

Summary of the Interpretations of the Supreme People's Court on Some Issues concerning the Application of Contract Law of People's Republic of China (II) (promulgated on April 24, 2009)

On April 24, 2009, China's Supreme People's Court promulgated the Interpretations of the Supreme People's Court on Some Issues concerning the Application of Contract Law of People's Republic of China (II) (the "INTERPRETATIONS"), which interpret and clarify the ambiguities of the Contract Law in five aspects: the conclusion, effectiveness, performance and termination of a contract and the liability of breach a contract. The INTERPRETATIONS became effective on May 13, 2009, the suspending dispute out of the contract executed after the Contract Law as well as the INTERPRETATIONS will be governed by the INTERPRETATIONS, whereas, the INTERPRETATIONS will not be applied to the rehearing of a final case.

1. Conclusion of Contracts

The INTERPRETATIONS clarify the following issues in connection with the conclusion of a contract:

(1) Preference for acknowledging the conclusion of a contract.

Where parties have differing views on whether a contract was concluded between parties, and unless otherwise provided or stipulated by laws or other stipulations, the people's court may find that the contract has been concluded if the names of the parties, the objects and the location where the contract is executed are clear and unambiguous.

(2) The contract can be concluded in ways other than in writing or orally.

Although the parties did not conclude a contract in writing or orally, if their actions indicate their intention to execute a contract, unless otherwise provided by laws, the people's court may find that a contract has been formed.

(3) The INTERPRETATIONS clarify the advertisement offering a reward.

Prior to the INTERPRETATIONS, there was controversy as to whether or not an advertisement constituted an offer or was a solicitation for offers. Clause 3 of the INTERPRETATIONS prefers the former to a great extent. Unless the advertisement was in violation of the Contract Law, a person who has complied with the terms of the advertisement can ask the person whose offer was contained in the advertisement to pay the advertised reward.

(4) The INTERPRETATIONS clarify the place where the contract was concluded.

In cases where the actual place of execution of a written contract was not the place of execution stipulated in the contract, the people's court may consider the stipulated place as the place of execution; where the place of execution was not stipulated in the contract, or where both parties executed the contract at different places, the final place of execution will

be the place of execution of the contract.

- (5) The effectiveness of a fingerprint is the same as a signature and/or stamp.

In cases where the parties to a contract use a fingerprint on a written contract instead of signature and/or stamp, the people's court may consider the contract effective.

- (6) According to the Contract Law, a party supplying standard terms shall draw the attention of the counterparty, using reasonable means, to the standard terms. The INTERPRETATIONS further specify what means will be considered reasonable in notifying the counterparty.

Provided the party supplying the standard terms specifies the terms which exclude or restrict his liabilities by special words, symbols, or typefaces adequate to draw the attention of the other party, and explain the standard terms to the other party as required, then the people's court may consider these means as reasonable means prescribed by the Contract Law. The supplier of the standard terms is liable for proving that reasonable means have been used in notifying the counterparty of the standard terms.

- (7) The INTERPRETATIONS specify the kinds of transaction practices.

The following practices may be considered as Transaction Practices if such practices are not violating the mandatory provisions of the laws and administrative regulations: (i) The customary practices generally accepted in a certain place, field or industry as well as if the other party is aware of or should be aware of the practices; and (ii) The practices which have always been accepted by the parties to the contract.

- (8) If the party that is liable for applying for approval or for registration of the contract neglects to obtain such approval or registration, that party shall be responsible for the failure to obtain the approval or registration.

Where the effectiveness of a contract is subject to approval or registration, and when the party who is liable for applying for approval or for registration neglects to obtain such approval or registration after concluding the contract, the people's court may order the counterparty to apply for approval or registration at the party's cost, and the party shall cover the counterparty's loss.

2. Effectiveness of Contracts

The INTERPRETATIONS specify the effectiveness of standard terms, ratifications, delegate without power of agency and the responsibility of a seller who concludes more than one contract regarding a single object.

- (1) Increase in responsibility of the party which supplies the standard terms.

If the party which supplies the standard terms neglects to draw the attention of the counterparty, using reasonable means, to the standard terms, inducing if the counterparty ignores such clauses which exclude or restrict the liability of the standard terms supplier, the counterparty may ask the people's court to revoke the standard terms. The party which supplies the standard terms must explain the standard terms in using reasonable means, and standard terms which exempt the supplier from liabilities, increases the liabilities of the counterparty, or excludes the rights of other parties, shall be null and void.

- (2) The ratifications may be effective in retrospect.

A contract concluded by a person with limited civil capacity of conduct, or concluded by a person who has no power of agency, who exceeds the power of agency, or whose power of

agency has expired and yet concludes a contract on behalf of the principal, will become effective from conclusion by ratification of a statutory agent or a principal.

- (3) The principle may ratify a contract by actual performance.

A contract concluded by a person without power of agency may be made effective by the principle's actual performance.

- (4) The principle may pursue recovery from the person without power of agency.

A principle may bring a claim against the apparent agent to recover any loss after taking responsibility for apparent agent.

- (5) The seller who concludes more than one contract regarding a single object is liable for indemnification to the counterparties.

In cases where a seller concludes more than one contract regarding a single object, and where all such contracts are effective according to the Contract Law, the purchaser who fails to obtain the object may make a claim for damages out of the seller's breach of contract.

3. Performance of Contracts

- (1) The people's court may make a party to an agreement of an assignment of credit or debts as a third party without independent rights to claim in a trial.

Where the parties agree that the obligor performs the obligations to a third party or a third party performs the obligations to the obligee, the people's court may set the third party as a third party without independent rights to claim in a trial, whereas the people's court has no right to set the third party as an defendant or a third party which has independent right to claim at its own discretion.

- (2) The INTERPRETATIONS specify the jurisdiction of a subrogation lawsuit where the defendant has no domicile in the People's Republic of China ("PRC").

Where an obligee files a subrogation lawsuit against a defendant who has no domicile in the PRC, the jurisdiction of the litigation shall be subject to Section 241 of the Civil Procedure Law of the PRC, i.e. if the contract is signed or performed within the territory of the PRC, or the object of the action is within the territory of the PRC, or the defendant has detainable property within the territory of the PRC, or the defendant has its representative agency, branch, or business agent within the territory of the PRC, the defendant is subject to the jurisdiction of the people's court located in the place where the contract is signed or performed, the subject of the action is located, the defendant's detainable property is located, the infringing act takes place, or the location of the representative agency, branch or business agent.

- (3) The INTERPRETATIONS specify the conditions under which the obligee may exercise the right of revocation.

In addition to the conditions specified in the Contract Law, the obligee may exercise the right of revocation widely according to the INTERPRETATIONS. The obligee may exercise the right when the obligor renounces its undue creditor's right or right of warranty, or maliciously extends the time limit for performance, the obligor purchases property at an obviously unreasonable high price, thus damaging the interests of the obligee.

Meanwhile, the INTERPRETATIONS specify the rule to decide whether the price is an obviously unreasonable low/high price. The people's court shall determine by a general business operator's judgement. The transfer price may be considered as an obviously

unreasonable low price if it is lower than 70% of the local directive price or market price; and may be considered as an unreasonable high price if it is in excess of 30% of the local directive price or market price.

- (4) The INTERPRETATIONS rank the payment of several debts to the same creditor and the payment of principle debts and affiliate debts.

When an obligor's payment is not sufficient to cover all the obligations of one kind to the same obligee, unless otherwise stipulated, the payment shall offset the due credit in advance; if all the debts are due, the debt without guarantee or with less guarantee shall be paid first; if all the obligations are covered by the same guarantee, the bigger debt shall be paid first; if the amount of the debts are the same, the debts shall be offset according to the expiration; if the debts shall become due at the same time, the debts shall be offset pro rata.

4. Termination of Contracts

The INTERPRETATIONS specify the following matters:

- (1) Taking action in good faith after the contract has terminated.

One party may be ordered by the people's court to indemnify the other party if the former fails to fulfill the assistance, notification and confidential clauses of a contract after the contract is terminated.

- (2) Parties to a contract may agree that the debts due to each other cannot be offset.

Although Clause 99 of the Contract Law provides that where each party to a contract has debts due to the other and the category and nature of the debts are the same, either party may offset his debt against that of the other, the INTERPRETATIONS empower the parties to deny an offset.

- (3) Setting a time limit to dispute the rescinding of a contract.

Where a party to a contract disputes with the other party's rescision of the contract, the objection should be lodged within a stipulated period or within three months from the notice to rescind the contract arrived.

- (4) The effectiveness of lodgement.

Where the obligor lodged the object or the money obtained from the auction or sale of the object to the lodgement, the lodgement shall be considered as performing the obligation to a lodgement extent by the people's court.

- (5) The INTERPRETATIONS specify the principle of circumstance alteration.

According to the INTERPRETATIONS, if the circumstance are materially altered after a contract was concluded, and the alteration could not be anticipated by the parties and cannot be ascribed to force majeure or business risk, and where continued performance is unfair or will frustrate the contract, the people's court may alter or rescind the contract according to the parties' claim.

5. Liability for Breach of Contracts

The INTERPRETATIONS set a rule to adjust the compensation when it is too high or too low.

- (1) One party can make a claim for an adjustment by counterclaim or as a defense during a trial.
- (2) A party making a claim for an increase in the compensation, should not make a claim for more

than the amount of the actual loss.

- (3) When a party makes a claim for a reduction in the compensation, the people's court may make the award based on the actual loss, the performance of the contract, both parties' fault and predictable interest as well as according to the rules of fair play and good faith.
- (4) If the stipulated compensation is in excess of 30% of the loss, it may be considered as excessively higher than the loss incurred.

If you have any questions about the above information, please feel free to contact us. Thank you.

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