

China Supreme People's Court Issued Provisions on Foreign Investment Disputes

The PRC Supreme People's Court issued the Provisions on Several Matters Concerning the Hearing of Disputes Involving Foreign-Invested Enterprises (I) (the "Provisions") on August 16, 2010, which entered into force on the same day. The Provisions provide guidance for certain disputes arising from the establishment and changes in the registration of the foreign-invested enterprise (the "FIE"). The key rules of the Provisions are addressed as follows:

1. Validity of Contracts

The Provisions provide that contracts concluded during the course of establishment or registration changes of a FIE become effective only after being approved by the FIE approval authorities (the "FIE Approval Authority").

The Provisions, among various matters, provide that a supplement agreement concluded by the parties concerning a FIE will not be considered as an invalid agreement, even if the same has not been approved by the FIE Approval Authorities, as long as it does not involve material or substantial change, such as changes of the registered capital, company form, business scope, business term, shareholder's contribution, etc.

2. Equity Transfer of an FIE

The Provisions provide the following rules in order to clarify the parties' obligations during the period between the conclusion of the agreement and the approval.

a. Transferee's Rights

If the transferor and the FIE fail to submit the agreement for approval within a reasonable period after being requested by the transferee the latter shall have the right to request the termination of the agreement, the refund of any part of the purchase price and the compensation. The transferee can also sue the transferor and the FIE to request them to submit the agreement for approval and the compensation.

b. Transferor's Rights

If the transferee has not paid the consideration within a reasonable period stipulated in the agreement, the transferor has the right to terminate the agreement and request the compensation for the losses arising from the late performance of the transferee.

If the transferee has participated in the management and business operation of the FIE and obtained the profits, but the agreement has not been approved, the transferor has the right to request transferee's withdraw from the FIE and the return of profits deducting the relevant expenses and costs.

c. Preemptive Right

If one of the shareholders of a FIE transfers all or part of its equity to the third party, he must obtain the unanimous consent of the other shareholders, otherwise, the other shareholders have the right to request to revoke the equity transfer agreement except under some special circumstances. However, the other shareholders must assert their preemptive rights within one year after the date they knew or should have known about such equity transfer.

3. Nominal Shareholder's Interest in the FIE

Shareholders of a FIE may reach an agreement that one shareholder shall act on behalf of another shareholder who is an anonymous investor (a "real investor").

The agreement between the real investor and the nominal shareholder will be valid unless it violates the relevant laws and administrative regulations and the parties shall perform their obligations. However, the Provisions provide that the real investor will not be considered as a shareholder of the FIE under some special circumstances.

Further, the real investor's has the right to terminate the agreement and request the nominal shareholder to bear the liability of breaching the agreement if the nominal shareholder fails to perform the obligation under the agreement.

If the agreement is held invalid, the real investor may request the nominal shareholder to return his contribution and a reasonable share of the investment proceeds, if the current value of his actual equity in the FIE is no less than the contribution. Otherwise, the real investor may request payment of an amount equivalent to the current value of his actual equity in the FIE.

4. Conclusion

The promulgation of the Provisions has set the basic principles regarding matters concerning certain contractual disputes of FIE in China. The Provisions will improve the foreign investment law systems of China and provide guidance to the courts on such foreign investment disputes.

However, the Provisions have only tackled part of the issues involved in disputes actually taking place regarding foreign investment. Further, certain legal concepts used by these Provisions are too broad and it is not easy to foresee how courts will decide on complex cases.