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Newsletter

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Legal Updates

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Legal Updates

1. Offshore Emergency Arbitration Procedures and the Need for Emergency Refinancing Restricted by Investors' Consent Rights (Authors: Chen Xianglin, Sun Ying)

A company requires emergency refinancing but is restricted by the original investors' consent rights—is there a legal channel for the company to seek relief? The answer is "yes". Emergency arbitrator procedures can be initiated to seek relief if international arbitration is the agreed dispute resolution method in the cross-border investment and financing agreements, and the selected arbitration institution rules provide for emergency arbitrator procedures. This article will provide a brief introduction to emergency arbitrator procedures in international commercial arbitration and the review criteria on which arbitrators will grant emergency relief.

What are emergency arbitrator procedures?

Parties to a dispute often encounter certain emergency circumstances after the dispute occurs. In such cases, the parties may suffer irreparable loss or damage if they do not seek emergency relief from an authoritative third party. In judicial proceedings, the parties involved are generally allowed to apply to a court for temporary measures (such as pre-action security, prior execution, etc. under PRC law) before or concurrently with the proceedings.

In international commercial arbitration, many international arbitration institutions provide emergency arbitrator procedures to solve the urgent needs of the parties involved. Emergency arbitrator procedures refer to the appointment by an arbitration institution, at the request of a party, of an emergency arbitrator to hear an application for emergency relief from the party and to make a decision, order or award, at the initial stage of the arbitration case (before the formal constitution of the arbitral tribunal).

Emergency arbitrator procedures have the following characteristics:

- **Urgency**. Considering the urgency of issues awaiting to be decided, emergency arbitrator procedures have a tight schedule from commencement to end. The arbitration rules of many arbitration institutions have clear time limits for the arbitration institution to appoint an emergency arbitrator and time limits for the emergency arbitrator to make an emergency decision after the procedure commences.
- **Procedural.** An emergency arbitrator hears applications for emergency relief only for the purpose of deciding whether to grant emergency relief. The emergency arbitrator will only preliminarily review, and will not decide on, substantive issues, which will be left for the formally constituted arbitral tribunal.
- **Temporary**. An emergency arbitrator may no longer exercise his powers after the arbitral tribunal has been constituted. An emergency arbitrator who has already exercised his powers

before the arbitral tribunal is constituted may not be appointed as a member of the arbitral tribunal. An Emergency Decision that has been issued may be amended, suspended or terminated by an emergency arbitrator or the arbitral tribunal (once constituted).

What is the process to appoint of an emergency arbitrator?

Taking the "Arbitration Rules" (Appendix 4) promulgated by HKIAC on November 1, 2018 as an example, the basic procedures for appointing an emergency arbitrator are as follows:

- **The party submits an application for the appointment of an emergency arbitrator**. The party applying for emergency relief may submit an application for the appointment of an emergency arbitrator to the arbitration institution before, at the same time as or after the submission of an arbitration notice (in any case, before the constitution of an arbitral tribunal). If necessary, the applicant should also submit other documents or information that will help to improve the efficiency of reviewing the emergency arbitration application.

- **Designating an emergency arbitrator.** If HKIAC decides to accept the emergency arbitration application, it will appoint an emergency arbitrator within 24 hours of receipt of the application and advance payment, and subsequently hand over the relevant case materials to the emergency arbitrator.

- **Case hearings**. The emergency arbitration procedure can be carried out in the manner as the emergency arbitrator deems appropriate after the emergency arbitrator takes over the case. For example, an emergency arbitrator may stipulate the time limit for the parties to express opinions and submit evidence, and may decide on the specific hearing arrangements.

- **Rendering an Emergency Decision.** The emergency arbitrator will render a decision with respect to the emergency relief application submitted by the parties within 14days from the date of receiving the case from HKIAC, or within a time limit as otherwise agreed by the parties or extended by HKIAC.

What are the criteria for reviewing an emergency relief application?

Generally, emergency arbitrators will substantively review the emergency relief applications mainly from the following three perspectives:

- **Urgency and the Need to Avoid Irreparable Harm**

One of the key considerations in the review of an emergency relief application is whether the relief is so badly needed that it cannot be delayed until the constitution of the arbitral tribunal. Article 2 of Appendix 4 of the HKIAC Rules stipulates the contents to be included in an emergency arbitration application, which explicitly provides that the applicant must state in the application the reasons for applying for emergency relief before the constitution of the arbitral tribunal.

In order to prove the "urgency" of the application, applicants are also required to prove that irreparable

harm would potentially be result if emergency relief is not granted. In practice, applicants are required to prove that they may suffer irreparable harm and the subsequent arbitration procedures may not provide sufficient relief if emergency relief is not granted.

Specifically, the company seeking emergency refinancing in our hypothetical may try to prove that it will face an imminent risk of bankruptcy and completely lose access to the relevant markets if alternative financing is not allowed and a rapid infusion of funds is not obtained. In most cases, the applicant only needs to present persuasive proof in support of its position and does not need to prove that bankruptcy will necessarily occur if no relief is obtained.

- **Likelihood of Success on the Merits**

If the arbitration requests of the applicant for emergency relief are likely to be completely untenable, the emergency relief, if granted, will be at high risk being inconsistent with the final arbitration award. Therefore, the likelihood of an applicant for emergency relief to succeed on the merits of its claims in arbitration is one of the basic considerations in deciding whether to grant emergency relief in international arbitration practice. For example, section 23.4(b) of the HKIAC Rules provides that a criterion for granting emergency relief is the likelihood of success on the merits of the underlying claims.

The likelihood of success is typically judged on the basis of a "reasonable possibility" standard. Applicants for emergency relief bear the burden of proving that there is a reasonable possibility of success. Emergency arbitrators will generally consider the likelihood of success from the perspective of a reasonable third person who understands the relevant factual background. This means that emergency arbitrators will heavily depend on their discretionary evaluation of evidence to make a decision with respect to a specific case.

It is worth noting that an emergency arbitrator's determination of the "likelihood of success" is mainly based on his general understanding of the case and a review of the prima facie evidence during a short period of time. This determination should not affect the arbitral tribunal's hearing and judgment of the substantive issues of the case once it has been constituted.

- **Balance of Convenience / Harm**

In practice, serious harm may result if emergency relief is improperly granted. Therefore, emergency arbitrators should weigh the damage avoided by the emergency relief and the harm potentially caused if the relief is improperly granted. Emergency arbitrators will prefer not to grant emergency relief if the damage caused by the emergency relief is likely to be greater than the damage avoided by the relief itself. In international arbitration, the above principle is broadly used for determining whether or not to grant emergency relief and interim measures, and is known as the "balance of harm" or "balance of convenience" principle.

Specifically, factors that emergency arbitrators will consider in applying the balance of convenience principle include: the damages which may result from granting the emergency relief, the damages

which may result if the emergency relief is not granted, whether the relevant damages can be remedied through due process and the possibility of the wrongly granting emergency relief. Some of these factors overlap with the irreparable harm principle and likelihood of success on the merits principle. In essence, the purpose of the balance of convenience principle is to guide emergency arbitrators to review emergency relief applications from a holistic perspective and to make decisions that produce more equitable outcomes.

The company applying for emergency refinancing relief may face bankruptcy if its application is denied and it is unable to obtain alternative financing. In this respect, the granting of emergency relief would benefit all shareholders (including those with consent rights). On the other hand, if the company's application is approved, alternative financing may cause certain harm to the original investors, such as equity dilution, stock devaluation and so on. Thus, the emergency arbitrator in this case should give consideration to reducing the concerns of investors with consent rights when reviewing the company's emergency relief application.

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2. AMAC Clarifies Personnel Requirements for Private Fund Managers (Authors: Yang TieCheng, Ge Yin, Zheng Ting, Olivia Shen)

On 7 December, AMAC issued an amended version of its *Private Fund Manager Registration Instructions* (《私募基金管理人登记须知》). The amendments cover a series of matters relating to the registration and post-registration compliance of private fund managers, including requirements for personnel, business premises, business scope, capital sufficiency and affiliates, among others. In general, the amendments are intended to supplement and clarify existing requirements and supersede inconsistent AMAC rules or other guidance that have previously been issued.

From an international asset manager's perspective, the most noteworthy aspect of the amendments is the clarification of and changes to certain personnel requirements. We have summarized the highlights as follows:

I. **General non-compete restriction added**. The business personnel and investors of a private fund manager are required to comply with the principle of non-competition and to refrain from engaging in any activity which may present conflicts of interest with the private fund management business.

II. **"Dual hatting" of senior management personnel further clarified:**

a. Except for legal representatives, senior management personnel may not in principle hold any concurrent positions; otherwise, AMAC will require evidencing materials to justify the relevant dual-hatting arrangement.

b. In addition, dual-hatted senior management personnel may not exceed 50% of all senior management personnel at a private fund manager. AMAC will focus particular attention on senior management personnel who hold concurrent positions at multiple institutions and such personnel should reasonably allocate their work time.

c. As a general principle, senior management personnel of a private fund manager may not take concurrent positions at (i) any unaffiliated private asset management institutions or (ii) any institution whose business may conflict with the private fund manager.

The definition of "senior management personnel" remains unchanged and expressly includes, but is not limited to, legal representatives/executive partners, general managers, deputy general managers and chief risk/compliance officers.

III. **Minimum staffing requirement expressly provided.** It is now clarified that private fund managers are required to have no fewer than five employees and non-senior management employees may not take concurrent positions at other institutions.

IV. **Personnel eligibility requirements.** While the general requirement remains unchanged that personnel involved in private fund management shall have professional capabilities matching their respective positions, the amended Instructions have added that senior management personnel in charge of investments shall also have corresponding investment capabilities.

V. **Continuity of senior management.** If any senior management personnel leaves a private fund manager, his or her replacement is required to be appointed within three months.

The requirements above make no distinction on their application to domestic and foreign-invested private fund managers, so it is presumable that they will generally apply to all AMAC-registered private fund managers. The new personnel requirements may be challenging for some international asset managers who intend to engage in QDLP and/or WFOE PFM business, especially at the initial stage. However, to the extent a holding structure is adopted where a WFOE PFM will establish a subsidiary as a QDLP fund manager, a proper dual-hatting arrangement will still be achievable to effectively manage human resources. Given the amendments are very new, further interpretation from AMAC may be required for implementation of these requirements in practice. We will continue to closely monitor for any developments.

We have prepared an English translation of the amended AMAC Private Fund Manager Registration Instructions. Please let us know should you wish to receive a copy.

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Important Announcement

This Newsletter has been prepared for clients and professional associates of Han Kun Law Offices. Whilst every effort has been made to ensure accuracy, no responsibility can be accepted for errors and omissions, however caused. The information contained in this publication should not be relied on as legal advice and should not be regarded as a substitute for detailed advice in individual cases.

If you have any questions regarding this publication, please contact:

Contact Us

Beijing Office
Tel.: +86-10-8525 5500
9/F, Office Tower C1, Oriental Plaza
No. 1 East Chang An Ave.
Beijing 100738, P. R. China

Wenyu JIN Attorney-at-law
Tel.: +86-10-8525 5557
Email: wenyu.jin@hankunlaw.com

Shanghai Office
Tel.: +86-21-6080 0909
33/F, HKRI Center Two, HKRI Taikoo Hui, 288 Shimen Road (No. 1),
Shanghai 200041, P. R. China

Yinshi CAO Attorney-at-law
Tel.: +86-21-6080 0980
Email: yinshi.cao@hankunlaw.com

Shenzhen Office
Tel.: +86-755-3680 6500
Room 2103, 21/F, Kerry Plaza Tower 3, 1-1 Zhongxinsi Road, Futian District, Shenzhen
518048, Guangdong, P. R. China

Jason WANG Attorney at-law
Tel.: +86-755-3680 6518
Email: jason.wang@hankunlaw.com

Hong Kong Office
Tel.: +852-2820 5600
Rooms 3901-05, 39/F., Edinburgh Tower, The Landmark 15 Queen's road Central, Hong Kong

Dafei CHEN Attorney at-law
Tel.: +852-2820 5616
Email: dafei.chen@hankunlaw.com