

## A SCHEME FOR LEGISLATING THE SIGNATURE PROCEDURE OF CHINA NATIONAL DEFENSE CONTRACTS

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**Abstract:** *By taking the process of signing a national defense contract as the breakthrough point of this thesis, we propose a scheme for legislating the signature procedure of China national defense contracts, with suggestions on setting a standard for categorizing the signature procedures, building a procedure for disclosing information in advance, as well as on normalizing the criterion for selecting suppliers, for the purpose of embodying the principles of “fairness & efficiency, openness & impartiality and normalization” during signing such a contract..*

**Keywords:** *China national defense, Signature procedure, Legislation*

### 1. INTRODUCTION

China, like many other developing countries, does not have a specialized law on regulating national defense contracts by now. Ma Jianguo, a deputy to the National People's Congress, said in 2011 that “it is urgent to do further legislative works on national defense contracts in order to limit the contractual behaviors within legal system and maintain the military and economic order”[1]. The enactment of a law, however, is not accomplished overnight. We need constant practices and have to keep drawing lessons from these practices such that we enact a law with the principle of “fairness, impartiality and efficiency”. As for China, the army can normalize the procedural rules involved in signing a national defense contract as work-level regulations before the launch of an official law of defense contracts.

### 2. RELEVANT CONCEPTS

Definitions and explanations of legal terms are different in countries because of their different legal systems. To avoid confusion, the following part gives some concepts and scopes related to procedural rules and signature procedure of national defense contracts.

**2.1 Procedural rules.** Procedural rule is a very big concept, including not only litigation rules such as administrative litigation act, criminal procedure law and civil procedure act, but also non-litigation rules such as administrative procedure law, legislative procedural law, election regulation, parliamentary rules and trade rules.

Generally speaking, non-litigation rules are legal clauses for normalizing behaviors as well as stipulating procedures, links, manners, steps, time, places and documents of matters, and are widely contained in types of laws. In general, civil law countries focus more on litigation rules than non-litigation rules. As a matter of fact, non-litigation rules are rules that are efficient in preventing disputes. The procedure of signing a contract, for example, can be deemed as a non-litigation rule. If the signature procedure is not stipulated by law, then it is hard to make clear of contracting parties' behaviors, rights and duties. What' more, confusion may also happen to the imputation of liabilities and duties after a dispute appears, especially when the main contractor has a complex identity. The procedural rules should be especially written in laws for those defense contracts in which the state, army, enterprise and individual are involved at the same time to reduce disputes and improve efficiency. In this sense, signature procedure of China defense contracts should draw lessons from the procedural rules of Anglo-American law system so as to legislate the signature procedure.

#### **2.2 Defense tender and defense contract.**

*Law of the People's Republic of China on Tenders and Bids* prescribes that tenders include public tenders and invitational tenders. A public tender means that a tender, in the form of tender announcement, invites unspecified legal persons or other unspecified organizations to submit their bids. An invitational tender means that a tender, in the form of invitation for submission of bid, invites specified legal persons or other specified organizations to submit their bids, and the number of invited parties must be larger than three.

In the United Kingdom, *The Contract Law of National Defense and Public Security* does not stipulate the ways of tendering and bidding in detail, but categorizes the procedures of defense contracts, including negotiated procedure, special procedure, restricted procedure and competitive dialogue procedure.

This categorization not only figures out whether the invited tenders are specified persons, but also takes into consideration of some factors, for example, whether the information is disclosed in advance; whether the negotiation is miscellaneous, or whether the scheme by the party who wins the bidding needs to be modified or not.

In China, as mentioned above, the scope of defense contract types is larger than that of tender types. A contract can come out not only from a tendering but also from the procurement without tendering, for example the non-competitive defense contract.

In the United Kingdom, *The Contract Law of National Defense and Public Security* specifies the service contract, procurement contract and construction contract. For the defense contract and tender types, however, it doesn't tell the difference in their scopes. But as a matter of fact, it sets a special procedure for the four types of contract, and the special procedure is exactly prepared for unusual tenders and bids. This is similar in the two countries.

**2.3 Procurement scope.** As described by *The Government Procurement Law of the People's Republic of China*, "procurement" refers to activities conducted by means of contract for the acquirement of goods, construction or services for consideration, including but not limited to purchase, lease, entrustment and employment; "goods" refer to objects of every kind and form, including but not limited to raw and processed materials, fuel, equipment and products; "construction" refers to all construction projects, including construction, reconstruction, expansion, fitting up, demolition and repair and renovation of a building or structure, and; "services" refer to any object of government procurement other than goods and construction.

In documents issued by authorities of the Chinese army, procurements of military goods, constructions and services are all called as the military procurement.

*The Contract Law of National Defense and Public Security of the United Kingdom* specifies three types of contract — service contract, procurement contract and construction contract, corresponding to activities of purchasing goods, constructing projects and purchasing services, respectively.

For this reason, procurement here refers only to activities of purchasing goods, excluding constructions and services. It is worth mentioning that the financial leasing contract, in which the ownership of goods is assigned to the tenant, is also classified as a procurement contract.

### 3. A SCHEME FOR LEGISLATING THE SIGNATURE PROCEDURE OF CHINA NATIONAL DEFENSE CONTRACTS

**3.1 Standard of signature procedure types, with the principle of "fairness and efficiency".** Differences and uncertainties exist both before and during signing a national defense contract. Distinguishing these differences and uncertainties is the best way to improve efficiency with consideration on fairness. The problem of asymmetric information may exist in a national defense contract because of its particularity. According to the number of suppliers and whether the information is disclosed in advance or not, the signature procedure can be therefore classified into following types:

The first is public negotiated procedure, namely the staged tendering procedure: the stage of offer and the stage of acceptance before a contract has been formally signed (*China Contract Law* stipulates that there are two stages for making a contract: offer and acceptance). To make clear of rights and duties and to avoid disputes, requirements on time and behaviors of contractual parties are particularly important during the two stages.

Therefore, the public negotiated procedure together with principle of fairness should be taken to make a contract. When this procedure is adopted, the army should officially release the tendering information, such that eligible tenderers can be informed and have opportunity to participate in.

During the procedure, tenderers can express their requirements and declare what they can provide in stages. In this way the best tender can be screened out. This procedure is designed with a feature that the negotiation is carried forward in stages and in a continuous way. The tendering announcement and documents should be clear (on the number of stages, deadline and requirements). At every stage, a part of suppliers should be selected for next negotiation, or, excluded out of the negotiating table. In a word, the number of suppliers should be decreased progressively but should be larger than three at the last stage. This procedure is featured in public information, full competition and complete process.

Staging the negotiation is good to a national defense contract due to its complexity. In this process, the army can not only know very well about suppliers but also set requirements in different stages to make full competition between suppliers (for a supplier who needs to be financed, for instance, financial indicators, such as debt-to-assets ratio, cash flow and tax, can be set in the first stage; or for a case where high technical requirements are needed, admittance criterion or quality certification can be set in the first stage). Finally, the supplier who meets the army's requirements can be selected out. Further, the army can assert to modify the scheme submitted by the final supplier who wins the tendering.

The second is special negotiated procedure. "Special" here means asymmetric information for some reason. When this procedure is adopted, tendering information is released not to the public but to only one supplier. The procedure will be used only for special cases, in which, there is no tenderer takes parts in; or, only specific suppliers can participate for reasons of technology or intellectual property; or, the goods is directly purchased or rented from public market; or, the goods is designed and purchased for special purpose; or, the requirements or services are added by the army under the contract; or, the supplier won the tendering in a illegal way or failed to pass subsequent assessment(s) but there is no material alteration made to the contract (according to China Contract Law, material alteration means any change to the eight basic articles); or, the contract is new but its content is the same to the original contract signed with the same supplier five years ago, etc. For these special cases, there is no public announcements and information. This is an exception to the principle of fairness. However, these cases are inevitable existence. The procedure shows that the principle of efficiency is superior to the principle of fairness.

The third is restricted procedure. If the special negotiated procedure can be deemed as a special version of the public negotiated procedure, then the restricted procedure can be deemed as a simplified version of the public negotiated procedure. What it restricts is the stage of the negotiation. In other words, there is only one stage in negotiation: the stage of offer and acceptance. Of course, this procedure involves several suppliers. When the procedure is adopted, the number of suppliers is required to be no less than three. When there are too many suppliers, the army can restrict them by setting objective and non-discriminatory conditions to improve efficiency.

After receiving the offers from suppliers, the army shall invite them in form of written notification, with the deadline for acceptance, exceptions or emergencies. In a public negotiated procedure, the army can assert its requirements for many times and can screen suppliers to pick out the best. Unlike that, this procedure is to search offers at the very moment when the tendering information is released, and after receiving the offers it decides to select a supplier to make the contract or decides to enter in other procedures (when there are not enough suppliers or the suppliers cannot meet the financial requirements). In fact, this procedure is an embodiment of the principle of efficiency and is also a supplement to the public negotiated procedure.

The fourth is competitive dialogue procedure. This procedure will be used when the army considers that it is impossible to make a successful tendering by using the public negotiated procedure or restricted procedure. A competitive dialogue procedure is applicable to complex cases: the purchaser itself cannot ascertain the technical solution that satisfies requirements, or cannot determine the legal or financial supplementary items of the purchasing scheme. It is worth to note that the cost of this procedure is high for both the army and the supplier(s). Therefore, it is not suitable for low-priced tenders.

A competitive dialogue procedure will also involve several suppliers, who are invited, in the form of notification, to take part in the tendering. Basically, it is similar to a public negotiated procedure, but it has following differences: First, in a competitive dialogue procedure, purchasing requirements are gradually revealed during several rounds of dialogue to make clear of suppliers' response. A public negotiated procedure, however, is a process for suppliers to show their powers and strengths. That is to say, the competitive dialogue procedure is more applicable to contracts that have higher requirements and more complex conditions. Second, in a competitive dialogue procedure, suppliers can modify their schemes in accordance with the information provided by the army; while in a public negotiated procedure, it is the army who asserts to modify the scheme after the final supplier has been determined. In other words, suppliers, as competitors, would face more uncertainties and risks in a competitive dialogue procedure.

Third, content of the dialogue can be related not only to technologies, but also to financial or legal terms, such as price, cost, tax, risk control and assignment, warranty and the possibility of founding a companying for a special purpose.

What's more, because the competitive dialogue procedure is used for complex contracts, the army shall control the process of negotiation to improve efficiency. During the process of making a national defense contract, this procedure can release a signal of complexity, facilitate an in-depth understanding between the two parties, and provide an opportunity for the army to cut its cost. It is also good for confidential information (for example, the army can let the most competitive suppliers into the core and top confidential information at the final stage to lower the possibility of information disclosure). In addition, there is more than one supplier participating throughout the procedure, demonstrating the principle of "fairness and openness".

**3.2 Building an information disclosure procedure to embody the principle of "fairness and openness".** A national defense contract is a special contract with special content. During signing a defense contract, the possible information asymmetry is likely to become a factor that blocks full competition, cause corruption and increase the cost of the army. For this reason, it is very necessary and urgent to design a procedure for disclosing information. The information disclosure procedure can be set, in the form of work-level regulation, to make sure of normalization and openness.

First, the scope of disclosure. That is to say, information for what types of defense contract and for what cases must be disclosed in advance; and what are exceptions. For instance, information for a draft contract doesn't have to be disclosed in advance. But the procedures of tendering invitation and negotiation must be made clear of.

Second, the content of disclosure, for example, the date for signing the contract; and the standard for defining the types of goods or projects.

Third, the criterion for forms and rules of submitting and approving documents.

Of course, the time and content of the disclosed information are different for different signature procedures. What needs to be noted is that whether the information of purchasing pattern needs to be disclosed, and whether the behavior of such disclosure can be prosecuted or not. By now, the disclosure of the formation of purchasing pattern cannot be prosecuted in China.

This is because such a disclosure is to ask for opinions from the public by an administrative agency, and the disclosure is not an administrative behavior.

For this reason, suppliers have no rights to take prosecution, administrative reconsideration or proceedings against the disclosure and its content.

**3.3 Normalizing the supplier inclusion criterion and Systematizing the selection standard.** First, inclusion criterion. Inclusion criterion is to guarantee the quality of suppliers for the military procurement. It is also to reduce the transaction cost of the two parties and the contractual risks during making a national defense contract. At present, this criterion can be implemented by grading: preferred supplier, Secondary supplier...; preferred contractor, Secondary contractor...; preferred services provider, Secondary services provider..., etc. Such priority level is related to contracts' importance, complexity and value.

Second, exclusion criterion. This criterion may include factors such as the loss of credit, the worsening of financial conditions, the loss of technical advantages, and so on.

Third, incentive standard. This is also a common method in managements. It is to make a dynamic management on suppliers, with setting some indexes such as: credit, cost and period.[2] Those who actively achieve or even over fulfil their tasks should be awarded or promoted.

In short, a good system design is an efficient way to prevent disputes, reduce transaction cost and improve purchasing efficiency. At present, it is feasible and necessary to normalize the signature procedure of China national defense contracts.

#### 4. CONCLUSION

The tentative conclusion that follows is that China need a scheme for legislating the signature procedure of national defense contracts. First, China need to standard of signature procedure types. Second, they need to build an information disclosure procedure to embody the principle of "fairness and openness". Third, they need to normalize the supplier inclusion criterion.

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