

Arbitral Settlement of Joint Infringement by Private Equity Funds

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Abstract

Based on the confidentiality and efficiency of arbitration, the dispute resolution method is often agreed as arbitration in the contracts involving private equity funds. The investment process of private equity funds often involves multi-layer nesting to avoid regulation and infringement of investors' rights and interests. Such infringement cases involve joint infringement by a majority of people, and it is difficult for investors to claim their rights through infringement lawsuits based on the exclusionary effect of a valid arbitration agreement on jurisdiction in the event that investors have signed a valid arbitration agreement. Due to the relativity of the arbitration agreement, the arbitral tribunal cannot break through the validity of the arbitration agreement to pursue the liability of other joint infringers when accepting the relevant case, and cannot resolve the dispute at once. If the validity of the arbitration agreement can be extended to other joint tortfeasors in the private equity fund, it will not only facilitate the investors to claim their rights and interests, but also improve the efficiency of dispute resolution.

Keywords

Private Equity Disputes; Joint Infringement; Expansion of Arbitration Agreements.

1. Introduction

Since its inception, partnership-based private equity funds have gained popularity in private equity investments due to their convenience. Private equity funds are divided into three organizational forms: contractual, partnership and corporate. With the maturity of the capital market and financial market, the private equity investment field has learned from the mature experience of the United States in the process of development, and has gradually formed a variety of indirect investment methods on its own initiative, and such products are often characterized by multi-layer nesting. Under the nested fund structure, the funds at different levels are often linked to each other through contractual documents such as partnership agreements, articles of incorporation and fund contracts. Generally, due to the relativity of contracts, it is difficult for fund investors to assert their rights against fund managers of other tiers.

Generally speaking, arbitration is often agreed upon in the "Application of Law and Dispute Settlement" chapter of the fund contract. Compared with litigation, arbitration is more autonomous and has the characteristics of confidentiality and convenience, which is highly favored by the parties. The arbitration agreement often involves only the investor, the manager or the investor, the manager, the custodian of the tripartite legal relationship. However, in reality, the infringement of investors' rights and interests often occurs in the subsequent recruitment, investment, management and withdrawal of the links, especially the joint infringement. At this time the arbitration clause in the original contract effect can not bind the subsequent behavior of the parties, if the original arbitration agreement based on the arbitration can not achieve the full effect of relief. And the parties to infringement as the reason to the court, often to "the existence of a valid arbitration agreement" was rejected, so that investors to protect their own rights and interests in the process suffered a lot of obstacles.

Through searching the CNKI, the author found that the analysis of the risk of private equity fund partnership focuses on financial regulation, while the protection of investors' interests is combing the fiduciary obligations of the manager and the custodian. In the author's view, the clarity of the responsibility of the manager and the custodian is important, but the clarity of the relief path is also important for the protection of investor interests. In view of the above situation, the author believes that, on the basis of arbitration of tort disputes, it is feasible to apply arbitration for tort disputes of partnership-type private equity funds. The problem lies in how to pursue the third party under the constraints of the effectiveness of the arbitration agreement, the responsibility of the subject of joint infringement, in this case, if the arbitration agreement can be properly expanded, the problem may be solved.

2. Joint Infringements in Private Equity Funds

2.1. Common Situations in Judicial Practice

The issue of joint infringement of investors in private equity funds involves investors, managers, custodians and other parties, and the common situation is to evade regulation through multi-layer nesting or channel business. Now the author extracted a case of Xue Liang and Hanfu Holding Company Limited and other infringement liability(case number: (2020) One of Beijing 0105 Minchu 57088) for specific illustration.

2.1.1. Case Studies

Xue Liang, an investor, signed the Fund Contract with the administrator, Novartis, and the custodian, Hengtai Securities, and remitted the funds to the designated account of Hengtai Securities. Later, Hengtai Securities operated on its own and transferred the funds in the fund account to its Outsourcing Fundraising Special Account, and on the same day, transferred the funds to the account of Yantai Hanfu Hanxin Investment Center (Limited Partnership) from the said account again in one go. Yantai Hanfu Hanxin Investment Center (Limited Partnership) is a limited partnership fund jointly established by Novartis as a limited partner and Hanfu Capital Corporation as a general partner, but it has not applied for fund filing in CDFIA. According to the information of Beijing Supervisory Bureau of China Securities Regulatory Commission: the actual controller of the five private equity fund managers, such as Novosolar and Hanfu Capital, is Hanfu Holding Company, which is under the unified management of Hanfu Holding Company. Xue Liang claimed that Novosolar, Hengtai Securities, Hanfu Capital and Hanfu Holding Company were jointly and severally liable for the joint infringement. The case was dismissed in the first instance on the grounds of "existence of a valid arbitration agreement", and the original decision was upheld in the second instance and retrial.

2.1.2. Case Analysis

The special feature of the case is that several private equity fund managers are controlled by the same company, and the custodian, Hengtai Securities, transferred the investment funds to the account of Yantai Hanfu Hanxin Investment Center (Limited Partnership), which is actually a channel business to avoid regulation. Although Hanfu Hanxin Investment Center adopts the limited partnership system, in which the general partner needs to bear unlimited joint and several liability for partnership debts. However, in this case, the limited partnership is a multi-layer nested structure of the limited partnership, the limited partner of the first level of the fund is often not the actual investor, the actual investor Xue Liang and the mezzanine fund only contractual relationship exists between the first level of the fund and the actual control of the operation of the underlying assets and does not have a legal relationship. Under such strange circumstances, neither the limited partners' right to supervise and advise as agreed in the partnership agreement of the primary fund, nor the limited partners' statutory rights in the Partnership Law could be actually owned by Xue Liang, the actual investor. The effect of the

fund contract, on which the investor Xue Liang could actually claim his rights, could not be extended to the primary fund, nor could the rights and interests actually be protected.

2.2. Impediments to the Apply Arbitration

In fact, arbitration, as one of the important means of commercial dispute resolution, is also widely used in private equity, for example, the Beijing Arbitration Commission has a special "Decision Guidelines for Private Equity Dispute Cases" to standardize the decision of the cases; and the China International Economic and Trade Arbitration Commission often organizes relevant forum activities. Typically, the parties agree that the use of arbitration to resolve disputes represents a waiver of the right to litigate the dispute in court. There is no problem with arbitration for investors and through their fund contracts with administrators and custodians, and the impediments to applying arbitration to private equity fund joint torts lie in two main points. First, whether the cause of arbitration is established. This case is to infringement as the focus of the dispute, the arbitration agreement between the parties often agreed to "disputes relating to the contract", infringement disputes in the end can be defined as "contract-related disputes" determines the infringement case can be arbitration. Second, whether the third party can participate in the arbitration. Private equity fund common infringement often involves multi-layer nesting, the establishment of channel business and other manipulation, the corresponding infringement of the parties also beyond the arbitration agreement investors, managers, custodians of the legal relationship. Based on the arbitration autonomy of meaning, based on the existing arbitration agreement can not achieve the purpose of claiming rights to the upper level of the actual infringer.

3. Application of the Expansion of the Arbitration Agreement

3.1. Feasibility of Applying Arbitration

According to the aforementioned, the arbitration agreement relied upon by the investor in claiming its rights and interests is the agreement between it and the custodian and administrator on contract-related disputes, however, the actual grounds for filing a dispute settlement is infringement, so the feasibility of applying arbitration to private equity fund infringement can be divided into two levels, one is whether the infringement is arbitrable, and the other is whether the arbitration agreement between the parties contains a consensual agreement to resolve infringement disputes by arbitration.

First of all, tort is arbitrable. The question of whether the infringement is arbitrable was first raised in the gazetted cases of the Supreme People's Court - China National Technology Import & Export Corporation v. Swiss Industrial Resources Corporation (hereinafter referred to as "Sinotech case") and Jiangsu Provincial Materials & Supplies Group Light Industry & Textile Corporation v. Yuyi Group Co. (hereinafter referred to as the "Sinotech case") and Jiangsu Provincial Materials Group Light Industry and Textile Corporation v. (Hong Kong) Yuyi Group Limited and (Canada) Prince Development Company Limited. In these two cases, the Supreme People's Court first denied the arbitrability of the infringement and then affirmed it. This matter was finally settled in the Second National Conference on Maritime Trial in Foreign-related Commercial Matters issued by the Supreme Court in December 2005, which stipulated in Article 7 that: "A valid arbitration agreement signed between the parties to a foreign-related commercial contract stipulates that all disputes arising out of or in connection with the contract shall be resolved by arbitration, and that the plaintiff's claim in respect of the disputes arising in the course of the parties' conclusion and performance of the contract to the People's Court on the ground of tort, the People's Court shall not have jurisdiction." Since then, the tort has arbitrable gradually become the judicial practice consensus. In fact, this question from China's Arbitration Law can also find the answer. China's "arbitration law" article 2 provides that "equal

subject of the citizens, legal persons and other organizations of contract disputes and other disputes over property rights and interests, can be arbitrated." Article 3 of the Law stipulates that "the following disputes cannot be arbitrated: (a) disputes over marriage, adoption, guardianship, dependency and inheritance; and (b) administrative disputes that should be dealt with by administrative organs in accordance with the law." Tort disputes can be applied to article 2 of the Law as "other disputes over property rights and interests", and at the same time, tort disputes do not fall into the category described in article 3 of the Law, so tort disputes are arbitrable.

Secondly, the arbitration agreement between the parties to submit contract-related disputes to arbitration could be interpreted to include tort. In the aforementioned case, the court of first instance held that "the basic facts on which Xue Liang claimed that Hanfu Capital Company and Hanfu Holding Company should bear the tort liability were all centered on the utilization and management of the investment funds corresponding to the Fund Contract, and that whether or not the tort facts mentioned by Xue Liang were established, and whether or not the relevant subjects should bear the tort liability all depended on the examination and determination of the basic facts of the contract"; the court of second instance held that "no matter what the actual legal relationship was, it should not affect the parties' interpretation of the dispute." The Court of Second Instance held that "no matter what Xue Liang thought the actual legal relationship was, it should not affect the choice of dispute resolution made by the parties before the dispute arose. In the case that the arbitration clause of the fund contract is legal and valid, even if one chooses to pursue the tort liability, it should still be carried out through arbitration"; the Court of Second Instance held that "the dispute in question belongs to the scope of the arbitration clause". From the viewpoint of the ruling, "contract-related disputes" obviously includes the tort arising from the contract, so, although the agreement between the parties to the arbitration agreement for the "contract-related disputes", but the "contract-related disputes" obviously can not be Disputes relating to the contract" obviously can not be equated with the narrow sense of the "contract dispute" to exclude the application of tort disputes. In fact, this is also the view of the judicial interpretation. Article 2 of the Interpretation of the Arbitration Law provides that "where the parties have agreed in general terms that the subject matter of arbitration is a contractual dispute, disputes based on the establishment, validity, modification, assignment, performance, liability for breach of contract, interpretation, termination, etc., may be recognized as arbitration matters."

3.2. The Need for Expansion of the Arbitration Agreement

Generally, the validity of an arbitration agreement that is formed and comes into force is limited to the parties who entered into the arbitration agreement and to the courts. The parties are bound by their agreement on dispute resolution, and the court does not have jurisdiction because of the parties' intention to exclude litigation. Academics have not formed a unified definition of what is the expansion of the effect of the arbitration agreement, in general, the expansion of the effect of the arbitration agreement can be understood as the effect of the arbitration agreement on non-agreement signatory. Based on the meaning of arbitration autonomy, if the introduction of the third party to participate in the arbitration process, the meaning of autonomy of the arbitration system is the cornerstone of the destruction. In this regard, China's legislation has not been clearly stipulated, but China's arbitration law, "arbitration law interpretation" article 8 provides for the subject of rights and obligations under the change of the expansion of the effectiveness of the situation, article 9 provides for the expansion of the effectiveness of the situation of the assignment of the contract, it can be said that China's "interpretation of the arbitration law" affirms the arbitration agreement of the contractual nature of the arbitration agreement, recognizes the automatic inheritance,

assignment of the arbitration agreement or the original contract of arbitration clauses, unless otherwise agreed or expressly made between the parties to refuse arbitration.

In fact, the expansion of the validity of the arbitration agreement can be supported by theories. For example, the theory of "lifting the corporate veil", the principle of "fair and reasonable expectations" and the relativization theory of the principle of "relativity of contracts" all support the expansion of the validity of the arbitration agreement in different ways.

To the above Xue Liang and Hanfu Holding Co., Ltd. and other tort liability as an example: the case, infringement of investors Xue Liang rights and interests of the company, Hanfu capital and other companies by the Hanfu Holding Co. unified management, in the administrator of the company's implementation of the misconduct of the company, but also in the new fund partnership with a limited partner in the case of the investor to claim only for the company's responsibility for the company's incumbent can not get the due relief, at this time, should be The veil of the company should be pierced to pursue the responsibility of the actual controller behind the Hanfu Holding Company, so as to make the investors' rights and interests fully protected. And the rest of the affiliates, in its existence with the help of legal personality to evade the relevant responsibility should also be pursued for the relevant responsibility.

In addition, the expansion of the validity of the arbitration agreement to other joint tortfeasors of private equity funds is conducive to the one-time settlement of disputes and improves the efficiency of dispute handling. In the private fund joint infringement case, the parties to the infringement of the court was dismissed the suit only according to the existing arbitration agreement to arbitration, in the arbitration agreement does not expand the effectiveness of the arbitration tribunal for the dispute is obviously not complete, the investors need to demand judicial relief for the infringement again. In this case, a private equity fund common infringement case through the court, the arbitration tribunal, the court three processes may be resolved, greatly reducing the efficiency of dispute resolution. If the arbitration effect can be extended to other private equity fund joint infringers, the parties do not need to hope that the court will reject the validity of the arbitration agreement and directly file a lawsuit, and they do not need to claim unfinished remedies to the court after the arbitration hearing, which can improve the dispute resolution efficiency and save judicial resources.

4. Conclusion

Commercial arbitration has an important position in the multiple dispute resolution mechanism for private equity funds, and plays an indispensable role in dealing with disputes involving private equity funds, promoting the compliant operation of private equity fund managers, and resolving financial risks. With the rapid development of the private equity fund market, the corresponding disputes are becoming more and more complex and diversified, and the risks borne by investors are getting bigger and bigger. In private fund disputes, investors are often in a disadvantageous position, how to strengthen the protection of the interests of investors should be a problem to be considered when dealing with disputes involving private funds. For private equity fund infringement issues, due to the multi-layer nested structure, the dispute often involves most of the infringers, investors initially signed the contract of arbitration agreement can not bind other joint infringers. Expanding the effect of the arbitration agreement to other tortfeasors will fully facilitate investors to safeguard their own rights and interests, and will also be conducive to the efficiency of dispute resolution.

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