SPC Guiding Case No. 166: Beijing Longchang Weiye Trading Co., Ltd. v. Beijing Urban Construction Heavy Industry Co., Ltd. (Contract Dispute)

Dan Young Business Consultancy — www.danyoungcpa.com

Unofficial English translation prepared for reference only. The official Chinese text prevails.

Discussed and adopted by the Judicial Committee of the Supreme People's Court; issued on November 9, 2021.

Keywords

Civil / contract dispute / adjustment of liquidated damages / principle of good faith

Holding

Where the parties reach a settlement agreement for the satisfaction of a debt, stipulating the release of property preservation measures and liability for breach of contract, and one party, in accordance with the agreement, applies to the people's court for the release of the preservation measures, while the other party, in violation of the principle of good faith, fails to perform the settlement agreement and requests a reduction of the liquidated damages in the litigation concerning the liquidated damages under the settlement agreement, the people's court shall not support the request.

Basic Facts

In March 2016, Beijing Longchang Weiye Trading Co., Ltd. ("Longchang Trading Company"), in respect of a sales contract dispute with Beijing Urban Construction Heavy Industry Co., Ltd. ("Urban Construction Heavy Industry Company"), brought a civil lawsuit before the people's court. The people's court rendered Civil Judgment (2016) Jing 0106 Min Chu No. 6385 in August 2016, ordering Urban Construction Heavy Industry Company to pay Longchang Trading Company goods payments of RMB 5,284,648.68 and the corresponding interest. Urban Construction Heavy Industry Company appealed against the judgment. During the appeal, Urban Construction Heavy Industry Company and Longchang Trading Company entered into an agreement, stipulating that: (1) Urban Construction Heavy Industry Company undertook to pay Longchang Trading Company RMB 3 million before October 14, 2016, and to pay the remaining principal of RMB 2,284,648.68, interest of RMB 462,406.72, and litigation costs of RMB 25,802 (totaling RMB 2,772,857.4) in full before December 31, 2016; if Urban Construction Heavy Industry Company failed to pay the first installment of RMB 3 million by the time agreed in the agreement or failed to pay all the amounts in full before December 31, 2016, it should pay Longchang Trading Company liquidated damages of RMB 800,000; if Urban Construction Heavy Industry Company failed to pay all the amounts in full before December 31, 2016, Longchang Trading Company could, from January 1, 2017, at any time apply to the people's court for compulsory enforcement based on Civil Judgment (2016) Jing 0106 Min Chu No. 6385, and was at the same time entitled to recover from Urban Construction Heavy Industry Company the liquidated damages of RMB 800,000 determined in this agreement. (2) Longchang Trading Company would apply for the release of the preservation measures over the property in the name of Urban Construction Heavy Industry Company in the other case. After the parties reached the agreement, Urban Construction Heavy Industry Company applied to the second-instance court to withdraw the appeal and, as agreed, paid Longchang Trading Company the first installment of RMB 3 million on October 14, 2016, and Longchang Trading Company, as agreed, applied for the release of the preservation over Urban Construction Heavy Industry Company's property. Subsequently, Urban Construction Heavy Industry Company failed to pay the remaining amounts as stipulated in the agreement. In January 2017, Longchang Trading Company applied for enforcement of the claim determined in Civil Judgment (2016) Jing 0106 Min Chu No. 6385, and in June

2017 sued Urban Construction Heavy Industry Company for the payment of liquidated damages of RMB 800,000.

In the first instance, Urban Construction Heavy Industry Company argued: Longchang Trading Company's request for payment was unreasonable and the amount of liquidated damages was excessively high. According to the effective judgment, the amount Urban Construction Heavy Industry Company should pay Longchang Trading Company was RMB 5,284,648.68 plus interest. The amount of liquidated damages claimed by Longchang Trading Company for Urban Construction Heavy Industry Company's failure to fully perform the settlement agreement was RMB 800,000, which was excessively high and the relevant claim was unreasonable. After the first-instance judgment was pronounced, Urban Construction Heavy Industry Company, dissatisfied with the judgment, appealed, arguing that the first-instance judgment, on the basis of erroneously finding that Urban Construction Heavy Industry Company had maliciously breached the contract, applied punitive liquidated damages and fully supported Longchang Trading Company's claims without considering the comprehensive factors such as Longchang Trading Company's losses, which was clearly unfair, and requested that the liquidated damages be appropriately reduced.

Judgment

The People's Court of Fengtai District, Beijing rendered Civil Judgment (2017) Jing 0106 Min Chu No. 15563 on June 30, 2017: Beijing Urban Construction Heavy Industry Co., Ltd. shall pay Beijing Longchang Weiye Trading Co., Ltd. liquidated damages of RMB 800,000 within ten days after the judgment takes effect. Beijing Urban Construction Heavy Industry Co., Ltd., dissatisfied with the first-instance judgment, appealed. The Second Intermediate People's Court of Beijing rendered Civil Judgment (2017) Jing 02 Min Zhong No. 8676 on October 31, 2017: dismissing the appeal and affirming the original judgment.

Reasoning

The effective judgment held: Longchang Trading Company and Urban Construction Heavy Industry Company entered into an agreement during the litigation, which was the true expression of the intent of both parties, did not violate the mandatory provisions of laws and regulations, and was lawful and valid; the parties should perform it in good faith. This case involved the issue of adjustment of liquidated damages under a settlement agreement reached during litigation. In this case, Longchang Trading Company and Urban Construction Heavy Industry Company entered into an agreement stipulating that if Urban Construction Heavy Industry Company failed to pay Longchang Trading Company RMB 3 million before October 14, 2016, or failed to pay the remaining principal of RMB 2,284,648.68, interest of RMB 462,406.72, and litigation costs of RMB 25,802 (totaling RMB 2,772,857.4) before December 31, 2016, Longchang Trading Company would have the right to apply for enforcement of the original first-instance judgment and to require Urban Construction Heavy Industry Company to bear liquidated damages of RMB 800,000. Urban Construction Heavy Industry Company failed to pay Longchang Trading Company the remaining RMB 2,772,857.4 as agreed before December 31, 2016, and Longchang Trading Company's loss was mainly the RMB 2,772,857.4 that had not yet been satisfied. Urban Construction Heavy Industry Company reached a settlement agreement with Longchang Trading Company during the litigation and withdrew the appeal, and Longchang Trading Company, as agreed, applied for the release of the freeze on Urban Construction Heavy Industry Company's account. However, Urban Construction Heavy Industry Company, as a commercial entity, voluntarily issued the settlement agreement to Longchang Trading Company and promised high liquidated damages, but after its account was unfrozen, it did not perform the subsequent payment obligations as agreed, which was subjectively malicious and contrary to good faith. The first-instance court's order that Urban Construction Heavy Industry Company pay liquidated damages of RMB 800,000 as agreed was not improper.

Relevant Legal Provisions

Source: https://www.danyoungcpa.com/spc-guiding-case-166-china/

Articles 6 and 114 of the Contract Law of the People's Republic of China (Note: the currently effective provisions are Articles 7 and 585 of the Civil Code of the People's Republic of China).

Disclaimer: This translation is provided for reference and informational purposes only. In the event of any discrepancy, the official Chinese text issued by the Supreme People's Court shall prevail. This translation does not constitute legal advice.