

Contracts, negotiation and enforcement in China: overview

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A Q&A guide to general contracts and their negotiation and enforcement in China.

The Q&A gives a high level overview of the key legal concepts including contract formation with general discussions as to authority, formal legal requirements, formalities for execution, the requirements for deeds and notarisation, and powers of attorney. It also considers the status of contractual terms, variation and assignment of contracts, and enforcement of the contract. In the enforcement section covers remedies and liability, exclusion of liability, and cross-border/jurisdictional matters.

The Q&A is part of the global guide to contracts, negotiation and enforcement.

Formation of contracts

Authority and capacity

1. What are the authority/capacity rules for entering contracts for different commercial entities?

Different commercial entities can generally enter into contracts with each other at will. However, to engage in transactions that require particular licences or permits (for example, sales of medical equipment, alcohol or tobacco), commercial entities must obtain the relevant licences or permits before entering into contracts to do business. In addition, local authorities cannot enter into guarantee agreements for others.

A commercial entity's legal representative and a representative that it authorises can enter into contracts on behalf of the commercial entity. A commercial entity may be bound by apparent authority if the counter party has grounds to believe that such authority should be effective. This applies to all types of commercial entities. Commercial entities can enter into outside contracts in excess of the powers granted in their constituent documents, except those for business that need particular licences or permits according to law. Otherwise, the contracts may be deemed to be invalid.

When a company is in an insolvent situation, the liquidators of the company can enter into contracts for matters relating to the liquidation on the company's behalf.

Formal legal requirements

2. What are the essential requirements to create a legally enforceable contract?

Offer and acceptance are essential requirements to create a legally enforceable contract. Consideration, however, is not necessary. In the offer, the offeror must express its intention and willingness to create a contract that will be legally binding on acceptance by the other party, and which must include the contract terms and conditions.

3. What are the main forms of contract (for example written and oral)?

The main forms of contract are written and oral. A contract can also be established through direct performance, without written or oral agreements.

An offer with the intention of being legally bound is different from an invitation to participate in negotiations because an invitation is only intended to invite to negotiate on offers, without intention of being bound. In an offer, the standard terms available on a firm's website can be incorporated by reference.

Offers can be withdrawn, as long as the withdrawal notice reaches the other party before or at the same time as the offer.

A contract in electronic form, for example by e-mail or web-based written form, is legally enforceable. Digital materials can be admitted as evidence in court as long as they pass these requirements: original copy available, authenticity, and completeness.

4. How are preliminary agreements used in your jurisdiction?

Preliminary agreements, such as letters of intent and memorandums of understanding, are usually used to set forth parties' intent to negotiate a deal. The agreement usually covers:

- The recital of the contract.
- Conditions between the parties.
- Confidentiality.
- Dispute resolution.

The agreement will also usually set a term for further negotiation for the parties to discuss the other details of the potential contract. It will specify that the agreement will not be binding or enforceable on the parties if no further agreement is reached within the term, except for the confidentiality and dispute resolution clauses.

5. Can negotiations become legally binding in any circumstances? What are the principles and rules (if any) on pre-contractual liability and good faith in negotiations?

Negotiations are not legally binding unless mutual agreements are concluded in the negotiations.

A party can claim damages for negotiations in bad faith in any of the following circumstances:

- Pretending to conclude a contract and negotiating in bad faith.
- Deliberately concealing important facts relating to the conclusion of the contract or providing false information.
- Performing other acts which violate the principle of good faith.

Formalities for execution

6. When are written contracts required and for which assets/interests?

There are some contracts that must be concluded in written form, such as:

- Loan agreements.
- Financial leasing agreements.
- Construction project agreements.
- Technology R&D agreements.
- Assignment of IP rights agreements.
- Labour contracts.
- Mortgages.
- Guarantee agreements.

7. Are there different formalities for different types of contractual documents?

There are no different formalities for different types of contractual documents.

8. What are the formalities for the execution of documents by companies, foreign companies and individuals?

Companies

Corporate seals are used in China. The corporate seal must be affixed on the documents. If it is agreed in the documents that the signature of the legal representative must also be included together with the seal, then the signature of the legal representative of the company must be added as well. It is possible to execute documents with the signature of the legal representative only if this is provided for in the articles of association or similar documents.

Foreign companies

The authorised representative of foreign companies must sign the documents, and if the companies have corporate seals, the corporate seals must be affixed.

Individuals

Individuals must sign the documents. In practice, the signatory will also have his or her fingerprint (usually the index finger) placed on the documents.

9. What is the status of electronic and faxed signatures in your jurisdiction?

Electronic and faxed signatures are recognised if they are proved to be authentic.

For some governmental filing matters, for example, tax return filing, parties can use a particular electronic device to submit filing applications to the governmental electronic systems. Electronic signatures will be created through this system by typing your name or clicking an "agree" button. The filing is deemed as effective as soon as it is submitted in the electronic system. For more provisions on the electronic signature, refer to the PRC Electronic Signature Law.

A faxed signature becomes effective when it is made on the documents and the fax of the signed documents arrives at the designated number of the recipient.

Deeds

10. When are deeds required in relation to contracts?

Deeds are not used for contracts in China. For some types of contracts, such as a Sino-foreign joint venture agreement or an acquisition by foreign investors in the foreign investment area, approval by a government department is necessary for those contracts to be brought into effect.

11. What are the legal formalities for a deed?

Deeds are not used for contracts in China (*see Question 10*).

12. What are the legal requirements for the execution of deeds?

Deeds are not used for contracts in China (*see Question 10*).

Notarisation

13. Is notarisation required for contracts in your jurisdiction?

Notarisation is not required for contracts to be effective. However, in practice, some parties or authorities may require the notarisation of contracts, for example:

- Property developers require a practicing lawyer to witness the signing of property sales contracts.

- Some local housing authorities require a local notary public to notarise a property mortgage contract when they are handling the property mortgage registration.

The purpose of this notarisation is to establish the authenticity and validity of the contract in case there is a dispute. The notary fee for each document is several hundred RMB.

14. What are the legalisation requirements in your jurisdiction and how are they carried out?

To use a document that has been signed outside of China, that document must be notarised by a local notary public (in that jurisdiction), and then legalised by the Chinese embassy or consulate in that territory. China is not a party to the HCCH Convention Abolishing the Requirement of Legalisation for Foreign Public Documents 1961. Apostilles are not used in China.

Powers of attorney

15. What are the main types of powers of attorney in your jurisdiction?

In legal proceedings, there are two types of powers of attorney:

- **General power of attorney.** This is sufficient for ordinary matters in litigation, for example, attending hearings or submitting complaints or responses.
- **Special power of attorney.** This is required for acknowledgements, waivers, alteration of litigation claims or client allegations, or settlement with the other party.

Principals can also issue powers of attorney for their representatives to deal with different types of matters, such as authorisations to:

- Act on the principal's behalf within a certain period, which ends on the expiry date of the power of attorney.
- Deal with certain transactions, with a term that is ends on completion of the transaction.

16. What are the main transactions when powers of attorney are used?

Powers of attorney are used in a comprehensive range of transactions and legal matters, such as:

- Litigation and arbitration.
- Property transactions.
- Filings of different types of applications or documents with government departments.

17. What are the key provisions in a power of attorney?

The following must be specified in a power of attorney:

- The identity of the representative, including his or her social security number.
- The object of the power of attorney (whether special or general).
- The entrusted matters.
- The scope of the authorisations.
- The term of authorisation.

18. What are the formalities for the execution of a power of attorney?

If the principal is an individual, the individual must sign the power of attorney. If the principal is a company, it is necessary to affix its corporate seal.

Other

19. Is virtual closing used in your jurisdiction?

Parties can opt for separate pages in distance closings, or execution in counterpart (where each party executes a separate physical copy of the contract before exchange of contracts). To avoid disputes, the parties must keep the documents in a complete and unchanged form (in practice, parties can initial each page of the contract or use corporate seals on each page).

20. How are legal opinions obtained and used in your jurisdiction?

Legal opinions can be issued by practicing lawyers. They are often required by the authorities in the security markets, such as opinions on the:

- Qualifications of institutional investors who are entering into the security market.
- Compliance of listed companies with market rules in important merger and acquisition projects.

In addition, well-known legal academics are sometimes requested in certain litigation cases to provide legal opinions to help the judges better understand the dispute. This type of legal opinion would be used for reference only by the judges in deciding the case.

21. What are the key issues in the conduct of completion meetings?

There is no such concept as completion meeting in China. Generally speaking, before signing contracts, the parties will:

- Have the confirmed contracts ready.
- Confirm the fulfilment of conditions to sign the contracts.
- Check the authority of the signatories.

After completing the contract, the parties will monitor each other's performance. Properly arranging monitoring contract performance is very important for the parties to avoid breaching the contract.

Content of contracts

22. What is the legal status of contractual terms in your jurisdiction?

All contractual terms are effective and binding on the parties, unless they are against laws or regulations.

Both express terms and implied terms based on the laws and practice rules in the contracts are binding on the parties. The contractual terms may be in oral or written form, or partly oral and partly written. Written form is, however, preferable to avoid disputes that some party breaks its promise in the oral agreements.

23. Are warranties recognised in your jurisdiction?

Warranties are recognised in China. There is no statutory limitation on contractual warranties, but basically the warranties must be:

- Genuine.
- Effective.
- Not against laws or regulations.

If one party breaches any of its warranties, the other party may require the breaching party to make a correction or continue to perform the contract, or compensate for the damages incurred. If the breach of any warranty results in the failing of the contract purpose, the non-breaching party has the right to terminate the contract according to law.

Also, the parties may agree in the contract that in case of breach of any warranty, the non-breaching party is entitled to claim against the breaching party for damages or terminate the contracts immediately.

Variation and assignment

24. What are the main ways to transfer contractual rights?

Parties can transfer contractual rights by assignment, novation or subcontracting. The party who intends to transfer its contractual rights to a third party must inform the other party to the contract of the transfer of contractual rights. Otherwise, the transfer will not be effective. If the contractual rights are closely connected to the personal relationship of the parties, the contractual rights cannot be transferred. An example of this is a legacy-support agreement (where one party takes on the duty to support another party in his or her lifetime and attends to his or her interment after death, in return for the right to a legacy).

25. What are the rules relating to waiver of contractual rights?

If any party intends to waive its contractual rights, it must expressly inform the other party of the waiver.

Enforcement

Liability and remedies

26. What are the rules relating to invalidity, misrepresentation and mistake relating to contracts?

Invalidity

There are different rules for invalidity of a contract and invalidity of exclusion clauses.

A contract is invalid where:

- One party induced conclusion of the contract through fraud or duress, thereby harming the interests of the state.
- The parties colluded in bad faith, thereby harming the interests of the state, the collective (groups of villagers) or any third party.
- The parties intended to conceal an illegal purpose under the guise of a legitimate transaction.
- The contract harms public interests.
- The contract violates a mandatory provision of any law or administrative regulation.

The following exclusion clauses in a contract are invalid:

- Excluding one party's liability for personal injury caused to the other party.
- Excluding one party's liability for property loss caused to the other party by its intentional misconduct or gross negligence.

Misrepresentation

There is no specific misrepresentation rule in Chinese contract law. There is a rule of pre-contractual liability (*see Question 5*).

Mistake

If a contract was concluded due to a material mistake, either party can petition the People's Court or an arbitration institution to amend or vacate the contract.

27. What are the main performance and discharge rules relating to contracts?

The parties to a contract can terminate the contract under any of the following circumstances:

- It is impossible to achieve the purpose of the contract due to an event of force majeure.
- Prior to the expiration of the period of performance, the other party expressly states, or indicates through its conduct, that it will not perform its main obligation.
- The other party delays performance of its main obligation after performance has been demanded, and fails to perform within a reasonable period.
- The other party delays performance of its obligations, or breaches the contract in some other manner, rendering it impossible to achieve the purpose of the contract.
- Another circumstance as provided by law..

28. What are the key rules on privity of contract and third party rights?

A third party can enforce a contract where and when the third party acts as an agent for the actual party of a contract. The agency is effective even where the third party is not an agent, acts beyond its authority, or its authority has expired, if the other party has reason to believe the third party has the power of agency.

Where a person having no right to disposal of property disposes of other persons' property and the principal ratifies the act afterwards or the person without power of disposal has obtained the power after concluding a contract, the contract is valid.

Where an obligor is remiss in exercising its due creditor's right under a contract, thereby harming the obligee's interests, the obligee can petition to the court for subrogation in its own name, except that the creditor's right exclusively belongs to the obligor.

29. What are the main rules relating to contractual liability?

If a party fails to meet its obligations under a contract, or its performance fails to satisfy the contract's terms, it is liable for breach of contract. For contractual remedies, see *Question 31*.

30. What are the main rules relating to excluding contractual liability?

Liability for the following cannot be excluded:

- Personal injury.
- Property loss caused by intentional misconduct or gross negligence.

Although the term "gross negligence" is used, there is no clear distinction between negligence and gross negligence in this context, as the term is not defined in the PRC Contract Law 1999, and gross negligence is the lowest threshold to trigger contractual liability throughout China's contract law.

31. What are the main contractual remedies?

The main remedies where a party fails to perform its obligations under a contract are that the party in breach be ordered to:

- Continue to perform its obligations.
- Compensate for the other party's loss.

Performance

The court can order the party in breach to perform the contract, although it has rarely in recent times ordered a party to perform a contract if it expresses in court that it is not willing to do so. If the party in breach refuses to perform, the non-breaching party may perform the original contract in some cases. For example, the buyer could complete a transfer of title without the signature of the seller in the transfer documents if the court orders the seller to perform the sale and purchase agreement and the seller refuses to do so.

Damages

The amount of damages payable is equivalent to the other party's loss resulting from the breach, including any benefit that may be accrued from performance of the contract. This is provided that the amount does not exceed

the likely loss resulting from the breach which was foreseen, or should have been foreseen, by the party in breach at the time of the contract's conclusion.

32. What are the main differences between indemnity and damages? Are penalty clauses subject to any limitation?

There is no official definition of "indemnity" under PRC law, which is regarded as one kind of "damage" in legal practice. Damages are compensatory in nature.

Penalties must be based on the damages incurred. The PRC Supreme Court has ruled that penalties must not exceed 130% of damages, and the court has the right to adjust penalties.

Enforcement and cross-border issues

Choice of law

33. Is a foreign choice of law in a contract upheld by the local courts?

The parties can select a foreign law as the governing law of a contract if there is a foreign element involved, such as that one of the parties is a foreign company or the contract is executed outside of China (*PRC Contract Law*).

In practice, most local courts will uphold the foreign choice of law and will require the parties to provide the details and requirements of those laws, and to explain them.

34. Are any mandatory terms implied by statute?

The Law on Application of Laws to Foreign-Related Civil Relationship 2010 stipulates the governing law of different foreign-related civil relationships. Some fundamental points of law cannot be amended by agreements, such as the governing law relating to:

- Civil capacity of a natural person, which is governed by the law of the place where the person naturally resides. (Civil capacity includes, among other things, the age in which that person becomes legally capable of entering into binding contractual obligations.)
- Administration of an estate, which is governed by the place where an estate is located.

Some legal requirements can be amended by agreement, such as the transfer and licensing of intellectual property rights.

Mandatory laws of the PRC apply regardless of choice of law, and PRC law is applied where the application of a foreign law will be prejudicial to the social and public interest of the PRC (*Articles 4 and 5, Law on Application of Laws to Foreign-Related Civil Relationship*).

Jurisdiction

35. Is a choice of jurisdiction in a contract upheld by the local courts?

The parties can choose jurisdiction, as long as that jurisdiction has an actual connection with the contract, such as the place of execution or performance of the contract. This does not apply to cases where there are mandatory jurisdiction requirements, such as marine cases. In addition, a foreign court has no jurisdiction over a joint venture contract, under the Law of the PRC on Chinese-Foreign Equity Joint Ventures.

When the parties choose an arbitral organisation to govern a dispute, the only requirements are that the arbitral organisation is currently in existence and in good standing.

Enforcement of foreign judgments

36. When are foreign judgments recognised in your jurisdiction?

The parties can file an application with an intermediate court to recognise and enforce a foreign judgment. The court will review the application. If there is no treaty regarding judicial assistance and/or judgment enforcement between China and the country where the foreign judgement was issued, the court will normally deny the application, except for judgments regarding divorce and child support.

Online resources

Contract Law of the People's Republic of China

W www.npc.gov.cn/englishnpc/Law/2007-12/11/content_1383564.htm

Description. This website is run by the National People's Congress of the PRC. The information the website contains is official and up-to-date. The translation is for guidance only

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