

China's new law on sales contracts – what changes on January 1, 2021?

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On May 28, 2020, the National People's Congress promulgated the new *Civil Code*. It will enter into effect on January 1, 2021. In 1,260 articles, it merges the previous *General Principles of Civil Law* with the currently separate laws on contracts, guarantees, property, tort, family matters (marriages, adoptions), and inheritance. All these other laws are simultaneously cancelled. This leads to the **largest civil law reform in China** since its opening up. This analysis focuses on sales contracts.

Conclusion of contracts

The *Civil Code* contains general principles regarding the conclusion of contracts. Same as under many continental European laws, a contract conclusion requires an offer plus an acceptance. The *Civil Code* also contains new more detailed and contractually modifiable regulations regarding declarations transmitted via the Internet (e.g. by e-mail). In general, to conclude a written contract, the following is sufficient:

- the signature (of the legal representative), or
- the official stamp, or
- a fingerprint.

Tip: by checking the available online registers, the currently registered legal representative of a company can be determined quickly. Just claiming a management function, e.g. allegedly holding a manager title, is not sufficient for the conclusion that valid representation rights exist.

Tip: In practice, company stamps of Chinese enterprises will remain to be of huge practical importance. It is generally recommendable, also for easier evidence, to always insist that the official company stamp or (as far as existing) the official contract stamp is attached in original to the contract.

General terms and conditions

The *Civil Code* contains more detailed regulations compared to today regarding general terms and conditions (GTC). GTC are standard terms prepared in advance by one party for repeated use and which are not negotiated with the other party when the contract is concluded. The *Civil Code* regulates the permitted content of GTC, information obligations of the party providing the GTC, as well as the (partial) invalidity and interpretation of GTC.

Tip: same as under the old law, exclusion clauses in the GTC are invalid regarding:

- personal injury to the other party,
- property damage to the other party as a result of intent or gross negligence.

But an invalidity of GTC can also occur in case of other unreasonable liability limitations / reductions in favor of the provider of the GTC, or in case of an increase of liability or restrictions / exclusions of main rights of the other party.

Large autonomy regarding contract content

In general, the new *Civil Code* provides for a large autonomy regarding the content of sales contracts. This means that various articles in the *Civil Code* expressly allow that the parties may deviate from the written law. Sales contracts may accordingly be adjusted to a strong degree according to the interests of the involved parties in each individual case.

As minimum content of a sales contract, the *Civil Code* in principle suggests:

- name and address of the parties
- subject matter
- quantity
- quality

- price
- time limit, place and method of performance
- packaging manner
- inspection standards and methods
- liability in case of breach of contract
- dispute settlement mechanism

The **main obligation of the seller** is the transfer of ownership in the subject matter. The seller must guarantee that no third party has any rights therein. In case the ownership transfer fails, the buyer has a termination right and the seller becomes liable for compensation of damages. The seller is further obliged to either transfer possession of the subject matter, or to hand over the delivery documents.

The **main obligation of the buyer** is the payment of the purchase price.

The *Civil Code* contains further detailed regulations regarding delivery time and the transfer of risks in case of an eventual loss of the subject matter, as well as on sales transactions by sample / by trial use.

Warranty

When the purpose of a sales contract cannot be achieved because of the subject matter not complying with the quality requirements, the buyer may refuse to accept the subject matter or terminate the Contract, or may potentially be allowed to request damages for breach of contract. In case of quality deviations, in a first step, the respective contractual clauses regulating such case apply. If such regulations are missing in the contract or cannot be determined through a respective interpretation, the seller is liable to

- repair / reworking
- replacement
- return of the goods
- price reduction
- compensation of damages foreseeable at the time when the contract was concluded

If the seller fails to notify the buyer of a defect as a result of the seller's intentional misconduct or gross negligence, the seller may not rely on a contractually agreed reduction or waiver of liability.

The buyer on the other hand has the obligation to inspect the subject matter within the agreed inspection time limit after receiving the subject matter. The length of the inspection period can be contractually agreed upon. In case the buyer does not notify potential quantity or quality defects to the seller within the time limit - or latest within two years after receipt of the subject matter -, it shall be deemed that the quantity or quality of the subject matter has confirmed to the terms of the contract. In case a deviating time period is agreed upon, such time applies instead of the two-year period.

If the inspection time limit agreed to by the parties is too short and it is difficult for the buyer to complete the inspection within the inspection time limit, such a time limit shall only apply to external defects.

Retention of ownership title

The parties may agree on a retention of the ownership in case the purchase price has not yet been paid or other contractual obligations have not been fulfilled. But if such retention of ownership has not been registered (which will be often the case in practice), the seller may not challenge the acquisition of ownership by any bona fide third party. The *Civil Code* contains further legal consequences in case of a retention of ownership titles.

Interpretation and contract language

The *Civil Code* states various helpful hints regarding the interpretation of contracts. In general, the rules are very similar to those known in continental European jurisdictions. The interpretation of a contract is based on:

- the literal meaning of the words
- a systematic interpretation in combination with other relevant clauses
- nature and purpose of the contract
- usual practices
- the principle of good faith

Tip: it is not mandatory to use Chinese as contract language. A sales contract may thus also be concluded e.g. in the English language. As under the old law, it is also allowed to conclude a contract in several language versions and to agree that all language versions shall be equally binding. In case of discrepancies between different language versions, the interpretation is then conducted based on the literal wording, contract nature and purpose, as well as according to the principle of good faith.

Limitation of action

The limitation of action period according to the *Civil Code* is generally **three years** from when the party knows or should have known that its right has been infringed upon. But courts will generally not protect such rights anymore after **20 years** have passed since the infringement. The debtor must actively raise the limitation of action in front of the court. The creditor on the other hand can interrupt the limitation of action through various measures. Importantly, the statutory time limits for limitation of action cannot be deviated from in the contract.

In case of international sales contracts, technology imports and exports, the limitation of action period is **four years**.