Research on the Recognition and Effectiveness of Pre-Contract Agreements

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Abstract: Since its introduction into China, the pre-contract has played a positive role in stabilizing and encouraging transactions, and has been widely used in areas such as housing sales, housing leases, equity transfers, and private lending. The Civil Code promulgated in 2020 formally provided a legislative definition of the pre-contract. However, the existing provisions of the Civil Code are still insufficient to compensate for the many differences in the adjudication of disputes over pre-contracts in judicial practice. There are still many issues in the specific application of pre-contracts in practice, such as their identification and determination of validity. This article analyzes the current problems of pre-contracts by reviewing their legislative and judicial practices, and on the basis of comparing and analyzing relevant controversial views in academia, analyzes the feasibility of categorizing the validity issues of pre-contracts.

Keywords: Appointment Contract; Main Contract; Declaration of Intention; Legal Effect

1. Introduction

A reservation contract is a "contract that stipulates the future formation of a certain contract"[1]. In the complex market trading environment, reservation contracts, as the prelude to the main contract, play an increasingly important role. Its functions are mainly manifested in three aspects: Firstly, it provides stability to the trading opportunities for both parties, preventing transactions from failing due to market fluctuations or uncertainty on one side; secondly, it safeguards the time, energy, and resources invested by both parties in the early negotiation and preparation process, avoiding unnecessary losses caused by transaction failures; thirdly, it creates conditions for the ultimate conclusion of the main contract, clarifying the rights and obligations of both parties and the direction of subsequent negotiations, reducing transaction costs, improving transaction efficiency, and thus promoting the smooth progress of market transactions as a whole. However, the relevant provisions on the pre-contract system in the Civil Code are not yet clear. In many key aspects such as the validity of pre-contracts and the standards for their determination, the current regulations are still incomplete and the overall operability is relatively weak. This has largely hindered the unification of the judicial standards. If we focus on the development in recent years, it can be found that there are significant differences in the academic and practical circles regarding the validity of pre-contracts and the specific forms of breach of contract liability. The persistence of such differences has led to a series of judicial disputes. Analyzing the judgments made by courts, most of them have not followed a unified standard. As a result, the phenomenon of different judgments for the same case occurs frequently, which to a certain extent has damaged the judicial credibility and weakened it to some degree.

2. Current Practice in China

2.1 Legislative Practice in China

The "Judicial Interpretation on the Sale and Purchase of Commercial Housing Contracts" promulgated in 2003, in its Articles 4 and 5, first touched upon the issue of pre-contracts in the field of commercial housing sales, mainly stipulating the relationship between pre-contracts and main contracts, including the conditions for the transformation of pre-contracts into main contracts. The "Judicial Interpretation on the Sale and Purchase Contracts" issued in 2012, for the first time,

established the concept of pre-contracts, affirmed their independence, and made general provisions on the liability for breach of pre-contracts. The "Civil Code of the People's Republic of China" (hereinafter referred to as the "Civil Code") promulgated in 2020 still adopted a principle-based approach to pre-contracts and did not make substantive breakthroughs in detailing the liability for breach of pre-contracts. Thus, the promulgation of the Civil Code has not resolved the historical issues of pre-contracts.

On December 4, 2023, the Supreme People's Court released the "Interpretation on the General Provisions of the Contract Code". It responded to common practical issues such as the formation conditions of pre-contracts and the distinction between pre-contracts and main contracts based on the Civil Code. However, its stance on some prominent issues in theory and practice remains unclear, including Article 7 of the "Interpretation on the General Provisions of the Contract Code" which stipulates two situations of non-performance of the obligations agreed in pre-contracts, but is vague about the validity of pre-contracts [2].

2.2 Judicial Practice in Chin

In the judicial field, cases involving disputes over pre-contracts occur frequently, and different courts hold different views, leading to inconsistent judgments in similar cases, which is not conducive to the standardization of pre-contracts.

Regarding the identification of pre-contracts, different courts have different standards. In the "Jia Bo case", the court held that the letter of intent in this case clearly stipulated the time, steps, and liability for breach of the letter of intent for the transfer agreement, and should be recognized as a pre-contract signed by the parties for the purpose of entering into the aforementioned transfer agreement [3]. In the "Zeng Jianhua case", the Supreme People's Court determined that the nature of the contract was a pre-contract based on the expression "Intentional Agreement" in the contract name, and thus it was a pre-contract rather than a main contract [4]. In addition, some courts have regarded subscription agreements, order agreements, and reservation agreements where the parties agree to enter into a contract within a certain period in the future as pre-contracts, or have considered the act of paying a deposit based on the intention to lease real estate as forming a pre-contract relationship.

As for the validity of pre-contracts, some courts hold that based on the principle of good faith, legally effective pre-contracts should be performed. When disputes arise regarding the continued performance of pre-contracts, if the purpose of the contract, the method of performance, and the actual performance situation allow for continued performance, it should be performed in accordance with the law. Moreover, the Supreme People's Court believes that the specific and clear contents in pre-contracts should be regarded as part of the main contract, and the definite terms agreed upon by both parties in the pre-contract should be incorporated into the main contract.

From a comprehensive analysis of multiple cases, it can be seen that even after the promulgation of the Civil Code, the identification and validity of pre-contracts remain unstandardized, and there is a high possibility of inconsistent judgments in similar cases, with significant disputes.

3. Appointment Contract Dispute

3.1 Confirmation of Appointment Contract

One of the significant features of appointment contracts in practice is their diversity in form and content. On the one hand, there is no unified standard for the names of contracts, and common forms of expression include subscription letters, purchase orders, pre orders, letters of intent, memoranda, framework agreements, etc; On the other hand, the rights and obligations stipulated in the contract also vary greatly depending on specific circumstances. The existence of such diversity makes it difficult to clearly distinguish what constitutes an appointment contract, what constitutes a current contract, and the difference between an appointment contract and a letter of intent in the actual identification process. The definition of the appointment contract and this contract is not yet clear, and there are ambiguous areas in the scope and degree of performance of their rights and obligations, which makes it difficult to accurately judge in specific cases. Similarly, there are similar issues with appointment contracts and letters of intent. Letters of intent

usually only express a willingness to cooperate, while appointment contracts have certain legal binding force, but the boundary between the two is not clear in practice. Due to the lack of clear differentiation criteria, it is difficult for current regulations and practices to unify and regulate appointment contracts. Different courts have inconsistent standards for recognizing appointment contracts, which makes it difficult to form a unified judgment scale in judicial practice. This inconsistency not only affects the consistency of legal application, but also hinders the parties' reasonable expectations of legal consequences, thereby posing a challenge to the stability and authority of the entire legal system.

There are currently several theories regarding the recognition of appointment contracts, especially regarding the determination of whether they are appointment contracts or contract agreements. One is the "doubt the contract from the original" theory, which states that a contract should be judged based on the true intention of the parties as an appointment or an original contract. When it is difficult to determine the nature of a contract, it should be recognized as this agreement [5]. Some scholars have classified reservation contracts into three types based on their completeness of content, believing that as long as the content is complete enough, it can be recognized as a contract. Professor Liu Chengyun believes that the completeness of the contract content should be examined first, and then the intentions of the parties should be considered. "Doubtful agreement should be based on the contract itself" can be used as a last resort[6].

However, some scholars have put forward different views, advocating that the legal binding force of a contract is based on the agreement of both parties. Therefore, when interpreting the nature of a contract, the true intentions of the parties should be fully explored, and efforts should be made to restore the consensus reached by both parties at the time of the contract. Especially when the parties have not clearly expressed their willingness to be bound by this agreement, they should weigh the factors of all parties and avoid pursuing a one-sided transaction. And the freedom of contract should be more important than facilitating the transaction. Therefore, unless it is further explicitly stated in the contract that both parties are willing to establish a specific legal relationship based on this contract, a contract containing words such as "subscription, order, reservation" can be recognized as this contract [7], that is, the "doubt from the original" theory.

The third is to emphasize the theory of "subjective intention". Whether it is a simple appointment, a typical appointment, or a complete appointment, the difference in content alone cannot change the fact that the appointment contract, as a type of contract, must have the consistency of the parties and their expressions of intention. Without parties involved, the contract cannot be discussed; Without a consistent expression of intent, the contract will not be established. In an appointment contract, it is usually necessary to indicate the intention to enter into this contract and that the parties have the intention to be legally bound[8].The intention to enter into this contract should be comprehensively determined based on factors such as the content of the agreement, negotiation process, and transaction habits[9].

There is also some debate regarding the distinction between "letters of intent" (including preliminary agreements concluded in the form of proposals, memoranda, meeting minutes, etc.) and appointment contracts. There is a consensus that forms such as letters of intent do not belong to pre-contract agreements and do not have legal binding force [10]. But some scholars argue that letters of intent cover a wide range, and appointment contracts are just one type. There is a possibility of categorizing letters of intent into appointments or even formal contracts. In Article 6, Paragraph 1 of the Interpretation [2023] No. 13, it is required that if the subject matter and subject matter of the contract are determined within a certain period of time in the future, and the contract is concluded in the form of a subscription letter, order letter, or reservation letter, the reservation contract shall be deemed to be established. But in judicial practice, some judges in certain cases believe that a letter of intent is not binding, while others verify the parties' intentions by examining the language in the letter of intent that indicates binding and their subsequent performance.

3.2 Validity of Appointment Contract

3.2.1 Theoretical basis for the effectiveness of

appointment contracts

The intention of the parties to a contract determines the effectiveness of a legal act, and a legal act that lacks the parties' inner intention is invalid[11]. The principle of freedom of contract is related to the principle of good faith and trustworthiness. The pre contract is not just an unnecessary preliminary stage of this contract, but is independent of the formal contract. The pre contract should be truly established only when both parties have reached a consensus on the pre contract, and it should meet the basic conditions for the establishment of the contract, including a qualified subject, legal content, true expression of intention, compliance with formal requirements, and certain legal effect.

3.2.2 Validity determination of appointment contract

There are three understandings of the effectiveness of appointment in academia: the theory of consultation, the theory of contractual obligation, and the theory of content based decision.

It is necessary to negotiate that the parties to the appointment only have the obligation to negotiate in good faith to reach this agreement [12]. If one party fails to complete the negotiation in good faith, it will be deemed a breach of contract. This doctrine focuses on the process of negotiation and emphasizes the protection of the negotiator's freedom of will. Although it may not be possible to sign this agreement as expected in the end, as long as good faith negotiations are conducted, it is the complete performance of the contract. The emphasis is on emphasizing that all parties do not violate good faith and public order and good customs in good faith negotiations, and whether this agreement is successfully concluded is not a question. It should be said that compulsory contracting cannot be regarded as a form of breach of contract liability, as the reservation effect did not intend to conclude this agreement from the beginning. However, when some pre contract agreements in trading practice only stipulate the obligation of the parties to continue negotiations, this statement is not sufficient to explain such pre contract agreements. In comparison, the contractual statement can better solve this problem.

The emphasis should be placed on the outcome of negotiation and consultation, and it is not enough for the parties to an appointment contract to only have the obligation of good faith negotiation. They must also fulfill the obligation of concluding this agreement[13]. Under the strict liability principle of contract law, even if one party has made reasonable efforts in negotiation without any legal fault, they will still be regarded as in breach of contract if they ultimately refuse to enter into the main contract, even if their decision is not made out of malicious violation of the principle of good faith but merely because they still feel that the future transaction does not meet their expectations after good faith negotiation and in-depth discussion. It can be seen that the "should enter into contract" theory imposes a compulsory effect on the parties to the pre-contract in terms of the outcome reached [14]. However, the "should enter into contract" theory makes mechanical judgments to some extent, divorced from the practice of pre-contracts, and is prone to deviate from the original meaning of the parties' expressions of intent and unduly intrude into the private space of the parties [15].

The "content determines" theory holds that the issue of the validity of pre-contracts cannot be generalized and should be treated differently based on the level of detail in the pre-contract. If the pre-contract terms are very complete and have the conditions to directly enter into the main contract, the "should enter into contract" theory should be adopted; if the pre-contract content is very simple and insufficient to enable both parties to directly enter into the main contract, it only has the effect of promoting negotiation.

In foreign legislation, Germany and Italy adopt the "should enter into contract" theory [6], laying the foundation for continued performance. Article 429, Paragraph 5 of the Russian Civil Code explicitly adopts the position of the "should enter into contract" theory, meaning that when one party obligated to enter into a contract refuses to do so, the other party has the right to request the court to enforce the signing of the contract [16]. Article 556, Paragraph 1 of the Japanese Civil Code stipulates that the legal effect of a pre-contract begins when the other party makes an offer to buy or sell. If no period is set for the offer to buy or sell, the party with the pre-contract right may set a period and urge the other party to

give a definite reply within the set period as to whether they are willing to buy or sell. If the other party does not give a clear reply within the urged period, the pre-contract right of the party with the pre-contract right is lost. This provision stipulates that only one party to the sale and purchase has the pre-contract right, while the other party bears the corresponding obligation. Once the party with the pre-contract right makes an offer to enter into a sale and purchase contract, the other party must make a commitment within the set period to enter into the main contract of sale and purchase [17].

However, the ordinary "content determines" theory is considered to have a "fence-sitting" nature in academic circles and poses significant challenges in practical application to judicial practice. The standards for the main terms in pre-contracts are not clear, and there are many disputes over the boundaries between the "should enter into contract" and "must negotiate" theories. When these standards are uncertain, the judge's discretionary power is too broad, leading to many differences in judicial decisions [15]. The Supreme People's Court also believes that the "content determines" theory does not match the current judicial level in China and cannot adapt to the current judicial situation [18].

Given the current situation of the "content determines" theory, if the content of pre-contracts is not systematically and typologically processed and left entirely to the judge's discretion, it will still be impossible to solve important issues such as the recognition and validity determination of pre-contracts. Building on the typological measures for recognizing pre-contracts mentioned above, Professor Liu Chengwei classified pre-contracts into three types: simple pre-contracts, typical pre-contracts, and complete pre-contracts, and further proposed that "simple pre-contracts and typical pre-contracts adopt the theory of compulsory negotiation, while complete pre-contracts should apply the theory of compulsory contract formation" [6]. Some scholars also solve the conflicts in pre-contracts based on the reasons for the breach of pre-contracts, dividing them into two situations: the parties' refusal to enter into the main contract and the failure to enter into the main contract due to the violation of the principle of good faith by the parties during the process of entering into the main contract, similar to the provisions of Interpretation No. 13 of 2023, Article 7. Professor Ran Keping, based on the special nature of the elements of a reservation contract, including the binding intention and the certainty of the content, has classified reservation contracts into four types. A reservation contract with complete content must be followed up with a formal contract, which is consistent with the first paragraph of Article 6 of the Interpretation of the Supreme People's Court on Certain Issues Concerning the Application of Law in the Trial of Disputes over Reservation Contracts (Interpretation [2023] No. 13). For reservation contracts with incomplete content or those that imply further negotiation, the principle of mandatory negotiation should be adopted. In summary, when the content of a reservation contract is complete and the intention is clear, the majority opinion in the academic and legislative circles is that a formal contract should be concluded, which is conducive to protecting fixed transaction opportunities, safeguarding the previous investment, and ensuring the birth of the formal contract. When the content of a reservation contract is incomplete, the determined contract content should be fixed, and unless both parties agree, it cannot be changed at will. For the undetermined content, both parties should adhere to the principle of good faith and further negotiate to reach an agreement. Classifying the content of reservation contracts for discussion is more respectful of the autonomy of the parties and the protection of transaction order compared to mechanically handling all reservation contracts.

4. Conclusion

Due to the various forms of reservations in practice, it is difficult to simply determine whether a reservation contract exists, the differences between reservation contracts and formal contracts or letters of intent, and the validity of the contract. In these two stages, legislation and judicial practice need to explore how to balance the autonomy of the parties and promote the conclusion of transactions. Laws and regulations should not be rigidly filled but should fully respect the shaping of the legal relationship of the reservation part by the parties, especially leaving room for negotiation for incomplete expressions of intention.

During the formation of reservation contracts, there are no common standards for the expression of intention and content completeness, and there are different differences. The validity of reservation contracts should be discussed in a classified manner, and a more scientific and reasonable legal system for reservation contracts should be constructed based on the intention and completeness of the parties. This is of great significance for unifying the standards of judgment, enhancing judicial credibility, and better balancing the interests of the parties, as well as promoting transaction security and economic development.

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