Litigation in China: How to win and enforce - A new method?

Litigation Update

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By:

For international companies with business in China, the legal dispute is one of their greatest fears. Even if you win an arbitration or court judgment, you may find you cannot enforce it.

The problem of enforcement is arguably the greatest challenge facing China’s civil system. What is the point of spending a year fighting a case, winning arbitration overseas or litigation onshore, and then finding that not only does the loser ignore the demand to pay, but the enforcement authorities ignore the problem? You may have won on the law, but you have nothing to show for it except a large legal bill.

What is the REJA?

The REJA, or more accurately the "Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters" was signed in 2006 between the Supreme People’s Court of the People’s Republic of China and the HKSAR Government, and finally became effective in August 2008. It provides a legal basis for PRC courts to enforce judgments from Hong Kong, which is extremely significant. It effectively allows common law courts to enforce in China.

China has very few reciprocal enforcement arrangements with foreign countries. Since China did, however, sign the New York Convention on international arbitration, international disputes have tended to be referred to arbitration, which can in theory be enforced in China under Chinese legislation transposing the New York Convention. That has not been the case for court judgments. China has no such treaty with any common law country, which is why the REJA is so significant.

Hong Kong, though part of China, has its own independent legal system. Its courts are as fair as England’s, and it has long been the default jurisdiction for contracts involving mainland Chinese parties and foreign parties, and so for Hong Kong court judgments to be enforceable in the Mainland is of great importance.

In other words, the REJA allows you to use independent, fair courts for cases in China, rather than mainland China’s own courts. And this works - see the case study below.

Case study

In November 2010, a Hong Kong judgment was recognized by a Shanghai court, the first ever such recognition. Despite being later subjected to judicial review, the judgment was enforced.

The background to this case was a promissory note relating to a debt owed by a Chinese entity to an international
company. Suspecting that the Chinese entity would not pay, in the belief that the debt would be unenforceable in China, the team provided for exclusive jurisdiction of the Hong Kong courts, in order to ensure that not only would the international client win a lawsuit on the promissory note but that we would also be able to take advantage of the REJA, and enforce against the debtor's assets in China.

The Chinese entity apparently believed that as it had no assets in Hong Kong, it could simply ignore the promissory note. And indeed, the Chinese entity did not pay.

In 2009, the international company's legal team served summons on the debtor in China. This process requires the Hong Kong high court to issue summons through the Shanghai High Court, which the debtor did not accept, so the team took advantage of a recent ruling from the Supreme People's Court recognizing service on housemaids or other people at the recipient's address.

We then proceeded to court in Hong Kong. The defendant did not attend and we won. In 2010, the client's team attended two hearings at the Shanghai No. 1 Intermediate Court, both of which were contested by the defendant, to enforce the Hong Kong judgment under the REJA.

In November 2010, the Shanghai No. 1 Intermediate Court issued a decision to acknowledge and enforce the award.

In 2011, the defendant requested a judicial review by the Shanghai High Court of the decision. However, there is no right to appeal, and so enforcement commenced in the first half of 2011, despite the pending judicial review.

Enforcement was then delayed because there were criminal charges against the defendant entity and its management, which resulted in police seizure of the relevant assets.

We took advantage of another unclear provision regarding "seizure by turn" and argued that it should be applied by analogy to criminal seizure, which mean that when the criminal process was completed, we would have our turn at the remaining assets.

This was accepted. When the criminal proceedings ended in 2012, the enforcement process began again.

It remained only for the judicial review to be defeated, which was in late 2012, after which the debt was finally paid.

**Can the REJA be used for every dispute?**

The REJA is limited in application.

- It applies only to commercial contracts, not to consumer contracts or employment relationships
- The contract must be subject to the exclusive jurisdiction of Hong Kong courts. If the contract has an arbitration clause, or if Hong Kong court jurisdiction is not exclusive, REJA cannot be invoked
- If enforcement would go against Mainland public policy, the judgment may not be enforced

The Hong Kong court will judge on the merits of the case first and make its judgment without reference to REJA, and will then decide whether to transmit the judgment to the Mainland Court for enforcement. The Mainland Court will then need to satisfy itself that the judgment has met the three requirements above, and if so, it will recognize the award and enforce it.

**How is the REJA applied in real life?**

As the case study shows, it's not as easy as the wording of the REJA implies. The mainland court will allow advocacy from both sides to help it decide whether or not the judgment does fall under REJA. The burden is on the party that lost in the Hong Kong court to show why the Mainland court should not enforce, and so each side brings out their lawyers and attends court to argue their case. Since the facts and legal basis for the case cannot be challenged, this means that the loser can only argue on the three bullet-points above, or that procedure was not followed correctly (for example, as in the case in point, that the defendant was not properly served with a summons in China).

**REJA compared with arbitration**
The REJA is a very new tool for enforcement in China against Chinese clients. A more tried and tested method is international arbitration. But reading statistics about enforcement of arbitration awards in China is extremely misleading. There is no public database of enforcement against rejection, and some researchers rely on statistics as to whether or not the award itself was successfully challenged or set aside.

It is common to read articles with statements like this: "Contrary to popular belief that enforcement of arbitration awards in China is very difficult, statistics show that less than 10% of arbitration awards are set aside by Chinese courts".

This is very misleading. Talk to those who actually work on arbitration enforcement and the picture is reversed: most awards are settled rather than enforced, and although courts hardly ever set aside awards, they do nothing at all - which of course works in favour of the Chinese party.

In conclusion, both arbitration and the REJA can be used - but the REJA's great advantage is that the local court cannot ignore the judgment.