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Executive Summary

Important Provisions and Analysis of Legal Problems related to Deposits of Bidding Activities



This article will set out the important provisions of law, administrative rules and departmental regulations related to deposits/security in bidding activities, together with a discussion of the differing views of the industry experts and judges, followed by our legal opinions and advice on several important problems arising in practice.

Important Provisions and Analysis of Legal Problems related to Deposits of Bidding Activities

The Bidding Law of the People's Republic of China entered into force on January 1st 2000. Articles 46 and 60 thereof constitute the first legislation in China to regulate performance guarantee deposits (which refer to the deposit paid by a bidder to its full performance of contract concluded with a tenderer) in relation to bidding activities. These articles have been deemed by industry experts as a milestone for the establishment of a system for performance security deposits. However, the content of the articles is so general that many issues related thereto have not been clearly specified, for instance, payment methods, payment criteria, refund and settlement, dispute resolution, administrative punitive measures etc. As a result, discrepancies in both understanding and operation in practice arise, which leads to disputes from time to time. 11 years after the implementation of the Bidding Law, the State Council of China promulgated the Regulation on the Implementation of the Bidding Law of the People's Republic of China (hereinafter referred to as "the Implementation Regulation"). The Implementation Regulation clarifies a few issues in connection with performance security deposits. However, from the limited content of the relevant articles, it is clear that legislators are maintaining the underlying principle of fully respecting the freedom and autonomy of the contracting parties, keeping legislative intervention to a minimum. In addition, new articles therein clearly and concisely regulate bid security (which refers to the security deposit paid by a bidder to assure its participation in the bidding process of a project), which help to settle some long-standing unsolved problems encountered in practice.

Besides the aforesaid performance security deposits and bid security, a quality guarantee deposit refers to the deposit of bidder given to the tenderer so as to guarantee the quality of project is in compliance with the agreement). At present, except for departmental regulations, no provisions of law or administrative rules clearly specify issues in relation quality guarantee deposits. The aforementioned types of deposits/security in bidding activities will hereinafter collectively be referred to as "bidding activity deposits",

This article will set out the important provisions of law, administrative rules and departmental regulations related to bidding activity deposits (hereinafter referred to as "Important Provisions"), together with a discussion of the differing views of the industry experts and judges, followed by our legal opinions and advice on several important problems arising in practice.



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Important Provisions and Analysis of Legal Problems related to Deposits of Bidding Activities

The Content of Important Provisions

1. Bid Security

Regulation on the Implementation of the Bidding Law of the People's Republic of China	
Payment Criterion	The amount of bid security shall not exceed 2% of the estimated value of the bidding invitation project. The validity term of bid security shall be consistent with the valid term of the bid invitation. (F26)
Payment Method	Bid security submitted in the form of cash or check by a domestic entity bidding for a project as legally required shall be transferred from such entity's basic account. (F26) Bid securities of different bidders are transferred from the bank account of the same entity or individual, which shall be deemed as bidder collusion (F40)
Refund and/or Liabilities for Breach of Contract	F31, F35 & F57
Administrative Punitive Measures	F66
the Measures for the Bid Invitation and Tender of Construction and Engineering Projects	
Payment Criterion	The bid security may not exceed 2% of the total tender price as a general principle, however, the maximum may not exceed RMB 800,000.00. The valid term of the bid security shall be 30 days longer than the valid term of the bid invitation.(F37)
Payment Method	Apart from cash, the bid security may be paid in the form of bank guarantees, confirmed checks, bank drafts or cash checks. (F37)
Refund and/or Liabilities for Breach of Contract	F40 & F81
Administrative Punitive Measures	N/A
The Measures for the Administration of Bid Invitation and Tender of Construction Projects of Houses and Municipal Infrastructure	
Payment Criterion	The bid security shall not exceed 2% of the total tender price as a general principle, however, the maximum shall not exceed RMB 500,000.00. (F27)
Payment Method	Bid guarantee may be in the form of letter of guarantee or bid security. Checks, bank drafts etc. may be used to pay bid security. (F27)
Refund and/or Liabilities for Breach of Contract	F47
Administrative Punitive Measures	N/A
Provisions on the Administration of Bid Invitation and Bid Tendering for Water Conservancy Construction Projects	
Payment Criterion	The amount of bid security shall be specified in the bid invitation documents, which shall be set according to the following rates: 1. If the estimated contractual value is more than RMB 100 million, the bid security shall not be more than 5% of the estimated contractual value; 2. If the estimated contractual value is between RMB 30 million and RMB 100 million, the bid security shall not be more than 6% of the estimated contractual value; 3. If the estimated contractual value is less than RMB 30 million, the bid security shall not be more than 7% of the estimated contractual value but shall not be less than RMB 10,000.00 at minimum. (F25)
Payment Method	N/A
Refund and/or Liabilities for Breach of Contract	F30 & F55 (If a bid invitation fails attributable to tenderer (including the failure of entering into contract with bidder within time limit as agreed), tenderer shall compensate bidder twice amount of bid security and refund bid security at the same time.
Administrative Punitive Measures	N/A

2. Performance Security Deposit

The Bidding Law	
Payment Criterion	N/A
Payment Method	N/A
Refund and/or Liabilities for Breach of Contract	F60
Administrative Punitive Measures	N/A
Regulation on the Implementation of the Bidding Law of the People's Republic of China	
Payment Criterion	Performance security deposit shall not exceed 10% of the awarded contractual value. (F58)
Payment Method	N/A
Refund and/or Liabilities for Breach of Contract	F55
Administrative Punitive Measures	F74
the Measures for the Bid Invitation and Tender of Construction and Engineering Projects	
Payment Criterion	N/A
Payment Method	N/A
Refund and/or Liabilities for Breach of Contract	F58, F84 & F85 (If a tenderer fails to perform the contract which it concluded with a bid winner, it shall refund twice amount of performance security deposit to the bid winner; if the amount of losses thereby caused to the bid winner exceeds the amount of refunded performance security deposit, the bid winner shall be compensated for the exceeding part; if the bid winner does not pay performance security deposit to the tenderer, the tenderer shall compensate for the losses of the bid winner.)
Administrative Punitive Measures	N/A

3. Quality Guarantee Deposit

Interim Measures for the Administration of Quality Deposits of Construction Projects	
F2, F3, F4, F5, F10 & F11	



Analysis of and Opinions on Several Important Legal Problems of Bidding Practice

1. The Nature of Performance Guarantee Deposit

With respect to the nature of performance guarantee deposits, scholars have differing interpretations. The first group consider that performance guarantee deposits constitute a penalty for breach of contract. The second group are of the opinion that such two legal concepts should not be confused as a penalty for breach of contract is both compensatory and punitive in nature, whereas performance guarantee deposits are purely compensatory. The second group further consider that performance guarantee deposits constitute a down payment as stipulated in Contract Law of China and so the defaulting party is obliged to refund twice the amount. However, no provisions of the Bidding Law and the Implementation Regulation regulate the refund obligations of tenderer. The third group are of the opinion that performance guarantee deposits are a form of pledge in nature. According to the Guarantee Law of China and the relevant judicial interpretations issued by the Supreme Court, after a debtor transfers to a creditor the possession of a sum of money which are exclusively used as security deposit, if the debtor fails to perform payment obligations, the creditor will have the priority to be repaid with such money. In practice, most tend to accept the opinion raised by the third group of scholars.

Disputes over the nature of performance guarantee deposits have existed since the implementation of the Bidding Law. The public hoped that relevant issues could be clarified or specified by governmental authorities through the issuance of administrative rules or by the Supreme Court through issuance of judicial interpretation. However, the Implementation Regulations do not clarify this problem.

The nature of performance guarantee deposits remains unclear, which may cause different courts and judges to have differing opinions, thereby potentially leading to, differing judgments.

■ Case study 1:

The creditor of a bidder filed a civil lawsuit at a local court requiring the tenderer to pay off all the outstanding debts, and at the same time it applied for property preservation in order to freeze the performance guarantee deposit being kept in the tenderer's bank account. The court held in the creditor's favour. Subsequently, the creditor applied for enforcement of the judgment deducting the performance guarantee deposit from the tenderer's bank account. The bidder raised an objection against this application but the court did not support it. The enforcement has been completed.

From this case we may infer that the court disagreed with the views of the third group of scholars who consider that performance guarantee deposit is a form of pledge in nature. As, according to such views, the bidder and tenderer reach written agreement first, then the pledge, in the form of the performance guarantee deposit is set at the time when the bidder transfers the possession of it to the tenderer; in the event that the bidder breaches the written agreement or in case of occurrence of any event causing realization of the pledge right, subject to mutual agreement, the tenderer has the right to be repaid with the performance security deposit. The general creditor's right enjoyed by the creditor can not fight against the pledge over performance security deposit enjoyed by the tenderer.

■ Case study 2:

By contrast, another court reached a differing opinion in the following case. A bidder borrowed a sum of money to pay a performance guarantee deposit but failed to pay it back within the time limit as agreed. The bidder's creditor filed a civil lawsuit at a local court in order to claim back the sum and at the same time listed the tenderer, who was keeping the performance security deposit, as a third party to the lawsuit. In their defense submission, the bidder alleged that the legal facts and relationship of the bidder borrowing money from its creditor are different from those of the bidder using the money to pay tenderer the performance guarantee deposit, because the former belong to general creditor's rights and debts, and the latter belong to usage of borrowed money and performance of contract by the bidder. In addition, the pledge right was set once the tenderer took possession of the performance security deposit which takes priority over a general creditor's right according to law. The trial court supported the above defense opinions.

2. The Application of Departmental Regulations concerning Deposits

It is not uncommon for bidders and tenderers to expressly agree in the contract that "matters not stipulated here will be subject to the law, administrative rules or relevant departmental regulations." Where parties fail to expressly agree on the manner in which the performance guarantee deposit is to be held, but simply agree "matters not stipulated here will be subject to law, administrative rules or relevant departmental regulations.", the parties may unknowingly be placing themselves in an unfavorable position.

For example, in some cases, "relevant departmental regulations" may encompass Article 85 of the Measure for Bid Invitation and Tendering for Construction and Engineering Projects (the Measures). In such cases, should the tenderer breach the contract, they will be liable, as per Article 85 of the Measures, to return to the bidder twice the amount of the performance guarantee deposit.

Such amount is likely to be higher than that of other means by which the tenderer may undertake liability for breach of contract, either according to Contract Law or as expressly agreed within the contract concluded with the bidder (i.e. a penalty clause). As such, it is important that the parties pay great attention to the general incorporation of governmental regulations.





Important Provisions and Analysis of Legal Problems related to Deposits of Bidding Activities

3. Issues related to Keeping and Managing Deposits of Bidding Activities

Article 26 of Implementation Regulation specifies that the tenderer is not allowed to use bid security for purposes other than those as agreed in contract. The Implementation Regulation clearly stipulates the time limit for refunding bid security. The Interim Measures for the Administration of Quality Deposits of Construction Projects stipulates the time limit for refunding of quality guarantee deposit. In addition, the Implementation Regulation provides administrative measures to sanction the tenderer for failing to refund bid security with accrued interest to bidder in a timely manner.

The above provisions protect the lawful rights and interests of the bidder and make up for the areas not clarified by the legislation. However, in practice people continue to discuss and study problems related to keeping and managing the deposits in bidding activities. Failure of tenderers to refund deposits on time or using them for purposes other than as agreed in advance have become the main cause of civil actions by bidders.

Conclusion

At present, this area of law holds many uncertainties and it is important for parties to bear this in mind when contracting. As both the Bidding Law and the Implementation Regulation do not clearly specify the nature of performance guarantee deposits, and scholars hold different opinions on this problem, we suggest that in case of occurrence of any legal dispute in this regard, parties concerned may take scholars' opinions into account, and utilize those opinions which support their claims, allegation or defense in order to protect their lawful rights and interests.

Bidders and tenderers are advised to pay attention to the application of departmental regulations with respect to bidding activity deposits, moreover, to note the important impacts which would have on their rights and obligations whenever both parties use general articles in agreement. If both parties agree that a certain or several departmental regulations will apply to their agreement, we suggest that both parties shall be well acquainted with content of such departmental regulations and then expressly indicate the names thereof in their contract. Should any provisions similar to Article 85 of the Measures apply, both parties shall negotiate as to whether such provisions have binding legal force upon them or not. If not applicable, both parties are advised to mention this point in their contract.

Scholars and industry experts have put forward advice on how to improve the system of bidding activity deposits. Some of these include:

- An official organization holding deposits for contracting parties,
- Governmental authorities carrying out a mandatory guarantee system for construction/engineering projects, and
- Establishing an enterprise credit system as well as punishment system for those enterprises lack of faith.

In our opinion, before legislators issue new law or revise existing legislation, and before governmental authorities adopt measures by reference to the advice mentioned above in this paragraph, bidders and tenderers are advised to hand over their deposits to a financial institution which functions as a custodian. Alternatively, the bidder may obtain a letter of guarantee from a guarantee institution first and then give it to the tenderer. Then, should the bidder breach the contract, the tenderer will have the right to obtain the deposit from the guarantee institution. At present, this can effectively reduce the legal risk that the tenderer fails to refund the deposit within the time limit as agreed and/or it fails to use deposit for the purpose(s) as stipulated in the agreement with bidder.

by Zhao Shuzhou & Yuan Xiaodan

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