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Drafting Sales Contracts

When Exporting to China

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This EU SME Centre report was written by:

Daniel de Prado Escudero: Partner, HFG Law & Intellectual Property

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Drafting Sales Contracts When Exporting to China

EXECUTIVE SUMMARY

Contract compliance and effective enforcement of contract rights concern every company doing business in China. When considering the issue of contractual enforcement, companies often focus on dispute resolution mechanisms, which indeed form a critical component of a contract. However, effective contract enforcement should be viewed as only one part of the overall contractual arrangement, perhaps the last one. Many problems that foreign companies encounter when doing business in China could be avoided by carrying out due diligence in partner selection, and by establishing a clear, well-drafted, and legally workable contract from the very start of the business relationship. Doing so is not – in most cases – a particularly difficult issue.

There are three general reasons for having a contract in place when doing business in China: clarity of obligations in the business deal, prevention of a dispute, and evidence in case of a dispute. This is regardless of whether the contract is drafted by EU SMEs without legal assistance, or by external professionals (which is the recommended option for EU SMEs without lawyers familiar with Chinese law and practice). In the contract, EU SMEs shall find replies to questions which look obvious, yet many still do not pay sufficient attention to asking and answering them. Some of these questions are:

- Do I know my business partner well? Does the information in the contract correspond to the reality and official database of Chinese companies?
- Is the person negotiating and signing the contract authorised to do so? Is the official company chop affixed to the contract an official one?
- Is the product and other deliverables identified without any doubts in terms of quality, quantity, design, etc.
- Are payment conditions drafted in a way that I am safeguarded against potential late payments or no payments?
- Are the terms of delivery clearly formulated? Who bears liability for damage?
- In the case of a breach of the contract, what are the mechanisms set to solve the situation as smoothly as possible? Is there a system of penalties or remedies set?
- If the contract is bilingual, are both versions identical so that there is no misunderstanding between parties?
- In case of a dispute, what action will take place? Litigation or arbitration? Under what law and in which jurisdiction?
- In the case of early termination of the contract, what procedures are necessary to conduct?

These guidelines identify the **key terms, tips and examples that should be considered in a sales contract for the export of goods to a Chinese buyer**. The objective is to provide European SMEs with basic, practical insight into the contractual aspect of Chinese businesses, and to help them evaluate the viability of contract arrangements with their Chinese business partners.

Specifically, the guidelines describe what provisions are important and why, and provide legal and practical background. Particular attention is given to payment provision, sufficient identification of contracting parties, description of product and delivery terms, language and contract validity, dispute resolution mechanisms, and term and termination of the contract.

Finally, the last section of these guidelines provides an overview of new regulatory developments in terms of privacy and data protection, which must be taken into consideration when developing business and negotiating in China.

1. PRE-CONTRACT STAGE

1.1 HOW TO CHECK ON YOUR POTENTIAL BUSINESS PARTNER?

Before entering into a contract, it is essential to assess the **legal status and reliability** of the Chinese business partner, especially when doing business with them for the first time. The EU SME Centre has several resources outlining simple and practical steps for EU SMEs to identify red flags of potential risks.[1]

In China, the State Administration for Market Regulation (SAMR) departments / bureaus at the local level are in charge of the registration and administration of companies. All companies, except in some special industries, must be registered with the local department of market regulation in order to be formally and duly incorporated to obtain the business license, legitimating their status as a Chinese legal person.

Nowadays, corporate information regarding Chinese companies is available to third parties through public and private business and credit-related information platforms. By conducting simple searches on such platforms, it is easy to obtain relevant information about potential business partners to assess their existence (due incorporation in China), the status and nature of the company, whether it has fully paid up its registered capital, as well as civil or criminal disputes the company may have been involved in. Specific information such as company registration information, registered capital, address, identity of the legal representative and directors, identity of the shareholders, articles of associations, information of changes, etc., can be obtained and be a good input to assess the reliability of potential business partners.

Another essential action is to request a **copy of the business license** from a prospective business partner, which contains key legal information of the company such as the official name and address, legal representative, registered capital, business scope, operating period, etc. However, these websites, as well as the original registration information, are usually only available in Chinese. At a company's request, the EU SME Centre can assist with making informal background checks on the Chinese company in question.

The **EU SME Centre can assist EU SMEs to conduct, free-of-charge, basic background checks on Chinese companies**, trying to identify red flags for scams and other credit-related risks. EU SMEs may request this service through the **Ask-the-expert** section on our website, https://www.eusmecentre.org.cn/expert or by sending an email to info@eusmecentre.org.cn

Nevertheless, the business license, combined with an online check, provide only the most basic information about a company. For sizeable business deals, more **thorough due diligence** on potential Chinese business partners is strongly recommended, which may include one of the following:

- Try to obtain the internal file of the target company registered at its local departments of market regulation. This file contains further detail on shareholders, registered capital contribution, copies of submission documents when the company was established and when changes to the company's registration were made, and it may even include some financial statements. The target company itself can always obtain (or help to obtain) a copy of this file. Regardless, it is often possible for third parties such as law firms to obtain a copy without the involvement of the target company.

- Certain service providers specialise in gathering information on target companies, including financial information, information on buyers, size, etc. Law firms often have contacts with such companies; however, prudence is advisable, since some of these companies may operate in grey areas.

It can also be very useful to make a personal site visit to the target company, to check its operations and speak to its managers. Consider being accompanied by a trusted local, as they may be able to gain deeper insights from the visit than an outsider.

1 See, for instance: (i) *Simple Steps to Minimise Risks of Being Scammed When Purchasing from China* (Aug 2022): https://www.eusmecentre.org.cn/article/simple-steps-minimise-risks-being-scammed-when-purchasing-china); (ii) *Knowing Your Chinese Partner* (May 2018): https://www.eusmecentre.org.cn/report/knowing-your-partners-china.

It is always useful to ask for references, especially from other European firms that have worked with the Chinese company and can be easily contacted. A list of service providers is also available at the EU SME Centre upon request.

Finally, two general principles to keep in mind are: (i) if a deal seems too good to be true, then it should be examined very closely, and with a sceptical eye; (ii) always perform some level of due diligence before committing substantial resources.

1.2 WHAT IRREGULARITIES SHOULD YOU PAY ATTENTION TO?

Unqualified operations. Double-check whether your potential business partner has obtained the mandatory qualifications required in China to operate with a specific product or within a particular field.

For instance, if negotiating the sale of food products, the Chinese company must possess a specific business license. Likewise, if the products are medical devices, the medical device trading permit must have been obtained. Furthermore, cooperation with companies whose qualifications are about to expire or have expired should be avoided.

Companies under abnormal operations or blacklisted companies. Normally, enterprises that have been involved in irregular activities or acts will be marked as being under abnormal operations, or even blacklisted. This can be easily identified as showed in the example below from China's National Enterprise Credit Information Publicity System (http://bj.gsxt.gov.cn/).

These acts may be characterised by: submitting false materials, organising and planning pyramid schemes, unfair competition acts, serious violation of consumers' rights and interests (especially causing personal injury), trademark infringements, etc.

Litigation or judicial disputes. Whether a company is involved in civil or criminal litigations and the object of those litigations can be also checked. These factors and situations are worth considering before cooperating with a company, so to anticipate in advance if potential disputes are to be expected. Some public or third-party credit-related platforms allow to conduct such search, although a subscription might be required. The EU SME Centre has an active subscription on some of these platforms and may therefore assist, free-of-charge.

Information on Chinese companies that have been involved in commercial disputes and/or scams with EU SMEs is available to the EU SME Centre, based on cases received in the past. EU SMEs may reach out to the EU SME Centre to check, **free-of-charge**, whether information is available on the Chinese partner they are negotiating with. Do so via https://www.eusmecentre.org.cn/expert or by sending an email to info@eusmecentre.org.cn

1.3 PRACTICAL AND CULTURAL ASPECTS WHEN NEGOTIATING WITH CHINESE PARTNERS

The most common mistake made by foreign companies when starting the development of a business project in China is to **underestimate the enormous differences** between China and other countries.

An example of an enterprise listed on China's National Enterprise Credit Information Publicity System as being involved in abnormal activities.

Source: http://bj.gsxt.gov.cn/

China is different. A world apart and in many ways featured by unparalleled complexity and unique distinctive peculiarities. And now, more than ever, there is no room for improvisation in this market. Not understanding this or not taking it into account means losing the battle beforehand in any project that is started in China.

Doing business in China and negotiating contracts are obviously not an exception. Certain features, formalities, common places and specific ceremonies do usually need to be followed to take any negotiation to a successful outcome. **This kind of peculiarities are often not well-known by foreign companies** and their representatives when they start doing business in China and begin negotiating with a Chinese partner. For that reason, there are a few aspects to consider beforehand, which will help to ease the negotiation and result in a better mutual understanding, bridging the cultural differences.

- **Knowing your counterpart**. One should always learn more about the counterparty before starting the face-to-face negotiation. Research on the potential partner´s background must always done, through online channels but also through partners on the ground.

- **Kindly contact and stress out the cooperation purpose**. In China's business environment, formalities are extremely important. One must begin by writing an email to the counterparty with a kind tone, making a brief introduction and describing the main purpose and contents of the situation before proposing face-to-face negotiation.

- **Small talk**. If an EU SME is going to meet up face-to-face with the potential business partner, according to the Chinese culture, a good beginning always comes with food. It is advised to initiate a small talk to warm up the negotiation for a few minutes before food is served. This will make Chinese partners feel closer and will ease the path to get into proper business negotiation later during or after dinner.

- **Describe the cooperation plan in detail**. A detailed description of the cooperation intention, cooperation procedure and cooperation content should be made, while potential questions that the partner may raise should be expected and prepared in advance. One should always keep in mind that, especially in China, it is all about gaining trust.

- **Provide flexible methods of quotation**. Generally, the quotation of goods is the point of highest concern for Chinese partners during the negotiation. Therefore, EU SMEs should convey to their Chinese counterparts their willingness to apply special discounts to ease the agreement. For example, the quotation may be provided first, but with a kind reminder that it can be adjusted based on actual needs. Equally, if the sale volume is large, a "package price" can be offered, as most Chinese entities prefer it this way. For large purchases, in practice, the buyer will not purchase a large volume at first. Thus, the possibility to grant certain discounts may be proposed for future deals.

2. CONTRACT CONCLUSION: WHAT TO CONSIDER

2.1 MAKE IT VALID: KEY FORMALITIES OF CHINESE CONTRACTUAL PRACTICE

There are a few particularities of Chinese contractual practice and legal system that must be duly considered when entering into a contract with a Chinese company. Bearing that in mind will allow EU SMEs to effectively protect and secure the validity and enforceability of the contract.

- **Chop**: The contract must be chopped with the official corporate chop of the Chinese entity. Chinese chops have standardised elements such as a circular shape, red ink, and a star in the middle, as shown in the examples below. Chops in other shapes and colours (with some exceptions) do not have any legal value in China.

- **Chinese names**: It is essential to include the Chinese name (in Chinese characters) of the potential business partner in the contract. English names of Chinese companies are not official and tend to be made up.

- **Original version**: always obtain and keep the original version of the contract duly signed and chopped by both parties.

- **Bilingual agreement**: even if not required, bilingual agreements (Chinese + foreign language) are highly recommended to avoid further misunderstanding and drawbacks with translations in case of litigation.

2.2 THE MOST IMPORTANT PROVISIONS AND CLAUSES

Overall, when drafting contracts, the two parties should focus on the basics and eliminate unnecessary details. Standard common-law agreements should be avoided, in favour of simple and straight contracts. As a matter of fact, generally contracts in China are better fit and more effective when they are simple, clear and precise. It is advised to clearly state obligations – who shall do what, when, and how much/many – and thus minimise risks of doubts or misinterpretation. Penalties for a breach shall be included (they might be subject to moderation by the court), as well as clear deadlines and way-out/termination clauses.

It is noteworthy that Purchase Orders are acceptable in lieu of contracts, but they shall have clear details. These must be original, printed out in paper version, and chopped with the official chop of the contracting party.

Contracting parties

It is important to determine exactly which parties are entering into a contractual relationship. In the case of Chinese companies, their official Chinese name rather than its unofficial translation in English must be included in the contract, together with other identifiers such as the registered address and legal representative, which can be found on the business licence and verified online.

It is not uncommon for Chinese companies to prefer that the contract is not signed in their name, but in the name of an offshore affiliate (a company belonging to the same group or cooperating company) – for example, a Hong Kong trading company. This is because, due to foreign exchange restrictions that continue to prevail in China, it is easier for payments to be made from or to an offshore company. This, however, puts the foreign counterpart at risk. If the Chinese company fails to meet its obligations under the contract, then any legal action will have to be taken against the offshore company. However, that offshore company may have no assets to enforce against, while the Chinese company with assets can walk away. Therefore, it is best to deal directly with the company that is the actual buyer.

Product description clause

After several rounds of discussions and negotiations (usually via email), parties often believe that they agreed on the exact product to be sold. However, it is a mistake not to include into the contract a **very detailed description of the product**, including any quality requirements. In case of a dispute, this will give a clear standard against which the court or

arbitration tribunal can measure performance. Moreover, it will ensure that parties' expectations are clear on how obligations will be performed. If a product is difficult to describe, then one approach is to work with a "golden sample," i.e. one product that both parties confirm as the sample for further production. Pictures and test reports may be attached to a contract to further support what has been agreed.

The description to be included in the contract must take into account the frequency of the sales and the scenario in which the parties will perform their obligations. Hence, the wording and regulation stated in the contract should not be the same for a one-off sale as for a regular provision of goods to the buyer.

For a **one-off sales contract**, a product description clause might be composed by a simple table such as the following:

序号 Item	数量 Quantity	商品规格 Product Specifications	单价 Unit price (EUR)	金额 Total (EUR)
1				
			EUR/KG	
Total Price				

For **regular sales contracts**, product description clauses might vary, for instance:

Contract with sales performed on a permanent basis

The products sold by the Seller and bought by the Buyer (the "Product/s") will be specified in the Sale Order (the "S.O.") together with all information necessary to successfully accomplish the purchase of the Products by the Buyer (the "Sale").

买方需要向卖方订购产品（"产品"）的所有信息，应通过销售订单（"订单"）的形式明确，以便成功完成采购（"交易"）

Contract with sales performed upon request of the buyer

1.1 The products sold by the Seller (the "Products") are [...].

1.2 Pursuant to the purchasing process described in Article 2 of this Agreement, on a time-to-time basis, the Seller will confirm to the Buyer the availability of the specific Product requested by the Buyer and the conditions of its sale to the Buyer.

1.1 卖方销售的产品（即"产品"）为 [···].
1.2依照本协议第2条中描述的采购流程，在长时间合作的基础上，卖方须向买方确认买方要求的特定产品的可得性及销售条件。

If a product comes with **after-sales services**, then this should be specific as well. In short, the full scope of deliverables by one party to the other party should be included in the contract, in as much detail as possible.

Purchasing process provisions

It is essential to include a detailed description of how the products shall be ordered (including their price, type, quantity, etc.), and **when such an order will be considered as accepted** by the seller.

In a one-off sale, this will not represent much trouble, as the above details will be easily described. However, if sales are expected to be performed on a permanent basis or from time to time, then a clear description of the process is highly advised to be agreed.

On the following page is an **example of a standard provision** that may be inserted in a sales contract to regulate the purchasing process of when sales are conducted in different batches.

Purchasing process

2.1 The supply of the Products will be performed in several batches. The purchasing process between the Parties will be carried out according to the following provisions and by means of specific Purchase Orders (the "P.O.").
产品供应将分批进行。 双方之间的采购流程将根据以下规定并通过特定采购订单("P.O.")进行。

2.2 Every time the Buyer wants to receive a new badge of Products from the Seller, the Buyer will communicate with the Seller to let him know the basic information about the supply.
每当买方想要从卖方收到新的产品时，买方将与卖方沟通，让其知道有关产品的基本信息。

2.3 The communication and information referred to in point 2.2 above shall be provided to the Seller by means of the P.O. whose template is attached hereto as Annex I. The P.O. will specify all the information described in Annex I hereto to formalize and execute the purchase.
述第2.2点所述的沟通和信息应通过P.O.提供给卖方。 其模板附于附件一。 P.O. 将指定所有必要的信息以正式确认并执行购买，包括但不限于：

2.4 Within 5 working days from receiving the P.O.:
在收到P.O后的5个工作日内：

a. If the Seller accepts the P.O., it shall send to the Buyer a written confirmation (the "Confirmation").
如果卖方接受P.O.，则应向买方发送书面确认（"确认"）；

b. If the Seller does not accept the P.O., it shall send a request for modification to the Buyer (the "Modification Request") which can be accepted or rejected by the Buyer. If rejected by the Buyer, the Seller and the Buyer will have to negotiate to agree on the final the terms for that P.O.
如果卖方不接受P.O.，则应向买方发送修改请求（"修改请求"），买方可以接受或拒绝该请求。 如果买方拒绝，则卖方和买方必须协商最终同意该P.O.的条款。

2.5 If the Seller does not accept the P.O., it shall send a request for modification to the Buyer (the "Modification Request") which can be accepted or rejected by the Buyer. If rejected by the Buyer, the Seller and the Buyer will have to negotiate to agree on the final the terms for that P.O.
如果买方在收到提案后的5个工作日内未发送确认书或修改请求，则视为提案已被拒绝，未完成购买。

2.6 For the avoidance of doubt, supply of the Products shall be deemed agreed between the Parties only when the Confirmation sent by one Party to the other Party matches the last P.O. or Modification Request sent by the other Party. That agreed P.O shall be deemed as the confirmed P.O. (the "Confirmed Order")
为避免歧义，只有当一方向另一方发送的确认书与最后一份P.O.匹配时，才会视为双方达成一致。 或另一方发送的修改请求。 同意P.O将被视为已确认的P.O. （"确认订单"）。

Payment terms

One of the key commercial terms of a sales contract is **the term on payment**, i.e. how and when the payment should be made. The most common methods include:

Payment upon delivery. From the buyer's perspective (in this case the Chinese party), the best option is to agree to make the payment a certain number of days after delivery. Larger buyers are generally able to impose such a term on the seller, especially where the deal is expected to be recurring. On the other hand, this arrangement does **present a considerable risk to the seller**: if the buyer does not pay, then the only option will be to file a claim against this buyer. In China, this problem is made worse by the fact that, in practice, many Chinese companies are relatively slow in making payments. Foreign sellers will generally spend a considerable time negotiating a solution, in order to keep the buyer and avoid a long battle in litigation or in arbitration. If possible for a seller, this situation should be avoided by choosing other options.

Advance payments. A method which is much more favourable to the seller (foreign party), is to agree to a partial advance payment, with the remainder

to be paid through progress payments and/or upon shipment, for example against the bill of lading.

This kind of method **provides highest security to the seller**, but for the buyer it presents a risk: if, upon delivery, the goods are found to be incompliant with the agreed conditions, then it will be up to the buyer to try to get his money back.[2] This burden may come on top of any customs duties and taxes that may have already been paid on the import of the goods. If a Chinese company is the buyer, it may, for example, insist on one of the above solutions:

- Part of the payment is delayed until the goods have been received and inspected;
- The goods are inspected by the buyer or its representative before they are shipped.

If the goods need to be installed by the seller, then it is common to link the payments to such installation. Moreover, for certain kinds of goods, it is usual to leave a final payment until much later – as a guarantee that the goods will work properly.

Letters of credit. Another option is to work with letters of credit, which are used extensively when selling into China, and tend to be the **preferred method of payment for larger transactions**. On the other hand, many smaller Chinese companies may not be familiar with letters of credit, and/or will have to incur additional expenses to convince their bank to support them. Regardless, the foreign seller should insist on letters of credit from well-established banks in China, such as Bank of China, China Construction Bank, Industrial and Commercial Bank of China, China Development Bank, Bank of Communications, China Merchants Bank, or the Chinese branch of a well-established American, Asian or European bank.

Currency and other specifics. Taking into account that the Chinese currency CNY is not convertible, international currencies like EUR, USD and GBP are often used for the settlement of export with Chinese companies.[3]

In addition, it is advised to define as clearly as possible **what exactly the agreed price includes**. In particular, whether taxes and customs duties are included. In this regard, reference can also be made to INCOTERMS, which are accepted in China. They determine the obligations of the parties, such as which party takes charge of delivery, takes the risk for the goods during transportation, is responsible for arranging (and paying for) freight and insurance, etc.

Delivery clause

Description of how the delivery of the goods will be carried out, including the process, periods and liabilities, must be as detailed as possible. The transmission of risks and use of INCOTERMS should be especially mentioned.

Particularly useful is a **retention-of-ownership clause**. Chinese law establishes that ownership of goods is transferred upon delivery, unless otherwise agreed between the parties. Hence, the parties can agree that ownership passes only upon payment of goods. This has an impact, particularly, in case the Chinese purchaser goes bankrupt – since the goods, still owned by the foreign seller, will not be part of the purchaser's assets to be liquidated.

In a one-off sale, the term agreed for the delivery of the product as well as the INCOTERM must be specified. This will govern the allocation of responsibilities in case of any loss, damage or breach of the conditions agreed. In a scenario of a sales contract for sales to be performed on a permanent basis, the following **example of a standard provision** may be considered.

2 The EU SME Centre has come across many cases of EU SMEs encountering problems when buying from Chinese suppliers. These range from receiving defect goods, or not receiving goods at all even if an advance payment was made. In practice, it is extremely difficult for them to *regain the money back. More details, and how to prevent such cases, can be found in the EU SME Centre's article Simple steps to minimise risks of being scammed when purchasing from China* (Aug 2022): https://www.eusmecentre.org.cn/article/simple-steps-minimise-risks-being-scammed-when-purchasing-china).

3 More details on payment options and foreign currency exchange are available in a dedicated EU SME Centre guideline: https://www.eusmecentre.org.cn/guideline/payment-options-and-foreign-exchange-control-china.

4. Delivery clause

4.1 The Seller shall deliver the Products to the Buyer or the importer, as the case may be, within the Delivery Term and in the manner specified in the Purchased Order.
卖方应在交货期限内以确认订单中指定的方式将产品交付给买方（或进口商）。

4.2 All Products ordered by Buyer shall be packed for shipment in accordance with Seller's standard commercial practices. It shall be Buyer's obligation to notify the Seller any special packaging requirements. Any packaging modifications different to the standard commercial practices of the Seller shall be made at Buyer's expense and subject to the Seller's approval.
买方订购的所有产品应按照卖方的标准商业惯例进行包装。 买方有义务通知卖方任何特殊包装要求。 任何与卖方标准商业惯例不同的包装修改均由买方承担费用，并须经卖方批准。

4.3 Notwithstanding article above, the Seller will use its best efforts to assure that the Products are delivered for shipment in perfect conditions for its use and that the Products will be delivered to Buyer on a timely basis insofar consistent with the Purchased Order.
尽管有上文第4.1条约定，卖方将尽最大努力确保产品在完美的使用条件下交付运输，并且产品将按确认订单的要求及时交付给买方。

4.4 The Parties agree that the applicable INCOTERM (version 2020) that will regulate the delivery of the Products pursuant to this Agreement shall be "CIF".
双方同意，本协议产品交付适用"CIF"国际商业术语（2020版）。

4.5 For the avoidance of doubt, it is the Buyer or the Importer obligation, as the case may be, to verify beforehand full compliance of the Products with the people's Republic of China ("PRC") applicable laws and regulations. In the event of any issue for the importation and sale of the Products in PRC due to non-compliance with PRC applicable laws the Buyer shall have no cause to raise any claim against the Seller.
为避免疑义，买方（或进口商）有义务事先验证产品是否完全符合中华人民共和国适用法律和法规。 如果由于不遵守中国适用法律而导致在中国进口和销售产品出现任何问题，买方（或进口商）均不得向卖方索赔。

Quality control procedure

By regulating a **quality control procedure**, for instance by adding an obligation to inspect the goods upon delivery, it is possible to minimise the potential eventuality of the business partner raising ungrounded complaints over the quality of the products delivered, or even using such argument as a countermeasure in a dispute over a potential breach of the buyer.

This happened in one specific case encountered by the EU SME Centre of an European SME selling machinery to a Chinese buyer, which failed to pay the agreed fees within the stipulated term. Upon the complaint of the seller, the buyer claimed that the product received had malfunctions or did not comply with the requested features.

Warranty, liabilities and penalties

Chinese laws sometimes have mandatory terms on potential warranties and liabilities, depending on the specific product that is being sold and purchased, while restrictions may also apply to possible penalties in case of non-delivery. For instance, Chinese law allows penalties only in form of liquidated damages. This means that the parties can agree on a fixed amount of damages in case of breach. However, a Chinese court or arbitration tribunal may adjust the final amount, based on the actual damages suffered by the non-breaching party.

Hence, it is always a good idea to **clarify specifically what warranties are given** with a product and for how long, and **what liabilities may arise** if one of the parties fails in its performance. For example, does the seller have the obligation to replace unqualified products, and within what time period? And what kind of damages should the purchaser be able to claim if the seller breaches the contract?

It is thus important to be strategic in determining the amount of liquidated damages specified in a contract. If too low, this can impact the ability to obtain compensation for losses, but if too high, it may be more easily challenged by a court or tribunal.

Term and termination

For a one-off transaction contract, including a specific term is not essential: the parties will agree that the contract becomes effective upon signing, and will conclude after the parties have performed all their obligations.

Many contracts, however, are signed as framework contracts, under which parties may continuously issue new purchase orders. In that case, the contract establishes the general terms of the relationship and will remain in force in perpetuity until it expires under an agreed term, or one of the parties initiates termination. Hence, in such cases, establishing a logical term is often not difficult: parties may, for example, agree to a one-year term, with automatic renewal unless one of the parties notifies the other party of its intention not to renew.

However, the **conditions for early termination** are usually more complex, in particular if the contract establishes a fixed price for a product at which the seller must sell, and/or the purchaser must purchase (e.g., for a certain volume). Common termination clauses relate to one of the parties going bankrupt or entering into liquidation, but they could also be linked to market developments (e.g., the price of raw materials) or even be fully discretionary (each of the parties may initiate termination without any reason, usually with some advance notice).

Confidentiality and IP rights protection

In many transactions, one of the key reasons for a strong and extensive contract is the protection of confidential information and other intellectual property (IP) rights, such as trademarks or designs. In fact, this is among the **most underestimated points by European companies** when doing business in China and, actually, one that causes most troubles, especially with regards to the protection, registration and use of the trademark in China.

When a European company sells a product to a Chinese company that contains IP rights, it wants to make sure that the Chinese buyer continues to respect such IP rights. For example, the Chinese buyer should be prevented from divulging IP to other parties in order to localise supply (which would be an IP infringement in itself).

Therefore, even before initiating any contact with a potential business partner, European SMEs should carefully consider the two following aspects, and take corresponding measures.

Aspects to consider	Corresponding measures
How will my products be commercialised in China?	Conduct a search for your trademark in China to detect and find out potential similarities on the same sort of products
Which distinctive signs will be used so the Chinese consumer can recognise and identify the products? For instance, trademarks, packaging, etc.	Register the trademark, design or any IP right owned, even before expanding the business into China

Yet, these aspects alone are not enough. In fact, the **protection of those IP rights also needs to be reflected and secured in the sales agreement** by means of a specific clause, where not only the rights but also the use of the European company´s distinctive signs is thoroughly regulated and limited to only those scenarios or fields in which the Chinese buyer is allowed to use them.

Furthermore, it is essential to expressly state that all the IP rights owned by the European company over the specific distinctive signs to be used or embodied in the products, shall remain the sole properties of the European company and the Chinese partner shall not dispute them in any way. Ideally, EU SMEs should also try to add a provision setting out that the Chinese company has no interest in and agrees that it will not at any time register or attempt to register their trademarks or any other distinctive sign confusingly similar thereto or any patent or utility model similar to the a patent owned by the foreign company.

For more information on IP registration, protection and enforcement in China, EU SMEs may refer to the **China IP SME Helpdesk**, an EU-funded project that provides, free-of-charge, assistance and advice on IP issues in various sectors.[4]

4 See: https://intellectual-property-helpdesk.ec.europa.eu/regional-helpdesks/china-ipr-sme-helpdesk_en.

Language

Considering that the representatives of many Chinese companies do not speak fluent English, while those of European companies generally do not speak Chinese, the question is often asked whether it is necessary for the contract to be in Chinese, or bilingual in both English and Chinese.

From a **legal enforcement perspective**, this is not necessary. A contract in English is perfectly valid and enforceable under Chinese law. However, there are a number of reasons why it is often a good idea to use a bilingual or Chinese contract:

- The Chinese party will often insist on a Chinese version, especially if it plans to involve its lawyers
- Having a Chinese version will ensure that the Chinese party knows perfectly what it is signing
- If the case goes to court, then a Chinese translation will need to be prepared anyway

Contract validity and effectiveness

In most jurisdictions, a contract becomes valid when signed by its authorised representative. In China, the signature of the authorised representative (usually referred to as the legal representative) binds a company as well, but every Chinese company also has a **registered company chop** (or company stamp/seal) which formally represents the company, and is used to confirm contracts. The best solution, therefore, is to ask the Chinese company to add its company chop on the document, and for big contracts also the signature of the buyer's legal representative.

One difficulty that many foreign companies face is in their ability to **recognise the official company chop**. While the registered company chop would be sufficient to make a contract effective, an unregistered chop would give the Chinese company basis to deny the validity of the contract later. There is no easy strategy for resolving this conflict. Sometimes it is possible to confirm directly with a local Public Security Bureau (PSB), but there is no public database where a third party can easily confirm what the official chop of a certain company looks like. On the other hand, most Chinese lawyers and consultants will be able to recognse a registered company stamp. At the same time, as indicated in section 2.1 of these guidelines, EU SMEs must always remember that company chops in China have **standardised elements** such as circular shape, red ink, and a star in the middle; any other shapes and colours should be rejected out immediately.

One further issue is whether an original signed/stamped contract is necessary, or whether a copy (sent by fax or email) is sufficient. Generally, Chinese courts and arbitration tribunals will require the original, as copies may be easily faked. Exceptions can be made where the copy can be notarised (e.g. from a computer server), though it is better to insist on the original, as protection in case of disputes.

Choice of law

The partners of an international sales contract are basically **free to choose the law** governing the interpretation of the contract, as well as the forum that will deal with any disputes arising out of or in connection with the contract).

Accordingly, it is possible to draft the sales contract in accordance with the laws of EU Member States, Chinese law, or even the United Nations Convention on Contracts for the International Sale of Goods (CISG) – all EU Member States have joined the CISG, except Ireland, Malta and Portugal.

No matter what, it is best to specify the choice of law in the contract, to ensure that in case of a dispute it is clear which law should be applied. Application of law means the procedural stage in litigation of a case involving the conflict of laws, when it is necessary to reconcile the differences between the laws of different legal jurisdictions, such as sovereign states. Namely, which law the court (or arbitration tribunal) and parties should refer to. **Key issues when negotiating the choice of law clause** include the following:

- European companies may be more familiar with their own laws, and will often prefer them over Chinese laws. In practice, though, especially when the European company is the supplier and the Chinese company is the buyer, it will be difficult to convince a Chinese company to accept the application of an unfamiliar European law.
- The choice of law often relates closely to the choice of forum – the place and mode of dispute settlement. For example, a Chi-

nese court has not extensive expertise on foreign laws, and so asking a Chinese court to apply, say, French law will complicate things and result in higher costs. To avoid this, it is advised to refrain from establishing application of a European law where a dispute is to be resolved by a Chinese court.

Dispute settlement

Even more important than determining the governing law, is to **include a clause in the contract that establishes where disputes will be settled**. The EU SME Centre has a dedicated resource in this field.[5] There are three main options: choosing European courts, choosing Chinese courts, or choosing arbitration.

Choosing European courts. A natural instinct of a European company is to choose the court in its home country as the competent court of jurisdiction. However, not only is such an agreement often not acceptable to the Chinese counterpart; it could also put the European company at a distinct disadvantage. In fact, China has signed very few agreements with European countries on the mutual recognition and **enforcement of judgments**. In practice, this means that it will be difficult, if not impossible, for the judgment issued by a European court to be **recognised and enforced in China**. Presuming that the Chinese party has no assets in Europe, the judgment then becomes useless, as it cannot be enforced against the assets of the Chinese company.

Moreover, even if China does have a bilateral treaty with a country (such as France or Italy), recognition and enforcement is still a long and difficult process, with a multitude of risks. At the same time, the European party will not have the option to apply for asset preservation or other preliminary injunctions in China, and so there is the real risk that during litigation in Europe, the Chinese company will move its assets out, so that a final order in China **still cannot be effectively enforced**.

Choosing Chinese courts. Many European companies are not enthusiastic about the prospect of litigating in China. Beyond the standard concerns of litigation, including inefficiency, cost, and time, commercial litigation in China raises a number of other significant concerns – many related to factors such as the lack of transparency, the lack of a litigation tradition for resolving commercial disputes, and the relative infancy of the country's judicial system.

Such concerns are less of a worry in highly-developed cities, such as Shanghai, Beijing, Guangzhou, and Shenzhen – their courts frequently deal with disputes involving foreign parties, and the experience of European firms with these courts is often quite positive, if one has the right (Chinese) lawyers to provide support. On the other hand, however, one can only choose a court in Shanghai, for instance, if either the Chinese party is Shanghai-based, or if there is another strong link to Shanghai when implementing the transaction. So, choosing a "developed" court is not always an option.

One **huge advantage of litigating in China** is that the same court can also accept applications for **preliminary injunctions**, and particularly for asset preservation. Chinese courts are relatively open to freezing assets (such as bank accounts) of the defendant pending the outcome of a trial, as long as three basic conditions are met:

- The case has been formally filed with the court
- The plaintiff can provide information on where the assets are
- The plaintiff has paid a guarantee deposit of between 25% and 100% of the amount to be preserved (in some cases, a court may also accept a financial guarantee from a third party).

Especially when the Chinese company is a trading, service, or small manufacturing company, the **preservation of assets is imperative** to ensure that they will not just disappear. In addition, the asset preservation may also pressure the defendant to settle, to avoid a long and protracted court battle. This should be an important factor in determining jurisdiction.

Arbitration. Arbitration refers to the settlement of disputes by a third party jointly appointed by the parties. It is generally referred to as an alternative dispute resolution mechanism. Chinese also recognise the use of arbitration to resolve disputes, and it has been common for foreign parties dealing with Chinese counterparts to choose arbitration over litigation.

5 https://www.eusmecentre.org.cn/guideline/dispute-settlement-chinese-companies.

There are **two main advantages to using arbitration** to resolve disputes. First, the parties can agree to a specific institute, and thus have a higher level of influence on the process. For example, the parties can appoint competent experts in their field to hear the dispute, and they may agree to conduct the arbitration in English. Second, an arbitration award in one country can be recognised and enforced in another country, as long as both countries are signatories to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention, 10 June 1958). All EU Member States are signatories, and China became a member in 1986. So, if an arbitration award is rendered in Paris, for instance, then this award should in principle be recognised and then enforced by a Chinese court.

In the past, arbitration was seen as the best way to avoid Chinese courts and so enjoyed a high level of popularity among both foreign companies and their Chinese subsidiaries. In recent years, however, as Chinese courts have become more experienced in dealing with disputes involving foreign elements, the drawbacks of arbitration have become clearer, as well. For example, **arbitration is more expensive than litigation**: the official fees to be paid to courts or arbitration institutions are calculated on a range of 1% to 5% of the compensation claimed by the plaintiff for litigation, and 5% to 10% for arbitration proceedings in China. International arbitration (e.g. through the ICC) is even more costly. Finally, the procedures, especially for arbitration held in China, are quite similar to those in litigation, and arbitration is often not faster than litigation (whether domestically or internationally). It is noteworthy that arbitration awards cannot be appealed.

In addition to deciding whether to seek arbitration, another **key issue is to determine which arbitration institute** will be dealing with the dispute. Chinese law holds that for an arbitration clause (e.g., the agreement to submit all disputes to arbitration, which is normally included as part of the sales contract) to be recognised by a Chinese court for enforcement, **the parties must agree on the specific arbitration institute**. There are basically two options of having international arbitration or arbitration in China.

International arbitration	Arbitration in China
For large deals, parties often prefer to choose arbitration outside of China, for example in one of the more famous arbitration centres (e.g. Singapore, Hong Kong, Stockholm, Paris, Vienna or London). The principal advantage of international arbitration is that the arbitrators can provide more expertise and a high level of neutrality, while the award can still be recognised and enforced by a Chinese court. However, international arbitration is often not ideal for many smaller deals, for a number of reasons: • International arbitration is generally very expensive; • International arbitration is often very slow, while individual arbitrators have a high level of influence on shaping procedures (meaning if they work slowly, there is little you can do); • Chinese courts do not accept applications for preliminary injunctions if the arbitration is on-going in a foreign jurisdiction (Hong Kong being the exception). This means that there is no way to preserve (freeze) assets, resulting in	Arbitration in China is usually preferred by the Chinese counterpart. Though procedures are often more rigid, costs are lower than international arbitration, and the plaintiff retains the option to apply for preliminary injunctions (such as asset preservation) as part of the arbitration process, but through the local court. The most experienced bodies in China in conducting foreign-related arbitration, are: • China International Economic Trade Arbitration Commission (CIETAC): subordinated to the China Council for the Promotion of International Trade. Its main office is in Beijing, but it has branches in several cities, including Shanghai and Shenzhen. • In Shanghai and Shenzhen, however, the preferred options are usually the Shanghai International Economic and Trade Arbitration Commission (also referred to as the Shanghai International Arbitration Centre, SHIAC) and the Shenzhen Court of International Arbitration (SCIA). The SHIAC and SCIA used to be the Shanghai and Shenzhen branches to the CIETAC,

International arbitration	Arbitration in China
the risk that the defendant will ultimately have insufficient assets for the final award to be enforced; • The procedure for recognition is complex and time-consuming, and always requires a considerable investment in time and funds. Local Chinese courts sometimes can find problems with the arbitration agreement, or with the arbitral procedure, that allows them to refuse recognition. But even if this recognition is not refused, it is quite common for the final decision to be a long time coming.	until they split in 2012 after a dispute about the arbitration rules. The SHIAC, in particular, has a good reputation of dealing with disputes in a commercial way. Most large cities also have local arbitration centres. These arbitration centres have considerable experience dealing with local arbitrations, but they have had much less exposure to foreign companies, and therefore are best avoided.

To ensure that the Chinese arbitration institute accepts jurisdiction, and (especially in the case of an international arbitration) that a Chinese court will recognise and enforce the arbitration award, it is important to be absolutely sure that the agreement between the parties for arbitration, as personified in the **arbitration clause, is legally valid and effective under Chinese law**. The law requires that a valid and effective arbitration clause includes the following:

- The explicit expression of application for arbitration
- Matters for arbitration
- The chosen arbitration commission (note: it is important to choose the specific arbitration commission or institute, and not to refer only to a city or a set of rules).

In addition, the following elements can be incorporated in an arbitration agreement:

- Language in which the arbitration is to be conducted
- Place of arbitration
- What arbitration rules to apply
- The number of arbitrators (one or three)
- How the arbitrators are selected (usually each party selects one, but either the two arbitrators or the arbitration commission selects the third)
- How the arbitration should deal with costs, such as legal fees and arbitration costs (this is particularly important in Chinese arbitrations, to ensure that the losing party is ordered to pay costs).

Do you have any other questions?

Would you like to ask us a question? Would you like to share your case? Reach out to **the EU SME Centre's team of experts for free-of-charge assistance and background checks on Chinese companies!**

To submit your enquiries directly to our experts go to **Ask-the-Expert**: www.eusmecentre.org.cn/expert, or contact us at info@eusmecentre.org.cn

3. NEW REGULATIONS ON PRIVACY AND DATA PROTECTION

One of the fields which has significantly evolved in China in recent years, impacting the way companies conduct their business in China is, no doubt, the **privacy and personal data protection regulations**. A wide range of regulations have been published in the past few years by the Chinese authorities.[6]

Even though the use or collection of personal data from Chinese consumers may vary enormously from one company to another, depending e.g. on the sector of the economy they are operating in or their degree of development and implementation in the Chinese market, the set of new regulations implemented and their enforcement by the Chinese authorities highlights the need for European companies to **assess and adjust their privacy policies in China**, particularly involving how the collection and processing of personal data from Chinese consumer is regulated in their contracts with Chinese partners.

The relevant point of privacy and data protection can be generally interpreted from two main aspects: the relevant legal framework, and the business mode related to the sales contract.

- Regarding the legal framework, EU SMEs should pay attention in particular to the definition, processing and processing measures of personal information, as stipulated by the *Cybersecurity Law*, the *Data Security Law*, the *Personal Information Protection Law* and their subsidiary regulations.

- According to the business model, any data protection clause in the sale contracts can differ depending on the B2B business or B2C business. If the business model is B2B, usually the European company that sells products to a Chinese company will not directly collect the data or personal information from Chinese consumers.

By contrast, if the European company handles relevant data as empowered by its Chinese partner, then the main focus will be to request the Chinese company/partner to take the responsibility to duly collect and transmit data or personal information in compliance with Chinese law. As an example, a standard clause of data protection in a sales agreement with a Chinese company, for the B2B model, might be the following.

> *Party B shall guarantee that the important data or personal information provided to Party A during the execution of this contract are legally collected and duly protected in accordance with the relevant P.R.C laws, and separate consent of the consumers has been acquired for Party A to access or handle the relevant personal information to perform the contract. Any claims against Party A caused by the failure of Party B to perform relevant data protection duty shall be solely dealt by Party B, and Party B shall compensate Party A for relevant loss.*

On the other hand, the B2C business model implies a major complexity; a key variable is the amount of personal information or sensitive personal information processed. Hence, a very detailed understating of the data collection operations and activities will be required to draft a comprehensive provision in the sales agreement. The European company may consider taking direct responsibility as it shall make sure the **whole process of data protection is compliant**, so regulating these activities and operations in the sales contract will be essential to be duly protected. A standard data protection provision for this scenario could go as follows.

> *By signing this agreement, Party B (the consumer) hereby gives consent to Party A for collecting and processing relevant personal information necessary to the performance of the contract, including name, address, phone number and other contact information, etc., and further agree Party A to transmit the personal information outside of P.R.C. territory as needed by the performance of the contract.*

In addition, the main key points of the procedure of data protection include the data collection, classification, storage, process and data outbound, every step should be in compliance with the Chinese law.

General terms of the sales contract may not cover the potential risk during the relevant process. To better avoid risk, it is recommended to also prepare the relevant addendum or appendix.

6 For a detailed overview of China's new regulatory regime for cybersecurity, data and personal information protection, including its implications on EU SMEs, see a dedicated report published by the EU SME Centre in Sep 2022: https://eusmecentre.org.cn/report/cybersecurity-data-and-personal-information-compliance-eu-smes-china.

About the EU SME Centre

The EU SME Centre helps European SMEs get ready for China by providing them with a range of information, advice, training and support services.

To find out more, visit: www.eusmecentre.org.cn

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Further reading...

The EU SME Centre has over 200 **reports, guidelines** and case studies in its Knowledge Centre, the following may be relevant to you:

- *Simple steps to minimise risks of being scammed when purchasing from China (August 2022): https://www.eusmecentre.org.cn/article/simple-steps-minimise-risks-being-scammed-when-purchasing-china*
- *Cybersecurity, Data and Personal Information Compliance for EU SMEs in China (September 2022): https://www.eusmecentre.org.cn/report/cybersecurity-data-and-personal-information-compliance-eu-smes-china*
- *Knowing your Chinese partner (May 2018): https://www.eusmecentre.org.cn/report/knowing-your-partners-china*
- *Payment options and foreign exchange control in China (July 2014): https://www.eusmecentre.org.cn/guideline/payment-options-and-foreign-exchange-control-china*
- *Dispute settlement with Chinese companies (July 2012): https://www.eusmecentre.org.cn/guideline/dispute-settlement-chinese-companies*

We have also available **recordings of previous webinars** in this field:

- *Simple steps to minimise risks of scams when purchasing from China (Aug 2022): https://www.eusmecentre.org.cn/event/2022-08-31/learn-how-avoid-scams-our-webinar-31-august*
- *The ABC of commercial dispute resolution in China (May 2022): https://www.eusmecentre.org.cn/event/2022-05-25/abc-commercial-dispute-resolution-china*
- *Knowing your Chinese partner (May 2021): https://www.eusmecentre.org.cn/event/2021-05-26/knowing-your-chinese-partner-0*
- *Data and cybersecurity in China: compliance, challenges and tips (May 2022): https://www.eusmecentre.org.cn/event/2022-05-24/cybersecurity-and-data-protection-china-compliancechallenges-and-tips*

We have also a **set of FAQs** on legal issues and dispute: *https://www.eusmecentre.org.cn/faq*

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