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New guidance on Foreign-Invested Enterprise disputes in the PRC

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On 16 August 2010, the *Provisions of the Supreme People's Court on Several Issues Concerning the Litigation of Disputes Involving Foreign-Invested Enterprises* came into effect. The new provisions offer valuable guidance on how PRC courts will deal with certain types of disputes involving FIE shareholders and may also serve as guidelines for arbitrators judging on such disputes.

Foreign-invested enterprise (FIE) contracts and side agreements

In respect of approved FIE contracts, the provisions validate side agreements by the court that do not contain any significant or substantial changes to the approved contract. The term "significant or substantial changes" by definition includes amendments to the registered capital, corporate form, scope of operations, contribution by shareholders, a merger of the company, equity changes or similar modifications to the original contract.

Equity transfer

Under PRC law, an equity transfer agreement involving an FIE must be approved by the authorities before becoming effective. The provisions address claims that arise during the period from execution to approval of the equity transfer agreement. They cover, for example, a buyer's request to terminate the unapproved agreement, recoup the purchase price and obtain compensation. On the other hand, if the buyer fails to pay the transfer price, the seller can terminate the agreement and make a claim for damages. If the buyer has exercised shareholder rights in the FIE before the agreement has been approved, the seller may also demand via court procedure the repayment of earnings and associated expenses.

An existing shareholder may revoke the transfer agreement on the basis of pre-emptive purchase rights, and a court will uphold the revocation unless it has been demonstrated that the shareholder has agreed to the transfer, has failed to respond to the seller's written notice on the transfer issue or has merely

objected to the transfer without seeking to purchase the equity interest.

Equity pledge contract

Although an equity pledge contract between a shareholder and creditor becomes effective without registration, the "pledge rights" are only established at the time of mandatory registration.

Nominal shareholders and actual investors

The provisions also cover an agreement between a de facto investor and a nominal shareholder. The court will only support a de facto investor's request to confirm its status as shareholder when the following criteria are met: the investor has made the investment contribution, shareholders other than the nominal shareholder have recognised the status of the de facto shareholder and the court or other parties have obtained the FIE examination and the approval organ's approval to change the de facto investor into a shareholder. Furthermore, the de facto investor may apply to the court if the nominal shareholder fails to fulfil the contract, the investor requests the nominal shareholder to perform the relevant obligations as agreed or there is a discrepancy between the investor's contribution and the share value of the nominal shareholder. However, the court will not support the investor's request to dispute profits or exercise a shareholder's rights as based on the agreement.

Other shareholder issues

If a shareholder of either party of a FIE applies to change a shareholder by submitting false materials to the approval organ, and this subsequently causes the loss of shareholder status or the original equity share of any other shareholder, a court may, unless a third party has obtained the equity in good faith, reinstate the original shareholder's status or equity share.

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