



SOUNDINGS

Enforcement of Chinese performance guarantees in China – new regulations and common pitfalls

The expansion of China's economy has resulted in a significant increase in fixtures with Chinese entities, many of which are substantial concerns operating and registered in China. Often, such charters are concluded with special purpose companies, which tend not to hold substantial assets and which may be domiciled in foreign jurisdictions – commonly Hong Kong, the BVI and Singapore. The practice therefore developed for a large parent corporation to guarantee the performance of its chartering entity. However enforcement of these guarantees can be problematic.

The three most common obstacles are:

- invalidity of the guarantee due to lack of approval and/or registration;
- lack of authority of the signatory to the guarantee;
- enforceability of a foreign award or judgment.

Of these, approval from and registration with the relevant authority and the capacity of the company official who issued the guarantee are difficult to determine and can be fatal to an enforcement claim. Recent amendments by the State Administration for Foreign Exchange ("SAFE") to its guarantee regulations has eased, in part, the requirements for approval and registration. These, and other issues relating to enforcement are summarised in this note.

continued overleaf

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Registration & legality

Until recently, a Chinese entity intending to conclude a guarantee agreement with a foreign firm required prior approval from SAFE. Failure to hold such approval, at the time of signature, rendered the guarantee unlawful and unenforceable before the Chinese courts. So too would the failure subsequently to register the guarantee with SAFE. It is particularly arduous for foreign firms to establish compliance with these formal, but vital, requirements. Fortunately, the Regulations on Foreign Exchange Administration of Cross-border Security which came into force on 1st June, 2014 have ameliorated this difficulty. Significantly, the new regulations no longer require prior SAFE approval for a guarantee to be considered lawful (Article 29). Moreover, failure to subsequently register certain categories of guarantee will not invalidate the agreement, but does attract a fine against the guarantor. In this regard, there are three categories of cross-border guarantees:

- i) An “outbound guarantee” – those provided by an onshore (i.e. Chinese) guarantor in favour of an offshore (i.e. foreign) entity to secure the obligations of an offshore entity. Such a guarantee must be registered within 15 days;
- ii) An “inbound guarantee” – provided by an offshore guarantor in favour of an onshore entity to secure the obligations of an onshore entity, which does not require registration;
- iii) Other “cross-border guarantees” which do not require registration.

Guarantees provided by a Chinese entity to secure the obligations of an offshore charterer would be regarded as an “outbound guarantee”; and those of a Chinese charterer as an other “cross-border guarantee” under category (iii) on the previous page. Failure to register an outbound guarantee may result in a fine up to RMB300,000, but the guarantee remains enforceable. The new regulations remove the uncertainty over whether a guarantee was intrinsically lawful and enforceable. However, the capacity of the party signing the guarantee continues to be problematic.

The authority of the issuer of the guarantee

The Company Law of China requires every business to nominate the company's legal representative (usually the chairman of the board, the executive director or general manager.) The legal representative must then be registered with the relevant local Administration of Industry and Commerce Bureau.

Only the legal representative has general power to conclude contracts, including guarantees, on behalf of the company. No other officer or employee can bind the company unless acting under a power of attorney (“POA”) authorised by the legal representative. The POA must be issued in the name of the company, and not, for example, a department within the company.

A company is bound to contracts concluded by its legal representative (unless there is knowledge of breach of authority). However, there is a risk that the legal representative may have their power to enter into a guarantee curtailed by the registered articles of association. Accordingly, before accepting a performance guarantee from a company in China, steps should be taken to confirm that the signatory is the legal representative of the company and, if not, a power of attorney issued by the legal representative must be produced. The guarantee should also be issued in the name of the company, rather than a department within the company unless authorised in writing under a POA from the company, which should also specify the individuals within the department entitled to execute the guarantee.

Every company in China has a company stamp, normally under the control of the legal representative. A guarantee signed by the legal representative is binding on the company, whether or not the guarantee bears the company stamp. A guarantee which bears the company stamp with or without a signature is also binding. It is however always advisable to have a guarantee both signed by the legal representative and stamped with the company stamp.

Enforceability of a foreign award or judgment against a guarantor domiciled in China

When a guarantor's obligations under a guarantee are triggered, it is often necessary to launch legal proceedings to enforce the guarantee. Often, the guarantee will provide for an international jurisdiction, outside China. However, it may not be possible to enforce a court order or arbitration award against the guarantor, for lack of assets, in the nominated jurisdiction. Accordingly, enforcement proceedings may be required in China and these may not straightforward. As English law and jurisdiction clauses are commonly found in charterparty guarantees, it is useful to highlight some of the enforcement difficulties that may be encountered.

i) Enforcement of arbitration awards

Both China and the United Kingdom acceded to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards ("the New York Convention"). Contracting States to the New York Convention recognise and enforce international arbitration awards.

Like most other signatories China only recognizes arbitration awards issued by other contracting states. The Civil Procedural Law of China (Article 283) requires a party seeking to enforce a guarantee to apply to the Intermediate People's Court located where the guarantor is domiciled or holds property. The time limit for seeking enforcement of a foreign arbitration is two years from the award, or a date for performance specified by the award.

Generally, enforcement of an award under the New York Convention is straightforward in China. However difficulties can be encountered when attempting to enforce a court judgment.

ii) Enforcement of foreign court judgments

The Civil Procedural Law of China (Article 282) recognises foreign judgments under an international treaty or reciprocal agreement, if not contrary to the basic principles of the laws of China or in violation of the national, social and public interest of China.

There is no treaty between the United Kingdom and China on the reciprocal enforcement of judgments. This means that a judgment rendered by an English court cannot be enforced in China. Accordingly, fresh action under the terms of the

guarantee must be launched in China. This will be met with the argument that the Chinese courts have no jurisdiction in light of any foreign law and jurisdiction clause. Litigation in a foreign court is therefore impractical unless the guarantor has assets in that jurisdiction.

In contrast, following the enactment of legislation in Hong Kong and China, judgments issued by a Hong Kong Court in civil and commercial matters are enforceable in China, subject to certain conditions. However, this will not result in the enforcement by the Chinese courts of an English judgment recognised in Hong Kong.

Conclusion

Restrictions imposed on foreign parties who seek to enforce a performance guarantee against a Chinese company have been relaxed over the years. Following the entering into force of the new Regulation on Foreign Exchange Administration of Cross-border Security on 1st June, 2014 the main obstacle affecting the validity of a performance guarantee has also been removed.

Members who accept a performance guarantee issued by a Chinese company will however continue to need to ensure that the person purporting to issue the guarantee on behalf of the company enjoys the legal capacity to do so.

Consideration will also need to be given to the law and jurisdiction clause or arbitration clause in any performance guarantee to ensure that any judgment/award issued under the guarantee will be recognised and enforced by the court in the jurisdiction where the assets of the guarantor can be found.

Whilst arbitration awards in a New York Convention contracting state can be prosecuted in China, the judgments of a state, such as the UK, which does not maintain a reciprocal recognition agreement with China, cannot be enforced – and action on the guarantee in China may be stymied by a foreign law and jurisdiction clause.

If Members have any questions concerning the enforcement of Chinese performance guarantees in China then please contact your usual contact at your local Managers' office.



Chinese performance guarantees. August 2014

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