

CHINA

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## Second Judicial Explanation on PRC Contract Law



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On 24 April 2009, the PRC Supreme Court issued the Second Judicial Explanation on PRC Contract Law (the Explanation). The Explanation addresses contract law issues that were not covered, or remained unclear, in the existing legislation and the First Judicial Explanation, including the following matters:

### Formation of a contract

Article 1 of the Explanation clarifies the existence of three indispensable elements for formation of a contract: parties, contract object, and quantity. Failure to agree on other matters should “generally” not impair the formation, unless the law otherwise provides or the parties have otherwise agreed.

### Effectiveness of a contract

- A contract signed by a person with limited civil capacity or without due authorisation shall be deemed retroactively effective as of its execution date when it has, after that date, been duly recognised by a statutory agent or represented party (Article 11).
- Where a represented party has started to perform the contract, such action may qualify as de-facto recognition of the contract (Article 12).
- In response to Article 52 (5) of the PRC Contract Law, Article 14 explains that only the violation of a “mandatory legal provision affecting the contract effectiveness” will invalidate a contract.

### Standard contract clauses

Any party providing standard contract clauses shall remind the other party of any clauses that exempt or restrict its liability, and explain such clauses at the request of the other party. If the party fails to do so and the other party remains unaware of the concerned clauses, the court will support an application of such other party for cancellation of those clauses (Article 9).

### “Default” before contract effectiveness

Where a contract shall only become effective following approval

by or filing with a government authority, the failure of the party responsible for such procedures to handle them duly may render it liable for losses incurred by the other party (Article 8).

### Cancellation of debtors’ transactions or disposal acts

Articles 18 and 19 extend the application of Article 74 of the PRC Contract Law so that a creditor may now seek invalidation of a wider range of malicious transactions or disposal acts of its debtor where such transactions or acts impair the debtor’s ability to pay.

### Objection to a termination right

Where one party seeks to raise an objection to the termination right exercised by the other party, Article 24 clarifies that a time period agreed by the parties shall apply. If no such period has been agreed, the objection must be raised within three months of the party’s receipt of the termination notice.

### Major change of objective circumstance

Article 26 offers a new legal basis for a contract party to require amendment to, or rescission of, a contract: where a major change of objective circumstances occurs after the contract’s conclusion which is not a commercial risk, nor was foreseeable at the contract’s conclusion, and has not been caused through a force majeure event.

### Liquidated damages

Articles 28 and 29 aim to bring compensation for liquidated damages in line with actual losses. Although the court should also consider loss of anticipated profits when reviewing liquidated damages that are alleged to be excessively high, the court’s decision shall be mainly based on actual losses. It has been further clarified that liquidated damages that exceed the losses by 30 percent may be generally considered as “excessively high”.

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