Same Bed Different Dreams: How to Handle Joint Venture Disputes in the PRC

Terence Wong
Partner
Shanghai and Hong Kong
Introduction

Before entering into a JV
- Governing Law
- Court or Arbitration
- Yin and Yang
- Scope of JV Agreement

Managing the JV
- Case Study 1
- Case Study 2

Resolving JV Disputes
- Damages
- Put Option
- Discharge of the JV Agreement
- Dissolution
Before entering into a JV
Before entering into a JV – Governing Law

Article 126 of the PRC Contract Law

For a Chinese-foreign equity joint venture contract, Chinese-foreign contractual joint venture contract, or a contract for Chinese-foreign joint exploration and development of natural resources which is performed within the territory of the People's Republic of China, the law of the People's Republic of China shall be applied.
Before entering into a JV – Governing Law

Reply from the Supreme People’s Court (“SPC”)

Pursuant to Article 126, a share transfer agreement in the course of a Chinese-foreign joint venture contract shall also apply PRC law as the governing law.

Share transfer agreement dispute between Jimei Investment Co Ltd, Henan Yingcheng Group Co Ltd, Zhang Shunyi, Zhang Lei
Before entering into a JV – Court or Arbitration

Article 266 of the PRC Civil Procedure Law

“Actions instituted for disputes arising from the performance of contracts for Chinese-foreign equity joint ventures, Chinese-foreign contractual joint ventures or Chinese-foreign cooperative exploration and exploitation of natural resources in the People's Republic of China shall be under the jurisdiction of the people's courts of the People's Republic of China.”
Before entering into a JV – Court or Arbitration

Article 531 of the SPC’s Interpretation on the Civil Procedure Law

"For cases which fall under the exclusive jurisdiction of a court in the People's Republic of China pursuant to the provisions of Article 33 and Article 266 of the Civil Procedural Law, the litigants shall not agree on selection of a foreign court with jurisdiction, except where the litigants agree on arbitration."
Before entering into a JV – Yin and Yang

U v A [2017] HKEC 468

Company U entered into:
- Preliminary Assignment Agreement (PAC) – Yin Contract
- Share Transfer Agreement (STA) – Yang Contract
- For JV Co, in Fujian China

Disputes arose re composition of the JV board

Company U
- ICC arbitration in Hong Kong under the PAC

Respondents objected
- Require registration and approval by the PRC authorities

HK Court
- Rejected the Respondents’ application
- Not against Hong Kong public policy to enforce the award when the arbitrator ruled (rightly or wrongly) that the PAC does not require registration and approval by the PRC authorities

The Respondents
- Applied to Hong Kong court to set aside
- Contrary to public policy
- PAC is invalid and ineffective for lack of registration and approval by the PRC authorities

ICC Tribunal
- PAC is valid and enforceable
- Amount to a framework agreement (not a share transfer agreement)
Before entering into a JV – Scope of JV Agreement

**Not extend to**

<table>
<thead>
<tr>
<th>Dispute between the JV Co and the JV Partners</th>
<th>Guarantor who guarantees the performance of the JV Partners</th>
<th>Dissolution of the JV</th>
</tr>
</thead>
<tbody>
<tr>
<td>SPC’s reply regarding Hemofarm DD, MAG International Trading Company, Surah Media Co., Ltd. and Jinan Yongning Pharmaceutical Co., Ltd. Joint Venture Contract Dispute Case</td>
<td>SPC’s reply regarding the request of the Yulin Intermediate People’s Court to file a request not to enforce the case involving a foreign arbitral award involving Chengwei Investment Co Ltd</td>
<td>SPC’s reply regarding the case of setting aside an arbitral award between Qingdao Jiacheng Engineering Co., Ltd., Weiainmu Company and Ximensite Company</td>
</tr>
<tr>
<td>(No. 11 [2008] of Civil Division IV of the Supreme People’s Court)</td>
<td>(No. 25 [2006] of Civil Division IV of the Supreme People's Court)</td>
<td>(No. 13 [2011] of Civil Division IV of the Supreme People's Court)</td>
</tr>
</tbody>
</table>
Managing the JV
Managing the JV – Case Study 1

- Foreign company in the food additives market
- JV agreement with a Chinese company

<table>
<thead>
<tr>
<th>Foreign company</th>
<th>Chinese company</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Recipes</td>
<td>• Equipment, factory, labor</td>
</tr>
<tr>
<td>• Legal Representative</td>
<td>• General Manager</td>
</tr>
</tbody>
</table>

51% shares | 49% shares
Managing the JV – Case Study 1

Stage 1
- GM in real control
- GM not cooperative
- Firing GM would result in Chinese company exercising an Option and receiving a large sum of money
- Proceedings at the PRC Labor Tribunal

Stage 2
- HKIAC arbitration proceedings
- Claims and counterclaims
- Board meetings cannot be properly held
- Foreign company contemplated D Day

Stage 3
- Settlement discussions between the parties
- Company chop
- Changing names
During the JV – Case Study 2

Danone v Wahaha

• Danone
  - Based in Paris
  - Dairy product and bottled water markets

• Wahaha
  - Based in Hangzhou
  - Largest Chinese bottled water company
During the JV – Case Study 2

By 2005
• Founder established “mirror” companies

Since 1996
• 39 joint ventures
• Danone 51% shares
• Founder of Wahaha is the Chairman

December 2006
• Agreement to integrate the mirror companies into the JVs
• Danone will pay RMB 4 billion
• Founder subsequently claimed that he had been “forced” to sign
During the JV – Case Study 2

2007
Danone
- Arbitration at the Stockholm Chamber of Commerce (SCC)
- Court proceedings in the US and British Virgin Island
- Trademark infringement
- Non-compete breaches
Wahaha
- Arbitration at the Hangzhou Arbitration Commission
- Court proceedings in China against Danone-nominated JV directors
- Wahaha owned the trademark
- Non-compete breaches

Late 2009
- Settlement
- Monetary settlement agreed upon by the parties
- Danone withdrew from the JVs

2009
Danone won the SCC arbitration
- Wahaha trademark belongs to the Danone-Wahaha JV
- Wahaha to cease usage of the Wahaha trademark
- Wahaha shall transfer the trademark to the JV
Wahaha won the Hangzhou Arbitration Commission proceedings
- China’s Trademark Office never approved the transfer of the Wahaha trademark
- Exclusive license agreement for the trademark never been registered
- Ownership of the Wahaha trademark had never been transferred to the JV
During the JV – Case Study 2A

Infringement liability disputes between Suqian Wahaha Hengfeng Beverage Co Ltd and KPMG Huazhen Certified Public Accountants and its Guangzhou branch

2007
• Danone commenced court proceedings in the US and British Virgin Island
• The BVI Court issued an order of asset take-over
• KPMG was appointed to take over the defendant's asset in China

End of 2007
• KPMG sent a notice to the Hangzhou branch of Industrial and Commercial Bank of China
• Requesting the bank to freeze Wahaha's bank account
During the JV – Case Study 2A

Infringement liability disputes between Suqian Wahaha Hengfeng Beverage Co Ltd and KPMG Huazhen Certified Public Accountants and its Guangzhou branch

• Reports from several news articles online
• Adverse impact on Wahaha
• Wahaha brought an action against KPMG
• Jiangsu Higher People’s Court
  • Violation of the PRC Civil Procedure Law
  • Adverse impact to Wahaha
  • KPMG shall compensate Wahaha and make public apology
Resolving JV dispute
1. Damages
2. Put Option
3. Discharge of the JV Agreement
4. Dissolution
1. Damages
2. Put Option
3. Discharge of the JV Agreement
4. Dissolution
Resolving JV Dispute - Damages

Article 114 of the PRC Contract Law

Where the amount of liquidated damages prescribed for breach of contract is lower than the loss caused by the breach, the party concerned may apply to a people's court or an arbitration institution for an increase.

Where the amount of liquidated damages prescribed for breach of contract is excessively higher than the loss caused by the breach, the party concerned may apply to a people's court or an arbitration institution for an appropriate reduction.
Resolving JV Dispute - Damages

SPC Interpretation II on Certain Issues Concerning the Application of the People's Republic of China Contract Law

Where a party claims that the amount of liquidated damages prescribed for breach of contract is excessively high and applies for an appropriate reduction, the people's court shall use actual losses as the basis, measure them in accordance with the principle of fairness and the principle of good faith, and make a ruling. If the damages agreed upon by the parties exceeds 30% of the losses, they can generally be regarded as excessively higher than the losses caused by the second paragraph of Article 114 of the Contract Law.
Resolving JV Dispute - Damages

Article 113 of the PRC Contract Law

If either party fails to perform its obligations under the contract or does not perform its obligations as contracted and thus causes losses to the other party, the amount of compensation for the loss shall be equivalent to the loss actually caused by the breach of contract and shall include the profit obtainable after the performance of the contract, but shall not exceed the sum of the loss that might be caused by a breach of contract and has been anticipated or ought to be anticipated by the breaching party in the making of the contract.
1. Damages
2. Put Option
3. Discharge of the JV Agreement
4. Dissolution
Resolving JV Dispute - Put Option

Grant of Put Option – During the Option Period, Party B has the option (“Put Option”) to Dispose all (but not part of) their shares to Party A for the Put Option Price and on the terms and conditions in this Agreement. The Put Option automatically lapses and are of no further force when the Option Period expires.

Put Option Price – The Put Option Price is fixed at $XXXX.

Conditions for Exercise of Put Options – Party B acknowledges and agree that its right to exercise its Put Option is conditional upon that it is not in breach of any of their material obligations under this Agreement.
1. Damages
2. Put Option
3. Discharge of the JV Agreement
4. Dissolution
Resolving JV Dispute - Discharge of the JV Agreement

UNDER THE CONTRACT
- Service of notice
- Strict compliance

UNDER THE LAW
Article 94 of the PRC Contract Law
- before the time of performance, the other party expressly stated or indicated by its conduct that it will not perform its main obligations
- the other party delayed performance of its main obligations, and failed to perform within a reasonable time after receiving demand for performance
1. Damages
2. Put Option
3. Discharge of the JV Agreement
4. Dissolution
Resolving JV Dispute - Dissolution

**Article 43 of the PRC Company Law**

A resolution made at a shareholders' meeting on revising the bylaw, increasing or reducing the registered capital, merger, split-up, dissolution or change of the company form shall be adopted by the shareholders representing 2/3 or more of the voting rights.
Resolving JV Dispute - Dissolution

**Article 182 of the PRC Company Law**

Where any company meets any serious difficulty in its operations or management so that the interests of the shareholders will face heavy loss if the company continues to exist and the difficulty cannot be solved by any other means, the shareholders who hold ten percent or more of the voting rights of all the shareholders of the company may plead the people's court to dissolve the company.
Resolving JV Dispute - Dissolution

Article 1 of the SPC’s Interpretation II on the PRC Company Law

Where any shareholders that separately or aggregately hold 10% or more of all the shareholder's voting rights of a company lodge a company dissolution case for any of the following causes, if which conforms to the provisions in Article 182 of the Company Law, the people's court shall accept the case
Resolving JV Dispute - Dissolution

1. The company cannot hold the meeting of shareholders or the general meeting of shareholders for two or more consecutive years, the company encounters serious difficulty in its business management;

2. The voting by shareholders cannot reach the statutory proportion or the proportion set down in the articles of association of the company, the meeting of shareholders or the general meeting of shareholders of the company cannot make any valid resolutions for two or more consecutive years, the company encounters serious difficulty in its business management;

3. The directors of the company are in conflict for a long time, the meeting of shareholders or the general meeting of shareholders cannot form any resolutions to solve the said conflict, the company encounters serious difficulty in its business management;

4. The company encounters any other kinds of serious difficulties in its business management, and the continuous existence of the company will cause major damage to the interests of shareholders.
Resolving JV Dispute - Dissolution

Dissolution and Dispute Case between the 20th Institute of China Electronics Technology Group Corporation v Xian Dongqiang Electronic Navigation Co Ltd

1999
- HK Company and Chinese company established a JV Co
- The Chinese company and JV could not contact the HK Company

2008
- No meetings by the JV board of directors

2016
- JV Co stopped running

2017
- PRC Court
  - Serious difficulties in operations or management
  - JV Co should be dissolved
Resolving JV Dispute - Dissolution

Nantong Shunlian Construction Engineering Co., Ltd. v. Liuan Risheng Real Estate Co., Ltd. Dissolution and Dispute Case

**Company**
- Serious loss for years during its operation

**Shareholders of the company**
- Apply to the court for dissolution
- Serious difficulties in the company’s business management

**Court**
- Serious difficulties in the company’s business management has two sides
  - First - Serious difficulties in the management authority of the company, whereby the relevant bodies (such as shareholder meeting or the board of director) cannot operate and no resolution can be made
  - Second - The company is in serious financial loss and is not properly operated
- If only the second, not dissolve the company
Questions?
Terence Wong is a partner at Winston & Strawn who focuses his practice on commercial arbitration. He helps clients resolve disputes via international arbitration as well as other dispute resolution mechanisms (such as mediation, expert determination, and court proceedings). In addition, Terence drafts construction contracts for major projects.

Terence is familiar with the arbitration rules of many arbitral institutions, including the China International Economic and Trade Arbitration Commission (CIETAC), the Shanghai International Court of Arbitration (SHIAC), the Hong Kong International Arbitration Centre (HKIAC), the Singapore International Arbitration Centre (SIAC), the International Chamber of Commerce (ICC), the United Nations Commission on International Trade Law (UNCITRAL) Model Rules, and the Terms of the London Maritime Arbitrators Associations (LMAA).

Terence is a Fellow with the Chartered Institute of Arbitrators, and is listed in the Panel of Arbitrators with CIETAC, SHIAC, HKIAC, and SAC.

Terence has solid experience in dealing with multi-jurisdictional disputes, including China, Hong Kong, Singapore, England, France, Indonesia, the Middle East, Nigeria, Tanzania, and Venezuela. His experience spans a wide range of sectors such as infrastructure (such as rail, roads, and bridges), power and utilities, energy, real estate, international trade, shipping, joint venture, intellectual property etc.
NOT LEGAL ADVICE

This presentation has been prepared by Winston & Strawn for informational purposes only and are not legal advice. Receipt of this information does not create an attorney-client relationship. Do not act upon this information without seeking professional counsel.

By viewing this presentation, you acknowledge and agree that any communication or material you transmit to Winston & Strawn, in any manner and for any reason, will not be treated as confidential or proprietary. Furthermore, you acknowledge and agree that any ideas, concepts, techniques, procedures, methods, systems, designs, plans, charts, or other materials you transmit to Winston & Strawn may be used by Winston & Strawn, anywhere, anytime, and for any reason whatsoever.

You acknowledge and agree that no partnership or client/attorney relationship is formed and neither of you nor Winston & Strawn has the power or the authority to obligate or bind the other.

Statement in Compliance with the Texas Rules of Professional Conduct: Lawyers resident in all offices, unless otherwise indicated in an individual attorney biography, are not certified by the Texas Board of Legal Specialization.

CASE RESULTS DEPEND ON A VARIETY OF FACTORS UNIQUE TO EACH CASE. ANY CASE RESULTS NOTED ON THESE SLIDES DO NOT GUARANTEE OR PREDICT A SIMILAR RESULT IN ANY FUTURE CASE.

For the full disclaimer, please visit our website at https://www.winston.com/en/legal.html