

The New “Interpretation on Several Issues Concerning the Application of the PRC Contract Law” issued by the Supreme People’s Court (13 May 2009): What it means for PRC M&A transactions?

Material Adverse Change (“MAC”)

<i>The Law</i>	<p>MAC is defined as:</p> <ol style="list-style-type: none">1. change which is unforeseeable, not a business risk, not caused by force majeure; and2. where continued performance is unfair to the other party or purpose of the contract cannot be realised. <p>(Article 26 of Interpretation II of the Supreme Court of Several Issues concerning the Application of the Contract Law)</p>
<i>PRC practice</i>	<p>Where a party files a request for modification or rescission of the contract with the court on the above basis, the ruling court has jurisdiction to modify or rescind the contract based on “equitable grounds”.</p> <p>This is why in practice, MAC clause should be made a contractual term and comprehensively defined in the M&A agreements.</p>

Incidental and Consequential Damage

<i>The Law</i>	<p>Quantum of breach includes foreseeable losses or losses which ought to be foreseeable losses when the contract is concluded.</p> <p>(Article 113 of Contract Law)</p>
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Best Endeavours/Efforts

<i>The Law</i>	There is no statutory provision of “best endeavours”
<i>PRC practice</i>	However, in practice, there is a concept of use of “appropriate measures” in duty: <ol style="list-style-type: none">1. to mitigate (Article 119 Contract law); and2. to rely on principles of good faith (Article 60 Contract law).

Force Majeure

<i>The Law</i>	In the event of force majeure, there is a duty: <ol style="list-style-type: none">1. to notify the other party;2. to mitigate losses; and3. to provide evidence of force majeure within a reasonable period of time. (Article 119 of Contract Law)
<i>PRC practice</i>	It is common to include a sovereign act as a force majeure event in the PRC. A force majeure event can be “certified” by notarization in the PRC. In the absence of this, it has to be decided by a court of law or arbitration.

“Break fee” clause

<i>The Law</i>	“Break Fee” is generally regarded as liquidated damages. If the liquidated damages exceed the actual loss by 30%, the affected party has the right to seek court redress for a reduction in the liquidated damages. (Article 29 of Interpretation II of the Supreme Court of Several Issues concerning the Application of the Contract Law)
<i>PRC practice</i>	As most Chinese bidders in international M&As are state-owned enterprises, the chain of approval for deal consummation may be bureaucratic. It is therefore advisable to set out break fee mechanisms in the contract.

Ordinary Course of Business

<i>Interpretation</i>	In its most general sense, the permitted business scope is normally stipulated in the business licence of a PRC company. However,
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	during the M&A period, it can be made a contractual term to restrict and limit control over the target company's business operation.
<i>The Law</i>	<p>A domestic company must have foreign exchange approval and foreign funded enterprise approval before the following events can take place:-</p> <ol style="list-style-type: none"> 1. distribution of profits; 2. provision of guarantee to associated companies; and 3. payment to any outside party for capitalization restructure. <p>(Article 37 of Interim Provisions on the Merger and Acquisition of Domestic Enterprises by Foreign Investors)</p>

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