Chinese Contract Law: A Brief Introduction

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Overview

1. In General
2. Principles of Chinese Contract Law
3. Formation of Contracts
4. Validity of Contracts
1. IN GENERAL
Laws Governing Contracts before Contract Law Act 1999

1) the Economic Contract Law of the People’s Republic of China(1982);
   --Contracts for economic purposes between Chinese legal persons, other economic org., individual business households, or leasehold farming households.

2) the Foreign-related Economic Contract Law of the People’s Republic of China(1985);
   --Contracts between Chinese enterprises (or other economic org.) and foreign enterprises (or other economic org., or individuals)

   --Contracts for tech. devel., trans., consult., or other tech. services between Chinese legal persons or citizens.
- General Principle of Civil Law (1986)
  - Article 85  A contract is an agreement whereby the parties establish, modify or terminate their civil law relationship. Lawfully concluded contracts shall be protected by law.
Plan Economy Oriented;
Public Interests Overemphasized;
Party Autonomy Restricted.
Features of Act 1999 Compared with its Predecessors

- Market Economy Oriented;
- Freedom of Contract Emphasized;
- Government Interference Restricted;
- Contractual Rights Better Protected.
- Technically Improved.
Business Scope unlimited

The Supreme People‘s Court‘s Interpretations of Certain Issues Concerning the Application of The Contract Law of the People‘s Republic of China (Part One)

Clause 10 Where the parties entered into a contract the subject matter of which was outside their scope of business, the People‘s Court shall not invalidate the contract on such ground, except where conclusion of the contract was in violation of state restriction concerning, or licensing requirement for, a particular business sector, or in violation of any law or administrative regulation prohibiting the parties from participation in a particular business sector.
Structure of Contract Law

General Principles and Rules

- Ch.1 General Provisions
- Ch.2 Formation of Contracts
- Ch.3 Validity of Contracts
- Ch.4 Performance of Contracts
- Ch.5 Modification and Assignment (& Delegation) of Contracts
- Ch.6 Discharge of Contractual Rights and Obligations
- Ch.7 Liabilities for Breach of Contracts
- Ch.8 Other Provisions
Provisions of Specific Contracts

- Ch.9 Sales Contracts
- Ch.10 Contracts for Supply of Power, Water, Gas, or Heat
- Ch.11 Gift Contracts
- Ch.12 Contracts for Loan of Money
- Ch.13 Leasing Contracts
- Ch.14 Financial Leasing Contracts
- Ch.15 Contracts of Hired Works
- Ch.16 Contracts for Construction Projects
- Ch.17 Carriage Contracts
- Ch.18 Technology Contracts
- Ch.19 Safekeeping Contracts
- Ch.20 Warehousing Contracts
- Ch.21 Agency Appointment Contracts
- Ch.22 Trading-Trust Contracts
- Ch.23 Brokerage Contracts

Supplementary Provisions
2. PRINCIPLES OF CHINESE CONTRACT LAW
Fundamental Principles of Contract Law

- Principle of Party Equality
- Principle of Contract Freedom
- Principle of Fairness and Good Faith
- Principle of Public Interest
Function of Principles of Contract Law

- Guidance for Legislation
- Guidance for Law Interpretation;
- Guidance for Contract Interpretation;
Principle of Party Equality

Article 3  Contract parties enjoy equal legal standing and neither party may impose its will on the other party.

[equality as prerequisite for freedom of contract]
Principle of Contract Freedom

Article 4  A party is entitled to enter into a contract voluntarily under the law, and no entity or individual may unlawfully interfere with such right.

[ freedom of deciding whether to enter a contract, with whom to enter a contract, and what terms to be included in a contract.]
A party should only be bound when its consent is free from any constraints by the other party.

Exceptions:
1. Requirements of good faith and fair dealing;
2. Mandatory transactions;
3. Form contracts;
4. Contracts concluded contrary to mandatory law, public order or bonas mores;
5. Juridical effects resulting from the law, usages or the requirements of reasonableness and equity, according to the nature of the contract;
6. Protection of those considered by statutes or courts to be weaker parties.
Principle of Fairness and Good Faith

- **Article 5** The parties shall abide by the principle of fairness in prescribing their respective rights and obligations.

- **Article 6** The parties shall abide by the principle of good faith in exercising their rights and performing their obligations.
- Governs the formation, performance, and enforcement of the parties duties under a contract, as well as the exercise of a party’s rights under the contract;
  - Duty not to negotiate with no real intention of reaching an agreement;
  - Duty not to take unfair advantage of the other party’s dependence, economic distress, or their weakness;
  - Right to be free of unconscionable bargain
  - Determination of the implied terms of a contract;
  - The concept in itself is broader than any of these specific applications
Notes on Principle of GF and FD

- Good faith and fair dealing: ‘GF’ as a subjective concept—means honesty and fairness in mind; “FD” has a more objective character—implies fairness in fact;
- Not confined to specific rules;
- Inconsistent behavior: GF prevents a party from adopting an inconsistent position when the other party has reasonably acted in reliance on the former’s statement or conduct;
- Mutual consideration: Parties should take each other’s reasonable interests into account;
- Good faith to be presumed;
- Mandatory provision: May not be excluded but may be influenced;
- Justice v. Certainty and predictability in contractual relationship
Principle of Public Interests

Article 7  In concluding or performing a contract, the parties shall abide by the relevant laws and administrative regulations and observe social ethics, and may not disrupt social or economic order or harm the public interests.
Scope of mandatory laws regarding enforceability

- SPC’s Interpretation: Clause 4. After the Contract Law became operative, a People’s Court may only invalidate a contract in accordance with laws adopted by the National People’s Congress or its Standing Committee, or administrative regulations adopted by the State Council, and may not invalidate a contract in accordance with any local statutes or administrative rules.

[Uniform Market to Be Established]
3. FORMATION OF CONTRACTS
Conclusion of a contract:
Mutual Assent - The Offer and Acceptance Process

- Conditions for the conclusion of a contract:
  1. The intention of the parties to be legally bound;
     -(Under the principle of GF, even if a contracting party in fact has no intention to
      bind itself, it might be so bound if the other party has reason to infer from its statements or
      conduct the it has the intention to be bound.)
  2. The existence of a sufficient of agreement between them.
Coverage of the Term ‘Contract’

- Agreements under which two or more parties have undertaken an obligation to render performance;
- Agreements where the offeree accepts the offer by undertaking the act or accepting the condition which the offeror requests of it;
- Agreements where only one party has obligations and where its promise needs to be accepted by offeree;
Promises to which one party is bound without acceptance by the other?
[Reward Offer]
The Offer

Article 14 An offer is a party's manifestation of intention to enter into a contract with the other party, which:

(i) is specific and definite; and

(ii) indicates that upon acceptance by the offeree, the offeror will be bound thereby.
- Clear and sufficient enough for determining rights and obligations of parties;
- The offeror’s intention to be bound.
- An offer may be made to one or more persons or to the public;
- A proposal to supply goods or services at stated prices made by a professional suppliers in a advertisement or by a display of goods, is presumed to be an offer to sell or supply at that price until the stock of goods, or the supplier’s capacity to supply the service becomes exhausted.

---Different intentions communicated in the proposal prevent the presumption.
Invitations to Make an Offer

- A delivered price list;
- Announcement of auction;
- Call for tender;
- Prospectus;
- Commercial advertisement (unless its contents meet the requirements of an offer).
Power of Acceptance

- **Rule of Arrival:**
  - Article 16  
  An offer becomes effectual when it reaches the offeree……

- **Withdrawal of an Offer:**
  - Article 17  
  An offer may be withdrawn. The notice of withdrawal shall reach the offeree before or at the same time as the offer.
Termination of the Power of Acceptance

An offeree’s power of acceptance may be terminated by:

1) Revocation by the offeror;
2) lapse of time;
3) rejection by the offeree; or
4) counteroffer.
Revocation of an Offer

- An offer may be revoked by a notice of revocation which shall reach the offeree before a notice of acceptance is dispatched by the offeree, (or in case of acceptance by conduct, before the contract has been concluded under Article 26.

  Article 26  A notice of acceptance becomes effective once it reaches the offeror. **Where a notice is not needed for the acceptance, it becomes effective once an act of acceptance is performed in accordance with the relevant usage or as required in the offer.**

- An offer made to the public can be revoked only by the same means as were used to make the offer, or, when the same means are not available, by means at least to the similar effect in terms of publicity.
Restrictions on Revocation

- An offer can not be revoked if
  - (i) the offer expressly indicates that it is irrevocable; or
  - (ii) it states a fixed period of time for acceptance; or
  - (iii) the offeree has reason to regard the offer as irrevocable, and has undertaken to prepare for performance (has acted in reliance on the offer).

(see Article 18, Article 19)
Lapse of Time

In cases of offers without stipulated period of time for acceptance:

- A verbal offer lapses when it is not immediately accepted;
- A written offer lapses when it has not been accepted within a reasonably period of time.

[see Article 23]
Rejection

- The offeree’s power of acceptance may be terminated when a rejection reaches the offeror even if the offer is irrevocable and even if the time for acceptance has not yet run out.
- The rejection may be express or implied by the offeree’s conduct.
- The offeree’s power of acceptance terminates when, rather than accepting, the offeree makes a counteroffer: The rationale for this rule is that a counteroffer is impliedly a rejection.
- Withdrawal of a rejection?
Termination by death or incapacity of the offeror or offeree?
Acceptance: manifesting assent

Article 21   An acceptance is the offeree's manifestation of intention to assent to an offer.
- An acceptance can be by statement or conduct (indicating the offeree’s assent to the offer).
- Need not be made by the same means as the offer.
- Unconditional and not subject to approval by the offeree or anyone else.
- Silence or inactivity does not amount to acceptance unless:
  --follows from an earlier statement by the offeree;
  --from a framework agreement between the parties;
  --from the usages of some trades; or
  --from practices between the parties.
Time of Conclusion of the Contract

Article 25  A contract is formed once the acceptance becomes effective.

Article 26  A notice of acceptance becomes effective once it reaches the offeror. Where a notice is not needed for the acceptance, it becomes effective once an conduct of acceptance is performed in accordance with the relevant usage or as required in the offer....
Withdrawal of Acceptance

Article 27  An acceptance may be withdrawn. The notice of withdrawal shall reach the offeror before or at the same time as the acceptance.
Modified Acceptance

Article 30  The terms of the acceptance shall be identical to those of the offer. A purported acceptance dispatched by the offeree which materially modify the terms of the offer constitutes a new offer. A change in the subject matter, quantity, quality, price or remuneration, time, place and method of performance, liabilities for breach of contract or method of dispute resolution is a material change to the terms of the offer.

Article 31  An acceptance containing nonmaterial modifications to the terms of the offer is valid and the terms thereof prevail as the terms of the contract, unless the offeror objects to such modifications without delay or the offer indicated that acceptance may not contain any modification to the terms thereof.

[See Article 19 of the UN Convention on Contracts for the International Sale of Goods]
Material terms: Rejection and new offer.

Non-material terms (frequently to clarify and interpret or to supply terms) -- Becomes part of the contract unless:

-- Objection by the offeror without delay;
-- Acceptance is limited by the offer to the terms of the offer.
Late Acceptance

- In order to be effective, an acceptance must reach the offeror within the time set for acceptance;
- The offeror may render the late acceptance effective by accepting it;
- Late acceptance caused by a delay in transmission.

see Article 28&29
Liabilities for Negotiations

Article 42 Where in the course of concluding a contract, a party engaged in any of the following conducts, thereby causing loss to the other party, shall be liable for damages:

(i) negotiating in bad faith under the pretext of concluding a contract;
(ii) intentionally concealing a material fact relating to the negotiation of the contract or supplying false information;
(iii) any other conduct which violates the principle of good faith.
- Concerns the pre-contractual stage;
- Free to negotiate and not liable for failure to reach an agreement;
- Enters into or continue negotiation without any real intention of reaching an agreement;
- Other misrepresentation as regards the subject matters of negotiation;
- Basis of liability: *A sui generis liability*
- Remedies: Retroactive damages
  --expenses incurred; the work done; losses on transactions entered into in reliance of the expected contract; arguably loss of opportunities.
4. VALIDITY OF CONTRACTS
Enforceability (or Avoidance) of Contracts (1)

- [Consideration?]
- Contract to be confirmed:
  - Incapacity & Limited Capacity
  - Contract by Unauthorized Agent
  - Unauthorized Disposal of Property
- Void contract:
  - Illegality or immorality (contrary to the public order)
  - Impossibility
Enforceability (or Avoidance) of Contracts (2)

- Avoidable contract:
  - Fundamental mistake
  - Unconscionability
  - Fraud
  - Threat
  - Unfair advantage
Incapacity and Limited Capacity: Minors & Mental Infirmity

- Limited capacity v. incapacity. (see Article 11-14 of GPCL 1986)
- Incapacity: Null and void
- Limited capacity: Neither void nor avoidable, but to be confirmed by the custodian.
- Limited capacity: Contracts appropriate for his age, intelligence or mental health.
  - Contracts for necessaries;
  - Benefit contracts;
  - Request to the custodian to confirm within a month;
  - Cancellation by the third party of good faith.
Article 48   Absent ratification by the principal, a contract concluded on his behalf by a person who lacked agency authority, who acted beyond his agency authority or whose agency authority was extinguished is not binding upon the principal unless ratified by him, and the person performing such act is liable.

The other party may demand that the principal ratify the contract within one month. Where the principal fails to manifest his intention, he is deemed to have declined to ratify the contract. Prior to ratification of the contract, the other party in good faith is entitled to cancel the contract. Cancellation shall be effected by notification.
Contract by a Seemingly Authorized Agent

Article 49  Where the person lacking agency authority, acting beyond his agency authority, or whose agency authority was extinguished concluded a contract in the name of the principal, if it was reasonable for the other party to believe that the person performing the act had agency authority, such act of agency is valid.
Unauthorized Disposal of Property through Contract

Article 51    Where a piece of property belonging to another person was disposed of by a person without the power to do so, such contract is nevertheless valid once the person with the power to its disposal has ratified the contract, or if the person lacking the power to dispose of it when the contract was concluded has subsequently acquired such power.

[Resulted from misunderstanding of the principle of abstraction embodied in German Civil Code?]
Illegality or immorality (contrary to the public order)

- See Article 52
- Exception to the notion of freedom of contract.
- Broader context of the principle of a person’s autonomy: A person should be given the opportunity to develop his personal, social and economic faculties and the law generally approves of the choices made by the individual.
Impossibility

- No specific rule laid down in GPCL (1986) or in CL 1999
- Objectively impossible: The performance of the assumed obligation is impossible for any other reasonably qualified person.
- Impossible at the conclusion of the contract
- No possibility to be expected at the conclusion
Fundamental Mistake

The mistake must be a fundamental one;
- The mistaken party, had it known the truth, would not have entered the contract or would have done so only on fundamentally different terms;
- Mistake as to terms of the contract; Not the motivations of parties which are not expressed in the contract;
- As to facts; Not law;
- Excusability: mistake not resulting from gross negligence or from intentional misrepresentation on the part of the mistaken party;
- Breach of GF by the other party not required;

Exceptions
- Risk of mistake was assumed or should be borne;
- Mistake leading to extra benefit for the mistaken party?
- The other party is willing to perform, or actually does perform the contract as it was understood by the party entitled to avoid it?

Either party may petition: Unilateral Mistake Bilateral Mistake?
Fraud

- The misleading party has the intention to deceive in order to induce the misled party to enter into the contract.
  - a fraudulent representation, whether by words or conduct;
  - fraudulent non-disclosure.
    - (the expertise of a party; the cost of acquiring the relevant information; the ease with which the other party could acquire for itself; the apparent importance of the information to the etc.)
- General recommendations cannot constitute a fraud.
- Causality: The contract as a consequence of the fraudulent.
Threats

- Threat of act by threatening party must be: 
  1) wrongful in itself; or 2) wrongful when used as a means to obtain the conclusion of the contract.

- The threat must be one that would have influenced a reasonable person.

- No reasonable alternative?: the existence of which suggests that the threat was not the real reason for entering into the contract.
Unfair Advantage

Essential factors for a case of unfair advantage:

- Economic distress or other urgent needs of a party;
- The knowledge of the other party.
Unconscionability: Excessive Benefits

- Unconscionability as a result of the conclusion of the contract in itself; Not of the ensuing events.
- Results or Process of the negotiation?
  - Parties are the best judges of the relative values to be exchanged;
  - improvidence; ignorance; inexperience; lack of bargaining skills.
Avoidance or Alteration through Litigation or Arbitration

Article 54  Either of the parties may petition the People's Court or an arbitration institution for alteration or avoidance of a contract ……

…Where a party petitions for alteration of the contract, the People's Court or arbitration tribunal may not avoid the contract instead.
• Courts and arbitration tribunals’ discretion to alter the contract?

• Time limit: The party entitled to avoid must file a case within one year after it knew or should have known about the cause for the avoidance.

• Confirmation: the aggrieved party willingly and knowingly abandons its right to avoid the contract 1) by statement or 2) by conduct.
Effect of Avoidance

- Retroactive effect: the contract is treated as if it had never been made;
- Mutual restitution is a natural consequence.
- Automatic re-transfer of property.
- Reasonable sum for what has been received when restitution cannot be made in kind for any reason.
- Not leave either party with a benefit at the other party’s expense.
Contract Void or Avoided

- Specific application of law of restitution;
- The party at fault is liable for loss suffered by the other party;
  see Article 58.
- Validity of the dispute settlement clause unaffected.
  see Article 57.