

# Liability for Violation of the Obligation of Approval

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**Abstract:** Article 12 of the Interpretation of the General Provisions of the Contract Section refines the provisions of the Civil Code regarding the obligation to apply for approval. It constructs a two-stage liability system for the breach of the obligation to apply for approval in contracts, with the judgment of the people's court as the dividing point. As a statutory pre-contractual obligation, the breach of the obligation to apply for approval before the judgment can be subject to liability for pre-contractual fault. The counterparty may request the continuation of performance or the termination of the contract and claim compensation in accordance with Article 12. If the counterparty chooses to terminate the contract, it is deemed to have voluntarily waived the performance interest, and the scope of compensation is limited to direct losses only. After the court orders one party to perform the obligation to apply for approval, if the party still fails to perform, the counterparty may terminate the contract and claim compensation by referring to liability for breach of contract. The term "refer to" here indicates that the compensation is not entirely equivalent to the performance interest. The scope of compensation can be dynamically adjusted by drawing on the theory of transaction maturity and considering factors such as the counterparty's subjective malice, reflecting the legislative orientation of punishing malicious breaches of the obligation to apply for approval.

**Keywords:** Obligation to Apply for Approval, Liability for Pre-Contractual Fault, Liability for Breach of Contract, Unenforceable Contract

## 1. Introduction

Article 12 of the Interpretation of the General Principles of Contract Codification provides detailed provisions on the liability for breach of the obligation to report for approval under paragraph 2 of Article 502 of the Civil Code, and makes a differentiated interpretation based on the judgment of the court: after the contract is established in accordance with the law, if the party with the obligation to report for approval fails to perform the obligation to report for approval, the other party may request to continue to perform or terminate the contract and request to bear the liability for compensation for the breach of the obligation to report for approval; When the court rules that a party has fulfilled its obligation to report for approval but still fails to do so, the other party may claim to terminate the contract and request it to bear the liability for compensation with reference to the liability for breach of contract for breach of contract. Before the court makes a judgment, the nature of the liability for breach of the obligation to report for approval is whether it is liability for negligence in contracting or breach of contract, liability for breach of obligation for approval or liability for breach of the entire contract, and how to determine the scope of compensation? Looking at the development of the obligation to report for approval at the legislative level, these questions have been coming from a long time and have not yet been conclusively concluded, and the Interpretation of the General Principles of Contract Codification has not been answered.

In order to explore the nature and scope of liability for non-performance of the obligation to submit for approval, this article will start from the nature of the obligation to submit for approval itself, in order to have a more accurate understanding of Article 12 of the Interpretation of the General Principles of Contract.

## 2. The nature of the obligation to submit for approval

### 2.1 The obligation to submit for approval is a legal obligation

The essence of the act of submitting for approval is administrative licensing, which is the manifestation of the intervention of public power in private law acts. From the point of view of the purpose of establishing the act of submitting for approval, it is to safeguard the national interest, the

public interest and the needs of administrative management, and it is a legal constraint on the space involving private autonomy adopted for specific industries. Article 502 of the Civil Code also directly stipulates that if a contract shall go through formalities such as approval in accordance with the provisions of laws and administrative regulations, such provisions shall be followed. Therefore, the act of reporting for approval itself does not belong to the scope of private autonomy, and the parties can neither agree to exclude it, nor can they agree to submit for approval on their own in the absence of provisions in laws and administrative regulations. If laws and administrative regulations do not stipulate that the contract must be approved before it can take effect, and the parties agree that approval is a condition for taking effect, this element is only an agreement in private law, and the validity of the contract will not be affected. There is also a view that the obligation to submit for approval can be transformed into a legal obligation of the contract through the carrier of the accompanying obligation[1][2]. Most of the scholars who support the obligation to submit for approval as a contractual obligation do so out of the consideration of preventing forced contracting. If the obligation to submit for approval is considered to be a statutory obligation, then once the contracting parties have agreed to enter into the contract subject to ratification, they enter into the shackles of having to submit for approval and actively contribute to the entry into force of the contract[3].

## ***2.2 The obligation to submit for approval is a pre-contractual obligation***

Pre-contractual obligations refer to various explanations, notifications, confidentiality, protection and other obligations that occur when the parties contact, prepare or negotiate for the purpose of concluding a contract [Wang Zejian, Principles of the Law of Obligations". The theoretical basis for the establishment of pre-contractual obligations is the principle of good faith. Article 8 of the Judicial Interpretation (II) of the Contract Law recognizes the breach of the obligation to report for approval as "other acts that violate the principle of good faith" and falls into the category of pre-contractual obligations. Although this scheme has not been continued in subsequent legislation, many scholars still believe that the obligation to submit for approval is a pre-contractual obligation. In the case where the obligation to submit for approval arises according to the agreement of the parties, the submission for approval is only a prerequisite for the realization of the approval formalities, and the submission for approval does not necessarily mean that the approval will be obtained, so the obligation to submit for approval is only a pre-contractual obligation to promote the development of the contract in the direction of effectiveness[4]. In short, no matter how the approval obligation arises, it cannot change the fundamental nature of the prior contractual obligation. However, scholars who oppose the obligation to report for approval as a pre-contractual obligation believe that if the obligation to submit for approval is only recognized as a pre-contractual obligation, the counterparty can only claim damages based on the liability for contractual negligence, and cannot obtain the relief of actual performance, and in order to better protect the interests of the counterparty, it can only be recognized as a contractual obligation and included in the scope of liability for breach of contract.

In the author's opinion, it is insufficient to conclude that the liability for contractual negligence does not include continued performance based solely on the "general theory" or "concept", because the contract has been established according to the agreement of both parties, and the next step is to make the contract effective only by performing the obligation to report for approval and obtaining the permission of the administrative authority. The nature of the contract to be ratified means that compulsory performance is not harmful to the freedom to conclude the contract (as also stated above in certain circumstances, it is necessary to restrict the freedom to conclude the contract), and to deny continued performance would encourage the speculative psychology of the obligor[4]. Although the obligation to submit for approval has come into effect, the other terms of the contract have not taken effect, and the contract has not entered the performance stage. The contracting stage should be understood in a broad sense, including both the stage when the parties reach an agreement on the main terms of the contract and the stage when the parties promote the contract to come into effect[5], so the end point of the pre-contractual obligation can be when the contract takes effect, and the obligation to submit for approval still belongs to the scope of pre-contractual obligation[5].

## **3. Liability for breach of approval obligations**

### ***3.1 The judgment is the responsibility of the party before it fulfills its obligation to report for approval***

The Judicial Interpretation on the General Principles of Contract distinguishes liability into "liability for breach of the obligation to report for approval" and "liability for breach of contract", but does not

clarify the nature and scope of "liability for breach of the obligation to report for approval". The majority view is that the parties can only request the approval obligor to bear the liability for negligence in contracting and compensate for the loss of trust interests. Some scholars also believe that if the parties violate the obligation to report for approval, there will be a competition of liabilities: from the perspective of the whole contract, the party with the obligation to report for approval should bear the liability for negligence in contracting if it violates the obligation to report for approval; From the perspective that the occurrence of the obligation to report for approval does not depend on whether the contract is effective, the party with the obligation to report for approval shall be liable for breach of contract if it violates the obligation to report for approval[6]. In terms of the scope of compensation, if the parties have agreed on the liability for breach of contract on the obligation to report for approval, since the clause of the obligation to submit for approval has taken effect independently, if one party violates the clause of the obligation to submit for approval, the other party can directly deal with the agreed liability for breach of contract when terminating the contract. When the parties did not agree on the liability for breach of contract for breach of the approval clause, Judge Liu Guixiang held that the people's court could determine the amount of compensation for the breach of the approval obligation with reference to the scope of compensation for breach of the reservation contract, and clearly apply the liability for breach of contract for breach of the reservation contract[7]. However, since the promulgation of the Interpretation of the General Principles of Contracts, different views have emerged. Some scholars believe that paragraph 1 of Article 12 of the Interpretation of the General Principles of Contract gives the counterparty the option to request continued performance or to request the termination of the contract and compensation for losses, and the counterparty waives the request for the approval obligor to continue to perform the obligation to submit for approval, which means that the other party has waived the performance interest, so the scope of compensation does not include the performance interest of the contract, but only the direct loss suffered by the other party as a result of the conclusion of the contract[8]. Although this view is deficient in argumentation, it can highlight the distinguishing significance and legislative orientation of Article 12 of the Interpretation of the General Principles of Contract Codification. In the early stage of the contract for approval, it is still uncertain whether the approval obligor will perform the approval obligation, and the counterparty can request continued performance but does not request it, and the issue of compensation for performance benefits or expected benefits is not involved at this time. In practice, since the contract between the parties does not take effect without the approval of the administrative authority, the liability for breach of contract for the entire contract cannot be applied. However, if the terms of the contract for approval and the terms related to the terms of the contract have come into effect, the liability for breach of contract may be applied to the terms of the agreement. Therefore, in terms of the amount of compensation, the liability for negligence in contracting for breach of the entire contract is the same as the amount of liability for breach of contract for breach of the obligation to report for approval, and the characterization of liability has little impact on the amount of liability, both of which are liable for the actual losses caused.

### ***3.2 Judgment on the responsibility of a party after it fulfills its obligation to report for approval***

Some scholars believe that the liability for breach of contract in paragraph 2 of Article 12 of the Interpretation of the General Principles of Contract refers to the liability for breach of contract for breach of the "obligation to submit for approval that has already taken effect", rather than the liability for breach of contract as a whole, because the entire contract has not yet taken effect. Although it is referred to as "liability for breach of contract" in the law, it essentially falls into the category of "liability for contractual negligence" from the perspective of the contract as a whole[9]. Some scholars also believe that when the obligor violates the obligation to report for approval, there is no essential difference in the nature of the damages claimed by the other party for directly terminating the contract and the damages claimed for terminating the contract after obtaining a favorable judgment, and there is no need to increase the compensation. The reason is that the actual performance of the judgment is intended to compel the obligor to perform the original payment obligation, and does not change the way the damage is assessed and calculated[10]. If the scope of compensation is extended to the liability for breach of contract as a whole, the legal effect of the contract not taking effect is exactly the same as the legal effect of taking effect, and the legal effect of the contract not taking effect will be hollowed out. The legislator held that in order to distinguish the liability of the parties themselves from the liability for compensation when the people's court has ruled that they have fulfilled the obligation to report for approval but still refuses to perform, in the latter case, the contract with the conditions for entry into force can be referred to. This method solves the consequences of the party with the obligation to report for approval and sanctions the blatant breach of contract that has the obligation to report for approval but refuses to perform the obligation for approval, which is punitive.

**3.3 If the approval is not granted for reasons attributable to the parties, it shall be handled in accordance with Article 157 of the Civil Code**

Paragraph 4 of Article 12 of the Interpretation of the General Principles of Contract determines the legal liability when the contract to be approved becomes ineffective based on the fault of the parties. If the party with the obligation to report for approval has gone through the formalities such as applying for approval or has fulfilled the obligation to submit for approval determined by the effective judgment, and the approving authority does not approve it, it is not the fault of the party that the contract has not taken effect, and shall not be liable for compensation. If the contract is not approved due to the non-performance or delay in the performance of the obligation to report for approval by the party with the obligation to report for approval, the party shall be liable for compensation for the reasons attributable to the party for the failure of the contract to take effect. When determining the scope of damages, it can still be dynamically adjusted based on practical factors such as the maturity of the transaction, the subjective fault of the parties, and the difficulty of submitting for approval. In addition to damages, according to article 157 of the Civil Code, the property thus acquired by the perpetrator shall be returned; where it cannot be returned or there is no need to return it, compensation shall be made at a discounted price. If both parties are at fault, they shall bear the corresponding responsibility according to their respective faults.

#### **4. Conclusion**

Article 12 of the Interpretation of the General Principles of Contract Codification uses the judgment of the people's court as a node to construct a two-level liability system. In the first stage, the contract is established in accordance with the law, but the party with the obligation to submit for approval does not perform or does not fully perform the obligation to submit for approval, although the terms of the approval report take effect independently, but the other parts of the contract have not yet taken effect because they have not been approved, and the contract has not yet entered the stage of performance. On the issue of the scope of compensation, since the counterparty can choose to request continued performance but does not do so, it is equivalent to voluntarily waiving the benefit of performance, so the obligor only needs to compensate the other party for the direct losses suffered by the other party as a result of the conclusion of the contract. In the second stage, if the people's court rules that one of the parties has performed the obligation to report for approval, but still fails to perform, the other party may claim to terminate the contract and request it to bear the liability for compensation with reference to the liability for breach of contract for breach of contract. Finally, if the result of the non-approval is not attributable to the obligor, then the obligor does not need to be liable for compensation; If the contract is not approved due to reasons attributable to the obligor, it can also be dynamically adjusted according to practical factors such as transaction maturity theory and subjective fault.

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