank against one another.

The Supreme People’s Court has given some guidance on the treatment of third parties relative to security interests. Any sale, transfer, or other disposition of a secured asset without consent of the secured party is void. Thus, the secured party has a kind of contractual “absolute priority” and can theoretically enforce against third parties receiving the secured property. This, of course, is not quite the meaning ascribed to “priority” in the United States. The Supreme People’s Court has said nothing to date about the priorities of competing secured parties when multiple parties have created valid security interests in the same collateral.

Although as of August 1994 the Supreme Peoples’ Court had not decided any case according to the Western concept of priority, this court probably will not strongly oppose the concept as understood in the United States. Some Chinese law firms, but by no means all, would presently be willing to render a legal opinion to the effect that, under current Chinese law, the first lender to record its security agreement can enforce the security agreement in a Chinese court against another secured party who records after the first party. The rationale for such an opinion would be that this is an accepted international practice and that the practice is reasonable.

Contracting parties should be aware that such an opinion probably would be given only if the facts showed that there had been a contractual arrangement between the mortgagor and the mortgagee indicating that the mortgagor could not mortgage the property again without the mortgagee’s approval. Many Chinese law firms would not go even this far at the present time.

---

259. *Loan Contracts* states: “Within 30 days of the execution of the real estate mortgage contract, the mortgagor must register the mortgage with the real estate administration or land administration agencies. Art. 30 Real Estate mortgages not going through registration at the registration department are invalid”;

Trial Measures of Guangzhou Municipality on the Compensatory Transfer and Assignment of Urban State-owned Land art. 30 (May 3, 1989) (effective June 1, 1989) (“Within 30 days of the notarising of a mortgage contract, the two parties to the mortgage shall present to the Municipal Real Estate Bureau... and shall undertake registration procedures. Any mortgage which has not been registered shall be deemed to be invalid.”).

260. See Wang, supra note 87, at 12 (“From the regulations, it would appear that the registration requirement of security documents relates mainly to those affecting real estate, properties which are originally subject to registration (e.g. patents and trademarks) and guarantees.”).

261. See Wang, supra note 87, at 12.

262. Opinion (Civil Law General Principles), supra note 79, art. 115.

263. Opinion (Civil Law General Principles), supra note 79, art. 115.


265. Zheng Interview (July 19, 1994), supra note 73.

266. Zheng Interview (July 19, 1994), supra note 73
C. The Government

This section discusses areas in which the holder of a security interest may be required to enforce its security interest in actions involving the government. With relation to China, the analysis and conclusions in this section are hypothetical, as the author is aware of no actual case involving the Chinese government. Chinese lawyers seem convinced, however, that private parties can enforce security interests in actions involving the Chinese government. As indicated elsewhere, what Chinese lawyers think the law is may have significance in itself.\(^{267}\)

The situation in which the holder of a security interest is most likely to encounter the Chinese government is that in which private land use rights are expropriated for government sponsored or sanctioned projects. In this situation, it is clear that compensation will be paid to the holder or owner of the land use rights.\(^{268}\) However, the position of a security interest holder is less clear. One Chinese lawyer assured the author that the security interest would continue in the compensation moneys and in any property purchased with the moneys — essentially, the "proceeds" of the secured property.\(^{269}\) Thus, it would appear that, as in the United States, enforcement proceedings against the Chinese government would rarely be necessary, as disposition of the security interest remains essentially a private matter.

A caveat is in order, however. As in the United States, if the land use rights originally were not obtained legally, or if the holder of the land use rights failed to fulfill its obligation to develop the land according to the land use rights contract, the security interest would cease to exist.\(^{270}\) This is because a security interest is considered a "secondary interest" under Chinese law.\(^{271}\) Thus, if the Chinese government were to expropriate land use rights that originally were not obtained legally, not only would the owner's interest in the land be extinguished, but the secured party would also be unable to enforce the security interest in the proceeds because the interest would be considered to have been invalid from the outset.\(^{272}\) To compound matters, the government has the right to take back land use rights without compensation where the obligation to develop the land has not been fulfilled.\(^{273}\) Therefore, there would be no proceeds in which the secured

\(^{267}\) See Jones et al., supra note 2.


\(^{269}\) Interview with Chen Jianlong, Lawyer with C & C Law Office, Beijing, in Hong Kong (Aug. 3, 1994).

\(^{270}\) The land use rights contract is a device used in all transfers of land in China. The contract is essentially an agreement between the Chinese government and the land grantee establishing certain obligations on the part of the grantee, including obligations to develop the land in a particular manner bargained for between the parties.

\(^{271}\) See Wang, supra note 87, at 9 ("Chinese law considers security rights as secondary rights so that if the obligation which is secured by the security turns out to be invalid, the security obligations will also be automatically discharged.").

\(^{272}\) See Wang, supra note 87, at 9.

\(^{273}\) See Liu & Reed, supra note 92, at 5.
party's security interest could continue.274

The situations in which the holder of a security interest in the United States is most likely to encounter the United States government are in eminent domain and government seizure cases. In eminent domain cases, similar to China, the security interest continues in the award proceeds.275 Where all of the property subject to the security interest is taken, the secured party is entitled to so much of the award as is necessary to satisfy the debt.276 In partial condemnation cases, the secured party automatically receives either the entire award,277 the amount of the award that will compensate the secured party for the impairment of the security, or a portion of the award based on the ratio that the debt bears to the security.278 In the eminent domain context, enforcement remains essentially a matter of private enforcement between private parties.

Ordinarily, the secured party must be given notice and opportunity to appear in the condemnation proceeding.279 A secured party who is not joined in such a proceeding retains the right either to foreclose on the condemned property,280 to seek and obtain a revaluation and new award in an amount sufficient to satisfy the secured claim, or to proceed against the government itself.281 The requirement that secured parties must be joined in condemnation proceedings illustrates a basic policy of protecting secured creditors in the United States.282 Even when private parties are joined in common proceedings with the United States government, they retain significant rights against the government. On the other hand, although the government must compensate interested parties, it retains the right to condemn land and buildings so long as it does not abuse its authority to do so.

V. LIQUIDATING THE SECURITY AFTER ENFORCEMENT

This part discusses liquidation law, which is in its infancy in China. To date, China has no national liquidation law, and in practice, liquidating the security after enforcement is probably one of the most difficult problems with taking security, especially for foreign parties. It is often difficult to locate markets for second hand goods in China.283 Therefore, in some cases the only practical method for liquidating the security may be to transport it out of
the country for sale.284 There are very few published examples where liquidation has been successful.

A secured party in China may liquidate its security after foreclosure in a manner provided for in local regulations.285 There are usually three methods of liquidation under most local regulations: auction, assignment, and encashment.286 The principal method is auction.287

Auctions are presently being carried out primarily in China’s SEZs and coastal regions.288 However, some of the auctions occur in the absence of published regulations. Where published regulations do exist, they contain very little detail and do little more than enable, authorize, or legitimize the development of local practices.289 Enforcement activity in the absence of published or detailed regulations indicates the existence of developed customary practices, practical necessity, or perhaps internal regulations authorizing these practices.290

The auction procedures that have been set out in some regulations closely parallel United States procedures. For example, the regulation in Guangdong Province stipulates that: (1) the lender must submit an application for auction and relevant documents to the auction organization; (2) the auction organization should check and authenticate the ownership of the secured property and establish a minimum price; (3) the auction organization should publicly announce the auction in a local paper for a period of thirty days; (4) the auction should be carried out by the auction organization after the

284. See Hebert, supra note 187, 188, 189, at 78. This is very difficult in practice. In the case of leased equipment, the lessor was forced to take possession of the equipment and make arrangements to export it to Hong Kong. This was made possible through the help of a cooperative government official who steered the lessor through the complexities of Chinese customs. Id.

285. Civil Code, supra note 76, at art. 89(c); see also Liu & Reed, supra note 92, at 12.

286. See, e.g., Guangdong Secured Loans, supra note 81, art. 25 ("The lender shall dispose of the secured property in the following ways: (1) auction; (2) assignment agreement; or (3) encashment."); Wuhan Municipality, Administration of Real Property Mortgage Procedures art. 34 (June 9, 1992), reprinted and translated in TAKING AND ENFORCING SECURITY IN CHINA, supra note 72, at 23, 28 ("A mortgagee may apply to dispose of a security in one of the following ways: (1) apply to the municipal real property exchange for public auction; (2) commission the real property exchange to sell the security; or (3) other methods approved by the Municipal Real Property Bureau.").

287. See, e.g., Tianjin Economic and Technical Development Zones, Administration of Real Property Mortgage Loan Procedures art. 36, reprinted and translated in TAKING AND ENFORCING SECURITY IN CHINA, supra note 72, at 41; see also numerous local regulations cited supra note 81.

For statutory bases for the practices see, e.g., Guangzhou Property Mortgages, supra note 81, art. 37; Tianjin Mortgage Loan Procedures, supra note 81, arts. 36-37, 39. ("When no one purchases mortgaged property at auction, other methods that may be used are: (1) both parties to the mortgage agree to transfer the ownership of the mortgaged property to the mortgagee, and carry out the procedures for the transfer of ownership of the property; (2) a replacement security provided for in the contract is auctioned; or (3) other methods agreed upon by both parties."); Fujian Secured Loans, supra note 81, art. 42; Shanghai Mortgage Loans, supra note 81, art. 26.

288. Zheng Interview (Aug. 4, 1994), supra note 212; Interview with Chen Jianlong, Chinese lawyer with C & C Law Office, Beijing, in Hong Kong (Aug. 4, 1994) ("I have seen auctions advertised in newspapers. . . . I am certain auctions are being carried out in China at the present time."). Apparently such auctions are advertised in local newspapers because I am not aware of any such notices being published in such national newspapers as Fazhi Ribao (Legal Daily) or Renmin Ribao (People's Daily).


290. Professor Jones has explained the existence of detailed internal regulations governing various aspects of China's bureaucracy. Some of these aspects are set out more completely under the first chapter of Jones et al., supra note 2.
expiration of the notice period, provided that the rights of possession in the property are not in dispute; (5) the payment of a transfer tax and the transfer of registration of the property should be carried out at the conclusion of the auction; (6) taxes owed and repayment loan principal and interest should be paid; and (7) remaining proceeds from the auction should be paid to the borrower after the costs of the auction are deducted.

Liquidation by assignment is analogous to strict foreclosure in the United States and applies in practice primarily to satisfaction of debts secured by real property. However, there appears to be no logical reason why this kind of foreclosure should not be equally useful for satisfaction of debts secured by other kinds of property. For liquidation by assignment to occur, the court must first determine that the secured party holds title to the asset. Then, the court grants possession to the secured party and presumably cancels all or part of the underlying debt. According to the regulations in Guangdong Province, possession is transferred only after an undefined “independent organization” appointed by the court determines that the asset’s market value is less than or equal to the value of the underlying debt. It can be concluded that liquidation by assignment cannot occur otherwise. In practice, assignments and transfers of all kinds of property in satisfaction of debts probably occur without regard to these paper requirements.

Encashment refers to the sale for cash of “liquid” types of property such as securities, gold, or automobiles. However, the Guangdong statutes mention encashment but provide no guidance on the proper procedures (if there are any) for performing encashment. The statutes do not even specify who is to perform the encashment.

VI. CONCLUSION

China’s dramatic modernization has introduced dynamic and powerful forces that will shape China in its future course. As discussed in this Article, important changes have already occurred. If ongoing efforts to introduce Western legal concepts and institutions continue to result in their crystallization into practice, as they seem to be doing, China’s legal system will become more dependable for domestic and foreign economic

291. In China, ownership is a loaded term with somewhat different meaning than it has in the United States. I have chosen “rights of possession” to distinguish ownership in the two countries. The two terms are becoming more synonymous with the passage of time. Property owners in China are beginning to have more freedom to transfer, convey, and alienate their rights of possession in land and other property. In some ways this occurs despite government efforts to curb such activity. Real estate speculation, one example of such activity, has been a large problem for the past two years.

292. Guangdong Secured Loans, supra note 81, arts. 27-29.

293. Zheng Interview (July 21, 1994), supra note 165. One recent example of this particular method involved the Garden Hotel in Guilin which was turned over to the lenders after the mortgagor failed to keep up on its mortgage payments.


295. See Liu & Reed, supra note 92, at 13.

296. See Liu & Reed, supra note 92, at 13.

297. See Jones, Questions, supra note 14; see also Frank Munger, Law, Change, and Litigation: A Critical Examination of an Empirical Research Tradition, 22 LAW & SOC’Y REV. 57, 77 (1988) (“Functional theory suggests that the need for intervention, at least in ongoing social relations, should not be continuing but should peak and decline as adaptations become routinized.”).
entities. Present trends will continue so long as marketization, modernization, industrialization, and internationalization remain consonant with China's other social goals.

One key to the future of China's system for taking and enforcing security is the promulgation of the long awaited national security law. In addition to being national in scope, the new law does not distinguish between foreign and domestic parties. Although more detailed and extensive in coverage than the local regulations discussed in this Article, the national security law generally provides for the same types of security as discussed here.

The new law appears quite helpful since it clarifies at which state agencies parties taking security should register, depending on the nature of the collateral they offer to secure their mortgages. It also provides that the notarial authority of the place where the mortgagor is located shall be the place for optional registration. Information filed with registration authorities is also to be made available for public perusal. Furthermore, the new law explicitly provides priority rules with respect to all mortgages. Registered mortgages take priority over mortgages registered later in time and unregistered mortgages, which in turn take priority over other unregistered mortgages entered into later.

The new security law represents a significant policy statement from the central authorities and, as such, is very important. Yet, while it represents significant developments in written law and as a matter of policy, it remains to be seen how these changes can or will be implemented in practice. It seems likely that varying location approaches to specific provisions (for example in relation to fees charged for registration) will continue to prevail. It is also unclear how long it will take for mandated changes to be implemented (in relation to the length of time it will take for registered documents to appear on a public register, for example). Numerous difficulties and complexities are certain to present themselves as the new law is implemented.

Even with the new security law, it appears that the primary and clearest source of creditor's security rights will continue to lie in the approved written agreement between debtor and creditor. Fundamental issues relating to

300. See Security Law, supra note 4, art. 42.
301. Security Law, supra note 4, art. 43.
302. Security Law, supra note 4, art. 45.
303. Security Law, supra note 4, art. 54(i).
304. Security Law, supra note 4, art. 54(ii).
308. See Oechsli, supra note 3, at 22-23 ("The most common alternatives [to a secured transaction] are to obtain payment guarantees from an authorized Chinese source or to lease the property that is purchased with the foreign creditor's funds to the Chinese venture."). See generally Cheng & Leung, supra note 137, at 1 (discussing Security Law's recognition of general principle of freedom of contract); William C. Jones, The New General Rules: A Realistic Perspective on Chinese Civil Law, E. ASIAN EXEC. REP., Sept. 15, 1986, at 9, 11 (stating that legal relations between foreigners and Chinese are mostly governed by contract); Henry R. Zheng, A Comparative Analysis of the Foreign Economic Contract Law of the People's Republic of China, 3 CHINA L. REP. 227, 257 (1986) (discussing types of contracts in
enforcement will not be resolved for a long time. However, present national
and local policies in China favor the ability of parties, both domestic and
foreign, to take security in China. Therefore, the Chinese system on paper
and in practice will continue developing to resemble United States and other
Western models even more closely.

Chinese foreign investment); Richard J. Goossen, Chinese Contract Law and the New Civil Code, E.