



Decoding the code - China's new General Civil Law Rules: the first step towards a comprehensive civil code

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Overview and background

On 15 March 2017, the *People's Republic of China General Civil Law Rules* (中华人民共和国民法总则) (hereinafter referred to as the "GCLR") were formally adopted at the Fifth Session of the Twelfth National People's Congress. The GCLR will enter into force on 1 October 2017. The GCLR contain a total of 206 articles divided into 11 chapters, setting forth provisions with respect to the basic elements of the civil law system, including:

- the basic principles of civil law
- subjects
- rights
- legal acts
- liability; and
- statute of limitations.

Together these will provide the basic framework for China's civil law system.

The relationship between the GCLR and the clearly overlapping and similarly named 1987 *People's Republic of China General Principles of Civil Law* (中华人民共和国民法通则) ("GPCL") is somewhat unusual, in that whilst the GCLR clearly overwrites many provisions of the earlier GPCL (and the basic legislative interpretation rule is that the newer legislation at the same level supercedes the older), for the moment the GPCL remain in force. It is not obvious on the face of it as to why the GPCL has not been replaced in its entirety by the GCLR.

Our understanding is that China is now in the process of writing a civil code, which is expected to be in place around 2020. The first step is to issue the GCLR, which will provide the overall framework of the future civil code. The second step is to conform, reconcile and systematize the other constituent elements of the civil code, including laws, regulations and other rules regulating property rights, contract, tort and so forth. In order to allow more flexibility when making amendments to such legislation which

may have been based on provisions of the GPCL, both the GCLR and GPCL will remain valid for an interim period presumably until the civil code takes effect in 2020.¹

One thing about the GPCL is clear: it contains many new provisions regulating areas that were not previously regulated or expanding on those areas which were not regulated in detail under the GPCL. These areas are analysed and highlighted below. The GCLR is, however, silent on any specific punishments for breach: in many ways it is similar to the scheme under the GPCL, in that it only provides the scheme of ways in which parties may assume civil liability for breach namely:

- the cessation of the infringing act
- the removal of any obstructions [preventing the party whose rights have been infringed from exercising its civil rights and interests]
- the elimination of any danger
- the return of property
- restoration to the original state or condition
- repairs, reconstruction/rebuilding or replacement
- continued performance
- compensation for losses
- payment of liquidated damages
- the elimination of any negative impact and restoration of reputation; and/or
- a formal apology.

¹ Please refer to the timeframe and chronicle of creating the PRC civil code announced by the National People's Congress and its Standing Committee: http://www.npc.gov.cn/npc/lfzt/rlyw/2017-03/09/content_2013895.htm

New basic principle of civil law: the "green principle"

Article 9 of the GCLR provides: "*Civil subjects engaging in civil [law] activities must help conserve resources and protect ecological environments.*". This article has been billed as a "green principle" and is a completely new departure compared to the GPCL. It was previously moved to the section dealing with civil rights in the third draft, before being moved back to the section on basic principals in the final draft, hinting at internal debate on the importance of the provision. China's issues with air pollution in the big cities and industrial pollution of the marine environment are well documented. In addition, China is increasingly facing a wide range of environmental issues with respect to water resources, deforestation, land desertification, climate change and so forth as the country's economy develops. The issue with statements of principle like this is that while they make nice sounding soundbites that suggest the politicians who write the laws in China are paying attention to these issues, they are probably too vague to be actionable in a legal sense. For this, litigants will have to look to environmental law specialist legislation. It is notable that Article 9 does not give any right to third parties to seek compensation for breach of the principle.

New legal source: "custom"

Article 10 of the GCLR provides: "*Civil disputes must be resolved in accordance with the law; where no relevant provision is prescribed by laws, customary practice may be applied, provided that doing so does not disturb public order or contravene good morals and progressive customs.*". This article effectively introduces customary practice as a source of legal rules into China's legal system, giving judges the discretion to directly use customs as a basis for their decisions. The GPCL only provided that civil law activities must comply with State policies. However, there has been no clarification, whether in the form of law or

judicial interpretation, on what constitutes a "customary practice": for example, for how long does it have to have been operating to constitute a "customary practice", how do you evidence what is a "customary practice", does it have to be a "customary practice" that is observed in the locality where the facts of the case took place and so forth? Do such customs include trade usages between companies in their commercial dealings? Do 'folk customs' only found in a particular geographical location count? Rather than letting judges make their own interpretation through judicial decisions that could lead to somewhat inconsistent outcomes and judges using this as a means to achieve desired outcomes based on picking and choosing which "good" customary practices to apply in cases, this is an area crying out for judicial interpretation to ensure a consistent approach.

New provisions regarding the natural person as a civil subject

There are a number of innovations in Chapter 2 of the GCLR, which deals with natural persons. These primarily include:

- Recognition of the civil rights of fetuses: fetuses are considered to have the legal capacity for civil rights with respect to inheriting property, accepting gifts and so forth unless the fetus is stillborn. Whilst similar provisions regarding the civil rights of fetuses can be found in China's existing inheritance laws, the GCLR further expand the scope of civil rights afforded to fetuses by including the right to accept gifts, in addition to the right to inherit property
- Lowering the age at which a person is first considered to have limited capacity for civil conduct: the age threshold for minors with limited capacity for civil conduct has been lowered from 10 years to 8 . This change was made in response to the social reality that minors nowadays have reached mental maturity earlier than in previous generations

and become increasingly involved in civil legal conduct at an early age, especially in relation to the cyber universe and online transactions

- Significant innovations in the guardianship system: the GCLR, for the first time, sets forth the principle that obligations of a legal guardian must be exercised in a way that is in the best interests of his/her ward, failing which the guardian is liable for breach of legal duty (although how damages will be assessed is not specified). The GCLR creates new provisions regarding the appointed guardianship system, under which an adult with full capacity for civil conduct may appoint his/her own guardian in writing upon discussions with close relatives, or other individuals or entities willing to act as a guardian, whose role will only begin when the adult loses all or part of his/her capacity for civil conduct e.g. due to suffering from dementia or other mental illnesses. This is designed to ensure that as far as possible the wishes of the living subject are respected even if the subject can no longer express or articulate them. The GCLR also allows those eligible to act as legal guardians to agree, subject to respecting the true wishes of the ward, as to who will act as guardian by means of an agreement between them, as well as allowing parents to appoint guardians by way of a will. The GCLR also provides for default guardianship (intuitively self-evident) when there is no qualified legal guardian.

The substantial amendments in the "natural person" section as compared to the GPCL show Chinese legislators' increasing focus on the protection of the lawful rights and interests of vulnerable groups, such as foetuses and minors.

Innovations and breakthroughs in terms of the classification of legal person systems

1. Classification of legal persons

The most significant breakthrough and innovation with respect to the legal person system in the GCLR are changes in the classification of legal persons. The GCLR discards the more politically charged method adopted by the GPCL, under which legal persons were classified based on their form of ownership, and instead divide legal persons into two general categories, i.e. for-profit legal persons and non-profit legal persons, depending on "whether or not they are established to make profits to distribute to shareholders". There are five specific sub-categories under non-profit legal persons:

- public institutions (事业单位)
- social organisations with the status of a legal person (社会团体)
- foundations (基金会)
- social service organisations (社会服务机构); and
- corporate bodies of government institutions (which are singled out as a 'special status' legal persons) (机关法人).

For-profit legal persons include limited liability companies, joint stock limited companies and other forms of enterprise legal person.

Non-profit legal persons, on the other hand, include legal persons established for public good or other non-profit purposes, such as public institutions, social welfare organisations, foundations and social service organisations.

Special legal persons refer to government institutions with independent funds and statutory organs which assume administrative functions, as well as rural collective economic organisations, urban-rural cooperative economic organisations and autonomous mass

organisations at the grass-roots level which may obtain legal person status in accordance with law.

Private non-profit entities (such as private schools), which are not included in the four categories of legal persons as set out in the GPCL, are generally considered to fall under in the 'social service organisation' category in the GCLR. In addition to the three categories of legal persons, the 'non-legal person form organisations' category was introduced to include partnerships that were categorised generically as 'other entities' in other laws and judicial interpretations and were not regulated under the Company Law. Non-legal person form organisation include sole proprietorships (独资企业), partnerships (合伙企业) and professional service providers without legal person status (不具有法人资格的专业服务机构).

The classification of for-profit legal persons and non-profit legal persons is generally consistent with the classification of legal persons found in the existing GPCL, and maintains continuity with respect to the legal person system. What is new is that it replaces the previous concept of 'enterprise' with the concept of being 'for profit'. This replacement is not only more logical, but it also more closely reflects the commercial reality in China.

2. Confirmation of key aspects of corporate law

There are various articles in the GCLR that are useful in confirming basic principles of corporate law:

- Article 60: A legal person shall assume liability independently to the extent of all its assets.

This confirms the principle of limited liability subject to certain limited exceptions where it is permitted to "pierce the corporate veil".

- Article 83: No investor in a for-profit legal person may abuse its rights as an investor to prejudice the interests of the legal person or

any other investors. Where any abuse of an investor's rights causes the legal person or other investors to suffer losses, such investor must assume civil liability in accordance with law.

The investors in a legal person must not abuse the legal person's independent legal person status and the limited liability of the investors to prejudice the interests of the legal person's creditors. Where a legal person's independent status and the limited liability of investors are abused to evade debts, thereby seriously prejudicing the interests of the creditors of such legal person, [such investors] must assume joint and several liability for the debts of the legal person.

This confirms that investors in a legal person may be held personally liable for abusing their rights to prejudice the creditors of a legal person, including using related party transaction where the limited liability status is used to evade debts prejudicing creditors, investors will bear joint and several liability.

- Article 170: Civil juristic acts performed in the name of legal persons or non-legal person organizations by their personnel during the performance of their work-related duties are binding on such legal person or non-legal person organization, provided that such acts pertain to matters falling within the scope of authority of such personnel.

Restrictions placed by legal persons or non-legal person organizations on the scope of authority of their personnel with regard to the performance of their work-related duties must not be used as a defence against a bona fide counterparty.

This confirms the principle of vicarious liability provided that the employee is not embarking on a "frolic of its own" and provides that internal restrictions on the scope of authority of an employee with apparent authority to bind are not good

against good faith third are not good against good faith third parties.

- Article 134: A civil juristic act may be created on the basis of the mutual expression of intent of two or multiple parties, or on the basis of a unilateral expression of intent.

Resolutions made by legal persons or non-legal person organizations in accordance with the methods of deliberation or voting procedures specified by law or their articles of association will be deemed to be duly made.

- Article 85: Where the procedure for convening a meeting convening or voting method whereby the supreme organ or executive organ of a for-profit legal person adopts a resolution violates laws, administrative regulations or the articles of association of such legal person; or where the contents of the resolution itself violate the articles of association of the legal person, the investors of the for-profit legal person may request the people's court to revoke said resolution, provided that so doing does not prejudice any civil legal relationship formed between the for-profit legal person and a bona fide counterpart on the basis of such resolution.

This confirms that a unilateral undertaking is effective in the absence of a counterparty and that a resolution passed by a legal person in accordance with its constitutional procedures is deemed to be duly made, however its validity may be subject to challenge where the procedural aspects are flawed or the resolution itself violates laws or the constitution of the legal person.

3. Protection of counterparties

In the GCLR section, the GCLR place great importance on the protection of 'third parties' acting in good-faith. In Article 61, it provides that limitations placed on the legal representatives' representation rights by the articles of association of a legal person or the

legal person's organ of power must not be used against a third party² acting in good faith, and in Article 65, it stipulates that where the actual circumstance of a legal person are not consistent with those registered e.g. the *de facto* legal representative or the *de facto* registered office used by a company are not those on the business license, these internal rules cannot be set up as a defence against a third party acting in good faith. From a corporate governance perspective, however, this means that internal rules designed to rein in the powers of a legal representative are ineffective against a third party acting in good faith.

In the past, the GPCL only provided that enterprise legal persons must be held accountable for business activities carried out by its legal representative and other staff members. However, the GPCL did not specify what acts carried out by a legal representative would be attributed to the legal person and what would happen when a third party acting in good faith was involved³. As the articles of association and the other internal documents in relation to corporate governance are not on the public record in China, counterparties have limited means with which to ascertain the extent of the legal representative's authority. The new provisions seek to give weight to the publicly-available registration details of a company by specifying that restrictions on the legal representatives' representation rights under the articles of association and other internal non-public corporate documents must not be set up as a defence against a good faith third party, thus minimizing any losses that would otherwise be suffered by counterparties as a

² Roughly equivalent to the common law "bona fide purchase for value without notice".

³ Note that as a matter of contract law, under the *People's Republic of China Contract Law* effective 1 October 1999 (the "**Contract Law**"), the position remains that the acts of the legal representative bind even if acting beyond his/her authority unless the counterparty knew or should have known he/she was acting without authority. It is not exactly clear what would happen if a third party acting in good faith had actual knowledge that the legal representative was exceeding his authority.

result of mistakenly believing the person they are dealing with has an unfettered right to enter into transactions on behalf of the company, when in fact, the legal representative has exceeded his/her actual authority.

4. Clarity with respect to liquidation obligors and liquidation responsibilities

The GCLR for the first time articulates the concept of "liquidation obligors" with respect to a legal person, i.e. members of the board of directors, supervisors or decision-makers. This is consistent with provisions in the *People's Republic of China Company Law* ("**Company Law**") and its judicial interpretations which provide that the liquidation group shall consist of shareholders in the case of a limited liability company, and members appointed by the directors or at a shareholders' meeting in the case of a company limited by shares. It also expands the scope of circumstances where liquidation obligor provisions shall apply, from limited liability companies and companies limited by shares to include all types of legal persons. On the other hand, it also clarifies that in the event that a liquidation obligor fails to perform its liquidation obligations in a timely manner and causes losses as a result, they shall assume civil liability therefor. This provides another source of personal liability for individual officers in a company in China.

Civil legal conduct and manifestation of intention

Compared to the GPCL, the draft GCLR make some adjustments to the definition of "civil legal conduct" by removing the requirement for civil law juristic acts to be lawful and restoring the traditional meaning of the term 'legal acts'. The form of civil legal conduct is expanded from "written or oral forms and such other forms as may be provided by law" under the GPCL to include "specific forms as may be required by law or administrative regulations or agreed between the parties concerned".

In practice, cases abound in which mandatory provisions with regard to the form of a particular type of contract are found in administrative regulations instead of the law. For example, the *People's Republic of China Copyright Law* does not provide for the form of copyright license contracts; the *Copyright Law Implementing Rules* provides that they must be in writing; as another example, the *People's Republic of China Property Right Law* ("**Property Rights Law**") does not provide for the form of property service contracts, whereas Article 35 of the *Property Management Rules* provides that such contracts must be in writing. Under such circumstances, administrative regulations play the role of specifying the form in which specific legal act must take place.

The new GCLR specifically introduce a sections devoted to the manifestation of intent and provide an integrated list of the GPCL for the validity of manifestation of intent, including rules on the validity of manifestation of intent that take the form of a dialogue, a form other than a dialogue, data messages, public announcements or with no counterparty. Manifestations of intent is the basis for establishing a civil legal act and is universally applicable. In particular, it serves as a legal basis for the validity of new types of civil conduct.

Optimising the civil rights system

It is common knowledge that "regulation of public rights and protection of private rights" is at the core of modern rule of law. The main function of law is to identify, distribute, protect and remedy private rights. The GCLR systematically identify the various personal and property right afforded to civil subjects and acknowledge citizens' right to life, one's body, health, name, image, reputation, intellectual property, property rights created through marriage family relationships, rights to inherit rights to hold equity securities and other investments and so forth. From the perspective of protecting citizens' property rights, for the first time the GCLR use the expression "equal" protection of property right of civil subjects in a legal context, which is a significant improvement on the Property Rights Law. It also recognizes the right to personal information, which reiterates the rules requiring that those acquiring personal data must ensure the security of such data in accordance with law and must not unlawfully collect, use, process or transmit the personal information of another party or unlawfully purchase, sell, provide or make public such information.

Extended statute of limitations

Compared to the GPCL, the GCLR extends the statute of limitations from two years to three years, removing the 1-year special short-term statute of limitations (for personal injuries, rent recovery and custody of property, etc.). Further, the statute of limitations for damages claims by a minor who is a victim of sexual assault will be counted from the time he/she reaches 18 years of age. The GCLR also contain new provisions stipulating circumstances where the statute of limitations will not apply at all. These include demands to cease an infringing act, remove obstacles or eliminating hazards; demands by owners of rights to immovable property and registered movable property for the return of property; and claims for the payment of alimony, child support or

maintenance and the cut is open so others may be added. This suggests that damages may cease to be available but the claim may remain available in the first two cases. Such amendments are expected to more effectively protect the rights of creditors and increase the overall creditworthiness of China's business community.

Conclusions

The GCLR is largely based on, but represents a development and refinement of, the GPCL. Compared to the broad-brush GPCL which dates back to the 1980s, the GCLR is a more granular and fully modernised model and a significant upgrade in terms of the protection of civil rights in China, regulating areas that were not previously regulated or expanding on those areas which were not previously regulated in sufficient detail.

More importantly, the GCLR is considered to be the first step in the codification of civil law in China. China plans to have a civil code by 2020, the first step towards which is introducing the GCLR as the overall framework and introductory part of the civil code, and then reconciling and systematising the specific legislation covering other civil matters on property rights, contract, tort and so forth. As the GPCL has been the fundamental source of civil laws for decades, and much of the related legislation has not been updated or amended, replacing the GPCL in its entirety by the GCLR overnight would undoubtedly have given rise to conflicts or inconsistencies when applying the laws and regulations at a lower level in the hierarchy, as many of these were built on the foundation of, and to be consistent with, the GPCL. For the moment, keeping both the GPCL and GCLR in force will leave greater flexibility in the hands of the legislators when amending the other constituent parts of the civil code in the interim period before the PRC civil code finally becomes a reality. We believe, however, that ultimately the GPCL will be replaced by the GCLR, and the GCLR will be incorporated into

the civil code, but this is a huge legislative project, and neither Rome nor the nascent Chinese civil code was built in a day.

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