

PANORAMIC **COMMERCIAL CONTRACTS**

China



LEXOLOGY

Commercial Contracts

Contributing Editors

Timothy Harkness, Linda H Martin, David Livshiz and Scott Eisman
Freshfields

Generated on: March 21, 2025

The information contained in this report is indicative only. Law Business Research is not responsible for any actions (or lack thereof) taken as a result of relying on or in any way using information contained in this report and in no event shall be liable for any damages resulting from reliance on or use of this information. Copyright 2006 - 2025 Law Business Research

Contents

Commercial Contracts

CONTRACT FORMATION

- Good faith in negotiating
- Oral contracts
- 'Battle of the forms' disputes
- Language requirements
- Signatures and other execution formalities

STATUTORY CONTROLS AND IMPLIED TERMS

- Controls on freedom to agree terms
- Standard form contracts
- Implied terms
- Vienna Convention
- Good faith in entering and performing

LIMITING LIABILITY

- Prohibition on exclusions and limitations
- Financial caps
- Indemnities
- Liquidated damages

PAYMENT TERMS

- Statutory time limits on payments
- Late payment interest
- Civil penalties

TERMINATION

- Implied terms
- Notice period
- Automatic termination on insolvency
- Termination for financial distress
- Force majeure
- Frustration and impossibility of performance
- Material adverse events and material adverse changes

SUBCONTRACTING, ASSIGNMENT AND THIRD-PARTY RIGHTS

- Subcontracting without consent
- Statutory rules
- Assignment of rights and obligations
- Enforcement by a third party

DISPUTES

Limitation periods
Contract interpretation
Choice-of-law clauses
Efficiency of the local legal system
New York Convention

REMEDIES

Available remedies

UPDATE AND TRENDS

Recent developments

Contributors

China

BUREN



Jan Holthuis

j.holthuis@burenlegal.com

CONTRACT FORMATION

Good faith in negotiating

Is there an obligation to use good faith when negotiating a contract?

Since coming into effect on 1 January 2021, the Chinese Civil Code brought the principle of good faith into the provision of liability for negligence in contracting. Under article 500 of the Chinese Civil Code, when entering a contract, the parties shall not:

1. negotiate the contract in bad faith under the pretext of concluding a contract;
2. deliberately conceal material facts relating to the conclusion of the contract or provide false information; or
3. perform other acts that violate the principle of good faith.

If a party behaves as mentioned above and thereby causes losses to the other party, it shall be liable for compensation.

In addition, article 501 further specified the principle of good faith in terms of non-disclosure of commercial secrets. It stipulates that a party shall not disclose or improperly use trade secrets or other confidential information known to it in the course of concluding a contract, no matter whether the contract is established or not; if it discloses or improperly uses such trade secrets or information and causes losses to the other party, it shall be liable for compensation.

The Civil Code also includes good faith as a general principle for all civil activities in article 7. Thus, the use of good faith has become an obligation for parties in the negotiation of a contract.

Law stated - 19 July 2024

Oral contracts

Is an oral contract binding in your jurisdiction?

Oral contracts are expressly permitted under article 469 of Chinese Civil Code, which stipulates that the parties may enter into contracts in written, orally or in other forms. That said, a valid oral contract shall identically include the parties, the subject matter and the amount despite its brevity. In commercial practices, it is recommended to adopt written contracts with detailed rights and obligations set forth therein to guard against disputes and the subsequent burden of proof that a valid and legal agreement exists.

Meanwhile, it is mandatory that the following types of contracts shall be made and executed in writing to be valid:

1. loan contracts other than otherwise agreed upon between natural persons;
2. guarantee agreements;
3. lease agreements with a term longer than six months;
4. finance lease agreements;

5. factoring agreements;
6. construction agreements;
7. technology development agreements;
8. technology transfer agreement;
9. technology licence agreement; and
10. property management agreement.

Law stated - 19 July 2024

'Battle of the forms' disputes

How are 'battle of the forms' disputes resolved in your jurisdiction?

When resolving the 'battle of the forms' disputes, the Chinese Civil Code adopts a resolution with reference to the Last Shot Rule and the Knock-out Rule.

The Chinese Civil Code recognises the 'mirror-image' principle by providing that the contents of an acceptance shall be consistent with those of the offer, that is to say, the offeree must accept the terms of the offer in their entirety.

However, to encourage the formation of a contract and to ensure business efficiency, the Chinese Civil Code makes a distinction between substantial alterations and non-substantial alterations, and only if the offeree substantially alters the contents of the offer shall it constitute a new offer. Substantial alterations, under the Chinese Civil Code, refer to alterations to the subject matter of the contract, quantity, quality, price or remuneration, time limit, place and method of performance, liability for breach of contract and method of dispute resolution, etc.

If the offeree makes non-substantial alterations to the contents of the offer, the offeree's acceptance shall be effective, and the contents of the contract shall be subject to those of the acceptance, except as rejected promptly by the offeror or indicated in the offer that an acceptance may not alter the offer at all.

On the other hand, under the Chinese Civil Code, an acceptance shall be made by notification, except where acceptance may be made by an act on the basis of customary business practice or as expressed in the offer.

Based on the above, a 'battle of the forms' dispute is resolved under the Chinese Civil Code by a logic of either 'offer – substantial alterations – new offer – acceptance' or 'offer – non-substantial alterations – acceptance'.

Law stated - 19 July 2024

Language requirements

Is there a legal requirement to draft the contract in the local language?

There is no legal language requirement for drafting a contract under People's Republic of China (PRC) law. In practice, parties may draft the contract in a bilingual form in both Chinese and another language, particularly if one of the parties is a foreign party. According to article 466 of the Chinese Civil Code, where a contract is concluded in two or more languages and it is agreed that all versions are equally authentic, the words and sentences in each version are presumed to have the same meaning. In the case of any discrepancy in the words and sentences used in different versions, they shall be interpreted in accordance with the relevant terms, nature and purpose of the contract as well as the principle of good faith.

Moreover, certain contracts are subject to approval or other procedures in accordance with laws and administrative regulations. In this circumstance, it is better to prepare a Chinese version of the contract for the competent authority to review.

Law stated - 19 July 2024

Signatures and other execution formalities

In what circumstances are signatures or any other formalities required to execute commercial contracts in your jurisdiction? Is it possible to agree a B2B contract online (eg, using a click-to-accept process)? Does the law recognise the validity of electronic and digital contract signatures? If so, how are they treated in comparison to wet-ink signatures?

In general, under PRC law, the parties can conclude a contract in written form or any other form. According to article 490(2) of the Chinese Civil Code, the written form requirement of a contract is not mandatory, and does not affect the effect of the contract.

Under normal circumstances, a signature or seal is proof of the establishment of the contract. According to article 490(1) of the Chinese Civil Code, when the parties conclude a contract in written form, the contract is established when both parties have signed it, affixed their seals thereon or have affixed their fingerprints thereon.

Regarding the signature and the stamp, in China, a stamp usually has priority and has the external effect that can be regarded as agency authority. Under PRC law, the company stamp is the externalisation of the company's will and is legally binding, which is of great significance for commercial activities.

It is possible to conclude a contract online under the Chinese Civil Code and E-commerce Law of the PRC (E-commerce Law).

According to article 469 of the Chinese Civil Code, the parties may conclude a contract in writing, orally or in some other form. Any electronic data that can show, in material form, the contents that it specifies through electronic data exchange or email can be accessed for reference and used at any time and shall be regarded as a written form.

In particular, if the contract is an online sales contract, the click-to-accept process can be adopted. According to article 491(2) of the Chinese Civil Code, where the information of any commodity or service released by one party via the internet or any other information network meets the conditions of the offer, the contract shall be established when the other party selects such commodity or service and submits the order successfully, unless otherwise agreed by the parties. It is also stipulated in the E-commerce Law that e-commerce participants using an automated information system to conclude or perform contracts

shall be legally binding on the parties using the said system (article 48(1)), and where the information on goods or services announced by an e-commerce business operator satisfies the criteria for making an offer, the contract shall be deemed established if the user selects the said goods or services and submits an order (article 49(1)).

In China, electronic and digital signatures have the same legal validity as a wet-inked signature or affixation of a seal, according to the Electronic Signature Law of the PRC (Electronic Signature Law).

However, certain conditions must be satisfied for the electronic signature to achieve legal effect. According to article 13 of the Electronic Signature Law, an electronic signature shall be deemed a reliable electronic signature if it satisfies all of the following criteria:

1. when the electronic signature creation data is used for electronic signature, it is exclusively proprietary to the electronic signatory;
2. the electronic signature creation data is exclusively controlled by the electronic signatory at the time of signing;
3. any subsequent alteration to the electronic signature after the signature can be detectable; and
4. any subsequent alteration to the content and form of the data message after the signature can be detected.

Reliable electronic signatures will have the same legal validity as a handwritten signature or affixation of seal.

Law stated - 19 July 2024

STATUTORY CONTROLS AND IMPLIED TERMS

Controls on freedom to agree terms

Are there any statutory or other controls on parties' freedom to agree terms in contracts between commercial parties in your jurisdiction?

In general, parties to a contract have the freedom to agree to the terms in a contract under PRC law. It is stipulated in article 470 of the Chinese Civil Code that the contents of a contract shall be agreed upon by the parties, and shall generally contain the following clauses:

1. personal names or names and domiciles of the parties;
2. subject matter;
3. quantity;
4. quality;
5. price or remuneration;
6. time limit, place and method of performance;
7. liability for breach of contract; and
8. dispute settlement method.

The parties may conclude a contract by reference to a format of texts of each type of contract.

However, this provision is guidance on the terms of contract rather than a mandatory requirement. The parties are not necessarily bound by those terms, and can adopt their own format texts and agreed terms.

There are certain conditions that shall be satisfied for the contract to be effective. According to articles 146, 153 and 154 of the Chinese Civil Code, the contract shall be null and void if it:

1. the terms are concluded by persons of civil conduct and counterparties under false manifestation;
2. the terms violate the mandatory provisions of laws and administrative regulations; or
3. the terms are concluded by a person who colludes with their counterparty to impair others' legitimate rights and interests.

In addition, certain types of exception clauses in a contract shall be null and void according to article 506 of the Chinese Civil Code as follows:

1. those that cause personal injury to the other party; or
2. those involving property damage to the other party as a result of deliberate intent or gross negligence.

In special situations, Chinese laws can restrict the liberty of parties to form contracts to safeguard public interests.

To illustrate, the Chinese Civil Code's article 494 mandates that pertinent civil entities enter into a contract compliant with requirements related to emergency response, disaster relief, disease prevention and management, or other necessities. These parties are obligated to propose or accept in accordance with legal or administrative rules. Furthermore, article 810 prevents a public transportation provider from declining a passenger or consignor's ordinary and justifiable transportation request.

Law stated - 19 July 2024

Standard form contracts

Are standard form contracts treated differently from those that are freely negotiated?

The standard form contracts have legal effect, but the party providing the standard terms shall observe certain obligations stipulated by the Chinese Civil Code.

Standard terms are clauses that are prepared by one party in advance for repeated use and that are not subject to negotiation with the other party when concluding a contract (article 496(1), the Chinese Civil Code).

As the standard terms are drafted in advance by one party without negotiating with the other party, to achieve the principle of fairness and protect the legal rights of the other party the

Chinese Civil Code stipulates some specific obligations on the party providing the standard terms as follows:

1. it shall observe the principle of fairness in determining the rights and obligations of the parties;
2. it must remind the other party in a reasonable way of the provisions that greatly affect the other party, such as those that exclude or mitigate the liability of the party providing the standard terms; and
3. it must explain the standard terms at the request of the other party.

If the party providing the standard terms fails to perform the obligations of reminding or explanation, causing the other party to fail to notice or understand the terms in which it has a material interest, the other party may claim that the terms do not form the contents of the contract.

Moreover, to better protect the other party, where there are two or more interpretations of standard terms, the interpretation unfavourable to the party providing such term shall prevail. Where a standard term is inconsistent with a non-standard term, the non-standard term shall prevail (article 498, the Chinese Civil Code).

Law stated - 19 July 2024

Implied terms

What terms are implied by law into the contract? Is it possible to exclude these in a commercial relationship?

In Chinese law, the concept of 'implied terms' is not introduced as in common law. According to article 470 of the Chinese Civil Code, the contents of a contract shall include the terms of the contract parties, subject matter, quantities, quality requirements, price or remunerations, time limit, places and method of performance, and such like.

Although the Chinese Civil Code does not provide which terms are implied by law, it respects trading practices and recognises that trading practices could fill in the blank space if there are no express terms. After the effectiveness of a contract, if there is no agreement on the terms regarding quality, price or remuneration or place of performance, or such agreement is unclear, the parties may enter into a supplementary agreement. If no supplementary agreement is reached, the relevant terms of the contract or trading practices shall govern.

Particularly in terms of any warranties on the quality of products, if quality requirements are unclear, the contract shall be performed according to compulsory national standards. In the absence of compulsory national standards, the recommended national standards shall apply. In the absence of recommended national standards, the industry standards shall be followed; in the absence of national standards or industry standards, the contract shall be performed in accordance with customary standards or specific standards in conformity with the purpose of the contract.

Meanwhile, in some judicial precedents, the Chinese courts may agree that the requirements stipulated in the Product Quality Law should be deemed as an 'implied guarantee' for the

quality requirements. Article 26 of the Product Quality Law was cited, which stipulates that product quality shall satisfy the following requirements:

1. no unreasonable danger to personal safety or the safety of property shall exist; where there are national or industry standards for the protection of health, personal safety and the safety of property, such standards shall be complied with;
2. products must possess the properties for use that should be possessed by such products, except for products where flaws in their properties for use are clearly indicated; and
3. products must conform to the product standards carried on the product or its packaging, and conform to the quality indicated by such means as the product description and physical samples, and such like.

For the requirements stipulated in the Product Quality Law, the provision also clarifies that the first requirement is compulsory and cannot be excluded, while the second is a non-compulsory requirement and could be excluded by agreement.

Law stated - 19 July 2024

Vienna Convention

Is your jurisdiction a signatory to the United Nations Convention on Contracts for the International Sale of Goods (the Vienna Convention)?

China signed the United Nations Convention on Contracts for the International Sale of Goods (CISG) in 1981 and approved it on 11 December 1986. China makes a reservation in relation to the application of article 1(1)(b) (ie, this Convention applies to contracts of sale of goods between parties whose places of business are in different states: when the rules of private international law lead to the application of the law of a contracting state, and only adopt CISG among contracting states).

Law stated - 19 July 2024

Good faith in entering and performing

Is there an obligation to use good faith when entering and performing a contract?

Good faith is established as a general principle for engaging in all civil actions under Chinese laws. When entering a contract, the Chinese Civil Code establishes that any party that violates the principle of good faith in negotiation shall bear the liabilities for negligence in contracting if losses are incurred by the other party.

In addition, a party shall not disclose or improperly use trade secrets or other confidential information known to it in the course of concluding a contract, no matter whether the contract is established or not; if it discloses or improperly uses such trade secrets or information and causes losses to the other party, it shall be liable for compensation.

When performing a contract, the Chinese Civil Code also establishes that contract parties shall observe the principle of good faith. Meanwhile, the parties shall not only fully perform their respective obligations as agreed, but also, under the principle of good faith, perform such obligations as notification, rendering assistance and maintaining confidentiality according to the nature and purpose of the contract as well as trading practices.

Law stated - 19 July 2024

LIMITING LIABILITY

Prohibition on exclusions and limitations

Can parties agree to limit liability? If so, are there any limits on what liabilities can and cannot be excluded or limited by contract (including, for example, by a supplier in a contract)?

Liabilities exemption or limitation clauses refer to clauses agreed by the parties that aim at limiting one party or both parties' liabilities in the future, thus reducing the parties' risks of being claimed. In general, Chinese law allows parties to agree on exemption or limitation clauses, but they cannot violate the good faith principle and public interest. According to the Chinese Civil Code, the following exception clauses in a contract shall be null and void:

1. those that cause personal injury to the other party;
2. those involving property damage to the other party as a result of deliberate intent or gross negligence; or
3. those endangering the interests of the state, the collective community or a bona fide third party.

Furthermore, considering that the essence of the exemption or limitation clause is to confirm and allocate prospective risks in advance (in particular, to exempt the liabilities incurred by events emerging after the contract has been signed), the parties shall not conceal practical risks occurring before or during the signing of the contract. According to the Chinese Civil Code, where the parties agree to relieve or exempt the liability of the seller for the defects of the subject matter, and the seller fails to inform the purchaser of the defects of the subject matter intentionally or due to gross negligence, the seller shall have no right to claim for relief or exemption of its liability.

In addition, where the exemption or limitation clauses are standard terms, the party providing the standard terms shall observe more obligations. If the party providing the standard terms unreasonably exempts or reduces its liability, increasing the liability of the other party; limits the major rights of the other party; or excludes the main rights of the other party, the standard terms shall be null and void.

Law stated - 19 July 2024

Financial caps

Are there any statutory controls on using financial caps to limit liability for breach of contract?

Under Chinese law, the liability for breach of contract is more about compensation rather than punishment or a penalty. The circumstances triggering liability for breach of contract are defined as a contracting party failing to perform its obligations under the contract, or its performance failing to conform to the agreement, and thus causing losses to the other party.

Under such circumstances, the financial caps to limit liability for breach of contract shall be equal to the losses caused by the breach of contract, including the interest receivable after the performance of the contract, but shall not exceed the probable losses caused by the breach of contract that have been foreseen or ought to have been foreseen by the breaching party when the contract is concluded. In a case where the contracting parties agree on liquidated damages, a People's Court or an arbitration tribunal is still entitled to adjust the amount of liquidated damages if such amount is too inappropriate compared to the actual losses.

Law stated - 19 July 2024

Indemnities

Are there any statutory controls on indemnities used to cover liability risks in contracts?

The concept of indemnity does not exist in Chinese law in relation to commercial contracts.

Indemnities serve to mitigate liability risks in contracts, established by a clause where one contracting party agrees to indemnify and hold harmless the other party from any obligations, liabilities, costs and expenses arising out of specific events or actions. The indemnities could be unilateral or bilateral. Once triggered, the indemnities shall become an independent debt in addition to the subject debt of the contract.

Under Chinese law, there is no provision or stipulation to control indemnity clauses, while in principle, wherever the breach of contract occurs, the breaching party shall compensate for the actual losses due to the breach of contract. The 'inferred reliance' doctrine is rooted in Chinese law and judicial practices in determining the burden of liabilities due to the occurrence of a breach of contract.

Law stated - 19 July 2024

Liquidated damages

Are liquidated damages clauses enforceable and commonly used in your jurisdiction?

Liquidated damages are explicitly permitted under Chinese laws. According to the Chinese Civil Code, the contract parties may agree on liquidated damages clauses, which could stipulate either a certain sum of liquidated damages in light of the circumstances of the breach or a method for the calculation of damages incurred as a result of a breach.

However, the Chinese Civil Code also grants the People's Courts and arbitration tribunals the discretion to adjust the amount of liquidated damages. In the circumstances where the amount of liquidated damages agreed upon is lower than the losses incurred, the court or an arbitration tribunal may increase such amount upon the request of the parties based on the actual loss caused by the breach of contract. Where the amount of liquidated damages agreed upon is excessively higher than the losses incurred, the court or the arbitration tribunal may appropriately reduce such amount upon the request of the parties. The amount of liquidated damages can be regarded as excessively higher if it exceeds 30 per cent of the losses caused.

Law stated - 19 July 2024

PAYMENT TERMS

Statutory time limits on payments

Are there statutory time limits for paying invoices? Is it possible to agree a different payment period?

There are no mandatory time limits for payment under Chinese law; instead, the parties can agree on the payment date or period. The purchaser shall pay the purchase price at the agreed time.

Where the time for payment is not agreed or the agreement is not clear, the parties may enter into a supplementary agreement; if no supplementary agreement is reached, the relevant terms of the contract or trading practices shall govern. If the payment time still cannot be determined in accordance with the aforementioned methods, the obligor may perform, and the obligee may request performance at any time provided that the other party shall be given the time required for preparation.

Law stated - 19 July 2024

Late payment interest

Is statutory interest charged on late payments? Is it possible to agree a different rate of interest?

In a sales contract, the contract parties may agree on liquidated damages or a rate of interest for late payment.

If no agreement is made in the sales contract, when the purchaser delays the payment, resulting in a breach of contract, the seller may initiate civil proceedings and claim damages of the late payment interest, where the rate of interest is stipulated by the Interpretation on Issues Relating to Application of Law in Hearing Cases of Disputes over Sales Contracts promulgated by the Supreme People's Court. Article 18 provides that if the breach of contract occurred before 19 August 2019, the court may make a computation on the basis of the benchmark interest rate of the People's Bank of China (PBC) for yuan-denominated loans of the same type and period, and with reference to late penalty interest rate standards; where the breach of contract occurred after 20 August 2019, the court may make a computation of losses incurred from late payment based on the one-year loan prime rate (LPR) announced

by the National Interbank Funding Centre with authorisation of the PBC at the time of occurrence of the breach of contract, further increased by 30 to 50 per cent.

Especially with regard to the LPR, the PBC has authorised the National Interbank Funding Center to release the benchmark LPR of the PBC at 9.30 am on the 20th of each month (subject to postponement in case of holidays). At the time of writing, the LPR is 3.55 per cent for a one-year loan.

Law stated - 19 July 2024

Civil penalties

What are the civil penalties for failing to comply with statutory interest rate or late payment of invoices?

For late payment, the obligee is entitled to request the obligor to continue performance as well as to compensate for the losses due to the late payment.

The interest rate for late payment stipulated in the interpretation fills in the blank space where no agreed rate of interest exists in the contract. Thus, when the obligor fails to comply with the interest rate either agreed by the contract parties or stipulated in the interpretation, the obligee may seek legal remedies and request the court to order the obligor to undertake the interest for late payment. Once an effective judgment upholds the obligee's claims, the obligee may apply to enforce the obligor's properties by filing at the Enforcement Department of the Court.

Law stated - 19 July 2024

TERMINATION

Implied terms

Are there rules regarding termination and duration of contracts that will be implied by law into a contract? Can these terms be excluded or limited by including appropriate language in the contract? Do special rules apply to termination of a supply contract?

There is no special rule applying to the termination of a supply contract implied by law. The termination of a contract, under Chinese laws, could be agreed upon by the contract parties or be sought under statutory circumstances provided by law, which, according to article 563 of the Chinese Civil Code, include the following:

1. it is impossible to achieve the purpose of the contract due to force majeure;
2. any party expressly states, or indicates through its conduct, that it will not perform its principal obligations prior to the expiration of the performance period;
3. any party delays in performing its principal obligations and fails to perform the same within a reasonable period after being urged to do so;
4. any party delays performance of its obligations, or has other violations, rendering it impossible to achieve the purpose of the contract; or

5. other circumstances stipulated by the law arise.

In addition to the above circumstances, it is also provided in the same article that, if an indefinite-term contract contains the continuing performance of obligations, any party may rescind the contract at any time, provided that it shall notify the other party before a reasonable time limit.

In terms of a supply contract, the performance could be one-time or continuing. For a supply contract of one-time performance, the termination shall follow the performance and if the time limit of performance is not expressly agreed in the contract, according to article 511 of the Chinese Civil Code, the obligor may perform, and the obligee may request performance, at any time, provided that the other party shall be given the time required for preparation. Meanwhile, for a supply contract of continuing performance, if the time limit of performance is indefinite, the termination shall apply the rule in article 563, whereby any contracting party may terminate the contract and provide the other party with a notice period.

Law stated - 19 July 2024

Notice period

If a contract does not include a notice period to terminate a contract, how is it calculated?

According to article 563 of the Chinese Civil Code, if an indefinite-term contract contains the continuing performance of obligations, any party may rescind the contract at any time, provided that it shall notify the other party before a reasonable time limit. According to this provision, the notice period refers to 'a reasonable time limit' from the moment the notice of termination reaches the other party until the termination takes effect.

Although 'a reasonable time limit' is a vague method for calculation of a notice period, it could be interpreted in combination with the purpose of the legislation. Generally, in indefinite-term contracts with continuing performance, the contract parties rely on each other, and if one party terminates the contract at any time, this will have a sudden impact on the other party and involve unexpected damages. This legislative arrangement of a reasonable time limit acts as a buffer period so as to protect the contract parties from sudden impacts and unexpected damages. Therefore, the party that wants to terminate the contract unilaterally should fully consider how to prevent the other from such damages when calculating the notice period.

With this concern, article 946 of the Civil Code provides a specific notice period for the contracts of property services, 'where a decision on dismissal is made, the property service provider shall be notified in writing 60 days in advance, unless the contract stipulates otherwise on the notice period'. This provision may be seen as a reference example for determining a reasonable time limit.

Law stated - 19 July 2024

Automatic termination on insolvency

Will a commercial contract terminate automatically on insolvency of the other party?

Once the insolvency application of a company is accepted by a People's Court, an administrator will be designated to take over all business of the insolvent company. Those contracts concluded between the insolvent company and other parties prior to acceptance of the insolvency application but which are still pending completion by the parties will not terminate automatically and will be handed over to the administrator. The administrator is entitled to decide whether those contracts shall be terminated or continued and will notify the other contracting parties.

If the administrator, within two months upon the acceptance of an insolvency application, has not notified the other contracting parties, or if the other contracting parties, within 30 days of receipt of the notification, have not replied to the administrator, the pending contract shall be deemed terminated.

When the administrator decides to continue the contract, the other contracting parties are entitled to request the administrator to provide security for the performance. Under such a request, if the administrator fails to provide security accordingly, the pending contract shall be deemed terminated as well.

For any damages arising from the aforementioned termination of contracts, the other contracting parties may declare credit rights in the insolvency procedures.

Law stated - 19 July 2024

Termination for financial distress

Are there restrictions on terminating a contract if the other party is in financial distress?

If a contracting party is in financial distress, it does not necessarily lead to termination of the contract. Under the Chinese Civil Code, if a contract party's business is seriously deteriorating, it shall grant the other party the unsafe right of defence, which allows the other party to notify the party in financial distress in a timely manner and suspend performance of the contract. Resumption of the performance will be subject to a guarantee provided by the party in financial distress. If the party in financial distress fails to restore its capacity for performance or to provide a guarantee within a reasonable time limit, the other party may terminate the contract and request the other party to bear the liability for breach of contract.

Alternatively, in the case that financial distress causes frustration to the performance of the contract, the principle of change of circumstances will be triggered.

According to the Chinese Civil Code, after the conclusion of a contract, if there is a significant change that occurred to the basic conditions of the contract, which was unforeseeable at the time of contract conclusion and was not a commercial risk, causing obvious unjust harm to a contracting party if performance of the contract is continued, the adversely affected party may renegotiate the contract with the other party. If the renegotiation fails within a reasonable period of time, the contracting parties may seek legal remedies requesting to modify or terminate the contract concerned.

Law stated - 19 July 2024

Force majeure

Is force majeure recognised in your jurisdiction? What are the consequences of a force majeure event?

The Chinese Civil Code acknowledges the concept of force majeure, defining it as events that are unanticipated, inescapable and unable to be overcome. Typically, if an obligation is not met due to force majeure, the responsible party can be partially or completely relieved from liability, depending on the extent of the force majeure's impact.

Where the force majeure causes a failure to perform a contract, the obligor shall notify the other party in time to reduce any possible losses, and shall provide proof within a reasonable time limit.

Furthermore, if the force majeure makes it impossible to achieve the purpose of the contract, the contracting parties may renegotiate or terminate the contract.

Nevertheless, force majeure cannot be used as a reason to exempt liability if the force majeure event happens after a delay in performance by any party.

Law stated - 19 July 2024

Frustration and impossibility of performance

Are the doctrines of impossibility or frustration of purpose recognized in your jurisdiction?

The doctrines of impossibility are recognised regarding the performance of non-monetary obligations in China. In accordance with article 580 of Chinese Civil Code, the party may request the other party who fails to perform non-monetary obligations or whose performance of non-monetary obligations is in breach to perform, unless:

- it is legally or factually impossible to perform;
- the subject matter is unenforceable or the cost incurring from performance is too high; and
- the debtor fails to request for performance within reasonable term.

When an obligation is legally impossible to perform refers to the scenario that continued performance of the obligation shall violate the laws. That the subject matter is damaged, destroyed or has been already transferred to others render the contract impossible to perform factually. Practically, contracts of which the performance relies on particular person such as entrustment contracts, technology development contracts, and such like, are deemed unenforceable in their subject matters.

When it is impossible to perform the obligation, both the breaching party and the non-breaching party are entitled to request to the people's court or the arbitration institution for termination of the contract rather than request for performance. Meanwhile, the termination of the contract does not impede the determination and bearing of liabilities for breach.

Law stated - 19 July 2024

Material adverse events and material adverse changes

Are material adverse event (MAE) or material adverse change (MAC) clauses used or enforced in your jurisdiction?

Material adverse event (MAE) or material adverse change (MAC) clauses are used and enforced in China. The parties are entitled to agree upon liability incurred from termination or liability for breaches of the agreements when facing such material adversity. In legislation, MAE or MAC clauses are generally reflected by the provision of the Change of Circumstance principle under the Chinese Civil Code. In accordance with article 533, which provides that when following the formation of a contract, if there is a significant unforeseen change in the fundamental conditions of the contract that does not constitute a commercial risk and the continued performance of the contract is significantly unfair to one party, the affected party may renegotiate with the other party. If no agreement is reached within a reasonable period, the affected party may request the people's court or arbitration institution to modify or rescind the contract.

The change of fundamental conditions of the contract refers to the basic facts contingent upon which the contracts are entered into have changed. Natural disasters, governmental orders or policies (eg, temporary measures during the pandemic) and abnormal market price fluctuations can lead to the application of a Change of Circumstance from which foreseeable commercial risks are excluded.

The Change of Circumstance results in pre-obligations for negotiations first. If the negotiation fails, the parties may submit the contract to people's court or arbitration for adjustment or termination. The party adversely affected by the Change of Circumstance whose obligations under the contracts are alleviated may be liable to compensate for the other party depending on the losses incurred.

Law stated - 19 July 2024

SUBCONTRACTING, ASSIGNMENT AND THIRD-PARTY RIGHTS

Subcontracting without consent

May a supplier subcontract its obligations under the contract without seeking consent from the other party?

Under Chinese law, if the supplier subcontracts all or part of its obligations to a third party, the consent of the other party must be obtained. The supplier or the third party may urge the other party to give its consent within a reasonable period, where the silence of the other party is deemed dissent.

On the other hand, the Chinese Civil Code also establishes that if the third party joins the supplier to perform the obligations, it is not necessary to obtain the consent of the other party. In this case, the third party or the supplier needs to notify the other party, and, as long as the other party does not explicitly reject the request within a reasonable period, the other party will be entitled to request the third party to perform the obligations.

Law stated - 19 July 2024

Statutory rules

Are there any statutory rules that apply to subcontracting in your jurisdiction?

The Chinese Civil Code provides several rules on general contract, and the party shall obtain the consent of the other party if it intends to subcontract all or part of its obligations to a third party.

With respect to construction contracts, there are specific statutory rules in the Chinese Civil Code, alongside regulations on construction projects promulgated by the State Council. If the construction projects involve bidding and tendering, the Bidding Law of the People's Republic of China shall also apply.

Although, under the general rules, the supplier may subcontract all obligations with the consent of the other party, in a construction contract, the supplier is not allowed to subcontract the entire construction project to a third party, nor may it split the construction project into parts and subcontract each part respectively to a third party in the name of subcontracting.

After subcontracting, the third party will bear joint and several liabilities with the supplier on the subcontracted parts of the construction project.

In addition, the third parties who accept such subcontracts should be qualified in accordance with laws and regulations. If there is any illegal subcontracting, the other party to the construction contract may unilaterally terminate the contract.

Law stated - 19 July 2024

Assignment of rights and obligations

May a party assign its rights and obligations under the contract without seeking the other party's consent?

For the assignment of obligations, the assignor shall obtain consent from the other party, and no reaction of the other party is deemed dissent. In a case where the third party joins the assignor to perform the obligations, the assignor or the third party should notify the other party and, unless the other party explicitly rejects the request, it is deemed that such a joining is recognised by the other party.

For the assignment of rights, on the other hand, the consent of the other party to the contract is not required. However, in the following circumstances, all or parts of the rights may not be assigned:

1. in light of the nature thereof;
2. according to the agreement between the contract parties; and
3. according to the provisions of the laws.

In particular, in cases where the parties have agreed not to assign such rights, if such rights are non-monetary, the agreement shall not act against a bona fide third party; if such rights are monetary, the agreement shall not act against any third party.

Upon the assignment of rights, the assignor should notify the other party, and if the other party is not notified, such an assignment of rights is not binding on the other party. The notification is not revocable unless the third party accepts the assignment and gives its consent.

In a case where the assignor assigns both rights and obligations, the consent of the other party is necessary, but the other controls on the assignment of rights and the assignment of obligation shall apply respectively.

Law stated - 19 July 2024

Assignment of rights and obligations

What statutory controls apply to the assignment of rights or obligations under a supply contract?

In a supply contract, the assignment of rights or obligations is first subject to the statutory control of general rules regarding the assignment of rights or obligations of a contract provided in the Chinese Civil Code.

The assignment of receivables of a supply contract usually involves a factoring contract signed between the supplier and a third party (called a factor) under Chinese law.

If the third party is a commercial factoring enterprise, such transaction will be subject to the regulation and supervision of the China Banking and Insurance Regulatory Commission (CBIRC), which is now incorporated into the National Financial Regulatory Administration. According to the Notice of the General Office of the CBIRC on Strengthening Supervision and Administration of Commercial Factoring Enterprises, a commercial factoring enterprise should comply with certain regulatory requirements.

Law stated - 19 July 2024

Enforcement by a third party

Can a third party enforce a term of the contract and, if so, are there any limitations on doing so?

In principle, the Doctrine of Privity shall apply in the enforcement of a contract (ie, where the parties agree that the obligor shall perform the obligation for the benefit of a third party, or those obligations owed to the obligee shall be performed by a third party, and the obligor or the third party does not perform the obligation or does not perform in conformity with the parties' agreement, the obligor shall be liable to the obligee for breach of contract).

However, since the Chinese Civil Code became effective, the contract for a third party has been introduced and established under Chinese law, where the third party is allowed to enforce the terms of a contract. Article 522 of the Chinese Civil Code provides that if the contract parties agree that the obligor performs obligations for a third party and that a third

party may directly request the obligor to perform the obligations, as long as the third party does not specifically reject within a reasonable period, once the obligor fails to perform the obligations for the third party or the performance does not comply with the terms of the contract, the obligor shall be liable for breach of contract and the third party may request the obligor to bear liability for breach of contract; the obligor may, in respect of the third party, avail itself of any defence it has against the obligee.

Except for the aforementioned circumstances, in a case of subrogation, the third party may also enforce the terms of a contract upon the demand of the obligee. The subrogation refers to if the obligor is remiss in enforcing its contract rights or the accessory rights related to its claims, thereby affecting the realisation of the due claims of the obligee: the obligee claims to the People's Court to enforce the contract rights of the obligor against the counterparty in subrogation in its own name. However, the scope of subrogation shall be limited to the due claims of the obligee.

Law stated - 19 July 2024

DISPUTES

Limitation periods

What are the limitation periods for breach of contract claims? Is it possible to agree a shorter limitation period?

According to the Chinese Civil Code, the ordinary limitation period for breach of contract claims is three years. The limitation period for claims for disputes arising from an international contract for the sales of goods or a contract for the import and export of technology is four years.

The above limitation periods start from when the claimant knows or should have known the facts giving rise to his or her claim and who the accused is. In any event, if more than 20 years have passed since the date of the occurrence of facts giving rise to the claim, the court shall not offer any protection.

The law outlines certain conditions under which the limitation period can be suspended. This applies if, within the final six months of the limitation period, the claimant's rights to make a 'demand' cannot be exercised due to circumstances including:

1. force majeure;
2. the person who has no or limited capacity for civil conduct has no statutory agent, or their statutory agent dies or loses the capacity for civil conduct or the power of agency;
3. neither a successor nor a legacy caretaker has been determined after the commencement of succession;
4. the obligee is controlled by the obligor or other persons; and
5. other obstacles resulting in the failure of the obligee to exercise the right of claim.

Once these impediments are resolved, the limitation period resumes.

In addition to suspension, the limitation period can be interrupted according to law. The limitation period is interrupted if legal proceedings are instituted or if a party demands or agrees to the fulfilment of its obligations. The limitation period commences anew from the time of interruption and can be interrupted repeatedly.

Article 197 of the Chinese Civil Code further regulates that the periods, calculation methods and reasons for a suspension or interruption in respect of the limitation of action shall be prescribed by law and those agreed by and between the parties shall be null and void. A party's prior waiver of the benefit of the limitation of action shall be null and void.

Law stated - 19 July 2024

Contract interpretation

How do courts in your jurisdiction approach contract interpretation when a dispute arises? How is the intent of the parties determined? Can extrinsic evidence (ie, evidence outside the four corners of the written contract) be admitted to show intent?

In accordance with article 142 and article 466 of Chinese Civil Code, the interpretation of disputed contracts shall be determined based on the words and sentences, considering relevant terms and clauses, nature and purpose of the behaviour, custom and the principle of good faith.

Particularly, when the contract is concluded in two languages with the same legal effect, it is presumed that the words and phrases shall contain the same meaning in each language. In the event of any irregularity between words and phrases in each language, the interpretation shall be based on the terms and clauses, the nature of the contract, the purpose of the contract and the principle of good faith.

As for items such as quality, price, reward and place of performance not agreed upon and not affecting the validity of the contracts, the Civil Code stipulates supplementary agreements to follow. Without supplementary agreements, relevant clauses and trading habits shall be referred to. In the absence of the aforementioned, quality shall refer to national standard or industry standard. Price shall refer to the market price where the contract is performed or the guidance price fixed by the government. Place of performance shall refer to the place of receipt of currency in the case of discharging monetary obligations, the place of real estate where it is located and the place of the party to perform obligations.

To determine the intent of the parties, a variety of interpretation methods are adopted by Chinese courts including literal interpretation, interpretation based on the entirety of the contract, interpretation based on purpose of the contract, interpretation based on trade habits and interpretation based on principle of good faith. In summary, the interpretation methods are adopted accustomed to specific circumstance.

Extrinsic evidence is generally admitted by the people's courts. Nevertheless, to convince the court, the extrinsic evidence has to be substantially true and formally presented. In accordance with the Interpretation of the Civil Procedure Law released by the Supreme People's Court (SPC), in principle, only when the evidence is able to convince the judges that the facts are highly possible, shall the facts be recognised by the court. Exceptionally, the

evidence shall be scrutinised with a stricter standard named exclusion of reasonable doubts regarding facts of deception, coercion, malicious conspiracy, oral will and gift.

Law stated - 19 July 2024

Choice-of-law clauses

Do your courts recognise and respect choice-of-law clauses stipulating a foreign law?

Under People's Republic of China (PRC) laws, parties to a contract with foreign elements are permitted to choose a foreign law as the governing law for their contract. The following factors are considered in determining whether a contract has foreign elements:

1. whether any party is a foreign party or resides in a foreign country;
2. whether the object of the contract is located in a foreign country;
3. whether the contract is signed, performed, revised or transferred in a foreign country;
or
4. whether factors that affect the rights and obligations of the parties take place in a foreign country.

Even if a contract is considered foreign-related, Chinese law must be applied if the contract falls under any of the following categories:

1. Sino-foreign equity or cooperative joint venture contracts;
2. contracts for Sino-foreign joint exploration and development of natural resources within China;
3. contracts transferring shares in Sino-foreign equity or cooperative joint ventures and foreign-owned enterprises;
4. management contracts allowing foreign nationals or corporations to manage Sino-foreign equity or cooperative joint ventures established in China;
5. purchase contracts involving foreign nationals or corporations acquiring shares in wholly Chinese-owned companies established in China; or
6. purchase contracts involving foreign nationals or corporations acquiring assets of wholly Chinese-owned companies established in China.

Furthermore, where a party intentionally creates a link to foreign elements to circumvent the mandatory provisions of PRC laws and regulations, the People's Court will hold that the foreign law cannot be applied.

Law stated - 19 July 2024

Choice-of-law clauses

Do your courts recognise and respect choice-of-jurisdiction clauses stipulating a foreign jurisdiction?

With respect to foreign-related disputes over contracts or other property rights, Chinese courts recognise choice-of-jurisdiction clauses stipulating a foreign jurisdiction, but such choice of jurisdiction, according to article 529 of SPC Interpretation on the Application of the Civil Procedure Law of the People's Republic of China (amended in 2022), shall satisfy the following conditions:

1. The foreign jurisdiction should be actually associated with the disputes, such as the place where the defendant is domiciled, the place where a contract is performed, the place where a contract is signed, the place where the plaintiff is domiciled, the place where the subject matter is located, the place where the infringing act is committed, and such like.
2. The choice of jurisdiction shall not violate the exclusive jurisdiction of Chinese courts stipulated in articles 34 and 273 of the Chinese Civil Procedure Law; for example, in the case of a real estate dispute lawsuit where the real estate is located in China, the Chinese court at the location of the real estate shall have exclusive jurisdiction.

In practice, if one of the contract parties brings a lawsuit at a Chinese court while the contract in dispute includes a choice-of-jurisdiction clause of a foreign jurisdiction, the Chinese court will put its focus on whether such clause excludes the jurisdiction of Chinese courts when determining the recognition of choice of jurisdiction. There have been precedents for recognising the choice of a foreign jurisdiction in recent years.

Law stated - 19 July 2024

Efficiency of the local legal system

How efficient and cost-effective is the local legal system in dealing with commercial disputes?

Normally, a general procedure for a civil claim at first instance is concluded within six months from the commencement of the proceeding. If there is a need for an extension under special circumstances, an extension of six months may be granted, subject to the approval of the president of the court. If there is a need for a further extension, the approval of the higher-level court is required.

However, the period for trial of foreign-related civil cases by courts is not subject to the above-mentioned time limits and restrictions. Therefore, in practice, the efficiency of the trial has a high degree of arbitrariness depending on the varied competency and capability of local judges from city to city.

Law stated - 19 July 2024

New York Convention

Is your jurisdiction a signatory to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards? Which arbitration rules are commonly used in your jurisdiction?

China acceded to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards on 22 January 1987.

In China, the leading arbitration institution handling foreign-related disputes is the China International Economic and Trade Arbitration Commission (CIETAC), and CIETAC procedural rules are the most commonly used arbitration rules in China. The most recent version of the CIETAC arbitration rules came into effect on 1 January 2015.

Law stated - 19 July 2024

REMEDIES

Available remedies

What remedies may a court or other adjudicator grant? Are punitive damages awarded for a breach of contract claim in your jurisdiction?

Depending on the nature of the disputes, common substantive remedies include damages compensation, permanent injunctions and specific performance.

In civil litigation, remedies are mostly compensatory, with punitive damages as an exception. However, according to the opinions of the Supreme People's Court on strengthening the punishment of intellectual property infringement, in the field of intellectual property, if the circumstances are serious, the right holder's claims of punitive damages shall be supported according to law, and the deterrent effect of punitive damages on intentional infringement shall be fully exerted.

Law stated - 19 July 2024

Available remedies

Can a court order specific performance (ie, can a court mandate that a party perform under a contract)?

Under the Chinese Civil Code, the court will order specific performance in the event of failure to perform the contractual obligations or defective performance. To be specific, in the case of monetary obligations, the court shall order specific performance as no doctrines of impossibility are upheld here. As for performance of non-monetary obligations, the court can order specific performance, unless:

1. it is legally or factually impossible to perform;
2. the subject matter is unenforceable or the cost incurred from performance is too high;
or
3. the debtor fails to request performance within a reasonable term.

It is worth noting that if, according to the nature of the contractual obligations, it is impossible to order specific performance and performance is not exclusively limited to the parties, one party may seek a third party for performance with relevant costs borne by the breaching party.

Law stated - 19 July 2024

UPDATE AND TRENDS

Recent developments

Are there any other current developments or emerging trends that should be noted?

On 5 December 2023, in order to enhance the accuracy and consistency in the application of the Contract Section of the Civil Code, the Supreme People's Court (SPC) promulgated the Interpretations on Issues relating to the Application of General Principles of Contract Section of Civil Code of People's Republic of China (Interpretation), which will serve as guidance by people's courts at all levels. Notably, the Interpretation addresses the following three aspects, among others, in relation to contractual disputes.

Further guidance for definition of reservation contract

In judicial practice, the courts find it difficult to define intention letter and memorandum as mere intention for possible transaction or reservation contract. The Interpretation provides specific standard by determining the agreements between the parties. For example, if the parties agree that a contract shall be concluded within certain period or with warrant delivered and parties and subject matter of the contract to be concluded clarified, the reservation contract shall be upheld. Parties failing to conclude the contract will be subject to liabilities of liquidated liabilities or compensations. If no agreements of liabilities are reached, the court shall decide taking into account factors such as the completeness of the reservation contract and the maturity of the terms based on which the formal contract is to be concluded.

Clearer calculation methods of expected benefits

In response to the adversity of the courts in determining the expected benefits of the non-breaching parties, the article 60 of Interpretation introduces three methods for determining the expected benefits from the performance of the contracts, basing on production profits, business profits and resale profit, alternative transaction price and market price. In accordance with article 584 of Chinese Civil Code, the compensation to the non-breaching party shall not exceed the losses foreseen by reasonable anticipation of the breaching party. Article 63 of the Interpretation provides further guidance for the courts by taking into consideration of factors such as, among others, the parties of the contract, content of the contract, types of trade and negotiation process.

Preservation of debt in favour of the creditors

In accordance with the Chinese Civil Code, the creditor is entitled to revoke the acts of the debtor by way of evidently unfair pricing which adversely affects the fulfilment of creditor's right such as abandonment of creditor's rights, transfer of property at zero consideration, and such like. The unfair price herein shall be scrutinised based on the regular local market price. Price lower than 70 per cent or higher than 30 per cent of the regular local market price is deemed as unfair. In the case of related parties or relatives, the aforementioned percentage shall not apply. The Interpretation further specifies acts causing damaging to the creditor's rights, listing property exchange, discharging debts by delivering properties, leasing properties, licensing of intellectual properties, and such like. The Interpretation allows partial revocation of the acts of the debtors if the subject matter under the acts to be revoked can be divided.

Law stated - 19 July 2024