Case study:development and transaction of industrial lands in Shanghai China

Description

Just recently, the dispute between Premier and Menghai Chemical that grabbed a lot of media attention has come to its final end with the announcement of the judgment by the appellate court affirming the decision of the district court in Fengxian.

The gist of the judgment that most intrigued me and people interested in the case is that the court concluded that in light of the nature/usage purpose of the land, Premier's conduct in dispute was in nature transfer of self-built factories, which didn't require Premier to be a general property developer that shall have to obtain a development qualification in order to legally develop land. In other words in short, companies that have bought industrial lands can develop the land into factories and sell the factories to others without having to obtain development qualification that is a must for a developer of other lands esp residential and commercial development.

Let us look back at the basic facts of the case: Premier acquired a company that held a piece of undeveloped industrial land in Fengxian District, southern part of Shanghai. Premier then started developing a number of factories based on the specific requirements of clients and at the same time of development Premier signed sale contract with clients under which the factories were sold to those clients. Menghai was one of the clients of Premier. After factory sale contract was struck, for some reason, Menghai sued to nullify the sale contract on the legal ground that Premier's subsidiary company in charge of development of the said industrial land did not have the statutory property development qualification and did not have approval for sale of the factory.

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To understand the situation, you'd better first get familiar with the term "industrial land" in China land administration regime. For purpose of administration of urban land development, urban lands are classified into six categories in Shanghai, among which "industrial land" means land to be used for manufacturing activities. It is the general understanding, also as provided by land ministry, that such industrial land is deemed as ancillary assets in support of the manufacturing business operation thereon. In other words, such industrial land is not to be developed in the general sense of property development whereby the development itself is the main business of the business entity. As such, buildings on industrial lands are registered in one piece of title deed and Shanghai has specifically prohibited division and sale of buildings on industrial lands.

However if we look at what Premier has done on the said industrial land in Fengxian, it is clear that Premier is not doing manufacturing business at all but construction and development only. Premier has turned the industrial land into an industrial park that are housing a dozens of manufacturers. On its face, the industrial land is now still kept for manufacturing purposes as businesses in it are all related to manufacturing. But the way in which Premier itself used the land has sparked controversies as to its legality esp on the backdrop that Premier itself is not a property developer and does not have the development qualification that is requisite for any other property developers such as residential and commercial properties. If we strictly interpret the current laws and rules in respect of land development in China, it is more likely to conclude that Premier has violated the laws by developing and selling the

land without qualification and government approval. This is the major legal ground for Menghai to present its case at court.

Furthermore, the sale of the factories on one piece of industrial lands to different buyers means that Premier has divided the properties on the land as well as the land itself, which ran against Shanghai local rules. Ironically enough, local real estate authority in Fengxian nevertheless issued title deeds to those sold factories despite the prohibition rule.

Much to the surprise of the public, the Shanghai courts now applied a different logic as described before. Now one cannot help asking a question: what the hell is property development under Chinese laws? what kind of property development shall require that the developer must have the qualification? Unfortunately, most Chinese courts' judgments never bring up the process of reasoning in reaching their decision.

Now with the court judgment in Premier case, should investors in industrial lands believe that they can do the same thing as Premier has done on industrial lands? Hard to tell.

It is hard to tell because as a non-case law country, the judgment is not binding on any future similar case. In other words, in a different case, the judges may come to a different or opposite decision. So one shall have to wait until high authorities shed lights on the issue.

On the other hand, just because it is not clear, investors in developing industrial land shall cite the judgment to argue in their favor with local authorities. I recalled a line told by a previous foreign businessman in Shanghai "Everything is possible in China".

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