Interpretations of the Supreme People’s Court on Certain Issues Concerning the Application of the Contract Law of the People’s Republic of China (II)

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Judicial interpretations by the Supreme People's Court (SPC) play an important role in the Chinese legal system, as they provide often-detailed guidance to courts throughout the country about how to interpret existing laws. Written in response to a perceived need rather than to resolve a single case, judicial interpretations function almost as laws or regulations, filling gaps and answering questions.

In April, the SPC issued a wide-ranging interpretation that is of particular relevance to foreign investors: the Interpretations of the Supreme People’s Court on Certain Issues Concerning the Application of the Contract Law of the People’s Republic of China (II) (Second Contract Law Interpretation). The Contract Law was enacted in March 1999 and took effect on October 1, 1999. The SPC issued its first judicial interpretation of the Contract Law on December 29, 1999.

The Second Contract Law Interpretation contains six chapters and 30 articles. Effective as of May 13, 2009, it governs both new contracts and disputes arising from contracts that were concluded after passage of the PRC Contract Law but that had not been finally adjudicated by May 13, 2009.

This SPC interpretation of Contract Law is intended to clarify ambiguities and provide greater certainty. It illustrates, among other things, the willingness of Chinese courts to grant greater recognition and respect to the voluntary choices of parties to a contract (for example, in choice of venue). We summarize below the main provisions that will have an impact on foreign businesses.

Place of Execution of the Contract

In determining, for legal purposes, where a written contract was executed, courts are directed by the Second Contract Law Interpretation to rule that it is: (i) the place of execution as agreed to and specified in the contract, even if the contract was actually signed or chopped elsewhere; (ii) the place where the parties actually signed or sealed the contract, if all parties signed in one location; or (iii) if the contract does not specify a place of execution and the parties did not sign or seal the contract in the same place, the place where the last signature or company seal was executed.

The place of execution is thus significant in that it determines which people's court has jurisdiction if a dispute arises; given the uneven quality of courts in different provinces, that can be an important issue. In addition, many business people are reluctant to cede a "home court" advantage to a counterparty; in the
past, some have even gone so far as to travel elsewhere when executing a contract, in order to assure a neutral, mutually acceptable jurisdiction.

Under the Second Contract Law Interpretation, there is no need to travel, as the SPC has enabled parties to freely choose the jurisdiction where they want to litigate. This change, however, is not without its drawbacks: Critics fear it will encourage widespread venue shopping as parties seek friendly jurisdictions.

Validity of the Contract

Another aspect of the Second Contract Law Interpretation that is of special interest to foreign companies doing business in China is that it grants them relief when a deadlock arises, especially in joint ventures. Article 8 provides that if a contract requires approval or registration in order to be effective in accordance with laws and regulations (which is the responsibility of the Chinese party) and the Chinese party fails to fulfill its obligation to obtain the required approval or undergo required registration procedures, that responsible party has violated the principle of good faith and will be held liable for its failure. The Second Contract Law Interpretation enables the other party, with the court's consent, to apply for such approval or registration itself, with the party that failed to fulfill its obligation bearing any costs and expenses, as well as actual losses, to the other party.

This provision will apply mostly in joint venture contracts. All joint-venture contracts executed between or among one or more foreign investors and a Chinese party (or parties) require government approval from MOFCOM or its lower-level counterparts before coming into effect. The Chinese party (or parties) is responsible for that approval process. Article 8 grants more protection to a foreign party if the Chinese party fails to fulfill its obligation under the joint venture contract.

Performance of the Contract

Foreign investors may also find comfort in Article 26, which adopts the specific performance doctrine under the civil law system. Where material changes occur after a contract has been executed that are unforeseeable by the parties at the time of execution, that are not attributable to force majeure and are not commercial risks, and further performance of the contract will be obviously unfair to one party or will prevent realization of the purpose of the contract, the party negatively affected by the changes is entitled to apply to a court for a change in or termination of the contract.