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Supreme Court Interpretation Brings Major Changes to China's Contract Law

On April 24, 2009, ten years after the PRC Contract Law was adopted, the Supreme People's Court of China issued the *Interpretation of Several Issues Concerning the Application of the "PRC Contract Law" (2)* ("Interpretation"). Some of the clarifications brought by the Supreme Court have a major impact on business contracts.

The regulation of standard form clauses is one such area. Under Article 39 of the Contract Law, a party that provides standard form clauses has the obligation to draw the other party's attention to limitations and exclusions of liability and explain them on request. The Interpretation clarifies how this obligation may be satisfied: if the drafting party uses language, signs, script or other means that sufficiently draw the other party's attention to the relevant clauses, and gives explanations requested by the other party, the requirement of Article 39 is deemed satisfied. Companies that conduct business in the PRC should review their standard form contracts and highlight relevant clauses accordingly. To reduce the risk of disputes, companies should consider including an explicit acknowledgement by the other party that it has received all explanations it requested in their standard forms.

Liquidated damages clauses are another potential source of disputes. The PRC Contract Law does not recognize the concept of liquidated damages, but treats them as penalties, which courts may increase if they are lower than the actual loss or reduce if they are "excessively" higher than the actual loss. The Interpretation determines how courts may exercise this power: (1) liquidated damages may only be increased up to the amount

of the actual loss, and no further claim for losses may be allowed; (2) the Court may deem liquidated damages "excessively high" if they exceed the actual loss by 30%; and (3) when reducing excessively high liquidated damages, the Court must take the actual loss as its starting point, but must also consider other factors such as performance of the contract, the degree of each party's fault and expected profits, and make a decision "weighing the principles of equity and good faith." This provision makes the outcome of disputes over liquidated damages clauses somewhat more predictable than before.

When the effectiveness of a contract is subject to government approval, the contract party in charge of the approval process can often prevent the contract from becoming effective, if it no longer wishes to be bound by it. The Interpretation now allows PRC courts to authorize the other party to carry out government approval procedures when one party fails in its obligation to do so. When faced with obstructive tactics by their counterparty, companies should consider applying for this remedy.

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