

**THE P.R.C.'S NEGOTIABLE INSTRUMENTS
LAW: AN INSTRUMENT FOR FACILITATING
PRIVATE ECONOMIC ACTIVITY OR
MONETARY CONTROL?**

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I. INTRODUCTION

In the years since China began its market reforms, negotiable instruments have played an increasingly

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important role in China's economy.¹ Their usage facilitates circulation of commodities, timely settlement of debts, and decreases reliance on cash.² Promoting the increased use of negotiable instruments is significant in light of China's huge circulation of cash,³ which has made it difficult to control the

1. See Ren Kan, *China: Cheques, Other Negotiable Instruments Given Boost*, BUS. WK. (China Daily Supplement), May 21, 1995, available in LEXIS, Asiapc Library, Allasi File; see also Huang Wei, *Negotiable Instruments Used in Economic Activities*, BEIJING REV., Aug. 26–Sept. 1, 1996, at 17.

[The] Chinese began using [negotiable] instruments in the first year during the reign of Dezong of the Tang Dynasty at the end of the eighth century. . . . In 1929, the Kuomintang government promulgated China's first law of negotiable instruments. . . .

After New China was founded in 1949, cashier's checks were eliminated and drafts were used only in international trade, while checks were used by government offices, businesses and institutions for the transfer of accounts. Instruments were managed in accordance with the administrative rules and regulations published by the state bank and related departments.

In 1988, the state published the Provisional Regulations on Cash Management and the Banking Settlement Method, introducing negotiable instruments such as banking drafts, commercial drafts, cashier's checks and personal checks, and allowing individual industrial and commercial households, as well as individuals to use checks.

Id.

2. See Ren Kan, *supra* note 1. Negotiable instruments have been "used to settle 60% of accounts throughout the country. The daily settlement value of negotiable instruments amounts to 104bn yuan" or US\$12.3 billion. *Id.* Every year, Chinese banks "use 54 million money orders, one billion cheques and 8.6 million cashier's cheques involving more than 45 trillion yuan" or US\$5 trillion. See *China Drafts Law on Negotiable Instruments*, REUTERS WORLD SERVICE, Feb. 22, 1995, available in LEXIS, Asiapc Library, Allasi File; see also Huang Wei, *supra* note 1, at 17 ("Incomplete statistics show that at present, various Chinese banks use around 54 million drafts valued at 4,500 billion yuan, and 1 billion checks valued at 36,000 billion yuan annually."). More recently, "The number of instruments used accounts for around 70 percent of various forms of non-cash payment. In large, economically developed cities, the use of such instruments for settlement exceeds 90 percent." *Id.*

3. See Siow Li Sen, *S'poreans Carry the Most Cash in Asia After Japanese*, BUS. TIMES (Singapore), July 16, 1997, at 2, available in LEXIS, News Library, Non-US File. "The amount of currency in circulation makes up 14.57 percent of China's GDP" partly because "the general public and commercial departments still prefer cash and are often unwilling to use or receive personal cheques . . . for fear of tax investigation" and people "spend most of their salary immediately." *Id.*; see Liu Weiling, *China: Cheques Still a Rarity in China*, BUS. WK. (China Daily Supplement), Sept. 12, 1993, available in LEXIS, Asiapc Library, Allasi File. Furthermore, certain banking and business services are not readily available in some areas of China.

"Personal checks are almost unknown in China, and company checks are very limited" Chinese business people routinely lug suitcases full of cash to pay for purchases. Since credit isn't available, a seller

total money supply, slowed the circulation of capital, and complicated monetary clearing procedures.⁴ While negotiable instruments have been utilized for some time according to commercial practice and custom, no over-arching legal framework has existed to clarify and protect parties' legal rights.⁵

The Negotiable Instruments Law of the People's Republic of China was enacted on May 10, 1995, by the Eighth Standing Committee of the National People's Congress, the highest legislative body of the People's Republic of China (PRC).⁶ The Negotiable Instruments Law, which came into effect January 1, 1996,⁷ consists of seven chapters, covering General Provisions, Drafts, Promissory Notes, Checks, Applicability of the Law to Foreign Negotiable Instruments, Legal Responsibilities, and Supplementary Provisions.⁸ Chapter 2 (Drafts) contains detailed provisions on endorsement, acceptance, guarantee, payment, and the right of recourse.⁹ Subsequent chapters discussing the various types of negotiable instruments, such as checks,¹⁰

must negotiate for a cash deposit and cash payments on delivery. Once paid, the seller then must arrange for one of the few American banks in China to convert Chinese cash to U.S. dollars.

Absorbing Culture Shock, OR. BUS., Mar. 1995, at 18, 18 (quoting Haiyang R. Yuan, President and owner of China Business Service, an Oregon based company).

4. See Ling Ling, *China: Plethora of Policies to Reduce Cash Flow*, BUS. WK (China Daily Supplement), Sept. 12, 1993, available in LEXIS, Asiapc Library, Allasi File. According to Xie Zhong, an official with the People's Bank of China, "A reduced cash circulation is of crucial importance to controlling the money supply, which is a key issue in the ongoing economic readjustment." *Id.* (quoting Zhou Zhengqing, Executive Deputy Governor, People's Bank of China).

5. See Ren Kan, *supra* note 1; see also *China Drafts Law on Negotiable Instruments*, *supra* note 2 ("[M]any disputes and instruments-related crimes have occurred due to a lack of a law on negotiable instruments, and substandard practices in handling instruments are rife.").

6. See Negotiable Instruments Law of the People's Republic of China (May 10, 1995), translated in CHINA ECON. NEWS SUPPLEMENT, July 3, 1995 [hereinafter Negotiable Instruments Law]. For an alternate translation, see PRC Negotiable Instruments Law, translated in BBC SUMMARY WORLD BROADCASTS, May 30, 1995, available in LEXIS, Asiapc Library, Bbcswb File [hereinafter BBC Translation].

7. See Negotiable Instruments Law, *supra* note 6, art. 111. The People's Bank of China will formulate detailed regulations for administering this law. See *id.* art. 110. The People's Bank of China will determine the form of negotiable instruments and their method of printing. See *id.* art. 109.

8. See *id.* Contents.

9. See *id.* ch. 2, arts. 19-72.

10. See *id.* ch. 4, arts. 82-94.

promissory notes,¹¹ and foreign instruments,¹² incorporate these provisions by reference.

While the Negotiable Instruments Law constitutes a comprehensive financial statute,¹³ it is perhaps more significant for what it does *not* address than for what it does. Without expressly stating so, the Negotiable Instruments Law is, in effect, a banking statute, one of several enacted at roughly the same time.¹⁴ It addresses a range of transactions or activities involving the use of negotiable instruments,¹⁵ but they are largely transactions in which banks participate, such as the negotiation of drafts, which need not necessarily,

11. *See id.* ch. 3, arts. 73–81.

12. *See id.* ch. 5, arts. 95–102.

13. *See* Huang Wei, *supra* note 1, at 18.

Through halting and punishing illegal activities, the law standardizes all activities dealing with negotiable instruments, safeguards the normal settlement order and places credit activities under legal jurisdiction. This law has been a great help to businesses. Commercial draft acceptance, and discount and rediscount instruments increase creditor and debtor responsibility, facilitating the establishment of a mutual supervisory mechanism. Anyone issuing drafts and cashier's checks without a reliable source of funds, or obtaining funds by deception, will be subject to legal sanctions. This measure gives businesses a higher credit guarantee. Over the past year, various banks nationwide have handled checks, draft discounts and rediscount business worth around 300 billion yuan. In all those transactions, no one has ever refused to meet their financial obligations.

In addition, detailed stipulations in the Law of Negotiable Instruments concerning the repayment time, acceptance time and related contents force the people who issue, hold and accept these instruments to do so legally and properly. Furthermore, legal instruments used for commodity transactions, discounts and rediscounts closely link the issuance and recovery of credit funds, commodity sales and the withdrawal of payments for goods sold, thus ensuring the quick allocation of funds and expediting the turnover of funds. At present, each turnover of the nation's bank loans takes 313 days, while the time limit for discount is not more than four months, and rediscount not more than three months, rotating three to four times a year.

Id.

14. In 1995 the "National People's Congress (NPC) and its Standing Committee successively enacted a much-anticipated wave of banking reforms, including the: People's Bank of China Law (PBOC Law), the Commercial Banking Law, the Negotiable Instruments Law, and the Guarantee Law." Lester Ross & Mitchell A. Silk, *Banking on Change*, CHINA BUS. REV., Nov.–Dec. 1995, at 35, 35.

15. The Negotiable Instruments Law "applies to all transactions in drafts, promissory notes, and checks in the PRC, including foreign-related negotiable instruments, defined as instruments for which draft, endorsement, acceptance, guarantee, or payment occurs in part within and in part outside the PRC." *Id.* at 38.

but in fact often do, involve banks,¹⁶ cashier's checks, and checks. What the Negotiable Instruments Law does not address is the use of promissory notes by private parties. It is in this regard that the Negotiable Instruments Law is most revealing about the Chinese government's perception of the role negotiable instruments should occupy in the economy, and perhaps the manner of conducting economic activity generally.¹⁷ The resolution of certain unanswered questions with respect to the Negotiable Instruments Law (if such issues are to be resolved) depends on the enactment of detailed implementing regulations or clarification through practice or judicial interpretation. The decision to address negotiable instrument usage in a limited fashion reflects a tension in the Chinese government's present approach to reform: to what degree should the state control economic activity? Are laws to be adopted to further individual economic activity and opportunity or to facilitate state control over the process of economic growth? The limited scope of the Negotiable Instruments Law suggests that the State Council¹⁸ adheres to the view that it is desirable to further state control over economic development and that negotiable instruments are in fact "instruments" of state involvement with and supervision over the economy. Correspondingly, the adoption of the Negotiable Instruments Law in its present form may reflect that the government is loath to enact laws that sanction or facilitate the private creation of "money" through the use of promissory notes.

II. GENERAL PROVISIONS

The Negotiable Instruments Law acknowledges a need to standardize transactions involving negotiable instruments, as

16. For a discussion of bank involvement in draft related disputes, see *infra* note 175 and accompanying text.

17. See *Top Legislator Qiao Shi Stresses Power of National People's Congress*, BBC SUMMARY WORLD BROADCASTS, Dec. 16, 1996, available in LEXIS, News Library, Curnws File (quoting Qiao Shi, Chairman of the Standing Committee of the National People's Congress; stating that economic legislation, including the Negotiable Instruments Law, is "designed to standardize the economic activities of the market, maintain market order and improve the systems of macro-control and social insurance").

18. "The bulk of legislative drafting work is performed by the State Council and its subordinate commissions, ministries, bureaus, and think tanks. The State Council also promulgates the majority of all national laws and regulations . . . and is, moreover, the key drafter of most of the NPC-promulgated laws." Murray Scot Tanner, *Organizations and Politics in China's Post-Mao Law-Making System*, in DOMESTIC LAW REFORMS IN POST-MAO CHINA 56, 65 (Pitman B. Potter ed., 1994).

well as the need to protect parties' legal rights and to promote "the development of the socialist market economy."¹⁹ According to the Negotiable Instruments Law, one does not have either liability or rights under a negotiable instrument except through the act of signing or affixing a seal to it.²⁰ Article 4 of the Negotiable Instruments Law states in part: "Other debtors who have put their signatures or seals on the negotiable instruments shall be obliged to perform the obligations arising out of the negotiable instruments."²¹ The use of the term "other debtors" or "debtor" in Article 4 is ambiguous. The term presumably encompasses all those liable on a negotiable instrument, such as the drawer, endorser, acceptor, and guarantor, but because the Negotiable Instruments Law does not define the term, its scope is not entirely clear.²² Notwithstanding the general rule set forth in Article 4 that liability arises only if one signs an instrument, Article 5 allows agents to sign on behalf of their principals if the agency relationship is disclosed on the instrument.²³ If the agent fails to disclose the agency, then the agent becomes primarily liable on the instrument.²⁴ Moreover, if an agent has a limited scope of authority and exceeds this scope, the agent, and not the principal, is liable for that part of the obligation that exceeds the scope of the agent's authority.²⁵ Where a party lacks legal capacity to execute a negotiable instrument, such party's signature is invalid.²⁶ However, this does not affect the liability of other parties' signatures on the instrument.²⁷

19. Negotiable Instruments Law, *supra* note 6, art. 1.

20. *See id.* art. 4. The rights which arise out of negotiable instruments are the rights of the holder to receive payment of the amount stated on the face of the instrument, and the right of recourse against prior holders. *See id.* Liability on the instrument is the liability of the "debtor" to pay to the holder the amount stated in the instrument. *See id.* The term "debtor" is not defined, but presumably includes prior holders. *See infra* notes 21–22 and accompanying text. Reflecting Chinese practices, Article 7 of the Negotiable Instruments Law provides that a party may execute a negotiable instrument either by signing the instrument, by affixing one's seal, or both. *See* Negotiable Instruments Law, *supra* note 6, art. 7. The signature or seal must be the party's actual name. *See id.*

21. Negotiable Instruments Law, *supra* note 6, art. 4.

22. *See id.* arts. 70–71 (defining draft debtors as including the drawer, endorser, acceptor, and guarantor).

23. *See id.* art. 5.

24. *See id.*

25. *See id.*

26. *See id.* art. 6.

27. *See id.*

Articles 8 and 9 specify certain information that must be included in a negotiable instrument.²⁸ For example, Article 8 states that the monetary amount of the instrument shall be written out both in Chinese characters and in numbers.²⁹ One form does not govern over the other; in the event of a conflict between the two, the instrument is void.³⁰ Article 9 provides that the amount, date, and name of the payee cannot be altered without voiding the instrument.³¹ However, the party issuing the instrument may modify other items in the instrument if he or she certifies the alterations by signature or seal.³²

The Negotiable Instruments Law does not contain a term precisely comparable to that of a “holder in due course” as stated in the Uniform Commercial Code (UCC);³³ however, Articles 10, 12, and 13 appear to embody certain principles contained within the holder in due course doctrine. Article 10 states:

The draft, acquisition and transfer of a negotiable instrument shall follow the principle of authenticity and creditability and be treated as a real act of trading or debt payment.

A negotiable instrument shall be acquired against a corresponding price, that is, the price acknowledged by both parties to a negotiable instrument.³⁴

The first paragraph of Article 10 seems to incorporate the good faith element of a holder in due course, with its reference to “authenticity and creditability.”³⁵ The second paragraph seems similar to the holder in due course requirement that value be given for the instrument.³⁶

28. *See id.* arts. 8, 9.

29. *See id.* art. 8.

30. *See id.*

31. *See id.* art. 9.

32. *See id.*

33. *See* U.C.C. § 3-302 (amended 1990), 2 U.L.A. 62-63 (1991).

34. Negotiable Instruments Law, *supra* note 6, art. 10.

35. *Id.*

36. *See id.*; *see also* U.C.C. § 3-302(a)(1). Under Article 11, if a negotiable instrument is obtained without payment of any consideration in certain circumstances, including by gift or inheritance, value need not be given. *See* Negotiable Instruments Law, *supra* note 6, art. 11. However, the holder will not enjoy rights superior to those of the prior holder. *See id.* art. 11. This appears similar to the rule set forth in UCC § 3-302(c) and (d). Section 3-302(c) states:

[A] person does not acquire rights of a holder in due course of an instrument taken (i) by legal process or by purchase in an

Article 12 embodies the principle that the holder in due course must take the instrument without notice of dishonor, default, claims, or defenses.³⁷ Article 12 states:

In the case of obtaining a negotiable instrument by deception, theft or coercion or obtaining a negotiable instrument which has been knowingly obtained by deception, theft or coercion out of ulterior motives, the holder shall not enjoy the rights arising out of the negotiable instruments.

A holder who has obtained the negotiable instruments not conformable to the provisions of this law due to major errors shall not enjoy the rights arising from the negotiable instruments either.³⁸

If the holder has notice of these wrongful acts, he or she will not possess full rights in the instrument.³⁹ However, as no subject is specified regarding *who* must commit the deception, theft, or coercion, or *who* must know of it, it is unclear whether it is the holder who must have committed the wrongful acts or whether liability is strict if the acts have occurred at all. Arguably, this provision could be construed to mean that whether the fraud or deception is perpetrated by the holder or some other person, the fact of its existence will defeat the holder's rights in the instrument. In such a case, a holder could take the instrument unaware of wrongdoing, and if *knowingly* obtained by deception by the *previous* holder, then the present holder's rights will be limited. A similar grammatical construction in original Chinese makes the meaning of the second paragraph of Article 12 ambiguous as well: "A holder who has obtained the negotiable instruments not conformable to the provisions of this law due to major errors shall not enjoy the rights arising from the negotiable instruments either."⁴⁰ Whose "major errors" are at issue—the holder's or some other party's?

execution, bankruptcy, or creditor's sale or similar proceeding, (ii) by purchase as part of a bulk transaction not in ordinary course of business of the transferor, or (iii) as the successor in interest to an estate or other organization.

U.C.C. § 3-302(c). Section 3-302(d) states: "[T]he holder may assert rights as a holder in due course of the instrument only to the fraction of the amount payable under the instrument equal to the value of the partial performance divided by the value of the promised performance." U.C.C. § 3-302(d).

37. See Negotiable Instruments Law, *supra* note 6, art. 12.

38. *Id.*

39. See *id.*

40. *Id.*

In analyzing the provisions of Articles 10 and 12 together, they seem to incorporate certain elements of the holder in due course doctrine and require that the circumstances of every transaction be scrutinized to determine whether the parties have a true contractual relationship, negotiated in good faith, have given consideration, and did not commit fraud or major errors. Article 13 provides in part:

Negotiable instruments debtors shall not protest⁴¹ against the holder by using the ground of protesting against the drawer or the prior holder, except when the holder has obtained the negotiable instruments with the c[lear] knowledge of the ground for protest. Negotiable instruments debtors may protest against holders who have [a] direct debtor-creditor relationship but refuse to perform their agreed obligations.⁴²

Apparently, the term “debtor” as used in this provision includes a drawee, as well as a prior holder against whom rights of recourse are sought. Such persons may not raise defects in the performance of the drawer’s or prior holder’s underlying obligations against a holder, unless that holder himself knows of such problems. Query *when* the holder must be in possession of such knowledge for his rights to be defeated. Article 13 implies that it is the holder’s knowledge at the time the instrument is acquired that is important.⁴³ What would be the result if the holder did not know of the grounds for protest at the time he acquired the instrument, but became aware of them prior to negotiating it further? An argument can be made that Article 13 as drafted does not limit such holder’s rights. In any case, an exception exists where the holder and the negotiable instrument debtor have a direct debtor-creditor relationship. In such a case, the debtor can raise the holder’s failure to perform the underlying obligation as a defense to payment on the instrument.⁴⁴

41. The term “protest” refers to when negotiable instrument debtors (the drawee or prior holders) refuse to perform their obligations to the creditors/holders. *See id.* art. 13.

42. *Id.*

43. “Negotiable instruments debtors shall not protest . . . except when the holder has obtained the negotiable instruments with the c[lear] knowledge of the ground for protest.” *Id.*

44. *See id.*

Article 14 sets forth provisions pertaining to forged or altered instruments.⁴⁵ Under Article 14, the information appearing on the face of the instrument must be true and may not be forged or altered. Those forging or altering signatures or seals, or other matters recorded on the instrument, will be liable.⁴⁶ Significantly, the statute does not state the instrument itself will be without effect in such a case. Rather, it provides the instrument is effective against the person who first signed it to the extent of its original unaltered terms.⁴⁷ Any person signing the instrument after the alteration is responsible to the extent of the forged or altered items.⁴⁸ The rule here, therefore, is one of strict liability for endorsers signing a forged or altered instrument, and protection for those who take the instrument in good faith. However, an endorser is protected by the presumption that when one cannot determine whether a signature or seal is made before or after the alteration occurred, the signature or seal is deemed to have been made prior to the alteration.⁴⁹

In cases in which an instrument is lost, Article 15 allows the person losing the instrument to stop payment on it so long as the payer (drawee) is identified on the instrument.⁵⁰ It seems that the “person losing the instrument” could refer to the drawer, the payee, or a subsequent holder. Upon receipt of the notice to stop payment, the payer is required to do so.⁵¹ The party losing the instrument must apply to the People’s Court for a public notice or file a lawsuit in the court within three days.⁵² The requirement of a public notice or lawsuit is intended to fill some sort of notice function to all parties to the instrument. In the case of Article 15, the Negotiable Instruments Law seems distressingly spare. What type of lawsuit is filed? Presumably, one to collect on the underlying debt. To whom will notice be given? Arguably, the statute leaves a great deal of discretion to those promulgating the implementing regulations or to the judiciary to apply its rules or discretion to the cases.

45. *See id.* art. 14.

46. *See id.*

47. *See id.*

48. *See id.*

49. *See id.*

50. *See id.* art. 15.

51. *See id.*

52. *See id.*

Articles 17 and 18 impose certain time limits⁵³ with regard to negotiable instruments.⁵⁴ Under Article 17 all bills and notes payable at sight become void within two years of maturity.⁵⁵ In the case of drafts, the holder's rights against the drawer will terminate six months after the date of the draft.⁵⁶ When a negotiable instrument is not accepted or is dishonored, the holder has six months to pursue his right of recourse against the prior holder.⁵⁷ When a holder has himself been sued, or recourse has been sought against him, such a holder has three months to proceed against the prior holder.⁵⁸ Should the holder fail to exercise his right to make a claim on the instrument within the specified time periods, the holder may sue on the underlying obligation.⁵⁹

Article 18 addresses the rights of a holder possessing a negotiable instrument that has become ineffective due to the expiration of time limits or because of deficiencies in the instrument.⁶⁰ Interestingly, the holder still retains rights under the civil laws to request that the drawer or acceptor remit to him the unpaid amount of the instrument.⁶¹ Perhaps this provision is intended to allow the holder to sue the drawer on the underlying obligation where the instrument itself is without effect, or to mitigate the fairly short time limits discussed above. Curiously, however, the section does not impose any requirement that the holder have a direct contractual relationship with the drawer apart from the obligations under the instrument itself. Therefore, it is not clear whether the holder can assert the contractual rights of a prior holder in seeking payment from the drawer on the obligation evidenced by the negotiable instrument or what other "civil rights" might be a source of a claim for payment.

Article 18 concludes the portion of the Negotiable Instruments Law addressing general provisions. The succeeding chapters deal with particular kinds of negotiable instruments: Chapter 2 (Drafts), Chapter 3 (Promissory Notes), and Chapter 4 (Checks). Of these chapters, Chapter 2

53. Under Article 108 of the Negotiable Instruments Law, all time limits stipulated in the law will be calculated according to the Civil Procedure Law. *See id.* art. 108.

54. *See id.* arts. 17, 18.

55. *See id.* art. 17.

56. *See id.* art. 17(2).

57. *See id.* art. 17(3).

58. *See id.* art. 17(4).

59. *See id.* art. 18.

60. *See id.*

61. *See id.*

is the most detailed, describing procedures for endorsement, acceptance, guarantee, payment, and rights of recourse. By reference to Chapter 2, Chapters 3 and 4 apply these provisions to promissory notes and checks.

III. DRAFTS

The first section of Chapter 2 (Drafts) addresses the drawing of drafts.⁶² Article 19 states that “[a] draft is a bill signed by the drawer, requiring the entrusted payer to make unconditional payment in the fixed amount at the sight of the bill or at a fixed date to the payee or the holder.”⁶³ The statute applies to bank drafts as well as commercial drafts.⁶⁴ Drafts, and in particular bank drafts, are important payment mechanisms in China today.⁶⁵ A draft is considered drawn when the drawer signs and delivers it to the payee.⁶⁶

The drawer must have genuinely entrusted payment of the draft to the payer (“drawee” in UCC parlance),⁶⁷ and must have “reliable sources of fund[s] to pay the draft amount.”⁶⁸ This requirement seems targeted at prohibiting drawers from passing drafts of which the ostensible payer is unaware. The Negotiable Instruments Law forbids signing drafts without consideration for the purpose of acquiring funds through deception from banks or from other persons.⁶⁹ Article 21 does not elaborate on how such schemes would be effected and the Negotiable Instruments Law does not contain official comments in the manner of the UCC. Perhaps the reference to a lack of consideration is intended to reflect that there is

62. See *id.* arts. 19–26.

63. *Id.* art. 19. This definition is very similar to that of the UCC. See U.C.C. § 3-104(a) (amended 1990), 2 U.L.A. 25 (1991) (“[N]egotiable instrument’ means an unconditional promise or order to pay a fixed amount of money, with or without interest or other charges described in the promise or order. . .”).

64. See Negotiable Instruments Law, *supra* note 6, art. 19.

65. See Huang Wei, *supra* note 1 (discussing Chinese banks’ use of approximately 54 million drafts annually, a total value of 4,500 billion yuan).

66. See Negotiable Instruments Law, *supra* note 6, art. 20.

67. See U.C.C. § 3-102 cmt. 3.

68. Negotiable Instruments Law, *supra* note 6, art. 21. The translation cited here translates the first paragraph of Article 21 as follows: “The drawer of a draft shall have real authorized payment relations with the *payees* and have reliable sources of fund[s] to pay the draft amount.” *Id.* (emphasis added). However, the term “payees” should be translated as “*payer*.” See BBC Translation, *supra* note 6, art. 21 (“The drawer of a bill of exchange must have a true relationship of payment authorization with the *payer*, as well as a reliable funding source from which to pay the amount stated on the bill of exchange.”) (emphasis added).

69. See Negotiable Instruments Law, *supra* note 6, art. 21.

no legitimate basis for the transaction, and hence, a deception is at work.

A draft must contain the following items: (1) the Chinese characters for draft; (2) an unconditional order to pay; (3) a fixed amount of money; (4) the payer's name; (5) the payee's name; (6) the date of the draft; and (7) the signature or seal of the drawer.⁷⁰ A draft omitting any of these items will be invalid.⁷¹ Article 23 states that "[t]he date of payment, place of payment and place of draft recorded on the draft shall be clear and definite."⁷² However, the Negotiable Instruments Law does not provide that a draft failing to state these matters clearly and definitely will be invalid.⁷³ Rather, if a draft does not state the date of payment, it is a sight draft.⁷⁴ If a draft does not state the place of payment, it shall be deemed to be the place of business, residence, or domicile of the payer.⁷⁵ If the place of the draft is not stated, the drawer's place of business, residence, or domicile shall be treated as the place of the draft.⁷⁶

A draft may contain matters in addition to those specified in Articles 22 and 23, but they will not be treated as part of the draft for purposes of the statute.⁷⁷ The due date of the draft may be expressed in four different ways: (1) payable at sight; (2) on a certain date; (3) at a fixed period after the draft is drawn; or (4) at a fixed period after sight.⁷⁸ The drawer ultimately bears responsibility for payment of the draft if it is not paid or accepted by the drawee.⁷⁹ Under Article 70, if a draft is not accepted or is dishonored, the drawer, in addition to paying the amount owing on the instrument, may be required to pay interest from the due date or the date of presentation of the draft to its liquidation, as well as any expenses incurred by the payee in "obtaining the related certificates of dishonour and the issuing of notification."⁸⁰ Under Article 71 a holder forced to pay amounts in accordance with Article 70 may pursue rights of "re-recourse"

70. *See id.* art. 22.

71. *See id.*

72. *Id.* art. 23.

73. *See id.*

74. *See id.*

75. *See id.*

76. *See id.*; *see also* discussion *infra* Part VI (discussing which country's law to apply).

77. *See* Negotiable Instruments Law, *supra* note 6, art. 24.

78. *See id.* art. 25.

79. *See id.* art. 26.

80. *Id.* art. 70.

against other “draft debtors.”⁸¹ This general reference to draft debtors appears intended to encompass both the drawer and previous holders, who are also liable on the instrument. Under this provision, the draft debtors are responsible for the same items as set forth in Article 70.⁸² These draft debtors can ultimately seek relief from the drawer.⁸³

Section 2 of Chapter 2 (Drafts) discusses endorsement.⁸⁴ Under Article 27, a draft holder may transfer all or certain rights⁸⁵ arising out of the instrument. Drafts are not transferable where the drawer writes “Not Transferable” across the face of the draft.⁸⁶ If a draft does not contain enough space for all endorsements, an allonge may be attached.⁸⁷ An endorser must sign and date the endorsement.⁸⁸ If no date is specified, the endorsement shall be treated as having been made before the maturity date of the instrument.⁸⁹ The endorsee’s name must appear on the draft if the endorser proposes to transfer all or even a portion of the rights under the draft.⁹⁰ By stating that endorsements must contain the name of the endorsee, the inference is that endorsements to the order of bearer are not allowed. However, a provision in Article 31 states: “If a draft is not endorsed over to another person, the holder shall put to the

81. *Id.* art. 71.

82. *See id.* arts. 70–71.

83. *See id.* art. 26.

84. *See id.* ch. 2, arts. 27–37.

85. The exact language of the Negotiable Instruments Law regarding endorsement is “[t]he holder of a draft may transfer the rights arising out of the draft or authorize others to exercise some of the rights.” *Id.* art. 27. The provision that an endorsement may authorize others to enjoy less than full rights suggests some kind of restrictive endorsement. Most likely, the Negotiable Instruments Law is referring to the kinds of restrictive endorsements which are common in commercial practice and which traditionally do not affect negotiability, such as “for deposit,” “for collection,” or “in trust.” *See* U.C.C. § 3-206 (amended 1990), 2 U.L.A. 57–59 (1991). However, this is not explicitly stated in the statute and hence is unclear.

86. Negotiable Instruments Law, *supra* note 6, art. 27.

87. *See id.* art. 28. An “allonge” is “[a] piece of paper annexed to a negotiable instrument or promissory note, on which to write endorsements for which there is no room on the instrument itself.” BLACK’S LAW DICTIONARY 76 (6th ed. 1990); *see also* U.C.C. § 3-204(a).

88. *See* Negotiable Instruments Law, *supra* note 6, art. 29.

89. *See id.*

90. *See id.* art. 30. The translation of Article 30 cited to herein uses the English word “endorser” rather than “endorsee.” However, the Chinese text should be translated as “endorsee.” *See* BBC Translation, *supra* note 6, art. 30. “The *endorsee*’s name must be noted on a bill of exchange when it is transferred by endorsement or when some of the rights under the bill are conferred on another person by endorsement for exercising.” *Id.* (emphasis added).

proof the right on the draft according to law.”⁹¹ By implication this provision allows the creation of bearer paper because it is not clear how a holder could obtain the instrument without endorsement except as a bearer.

Endorsements must appear on the instrument in the order in which the instrument was endorsed. This prevents an endorser from signing his name above a previous endorser’s name.⁹² A holder “shall prove the rights arising out of the draft by the uninterrupted series of endorsement.”⁹³ This provision could be construed as meaning the holder must sequentially assert his rights in the instrument against previous holders, exhausting his rights against the prior holder before proceeding to the next prior holder. However, such an interpretation would contradict Article 68, which states that the holder may exercise his right of recourse “in disregard of the sequential order of the debtors.”⁹⁴ Perhaps this provision means that the sequence of endorsement serves as evidence of the holder’s rights to the instrument.

When making an endorsement, an endorser is deemed to warrant the authenticity of the immediately prior endorsement.⁹⁵ An endorser may not attach conditions to his endorsement, and if he does so, those conditions are without effect.⁹⁶ Moreover, an endorsement purporting to transfer part or the entire amount of the draft to more than one person is without effect.⁹⁷ If an endorser writes “Not Transferable” on an instrument, and the subsequent endorser nonetheless transfers it, then the original endorser who limited the instrument’s transferability is without liability.⁹⁸ When an endorser restricts the instrument’s endorsement by noting “Collection,” the endorsee (the person receiving the instrument from the endorser) may submit the instrument for collection on behalf of the endorser, but may not further transfer the instrument to others.⁹⁹ As in the

91. Negotiable Instruments Law, *supra* note 6, art. 31. Another translation might be: In the case of an instrument that is not transferred by endorsement but is obtained through other legal means, the holder may prove his rights in the instrument by producing evidence in accordance with law.

92. *See id.*

93. *Id.*

94. *Id.* art. 68; *see infra* notes 162–65 and accompanying text.

95. *See* Negotiable Instruments Law, *supra* note 6, art. 32.

96. *See id.* art. 33.

97. *See id.*

98. *Id.* art. 34.

99. *See id.* art 35. The term “collection” could be more accurately translated as “collection by proxy.” BBC Translation, *supra* note 6, art. 35. Thus, the

American legal tradition, the Negotiable Instruments Law provides that a draft may be hypothecated.¹⁰⁰

Once payment or acceptance on a draft has been refused, or the time period for payment has passed, the draft may not be endorsed over to others.¹⁰¹ If subsequently endorsed, the person endorsing it bears liability on the draft.¹⁰² The statute does not expressly provide that the original drawer is relieved of liability, but arguably that may be the implication of this section.

An endorser becomes liable on the instrument by virtue of his endorsement.¹⁰³ The liability is twofold: the endorser guarantees acceptance or payment on the draft.¹⁰⁴ If the draft is not accepted or paid, then the endorser himself must pursue payment of the amounts due as provided in Articles 70 and 71.¹⁰⁵ Acceptance is covered by Section 3 of Chapter 2 (Drafts).¹⁰⁶ Article 38 states the general principle that acceptance is the act of a payer's promising to pay the amount of the draft when the draft falls due;¹⁰⁷ in other words, the acceptor becomes primarily liable on the instrument.¹⁰⁸ Acceptance is indicated by writing the word "Accepted" on the face of the instrument, together with the date of acceptance and the payer's signature and/or seal.¹⁰⁹ The term "presentation for acceptance" is defined as the act of the holder in presenting the draft to the payer and requesting the payer's commitment to pay it when due.¹¹⁰ Presentation for acceptance must be made within certain specified time periods for drafts payable at a fixed date or a

endorsee could be better understood to be the agent of the endorser, who is entrusted to present the instrument for collection. Apparently this section is aimed at limiting the agent's authority. The term "endorsee" used in Article 35 is not defined elsewhere in the statute, and is used in contrast to the more prevalent term appearing elsewhere in the statute as "subsequent endorser." See Negotiable Instruments Law, *supra* note 6, arts. 32, 34. Therefore, in this context, presumably the term "endorsee" is used because the agent taking the instrument under the limited endorsement of "collection" does not himself subsequently endorse the instrument.

100. See Negotiable Instruments Law, *supra* note 6, art. 35.

101. See *id.* art. 36.

102. See *id.*

103. See *id.* art. 37.

104. See *id.*

105. See *id.*; see also *infra* notes 162–65 and accompanying text.

106. See Negotiable Instruments Law, *supra* note 6, arts. 38–44.

107. See *id.* art. 38.

108. See *id.* art. 44.

109. See *id.* art. 42.

110. See *id.* art. 39.

fixed date after sight.¹¹¹ If presentation is not made during such time periods, the holder forfeits his right of recourse against any prior party.¹¹² There is no presentation requirement in the case of “a draft payable at sight.”¹¹³ A payer has three days within which to accept or refuse to accept a draft.¹¹⁴ Acceptance may not be conditional, and if an acceptance purports to impose conditions, then it is equivalent to a refusal.¹¹⁵

The role of guarantors of drafts is addressed in Section 4 of Chapter 2 (Drafts).¹¹⁶ A guarantor assumes liability for paying the amount due under a draft.¹¹⁷ A guarantor indicates his guarantee by recording on the draft or allonge the word “guarantee,” together with his name and address, the name of the guaranteed party, the date of the guarantee,¹¹⁸ and the guarantor’s signature or seal.¹¹⁹ When no guaranteed party is specified, and the draft has not been accepted, the drawer will be treated as the guaranteed party;¹²⁰ however, where the draft has been accepted, and the guaranteed party is not named, then the acceptor is assumed to be the guaranteed party.¹²¹ The Negotiable Instruments Law provides that guarantees shall be unconditional.¹²² Where a guarantee purports to be conditional, such conditions are without effect and the guarantor is still liable on the draft.¹²³ The guarantor must pay the holder who has acquired the draft in accordance with the Negotiable Instruments Law; the corollary of this, however, is that if the instrument is void because it does not comply with the provisions of the Negotiable Instruments Law, then the guarantee is also without force.¹²⁴ In this sense the guarantee

111. *See id.* arts. 39, 40.

112. *See id.* art. 40.

113. *Id.*

114. *See id.* art. 41.

115. *See id.* art. 43.

116. *See id.* ch. 2, arts. 45–52.

117. *See id.* art. 45.

118. Where no date is recorded, the date of the draft is considered the date of the guarantee. *See id.* art. 47.

119. *See id.* art. 46.

120. *See id.* art. 47.

121. *See id.*

122. *See id.* art. 48. The Negotiable Instruments Law does not specify whether the parties to a draft may vary its terms after a guarantor has signed, such as extending its due date, without affecting the guarantor’s liability. *See id.* arts. 45–52.

123. *See id.* art. 48.

124. *See id.* art. 49.

is conditional—it is conditioned on the validity of the instrument itself.

The guarantor and the guaranteed party (the draft debtor) are jointly and severally liable to pay the draft.¹²⁵ The Negotiable Instruments Law further emphasizes that if the draft is not paid when due, the holder may proceed against the guarantor for payment of the full amount without first proceeding against the guaranteed party.¹²⁶ Where there are two or more guarantors, they possess joint and several liability.¹²⁷ After paying on the guarantee, the guarantor may exercise rights of recourse against the guaranteed party and any previous holders.¹²⁸

Obligations of payment are addressed in Section 5 of Chapter 2 (Drafts).¹²⁹ Article 53 specifies certain time limits for presenting a draft for payment;¹³⁰ however, where a holder fails to make presentation for payment within the specified time periods, and provides an explanation for such failure, the acceptor or payer shall nonetheless continue to be liable under the draft.¹³¹ Where the holder presents the draft within the required time periods, the payer must pay in full on the day of presentment.¹³² A holder must sign and relinquish to the payer a draft that has been paid.¹³³

When making payments on a draft, a payer or paying agent must inspect the endorsements on the draft and examine the identification of the person presenting the instrument for payment.¹³⁴ The payer or its paying agent, as the case may be, is liable for wrongful or negligent payment,¹³⁵ such as paying an instrument before it is due.¹³⁶ Where the amount of the instrument is stated in a foreign currency, the amount shall be paid in Renminbi at the exchange rate in effect on the date of payment, unless the

125. *See id.* art. 50.

126. *See id.*

127. *See id.* arts. 51, 52.

128. *See id.* art. 52.

129. *See id.* ch. 2, arts. 53–60.

130. *See id.* art. 53.

131. *See id.* The Negotiable Instruments Law implies that a holder must explain why presentation for payment was not made within the specified time limits. However, the Negotiable Instruments Law provides no standard or criteria for acceptable explanations.

132. *See id.* art. 54.

133. *See id.* art. 55.

134. *See id.* art. 57.

135. *See id.*

136. *See id.* art. 58.

parties to the draft expressly agree otherwise.¹³⁷ Once the instrument has been paid, all debtors on the draft are released from liability.¹³⁸

Section 6 of Chapter 2 addresses the right of recourse.¹³⁹ Under Article 61, when a draft has been rejected for payment, the holder may pursue a right of recourse against the endorser, drawer, or other debtors¹⁴⁰ under the draft.¹⁴¹ Under the provisions of Article 61:

The holder may also exercise the right of recourse before the due day of a draft in one of the following cases: (1) The acceptance of a draft is refused; (2) The acceptor or payer has died or fled or lived in hiding; (3) The acceptor or payer has been declared bankrupt according to law or whose business operations have been suspended due to violations of the law.¹⁴²

In the American tradition, the payer/drawee is not liable on the draft until he accepts it.¹⁴³ Unwillingness to accept a draft does not, however, trigger the holder's right of recourse; only failure to pay does so.¹⁴⁴ By contrast, subparagraph 1 of Article 61 makes an acceptor's or payer's refusal to accept a draft grounds for the holder's exercise of the right of recourse.¹⁴⁵ Furthermore, subparagraph 3 of Article 61 makes a payer's insolvency or suspension of business operations grounds for the exercise of a holder's right of recourse.¹⁴⁶ This greatly increases the significance of acceptance because failure to accept is treated as tantamount to failure to pay. In reality, the failure to accept means only that one must look primarily to the drawer for payment. Arguably this emphasis on the importance of acceptance arises from the commercial realities of China today. The relative unfamiliarity with the use of negotiable

137. *See id.* art. 59.

138. *See id.* art. 60.

139. *See id.* ch. 2, arts. 61-72.

140. For a discussion of the Article 4 definition of "debtors," see *supra* notes 21-22 and accompanying text.

141. *See* Negotiable Instruments Law, *supra* note 6, art. 61.

142. *Id.*

143. *See* U.C.C. § 3-408 (amended 1990), 2 U.L.A. 108 (1991) ("[T]he drawee is not liable on the instrument until the drawee accepts it.").

144. *See id.* § 3-409(d), cmts. 1, 4 (discussing acceptance of certified checks, a type of draft).

145. *See* Negotiable Instruments Law, *supra* note 6, art. 61(1).

146. *See id.* art. 61(3).

instruments as settlement mechanisms,¹⁴⁷ or alternatively, the widespread incidence of fraud in their use, may make obtaining a third party's liability on the instrument critical to its credibility. By their treatment of the acceptance issue, the drafters of the Negotiable Instruments Law evidently made a policy decision to provide protection to the draft payee by accelerating the payee's right to recourse in the case of an unaccepted draft.

A holder pursuing his right of recourse must make available the proof of refusal to accept or of dishonor which the acceptor or payer has an obligation to provide the holder.¹⁴⁸ An acceptor or payer who fails to supply the holder with proof of dishonor or a statement of reasons for refusal of acceptance will subject the acceptor or payer to civil liability.¹⁴⁹ Where the acceptor or payer has fled, died, or gone into hiding, and proof of dishonor cannot be obtained from such person, then the holder may rely on other evidence to prove his right of recourse.¹⁵⁰ Additionally, in the case of an acceptor's or payer's bankruptcy, the holder may rely on court documents regarding the bankruptcy to certify the refusal.¹⁵¹ Where the acceptor's or payer's business operations have been suspended, the administrative decision of suspension serves as proof of refusal.¹⁵² If the holder fails to obtain the appropriate legal documents or proof as specified above within certain prescribed time limits,¹⁵³ then the holder forfeits his right of recourse against prior holders.¹⁵⁴ However, the acceptor or payer remains liable to the holder.¹⁵⁵

147. Despite the large number of drafts and other negotiable instruments used in China, cash plays a significant role in the nation's economy. *See supra* notes 2-3. It would be interesting to determine what percentage of China's population has any experience using negotiable instruments as a payment method, either in the commercial or personal context. The large volume of instruments negotiated may be used by only a small percentage of the population, making the need to provide assurance through the mechanism of acceptance more important.

148. *See* Negotiable Instruments Law, *supra* note 6, art. 62. This may take the form of a "certificate of dishonor" or a "statement of the grounds for protest." *Id.*

149. *See id.* The extent of potential liability is not stated. *See id.*

150. *See id.* art. 63.

151. *See id.* art. 64.

152. *See id.*

153. Presumably, these are the time periods stipulated in Article 17, regarding the statute of limitations for actions under negotiable instruments. *See supra* notes 54-58 and accompanying text for a discussion of Article 17.

154. *See* Negotiable Instruments Law, *supra* note 6, art. 65.

155. *See id.*

Article 66 sets forth the time period within which a holder must notify¹⁵⁶ prior holders of an instrument's dishonor. Within three days of the holder's receipt of the statement of refusal or notice of dishonor, the holder must provide written notification to the immediately preceding holder.¹⁵⁷ The holder must then notify his prior holder in writing within three days of receiving the notice.¹⁵⁸ The holder may also elect to provide written notice to all prior holders at the same time.¹⁵⁹ Interestingly, if prior holders are not notified within the three-day time period, the holder may nonetheless pursue his right of recourse against them.¹⁶⁰ The Negotiable Instruments Law states that failure to provide statutory notice does not diminish a holder's right of recourse; however, any party who fails to notify prior holders within the prescribed time limits may be liable for any monetary losses incurred, up to the entire amount of the draft.¹⁶¹

Holders may exercise their right of recourse against the drawer, endorser, acceptor, and guarantor, who are jointly and severally liable on the instrument.¹⁶² Furthermore, the holder may pursue his right of recourse against one, some, or all of the draft debtors (the persons specified above) without regard to the sequential order of their endorsement.¹⁶³ Even if the holder exercises his right of recourse against one or more of the draft debtors, the holder may continue to pursue this right against other debtors on the instrument.¹⁶⁴ Once a draft debtor has satisfied the debt on the instrument, he stands in the shoes of the holder.¹⁶⁵

156. Under Article 67 written notice must contain the chief details of the draft and indicate that the draft has been dishonored. *See id.* art. 67. The holder must provide proof of mailing, not proof of actual receipt by prior holders. *See id.* art. 66.

157. *See id.*

158. *See id.*

159. *See id.*

160. *See id.*

161. *See id.*

162. *See id.* art. 68. For a discussion of amounts due and expenses owing to a holder exercising his right of recourse or the right of "re-recourse," see *supra* text accompanying notes 79–83. When the right of recourse or re-recourse is exercised against a debtor, the claimant shall deliver the draft together with the proof of dishonor and the receipts for interest and expenses received from the debtor. *See Negotiable Instruments Law, supra* note 6, arts. 70, 71.

163. *See Negotiable Instruments Law, supra* note 6, art. 68.

164. *See id.* By implication, the holder should be able to pursue this right against other debtors on the instrument only if not fully satisfied; otherwise, he would receive more than his due. However, this fact is not expressly stated.

165. *See id.*; *see also id.* art. 72.

Article 69 limits who may possess the right of recourse: “In the case in which the holder is the drawer, the holder has no right of recourse to the prior holder. In the case in which the holder is the endorser, the holder has no right of recourse against the subsequent holders.”¹⁶⁶ The first sentence of Article 69 appears to address the situation in which a draft is endorsed back to the original drawer. In such a case, the drawer/holder cannot refuse payment and then, in his capacity as holder, pursue right of recourse against prior holders.¹⁶⁷ The second sentence appears to address the situation where a party endorses a draft to another, and thereafter reacquires the draft, thereby becoming the holder. Such a person cannot pursue right of recourse against subsequent holders.¹⁶⁸

IV. PROMISSORY NOTES

As mentioned above, Chapter 2 comprehensively sets forth the mechanisms for negotiability in the context of drafts. Chapter 3 focuses specifically on promissory notes,¹⁶⁹ but incorporates by reference the provisions in Chapter 2 regarding endorsement, guarantee, payment, and right of recourse.¹⁷⁰

A promissory note is defined by the statute in a manner that seems familiar enough to an American lawyer, except for one term: “A promissory note is an instrument written and issued by a *drawer*, promising to pay unconditionally a fixed amount of money to a payee or holder at the sight of the instrument.”¹⁷¹ Interestingly, the statute uses the term “drawer” rather than “promisor,” “debtor,” or “maker.” The translation generally cited to here translates the Chinese term “ ” as “promissory note.” However, others have translated it as “cashier’s check.”¹⁷² Technically, the term should be translated as “promissory note.”¹⁷³ However, use of the translation “cashier’s check” here is supported by the second paragraph of Article 73, which states that the

166. *Id.* art. 69.

167. *See id.*

168. *See id.*

169. For a discussion of the limited applicability of this chapter, see *infra* text accompanying notes 171–77.

170. *See* Negotiable Instruments Law, *supra* note 6, art. 81.

171. *Id.* art. 73 (emphasis added).

172. *See* BBC Translation, *supra* note 6, art. 73.

173. PHILIP R. BILANCIA, *DICTIONARY OF CHINESE LAW AND GOVERNMENT* 486 (1981).

Negotiable Instruments Law applies to bank checks *only* (where the bank is both drawer and drawee).¹⁷⁴

This fact is significant because nowhere in the Negotiable Instruments Law are promissory notes between private parties addressed. This omission makes the Negotiable Instruments Law essentially just another banking law, rather than a tool for facilitating and regulating the use of negotiable instruments (promissory notes) by private parties. One could argue that drafts are negotiable instruments which may be employed by private parties without the involvement of banks, yet, in the context of China, an examination of cases involving disputed drafts reveals that banks often are participating in the negotiation, or attempted negotiation, of such instruments.¹⁷⁵ The issue is whether the Negotiable Instruments Law is a “test law” for negotiable instruments in the manner that a specific geographic region often is a “test site” for new laws or policies.¹⁷⁶ Or, is the scope of the Negotiable Instruments Law the extent of what the PRC government perceives as necessary or useful in promoting its plan for China’s economic development? It is too early yet to predict an answer to this question.

Limiting the provisions of the Negotiable Instruments Law which address promissory notes and bank notes enables

174. See BBC Translation, *supra* note 6, art. 73. Compare Negotiable Instruments Law, *supra* note 6, art. 73, with U.C.C. § 3-104(g) (amended 1990), 2 U.L.A. 26 (1991) (defining a cashier’s check as “a draft with respect to which the drawer and drawee are the same bank or branches of the same bank”), and RONALD R. ANDERSON, 5A ANDERSON ON THE UNIFORM COMMERCIAL CODE § 3-104:47 (3d ed. 1994) (defining a cashier’s check as “a draft drawn by the bank upon itself which is accepted by the act of issuance”).

175. See *Jiangling Xian Di'er Mafangzhichang su Zhongguo Nongye Yinhang zhu Madian Diqu Zhongxin Zhihang Piaoju An* [*Jiangling County Second Textile Factory vs. Madian Area Branch of the Farmers' Bank of China Negotiable Instruments Case*], *Zhongguo Shenpan Anli Yaolan* [Collection of Model Chinese Cases] [hereinafter Model Cases], 1995, 1233 (Henan Sheng Zhu Madian Shi Renmin Fayuan [People’s Court of Madian City, Henan Province], 1993); *Changzhou Jinuo'er Dianqi (Jituan) Gongsu su Zhongguo Gongshang Yinhang Changzhou Fenhang, Zhongguo Gongshang Yinhang Shouning Xian Zhihang Piaoju An* [*Changzhou General Electric Company vs. Shouning County Branch of Changzhou Commerce Bank of China Negotiable Instrument Case*], Model Cases, 1995, 1239 (Jiangsu Sheng Changzhou Shi Jiaoqu Renmin Fayuan [People’s Court of the Suburbs of Changzhou City, Jiangsu County], 1993); *Zhongyinjintuo Wuzi Gongsu su Zhongguo Nongye Yinhang Xining Shi Zhihang Dongjiao Banshichu Yinhang Chengdui Huipiao An* [*Bank of China Investment Trust Company vs. East Suburban Branch of Xining City, Farmers' Bank of China, case involving the honoring of drafts*], Model Cases, 1995, 1241 (Qinghai Sheng Gaoji Renmin Fayuan [High People’s Court of Qinghai Province], 1992).

176. See *infra* note 190 (discussing Shanghai as a “test site” for the use of checks).

the government to maintain control over the money supply and economic relationships. Clearly, in developing a market-oriented economy, the existence of a legal framework governing the use of promissory notes between private parties would seem important; however, the government's unwillingness to address this issue reflects a more general dilemma: what degree of control should the government have over economic relationships? On one level, having more control is certainly advantageous to the government. Nonetheless, the Chinese government has also obviously recognized that it is necessary to relinquish a measure of control to realize its goal of economic development.¹⁷⁷ By not regularizing the ability of private parties to create "private money" through the use of enforceable promissory notes, the government maintains more control over economic interactions.

Another possibility, however, is that the government is merely taking an incremental approach, and provisions addressing uniform treatment of non-bank promissory notes will eventually be adopted. However, because the Negotiable Instruments Law only addresses a narrow scope of activity relating to promissory notes and does not address the use of promissory notes by private parties, the term " " will be translated herein as "cashier's check." The authors posit that this translation more accurately describes the instruments addressed by the Negotiable Instruments Law.

A cashier's check must contain the following provisions:

1. The Chinese characters for promissory note (cashier's check);
2. An unconditional promise to pay;¹⁷⁸
3. A fixed amount of money;
4. The payee's name;
5. The date of issuance; and
6. The signature of the drawer.¹⁷⁹

A cashier's check omitting any of the above items is void and non-negotiable.¹⁸⁰ The Negotiable Instruments Law

177. See Huang Wei, *supra* note 1 ("Along with China's rapid economic development resulting from reform and opening policies, all types of negotiable instruments have penetrated into every scope and level of Chinese society.").

178. This is in contrast to the UCC definition of a cashier's check as containing an *order* to pay. See U.C.C. § 3-104. The characterization of a promise to pay, rather than an order, makes sense given that the bank's own check and hence its agreement to pay is at issue.

179. See Negotiable Instruments Law, *supra* note 6, art. 76.

stipulates that the place of payment, place of issuance, and other matters recorded on the cashier's check must be "clear and definite."¹⁸¹ However, failure to clearly record such items does not affect negotiability.¹⁸² Article 74 states that the drawer-bank must have sufficient funds to pay the amount due under the cashier's check.¹⁸³ Under Article 75, the People's Bank of China must verify the drawer-bank's qualifications.¹⁸⁴

The drawer is liable to pay the cashier's check upon presentment;¹⁸⁵ however, the payee must make presentment within two months of the date of issuance.¹⁸⁶ The limited time period for the effectiveness of these instruments underscores the fact that they will not serve the function of creating an alternate money supply outside the purview of the Chinese government. Failure to present the cashier's check within the specified time period results in the holder forfeiting his right of recourse against prior parties other than the drawer.¹⁸⁷ Because the provisions of Chapter 2 are incorporated by reference and provide for endorsers' and drawers' joint and several liability,¹⁸⁸ the holder of a cashier's check may assert his right of recourse against either party. However, Articles 79 and 80 limit the duration of this right concerning endorsers to two months.¹⁸⁹

V. CHECKS

Chapter 4 of the Negotiable Instruments Law addresses checks,¹⁹⁰ and like Chapter 3, incorporates Chapter 2 by

180. *See id.* A cashier's check may contain other items, but they do not affect negotiability. *See id.* arts. 24, 81.

181. *Id.* art. 77.

182. *See id.* arts. 76, 77. If the cashier's check does not specify place of payment or place of issuance, the drawer-bank's place of business shall be deemed the place of payment and place of issuance. *See id.* art. 77.

183. *See id.* art. 74.

184. *See id.* art. 75. Administrative procedures for doing so will be promulgated by the People's Bank of China. *See id.*

185. *See id.* art. 78.

186. *See id.* art. 79.

187. *See id.* art. 80.

188. *See supra* notes 116-28 and accompanying text.

189. *See* Negotiable Instruments Law, *supra* note 6, arts. 79, 80.

190. *See id.* ch. 4, arts. 82-94. Shanghai was the first area in China to allow the use of personal checks "to save people from dragging huge piles of cash with them to make large purchases." *China Inaugurates Personal Cheques in Shanghai*, REUTERS, LIMITED (Money Report), Oct. 9, 1995, available in LEXIS, Asiapc Library, Allasi File. One news report indicated that more than 100 people either opened accounts or made appointments to do so on the first day of availability of the personal checks. *See China: Banks Grant Personal Checks*

reference with regard to endorsement, payment, and right of recourse.¹⁹¹ A check is defined as an instrument signed and issued by the drawer, who entrusts a bank or other financial institution to unconditionally pay the holder or payee at sight¹⁹² the amount of the check.¹⁹³ A check must contain the following:

1. The Chinese characters for cashier's check;
2. Order for unconditional payment;
3. A fixed amount;
4. Payee's name;
5. Date of the check; and
6. The drawer's signature.¹⁹⁴

A check omitting any one of these items is invalid.¹⁹⁵ A drawer may make a check payable to himself.¹⁹⁶ An applicant

in Shanghai, CHINA DAILY, Oct. 13, 1995, available in LEXIS, Asiapc Library, Allasi File. The Shanghai branch of the People's Republic of China issued temporary regulations for the use of personal checks. See Zheng Jie, *China: Personal Cheques Make Broad Debut*, SHANGHAI STAR, Sept. 15, 1995, available in LEXIS, Asiapc Library, Allasi File. These regulations actually relaxed previous restrictions on the application of checking accounts by allowing people with certain income levels and long-term residence to apply for accounts. See *id.* In 1988 the Shanghai City government promulgated "Temporary Provisions for the City of Shanghai for Negotiable Instruments." *Shanghai Shi Jinshan Xian Lugang Xinyongshe su Shanghai Yili Wenhua Jingying Gongsi*, *Shanghai Jinshan Xian Qifeng Daohang Yiqichang Piaoju Jiufen An* [Shanghai, Jinshan County Lugang Credit Society v. Shanghai Yili Cultural Management Company, Shanghai, Jinshan County Qifeng Navigational Instrument Factory Negotiable Instrument Case], Model Cases, 1993, 1006, 1008 (Shanghai Shi Huangpu Qu Renmin Fayuan [People's Court of Shanghai, Huangpu Area], 1992 ("With respect to what law to apply, currently we do not have a national negotiable instruments law. Even though the *Temporary Provisions for the City of Shanghai for Negotiable Instruments* . . . are only local regulations, in a case involving negotiable instruments and this city's enterprises, they are applicable.")).

191. See Negotiable Instruments Law, *supra* note 6, art. 94.

192. See *id.* art. 91. Article 91 stipulates that checks may not contain a later date for payment and any later date is void. See *id.*

193. See *id.* art. 82.

194. See *id.* art. 85.

195. See *id.* But see *id.* arts. 86, 87 (allowing the amount of the check and the name of the payee to be recorded later with the drawer's permission). The Negotiable Instruments Law does not state whether bearer checks are allowed. If the check does not state the place of payment or place of issuance, the Negotiable Instruments Law implies that the place of payment is the payer's place of business and the place of issuance is the drawer's place of business or residence. See *id.* art. 87. Query whether the drafters of the statute intended that the place of payment is a *bank* where the payer is located or where the payer's actual place of business exists. If the latter is the intended site (and this is what the statute states on its face), does this defeat one benefit of using a check which is to have an instrument which may be cashed at any number of places? A check may contain other items, but they do not affect negotiability. See *id.* arts. 24, 94.

opening a checking account must do so under his true name.¹⁹⁷ The applicant must be creditworthy and must deposit a certain amount in the account.¹⁹⁸ The drawer must ensure that at the time of presentment for payment, the account contains sufficient funds.¹⁹⁹ The Negotiable Instruments Law provides that checks may be used to withdraw cash or to transfer funds between accounts; specialized checks may also be printed to allow exclusively for the withdrawal of cash or transfer of funds.²⁰⁰ In all cases, the drawer is ultimately liable for payment of the amount of the check.²⁰¹

The Negotiable Instruments Law contains a very short period for presenting a check for payment: within ten days from the date of issuance.²⁰² A payer may refuse to honor checks presented after the ten-day period.²⁰³ The extremely short time frame for presenting a check for payment may be an indication that the Chinese government views checks as essentially local payment mechanisms. In the alternative, the government may again be taking an incremental approach: Checks will first be available for local transactions before expanding their scope of use to greater geographic distances.²⁰⁴ If the payer has refused payment, the drawer remains liable to the holder for the amount of the check.²⁰⁵

196. *See id.* art. 87.

197. *See id.* art. 83. Left unanswered is if one does business under a trade name, may one open a bank account under such assumed name? Perhaps the detailed banking regulations will address this issue.

198. *See id.* Presumably, the regulations will specify what this amount must be. If not, it allows the banks leverage in determining what the amount should be.

199. *See id.* art. 88. Failure to do so is "strictly forbidden." *Id.* This is a strong policy statement, however, the statute interestingly lacks penalties or fines. It is likely that the regulations will address such matters. Or, perhaps the judiciary will impose fines for which they will determine the amount.

200. *See id.* art. 84.

201. *See id.* art. 90. A drawer failing to pay the amount of the check will be liable for the amount and expenses as specified in Articles 70 and 71. *See id.* arts. 24, 94.

202. *See id.* art. 92. Other time limits may be set for checks presented in locations different than those where they are issued. *See id.* This provision would appear to recognize the difficulty of presenting a check for payment within 10 days of issuance when, for example, the check is mailed from Beijing to Chengdu. It is hoped that the implementing regulations will clarify this point.

203. *See id.*

204. *See supra* note 202 (discussing the possibility of setting alternative time limits for checks presented in different locations from those where they were issued).

205. *See* Negotiable Instruments Law, *supra* note 6, art. 92.

By having such a short time period during which a payee may present a check to a payer, query how useful checks will be in transactions involving great geographic distances. If the payee will have to look to the drawer for payment in cases where the ten-day time period is exceeded, this severely undercuts the convenience and usefulness of checks. The payee will have to pursue the drawer directly, working at a disadvantage because of physical distance. Consequently, a payee may regard a check as no more convenient a payment mechanism than a promissory note would be.

When the time limit for presentation is met and the payer makes payment on the check, the payer is discharged from liability, except in cases of gross negligence or malice.²⁰⁶ The Negotiable Instruments Law does not specify what acts or failures to act would constitute per se gross negligence or malice. Is it gross negligence for a payer bank to make payment on a check where the drawer's signature is forged? Article 85 states that to be valid, a check must contain the signature of the drawer;²⁰⁷ however, the Negotiable Instruments Law does not contain a provision comparable to section 3-401 of the UCC which provides that a person is not liable on a negotiable instrument unless he or she or an authorized representative has signed it.²⁰⁸ Arguably, it is gross negligence for a payer bank to honor a forged instrument. However, given the wide usage of chops (seals) in China and the acknowledgement of this fact in the Negotiable Instruments Law,²⁰⁹ if a drawer's chops are misappropriated and affixed to a check together with a forged signature, is the bank grossly negligent for honoring the check if it is unaware of the misappropriation? Apparently, this will be a factual determination made on a case-by-case basis and presumably it will fall to the judges to make such decisions.

VI. FOREIGN-RELATED INSTRUMENTS

Chapter 5, which discusses foreign-related negotiable instruments, addresses conflicts of law issues. Foreign-related negotiable instruments are defined as "instruments whose draft, endorsement, acceptance, guaranty or payment

206. See *id.* art. 93. The translation of the Negotiable Instruments Law cited here translates these terms as "major blunder" and "ulterior motives." *Id.* The term ". . ." should be translated as "malice" and the term "." should be translated as "gross negligence."

207. See *id.* art. 85(6).

208. See U.C.C. § 3-401 (amended 1990), 2 U.L.A. 91 (1991).

209. See Negotiable Instruments Law, *supra* note 6, arts. 4, 7.

occur both within and outside the territory of the People's Republic of China."²¹⁰ International treaties to which China is a party take precedence over the Negotiable Instruments Law, except where China has made express reservations.²¹¹ In cases not addressed by the Negotiable Instruments Law or international treaties to which China is a signatory, international custom will govern.²¹² This is an intriguing provision. Will Chinese courts actually look to international custom in dealing with negotiable instruments?

Legal capacity to negotiate an instrument is controlled by the law of the debtor's country.²¹³ However, if the debtor lacks legal capacity under the laws of his country, but the laws of the place where the act occurs allow for legal capacity, then he shall be deemed to have legal capacity.²¹⁴ With regard to what information must be contained in a draft or cashier's check, the law of the country where the draft or cashier's check was drawn applies.²¹⁵ In the case of checks, the governing law is the law of the place where the check is issued, unless the parties have stipulated that the law of the place of payment shall control.²¹⁶

With regard to endorsement, acceptance, payment, and guaranty, the law of the place where the act occurs governs.²¹⁷ In exercising the right of recourse under a draft, the law where the draft is drawn shall apply regarding the

210. *Id.* art. 95. Arguably, the Negotiable Instruments Law does not mean that all of the acts referred to occur both in China and in another country, which would seem a physical impossibility. Presumably what is meant is that certain acts occur in China and certain acts occur elsewhere, or at least there is a potential for this to be so, under the terms of the negotiable instrument.

211. *See id.* art. 96. However, this provision is largely without meaning, given that China is not a signatory to any major conventions addressing negotiable instruments. *See* Xiangmin Xu & Robert Caldwell, *An Analytical Perspective on China's Negotiable Instruments Law*, CHINA BANKING & FIN., Dec. 1995-Jan. 1996, at 5.

212. *See* Negotiable Instruments Law, *supra* note 6, art. 96.

213. *See id.* art. 97.

214. *See id.* This provision brings into play other provisions of the Negotiable Instruments Law such as Article 23. Article 23 states if the place of payment is not specified, the place of payment shall be the business site or the residence of the payer or the place where the payer often lives. *See id.* art. 23. If the place of draft is not specified on the instrument itself, it shall be taken as the business site or residence of the drawer or the place where the drawer often lives. *See id.* If the place of payment is the business site or residence of the payer under Article 23, then the laws of that place will determine legal capacity for purposes of Article 97. *See id.* art. 97.

215. *See id.* art. 98.

216. *See id.*

217. *See id.* art. 99.

time limits within which such rights must be exercised.²¹⁸ The time limit for presenting negotiable instruments for payment, the method of proving dishonor, and the period for providing proof of dishonor are determined by the law of the place of payment.²¹⁹ Where a holder has lost an instrument, the law of the place of payment governs the procedures for the holder to pursue his rights in the instrument.²²⁰

VII. VIOLATIONS

While Chapters 1 through 4 set forth the substantive provisions of the law, and Chapter 5 deals with conflicts of law issues, Chapter 6 addresses punishments for violations of the Negotiable Instruments Law. A variety of fraudulent acts constitute criminal behavior under the Negotiable Instruments Law.²²¹ Such acts are: (1) forging or altering an instrument; (2) intentionally negotiating a forged or altered instrument; (3) writing checks with insufficient funds or deliberately issuing checks with a signature that does not conform with the signature on file with the bank;²²² (4) fraudulently obtaining funds through the use of cashier's checks²²³ or drafts when there is not an actual source of funds; (5) obtaining goods by recording false information on a draft or cashier's check; (6) acquiring goods or money by wrongfully using other people's negotiable instruments or intentionally using past-due or invalid instruments; or (7) maliciously colluding between the payer and drawer or holder in committing one of the six aforementioned acts.²²⁴ Under Article 104, if one of the foregoing acts is not considered serious enough to constitute a crime, then an administrative punishment may be imposed.²²⁵ Thus, notwithstanding the provisions of Article 103 imposing criminal liability for certain acts, Article 104 allows discretion in imposing less severe punishments instead.²²⁶

218. *See id.* art. 100.

219. *See id.* art. 101.

220. *See id.* art. 102.

221. *See id.* art. 103.

222. *See id.* art. 83 (requiring an applicant opening a checking account to leave on file with the bank an example of his signature and/or seal).

223. In this context, the person being defrauded is arguably the bank because the bank will have sufficient funds to pay its check; however, the person obtaining the cashier's check may not have sufficient funds.

224. *See* Negotiable Instruments Law, *supra* note 6, art. 103.

225. *See id.* art. 104.

226. *See id.*

The Negotiable Instruments Law imposes liability in the case of employees of financial institutions who are negligent in carrying out their duties and who, as a consequence, violate provisions of the Negotiable Instruments Law.²²⁷ If an employee's negligence causes someone to suffer severe losses, then the employee may be criminally liable.²²⁸ Liability to compensate parties for losses extends to the financial institution itself and to supervisory personnel.²²⁹ Where a payer intentionally delays payment on a negotiable instrument that is due, the payer will be subject to fines, and those directly responsible will be administratively sanctioned.²³⁰ A payer who through delay causes losses to the holder of a negotiable instrument must compensate the holder accordingly.²³¹ Under Article 107, civil liability is available for acts violating the Negotiable Instruments Law, but for which compensation is not specifically provided.²³²

VIII. CONCLUSION

The Negotiable Instruments Law is an important step in developing a body of commercial law in China. However, its scope is narrow in that it addresses negotiable instruments primarily in the context of banking transactions. This is especially apparent in the case of promissory notes that are regulated solely in their use as bank notes.²³³ It will be interesting to observe whether, in the future, the Chinese government will, either through enactment of implementing regulations or passage of an amended statute, develop laws regarding promissory notes and their use in private settings.

On the whole, the Negotiable Instruments Law is well drafted and well organized; however, a critical weakness is the absence of a comprehensive definitional section.²³⁴ For example, throughout the Negotiable Instruments Law, the

227. *See id.* art. 105.

228. *See id.*

229. *See id.* Perhaps it is pursuant to Article 105 that a bank, and possibly its employees, would be found liable for honoring a check containing the forged signature of the drawer. *See supra* text accompanying notes 227–29.

230. *See* Negotiable Instruments Law, *supra* note 6, art. 106.

231. *See id.*

232. *See id.* art. 107.

233. For a discussion of promissory notes versus cashier's checks, see *supra* notes 171–90 and accompanying text.

234. One way of remedying this would be to include official comments in the manner of the UCC.

term “other debtors” is used, but not clearly defined.²³⁵ Additionally, its meaning apparently changes depending on the context.²³⁶ Moreover, the Negotiable Instruments Law appears to incorporate, in part or in whole, certain terms of art which are well-established in American negotiable instruments law—such as “holder in due course”—without express definition.²³⁷

The Negotiable Instruments Law addresses negotiable instruments in a particularly Chinese setting. The significance of certain provisions at the outset may be unclear; however, they reflect the circumstances and perceptions of China’s developing market economy and legal system. For example, Article 21 forbids signing drafts where there is no consideration to acquire funds through deception, such as in circumstances where there is actually no underlying transaction and the parties are attempting to create a false draft. The Negotiable Instruments Law fails to specify or clarify why such a provision is needed or what constitutes this kind of deception; however, presumably this provision exists because parties in China are currently engaging in this kind of behavior.

The Negotiable Instruments Law contains drafting weaknesses characteristic of Chinese statutes in terms of providing a standard, exception, or prohibition, without defining the stated term. One example is Article 53, which provides that an acceptor or payer is still liable under a draft when a holder fails to make presentation within the time periods specified in the statute but supplies an explanation for such behavior.²³⁸ The Negotiable Instruments Law does not elaborate on what constitutes an acceptable explanation or who would make such a determination, nor does it specify standards or examples.²³⁹ Absence of a clear standard means that the parties involved must resort to administrative or judicial procedures to obtain an interpretation of the section. One advantage of this drafting technique, however, is that it

235. For a discussion of Article 13, see *supra* notes 41–44 and accompanying text.

236. *See id.*

237. For a discussion of the treatment of the “holder in due course” concept in the Negotiable Instruments Law, see *supra* notes 33–40 and accompanying text.

238. *See* Negotiable Instruments Law, *supra* note 6, art. 53.

239. *See id.*

provides such authorities a great deal of flexibility in applying the statute.²⁴⁰

The passage of the Negotiable Instruments Law demonstrates that the government recognizes the importance of negotiable instruments in a market economy. While the scope of this law is admittedly narrow, it focuses on regulating significant aspects of negotiable instrument transactions. Consequently, the Negotiable Instruments Law should provide an important framework for the use of bank-related negotiable instruments in China's burgeoning economy.

240. See Pamela Yatsko, *Strings Attached*, FAR E. ECON. REV., Jan. 16, 1997, at 52; see also Law of the P.R.C. to Administer the Laying and Collecting of Taxes, art. 20 (Aug. 4, 1993), translated in [Tax'n & Customs] China L. For. Bus. (CCH) para. 39-622, discussed in Amy L. Sommers & Kara Lea Phillips, *Assessing the Tax Administration Law of the People's Republic of China*, 18 LOY. L.A. INT'L & COMP. L.J. 339, 356 & n.96 (1995) ("Notwithstanding the obligation of taxpayers to pay taxes when due, Article 20 of the Tax Administration Law provides for the grant of extensions 'due to special difficulties.' Neither the Tax Administration Law nor the Implementing Regulations define the term 'special difficulties.'") "Because so many things are new, China always leaves room for fine-tuning," Yatsko, *supra* (quoting Andrew Goodwin, a British attorney posted in Shanghai).