

TAMING THE DRAGON: ENFORCING CONTRACTS IN CHINA

By Nigel Cotman SC and Wilson Chan

Nigel Cotman SC is a barrister at Level Nine Wentworth Chambers.

Wilson Chan is a barrister at Seven Windeyer Chambers and a barrister of Hong Kong SAR.



China is now one of Australia's largest trade partners. Commercial transactions between an Australian client and a Chinese counterpart are now common. This has given rise to the problem of enforcement of contractual obligations in the event of a breach of contract.

Australian individuals and businesses involved in commercial transactions with mainland Chinese residents may want to be able to obtain a judgment enforceable against people and assets in mainland China, without having to litigate in mainland Chinese courts. It is understandable that Australian clients would prefer the familiarity of the common law process and New South Wales law. The issue is how to achieve that outcome, or at least seek to achieve it.

Enforcement of contractual obligations in China

It is effectively impossible to directly enforce an Australian judgment in China. An attempt was made by DNT France Power Engine Co Ltd, after it obtained judgment in a Western Australian court against a Chinese national defendant. In the *Letter of Reply of the Supreme People's Court on Request for Instructions Re Application of DNT France Power Engine Co., Ltd. for Recognition and Enforcement of Australian Court Judgment* [2006]民四他字第45号, the Supreme Peoples' Court refused to recognise the Australian judgment, primarily for want of reciprocity, that is, because Australian courts did not recognise Chinese judgments. The requirement of reciprocity is a common theme in enforcement issues in China (and many other jurisdictions).

However, reciprocity issues are explicitly dealt with under the *Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters by the Courts of the Mainland and of the Hong Kong Special*

Snapshot

- Currently there is thought to be no alternative except via arbitration if a client wants to enforce a contractual obligation in mainland China.
- There is a bilateral agreement between Hong Kong and China for the mutual recognition, registration and enforcement of judgments.
- Australians can take advantage of the Agreement by drafting a contract, applying the law of NSW, which permits litigation in Hong Kong and thereby obtaining a judgment that is enforceable in mainland China.

Administrative Region Pursuant to Choice of Court Agreements between Parties Concerned ('the Agreement') between Hong Kong and China. That Agreement allows mutual recognition and enforcement of Hong Kong judgments in mainland China, provided specified criteria are met, and, incidentally, we would suggest, provides an avenue for access to mainland China curial enforcement for Australians.

The Agreement came into effect in 2008, after it was decided in a line of cases in both Hong Kong and mainland China that, despite being the 'one country', Hong Kong was a separate 'foreign' jurisdiction. The process of recognition and enforcement under the Agreement has been used by Hong Kong practitioners with success for some years. It has allowed Hong Kong locals to minimise their business risk

and exposure in the event of a breach by their mainland counterpart.

Under the Agreement, the courts of China do not look behind a Hong Kong judgment. Once judgment is obtained from the appropriate Hong Kong Court, an application can be made to the mainland Court for recognition and enforcement. That application is a paper process only to prove eligibility under the Agreement and does not involve the need for further evidence in relation to the merit of the claim. Recognition and enforcement under the Agreement is wide enough to include the legal fees expended in the litigation in Hong Kong. Importantly article 11 of the Bilateral Agreement gives a recognised judgment the same force and effect as one being made by a Court of mainland China.

The enforcement of a judgment in China is executed by the courts themselves, not as a separate process as in Australia. The enforcement process is relatively straight forward and transparent in major cities of China. In relation to enforcement, it is significant that bankrupt administration, as Australian lawyers would understand it, does not exist in China. If there are insufficient assets to meet a judgment debt, then the curial recovery process is stayed. The recovery process can be, and will be, reactivated in the future when the debtor has acquired more assets or if more assets are discovered. Until such time as the judgment debt is repaid, the judgment debtor will have various limits placed on his or her lifestyle which are similar to those placed on a bankrupt in Australia.

Taking advantage of the Agreement

The Agreement can provide Australian parties with a 'bridge' into the mainland China court system and its enforcement processes in relation to contract based claims, the bridge being a judgment obtained in the Hong Kong legal system.

Some major elements necessary to take advantage of the Agreement include:

- the judgment to be registered must be based on a claim in contract;
- the contract sued on must be commercial in nature;
- the jurisdictional clause of the contract sued on must be in writing; and
- Hong Kong must be the choice of jurisdiction.

In prospective commercial transactions, Australian clients can seek to take advantage of the Agreement by seeking, in negotiation with the counter party, to obtain contracts containing a choice of forum clause, nominating Hong Kong as the jurisdiction, and meeting the other requirements of the Agreement.

We suggest that the term 'commercial' is sufficiently wide to cover matters well beyond simple sale and purchase of goods, or a lending, and includes matters such as shareholder agreements and other matters of a general corporate and business nature. Because the Agreement operates in relation to contracts, it is substantially based in commercial relationships in any event.

The range of allowed contracts seems to be wide enough to allow a court settlement in an Australian matter to be drafted in such a way as to comply with the requirements of the Agreement. This allows pre-existing matters litigated in Australia to be enforced in China to some degree.

Simple registration of an Australian judgment in Hong Kong does not create an 'Agreement judgment'.

It is vital that all requirements and formalities are met. Failure to meet any requirement will result in the client being unable to rely on the Agreement to access the mainland courts with a Hong Kong judgment. A judgment from Hong Kong which does not take advantage of the Agreement will be considered a 'foreign judgment' by the mainland courts and the civil laws regarding recognition and enforcement of foreign judgments will be applied. In the past the mainland courts have refused to recognise and enforce some Hong Kong judgments which did not comply with the Agreement.

Given that a contract will nominate Hong Kong as the forum, the issue then

is what law will be applied? As is the general case, contracts can be drafted to apply New South Wales law (or any other set of laws) to the contract while having the matter litigated in Hong Kong. The effect will be that the matter will be litigated in Hong Kong applying the laws of NSW and the civil procedure of Hong Kong. Once the proceedings are disposed of, the Hong Kong judgment can be taken to mainland China for registration and enforcement. As noted above, the process of registration is by way of paper application and is described in the Agreement itself.

Apart from drafting a contract which complies with the Agreement, it is also necessary to consider some additional practical issues. Given that both parties are outside the jurisdiction of Hong Kong and may or may not have a presence in that jurisdiction, it may be necessary to consider special contractual clauses to meet that situation.

The Hong Kong judicial system

Hong Kong is a common law system with procedural rules and, in the commercial setting, substantive law, similar to Australia because of its development until its return to China in 1997. The Basic Law of Hong Kong guaranteed the continued application of laws before 1997. The civil procedure of Hong Kong is close to the *Civil Procedure Act 2005* (NSW) and *Uniform Civil Procedure Rules 2005* (NSW). Hong Kong courts are familiar with the law of Australia and often refer to Australian domestic judgments in deciding local matters. Eminent retired judges of Australian courts have been appointed to sit on Hong Kong's Court of Final Appeal, and assist in the development of the law of Hong Kong. In short, litigating in Hong Kong is not significantly different from Australian proceedings.

Whilst the Hong Kong court system does not have a commercial list like the NSW Supreme Court, it does sit a number of judges who specialise in commercial matters. Those judges are acutely aware of the practical realities of commercial matters and the fact that time is essential and delay can render a judgment practically worthless. The Hong Kong court system also has the benefit of dual language system of English and Chinese. Contractually or, with less certainty, subsequently, English can be chosen as the language of choice for the litigation,

The Agreement can provide Australian parties with a 'bridge' into the mainland China court system and its enforcement processes ...

so there will be no issue of voluminous and costly translations.

The cost of litigating commercial suits in Hong Kong is not much more than litigation in Australia. Arrangements can be entered into with Hong Kong lawyers so that the instructions are taken from clients by their Australian lawyers. Litigation time frames are similar to those found in New South Wales and there are similar procedures in place for fast tracking matters if necessary.

Other methods of enforcement

The current most common method for an Australian party to obtain an enforceable order against a China counterpart is through arbitration, relying on China's signature of the *Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, otherwise known as the *New York Convention*.

For an arbitral award to be enforceable in China it must meet the various requirements set out by the *Arbitration Law of the Peoples' Republic of China* and the *Civil Procedure Law*, art 237, apart from those recited in the *New York Convention* itself. China has imposed 'commercial' and reciprocity reservations. The award must be registered with, and recognised by, a Chinese court after demonstration of the award, its foundation and current effectiveness. The relevant People's Court may not accept the award for registration on public policy grounds including if the dispute was not arbitral in its place of origin (see also art 3 definition of non-arbitral disputes) and other exceptions to recognition in the *Convention*.

Neither arbitration nor this 'new' litigation method is necessarily better than the other in an absolute sense. Both methods will eventually obtain an enforceable result in mainland China. Both are potential tools and the choice should be a result of a consideration of a variety of factors unique to the client. **LSJ**