

China's Supreme People's Court Issues Notice on Trial of Cases Involving Transfers of Nonperforming Assets to Foreign Investors

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According to the Supreme People's Court, when foreign investors purchase non-performing assets from Chinese firms and collect payments from the original borrower/guarantor it somehow changes the nature of the original guarantee. Consequently, on October 27, 2010, the Supreme People's Court issued Notice on Trial of Cases Involving Issues of Validity of Guarantee Contracts Related to Use of Foreign Investment by Chinese Companies in Dealing with Nonperforming Assets (the "Notice") in an effort to provide some guidance on such matters.

I. Registration with Foreign Exchange Administrations is Critical

The Notice states, if a foreign investor bought nonperforming debts from a Chinese firm and tried to collect by bringing a suit against the original debtor and guarantor, the fact that the guarantor didn't agree to the transfer of the debt or that the transfer failed to get the approval by relevant authorities will not necessarily invalidate the original guarantee agreement if the transaction took place after January 1, 2005. The court shall enforce such a guarantee agreement so long as the foreign investor can show:

- the Chinese seller of the debt has provided the required notice to the guarantor;
- the investor has provided information about the original guarantee agreement when having the transfer registered;
- and that the transfer has been approved by and registered with foreign exchange administration authorities.

II. How to Remedy a Flawed Registration

The Notice says, during the registration with foreign exchange administration authorities, details of the guarantee must be provided otherwise the guarantee agreement will not be enforceable. However, the investor is not totally out of luck in such a situation. The Notice asks the court not to treat the guarantee agreement as invalid on the ground of lack of governmental approval, if the

investor resubmits the application with the foreign exchange administration authorities providing the required details and complete the process before the closing argument of the trial.

III. Transactions before January 1, 2005

With respect to suits related to nonperforming debt transfer transactions that took place prior to January 1, 2005, the court will not invalidate a guarantee agreement on grounds of lack of governmental approval if the investor received all the approvals and completed all the filings and registrations required under the laws and regulations then in effect.

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