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Cover Page Footnote

J.D. Candidate, Fordham University School of Law, 2014; B.B.A., Business, University of Michigan, Stephen M. Ross School of Business, 2009. I thank my friends and family for their support, as well as the staff and editors of the Fordham Journal of Corporate & Financial Law for their excellent editorial review. Finally, I thank the professors and practitioners who lent their advice and expertise to this Comment. All errors are mine alone.

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JUDGMENT UNENFORCEABILITY IN CHINA

Jason Hsu

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ABSTRACT

Parties often take judgment enforcement for granted in the United States as a result of decades of reinforcement from the Full Faith and Credit Clause. As the world becomes increasingly globalized, however, corporate defendants may only have nominal holdings within the United States, with the majority of their assets held abroad. Plaintiffs may then be in for a rude awakening when they bring their U.S. money judgments abroad, for such judgments are routinely unenforceable. China has proven no exception, and foreign judgments are rarely, if ever, enforced there. The problem is compounded by the fact that trade between the United States and China increases every year, leading to a likely corresponding increase in cases where U.S. money judgment creditors are left holding the bag. This Comment briefly explains the reasons for why U.S. money judgments often go unenforced abroad—a strange confluence of principles of federalism, comity, and Erie doctrine—and discusses recent cases of judgment unenforceability against Chinese parties. More importantly, however, the Comment seeks to provide professionals with practical advice in how to plan ahead when transactions involve foreign parties.

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INTRODUCTION

Globalization has provided a host of benefits to countries around the world and offers an increasingly vast array of opportunities for investors of all kinds to choose from.[1] Nonetheless, any parties to an international project or deal must carefully consider a range of issues

1. *See, e.g.*, *Globalization: A Brief Overview*, INTERNATIONAL MONETARY FUND (May 2008), http://www.imf.org/external/np/exr/ib/2008/053008.htm.

and concerns.[2] Sovereignty remains a critical issue which overshadows all disputes that may result in judicial litigation between parties of diverse nationalities,[3] and investors and practitioners in the United States must remember that a money judgment which cannot be enforced is practically worthless.[4]

Nations' inclinations to enforce foreign judgments vary widely and often turn on a variety of factors.[5] This Comment principally focuses upon the notoriously difficult enforcement of U.S. money judgments ("USMJs") in China in light of the absence of a treaty of reciprocity for the enforcement of judgments. In particular, holders of USMJs are in a highly unenviable position when they discover that their Chinese adversaries have few to no assets in the United States and that they have few viable options in reducing their judgment into assets.[6]

Moreover, it appears that instances of judgment unenforceability are no longer discrete incidents as trade increases between the United States and China.[7] The net result of judgment unenforceability is a limitation on trade between both nations[8]—U.S. parties are less competitive when they must demand greater concessions to secure their interests from their Chinese counterparts, and Chinese parties are less attractive because such demands must be made in the first place.[9]

Part I of this paper first briefly discusses both the domestic and foreign enforcement of USMJs. Part II summarizes several cases where USMJ creditors have been stymied by the lack of judgment enforcement in China. Part III then discusses several major factors giving rise to judgment unenforceability in China, while Part IV discusses the

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2. *See, e.g.*, Matthew Murphy, *Knowing the Chinese Market: Key Tips for Attorneys Representing Foreign Clients Doing Business in China*, *in* BEST PRACTICES FOR INTERNATIONAL BUSINESS TRANSACTIONS IN CHINA (2011 ed.), *available at* 2011 WL 1572016.

3. *See* discussion *infra* Part II.

4. *See, e.g.*, Rainer Böhm & Julian Eberhardt, *The Enforcement of U.S. Judgments in Europe: A U.S. Judgment Won't Be Worth Much in Europe if You Can't Enforce It*, 21 NO. 3 PRAC. LITIGATOR 57 (2010) ("A multi-million dollar verdict is at long last worthless if it cannot be enforced in the country where the debtor's assets are located.").

5. *See* discussion *infra* Part I.B.

6. *See* discussion *infra* Part II.

7. *See generally* WAYNE M. MORRISON, CONGRESSIONAL RESEARCH SERVICE, CHINA-U.S. TRADE ISSUES 3 (2013), *available at* http://www.fas.org/sgp/crs/row/RL33536.pdf.

8. *See* discussion *infra* Part IV.

9. *See id.*

attendant ramifications. Finally, Part V provides some suggestions for practitioners to avert enforceability issues and a discussion of a broader policy solution through the ratification of a treaty for the mutual enforcement of judgments.

I. ENFORCEMENT OF UNITED STATES JUDGMENTS

Parties do not litigate for the privilege of obtaining a piece of paper from a judge; rather, it is what the paper represents that is critical—a judgment with the force of the law.[10] Accordingly, a judgment which cannot be enforced has little value.[11]

A. DOMESTIC DOCTRINE—THE FULL FAITH AND CREDIT CLAUSE

Domestic enforcement of USMJs is governed by the Full Faith and Credit Clause, which requires state courts to recognize and enforce the judgments of other states.[12] Thus, in theory, parties cannot avoid judgment enforcement simply by leaving the state where the judgment was issued. Indeed, in modern times, enforcement of USMJs within the United States has become relatively smooth.[13]

Additionally, USMJ enforcement in the United States is affected by an important corollary of the landmark federalism case *Erie R.R. Co. v. Tompkins*.[14] As all law students and legal professionals know in practice, if not by name, *Erie* doctrine holds that federal courts with subject-matter jurisdiction based solely on diversity jurisdiction must apply state law.[15] Thus, unless a federal statute is applicable, federal courts must apply state laws regarding judgment enforcement (foreign

10. *See* Böhm & Eberhardt, *supra* note 4.

11. *See id.*

12. U.S. CONST. art. IV, § 1.

13. *See* Melinda Luthin, *U.S. Enforcement of Foreign Money Judgments and the Need for Reform*, 14 U.C. DAVIS J. INT'L L. & POL'Y 111, 114 (2007) (discussing the history of the Full Faith and Credit Clause).

14. 304 U.S. 64 (1938).

15. *See id.* at 78 ("Except in matters governed by the Federal Constitution or by acts of Congress, the law to be applied in any case is the law of the state."); *see also* Somportex Ltd. v. Phila. Chewing Gum Corp., 453 F.2d 435, 440 (3d Cir. 1971) (holding that when "jurisdiction is based solely on diversity, 'the law to be applied . . . is the law of the state'") (citing *Erie*, 304 U.S. 64).

or domestic).[16] This feature of U.S. jurisprudence has important ramifications for the enforcement of foreign judgments in the United States and consequently for the enforcement of USMJs abroad.[17]

B. INTERNATIONAL DOCTRINE—COMITY AND TREATIES OF RECIPROCITY

Obviously, foreign nations are not obligated to enforce USMJs by the Full Faith and Credit Clause.[18] Instead, nations have traditionally enforced foreign judgments upon the principle of comity.[19] Indeed, the United States still operates in this manner, precisely because enforcement of judgments remains a state prerogative.[20]

1. Comity—Generally and in the United States

Comity has been described in a number of ways, but an exact definition is elusive.[21] As one leading commentator has explained, comity is both a bridge "meant to expand the role of public policy, public law, and international politics in domestic courts . . . between competing domestic and foreign public policies," and a wall,

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16. *See* FED. R. CIV. P. 69(a) ("The procedure on execution—and in proceedings supplementary to and in aid of judgment or execution—must accord with the procedure of the state where the court is located, but a federal statute governs to the extent it applies.").

17. *See* discussion *infra* Part I.B.

18. Nevertheless, U.S. parties litigating abroad often seem to forget this detail. *See* Rich Kuslan, *What Happens When Your Chinese Supplier Says: Sure, Go Ahead, Sue Me!*, ASIABIZBLOG (July 17, 2007), http://www.asiabizblog.com/archives/2007/07/what_happens_wh.htm.

19. *See generally* Joel R. Paul, *Comity in International Law*, 32 HARV. INT'L L.J. 1 (1991) (discussing the history and evolution of comity internationally).

20. The Full Faith and Credit Clause does not bind states to enforce foreign country judgments. *See Somportex*, 453 F.2d at 440 (distinguishing between domestic judgments, "which are entitled to full faith and credit, and those of foreign courts, which are subject to principles of comity") (citations omitted). In practice, however, states often do enforce foreign country judgments. *See* Brandon B. Danford, Note, *The Enforcement of Foreign Money Judgments in the United States and Europe: How Can We Achieve A Comprehensive Treaty?*, 23 REV. LITIG. 381, 424 (2004) (explaining that state law continues to govern the enforcement of foreign judgments in the absence of a federal law or a treaty); discussion *infra* note 32 and accompanying text; *see also* discussion *supra* Part I.A.

21. *See* Paul, *supra* note 19, at 3–4 (providing numerous examples of attempts to define comity).

"containing and delimiting the public domain of the forum state's law."[22] At its core, comity is a principle that addresses the inherent tension between a state's own sovereignty and its respect and deference to the sovereignty of other states.[23]

Hilton v. Guyot was the seminal U.S. case discussing comity.[24] There, the Court stated that

> '[c]omity,' in the legal sense, is neither a matter of absolute obligation, on the one hand, nor of mere courtesy and good will, upon the other. But it is the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens, or of other persons who are under the protection of its laws.[25]

While *Hilton* is not binding authority for state courts because of *Erie* doctrine,[26] comity nevertheless generally prevails as the method by which states enforce foreign judgments.[27] A further consequence of the absence of federal legislation in this area means that enforcement of

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22. *Id.*

23. *Id.* at 6 ("Although the state is an independent and supreme body within its own territory and over its own subjects, it is also an equal member of a community of nations, bound to respect the rights of other sovereigns, and thus not completely independent.").

24. 159 U.S. 113 (1895).

25. *Id.* at 164; *see also Somportex*, 453 F.2d at 440 ("Comity is a recognition which one nation extends within its own territory to the legislative, executive, or judicial acts of another. It is not a rule of law, but one of practice, convenience, and expediency. Although more than mere courtesy and accommodation, comity does not achieve the force of an imperative or obligation. Rather, it is a nation's expression of understanding which demonstrates due regard both to international duty and convenience and to the rights of persons protected by its own laws. Comity should be withheld only when its acceptance would be contrary or prejudicial to the interest of the nation called upon to give it effect.") (citing *Hilton*, 159 U.S. 113).

26. *See* discussion *supra* notes 14-17 and accompanying text; *see also* RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 481 cmt. a (1987) (noting that barring a treaty, "recognition and enforcement of foreign country judgments is a matter of State law" under the *Erie* doctrine).

27. *See, e.g.*, Johnston v. Compagnie Generale Transatlantique, 242 N.Y. 381, 386–87 (1926) (holding that *Hilton* is not binding authority, but nonetheless applying the principles of comity discussed therein).

foreign judgments is governed by a dizzying myriad of interpretations of state law by both state and federal courts.[28]

2. Moving Away From Comity Towards Treaties

Due to the uncertainty surrounding comity, nations have increasingly enacted treaties of reciprocity for the mutual recognition and enforcement of judgments.[29] However, because federalism prevents the United States from enacting a uniform judgment enforcement regime,[30] and because the Constitution prohibits states from negotiating treaties with foreign nations,[31] the United States has few official treaties of reciprocity. Thus, while states within the United States generally honor the judgments of foreign nations,[32] courts of foreign nations may not do the same for USMJs.[33] Recognition and enforcement of USMJs in the absence of a treaty of reciprocity varies by nation;[34] China, for example, has a reputation for refusing enforcement of USMJs.[35]

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28. Ronald A. Brand, *Enforcement of Judgments in the United States and Europe*, 13 J.L. & COM. 193, 197 (1994).

29. *See* Samuel P. Baumgartner, *How Well Do U.S. Judgments Fare in Europe?*, 40 GEO. WASH. INT'L L. REV. 173, 227 (2008) (discussing the trend toward increasingly liberalized treaties of reciprocity); *see also* Vishali Singal, Note, *Preserving Power Without Sacrificing Justice: Creating an Effective Reciprocity Regime for the Recognition and Enforcement of Foreign Judgments*, 59 HASTINGS L.J. 943, 954–55 (2008) ("As of 2001, at least seven major U.S. trading partners—Mexico, England, Canada, China, Japan, Spain and Germany—require reciprocity to some degree before they will recognize and enforce a [USMJ].") (citing ASS'N OF THE BAR OF THE CITY OF N.Y., SURVEY ON FOREIGN RECOGNITION OF U.S. MONEY JUDGMENTS 18–20 (2001)).

30. *See* discussion *supra* notes 14-17 and accompanying text.

31. U.S. CONST. art I, §10.

32. *See* Volker Behr, *Enforcement of U.S. Money Judgments in Germany*, 13 J.L. & COM. 211, 223 (1994) (noting that "reciprocity is generally guaranteed in the United States").

33. *See* Russell J. Weintraub, *How Substantial Is Our Need for a Judgments-Recognition Convention and What Should We Bargain Away to Get It?*, 24 BROOK. J. INT'L L. 167, 168 (1998) (explaining that while states will generally enforce foreign judgments, "there is a perception that this favor is not reciprocated abroad").

34. *See* ASS'N OF THE BAR OF THE CITY OF N.Y., SURVEY ON FOREIGN RECOGNITION OF U.S. MONEY JUDGMENTS 18–20 (2001) [hereinafter NYC BAR SURVEY] ("Without reciprocity, many of the [nations surveyed] will not recognize a USMJ."); *see also* Weintraub, *supra* note 33, at 220 (listing cases and articles which discuss foreign judgment enforcement practices in different countries).

35. *See* Carlyn Kolker, *U.S. Lawsuits Against China Companies Face Hurdles*, REUTERS, Feb. 14, 2011, http://www.reuters.com/assets/print?aid=

It appears that, for much of the twentieth century, U.S. parties relied upon the United States' prominent role in international trade to ensure the good faith of foreign parties.[36] A foreign company with significant assets in the United States disobeys U.S. courts at its peril precisely because USMJ creditors may attach assets wherever located in the United States.[37] Now, however, as the role of other nations grows, a foreign party may have little incentive to litigate in the United States if it knows that an adverse judgment cannot be effectively satisfied against it without recourse to its home courts, where enforcement would be wanting.[38] This is a serious problem which has arisen for creditors who hold USMJs against Chinese parties.

II. CASES OF JUDGMENT UNENFORCEABILITY IN CHINA

The following cases serve as examples of the unenforceability of USMJs in China. In each case, the Chinese parties have few assets in the United States and have generally been uncooperative during litigation, if they participate at all—this is a logical consequence of when parties believe that adverse judgments will be unenforceable against them.[39]

USN1429211020110214 (quoting an attorney who has practiced in China for over 30 years: "To date I am not aware of a single case where a United States judgment has been enforced in China"); *see also* Dan Harris, *Will Your US Judgment Be Enforced Abroad? Not China, but Maybe.*, CHINA LAW BLOG (Mar. 5, 2009), http://www.chinalawblog.com/2009/03/will_your_us_judgment_be_enfor.html ("[T]here is no reason to [seek enforcement of a USMJ in China] because they have no value there.").

36. *See Leveling the Playing Field and Protecting Americans: Holding Foreign Manufacturers Accountable: Hearing Before the Subcomm. On Admin. Oversight and the Courts of the Comm. on the Judiciary*, 111th Cong. 16 (2009) (statement of Louise Ellen Tietz, Professor, Comm. on the Judiciary) [hereinafter *Hearing on Holding Foreign Manufacturers Accountable*] ("Once upon a time, [enforcement] was not quite as bad because foreign companies generally had assets in the U.S. so you could enforce a judgment you got here against one of them here. But that, of course, has changed. With a click of the mouse, one can move assets offshore and then you are stuck.").

37. *See* Friedrich K. Juenger, *A Hague Judgments Convention?*, 24 BROOK. J. INT'L L. 111, 114 (1998) (concluding that "the problem of recognizing American judgments abroad tends to arise only in the event that the defendant is a fairly small business or an individual."). *But see* discussion *infra* note 137 and accompanying text.

38. *See, e.g.*, *infra* note 138 and accompanying text.

39. *See* Jessica Seah, *Decline in Securities Litigation Against U.S.-listed Chinese Companies*, THE ASIAN LAWYER, Jan. 30, 2013, www.law.com/corporatecounsel/

A. VISIONCHINA

1. Facts of the Dispute

In the VisionChina case, a pair of private equity funds has been unable to recover payments due to them under contract from VisionChina Media Inc. ("VisionChina"), a publicly-traded company incorporated in the Cayman Islands with stock traded on the NASDAQ.[40] Importantly, VisionChina's operations as a major provider of digital advertising on public transportation are exclusively based in China,[41] as are the majority of its assets.[42] Digital Media Group Company Limited ("DMG") was a competing digital advertising company, with its primary business operations also located in China.[43] DMG's primary shareholders (and the plaintiffs in the now-main case) were the U.S. venture capital firms Gobi and Oak ("Gobi-Oak").[44]

By the end of September 2009, DMG and VisionChina had outlined the major provisions of a Merger Agreement.[45] VisionChina began conducting its diligence, including meeting with the executives of DMG.[46] Under the final Merger Agreement, VisionChina would pay $100 million in cash and stock at closing, and an additional $60 million in cash and stock in two payments over the next two years.[47]

While VisionChina paid the initial $100 million, it notified Gobi-Oak in late 2010 that it would not be paying the remainder, citing breach

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PubArticleFriendlyCC.jsp?id=1359299346689 (quoting Jerome Fortinsky, a Shearman & Sterling attorney: "Chinese defendants who do not have assets in the U.S. are in a position where they can think about simply not engaging in the litigations. . . . *If they only have interests in China, or have no interest in expanding in the U.S., they can simply choose not to engage in litigation.*") (emphasis added).

40. *See* Defendants' Answer, Affirmative Defenses, and Counterclaims at ¶ 102, VisionChina Media Inc. v. S'holder Representative Servs., LLC, No. 650526/2011 (N.Y. Sup. Ct. Mar. 17, 2011) [hereinafter VisionChina Answer].

41. *See* Decision and Order on Motion at 3, VisionChina Media Inc. v. S'holder Representative Servs., LLC, No. 652390/10 (N.Y. Sup. Ct. Oct. 12, 2011) [hereinafter Preliminary Decision].

42. *See* VisionChina Answer, *supra* note 40, at ¶¶ 102–03.

43. *See* Preliminary Decision, *supra* note 41, at 3.

44. *See* VisionChina Answer, *supra* note 40, at ¶¶ 105–08.

45. *See* Preliminary Decision, *supra* note 41, at 4.

46. *See id.* at 4–5.

47. *See id.* at 6. The Merger Agreement also contained an indemnity clause which was to be "VisionChina's 'exclusive post-closing remedy.'" *Id.*

of contract and misrepresentations in the Merger Agreement.[48] Shortly thereafter, each party commenced a separate suit in New York State Court (the "VisionChina Action"[49] and the "Shareholder Representative Action"[50]).

2. The Preliminary Decision

The court subsequently issued a Preliminary Decision in the VisionChina Action, effectively dismissing the VisionChina Action.[51]

The court also granted Gobi-Oak's motion for an order to attach VisionChina's assets.[52] The court found that it was "more likely than not" that Gobi-Oak would prevail in the litigation,[53] and that it was possible that VisionChina would not satisfy any judgment made against it because the majority of its assets were located in China.[54] In particular, the court made specific reference to VisionChina's own filings with the U.S. Securities & Exchange Commission ("SEC") which noted that parties might have difficulty enforcing judgments against it in China,[55] and recognized that this was exacerbated by the fact that there is no treaty between the United States and China providing for the mutual enforcement of judgments.[56] In light of these considerations, the court levied $60 million against VisionChina in two separate Attachment Orders, one for each deferred payment under the Merger Agreement.[57] The court later ordered VisionChina to transfer the $60

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48. *See id.* at 7–8. Soon after the closing of the merger, auditors produced a report showing DMG's total revenue to be much lower than reported by DMG's executives and which "made clear that DMG was actually on a downward, rather than upward, trend." *Id.* at 7. However, VisionChina did not act on this information or raise concerns until its notice to withhold payment in late 2010. *See id.* at 7–8.

49. VisionChina Media Inc. v. S'holder Representative Servs., LLC, No. 652390/10 (N.Y. Sup. Ct. Dec. 27, 2010).

50. S'holder Representative Servs., LLC v. VisionChina Media Inc., No. 650526/11 (N.Y. Sup. Ct. Feb. 25, 2011).

51. *See* Preliminary Decision, *supra* note 41, at 16.

52. *See id.* at 21.

53. *Id.* at 19.

54. *See id.* at 20.

55. *Id.*

56. *Id.*

57. *See id.* at 24; Order of Attachment at 2–3, S'holder Representative Servs., LLC v. VisionChina Media Inc., No. 650526/11 (N.Y. Sup. Ct. Dec. 1, 2011) [hereinafter Order of Attachment].

million in assets into an escrow account by August 21, 2012 (the "Transfer Order").[58]

3. Order for Contempt

By the deadline, VisionChina had transferred only approximately $3.2 million into the escrow account, which VisionChina claimed was the majority of its non-China holdings.[59] As a result, in mid-October 2012, Gobi-Oak filed a motion to hold VisionChina in contempt for deliberately failing to transfer sufficient assets.[60] In response, VisionChina asserted that it had done all it could.[61] VisionChina first asserted that it had applied to the PRC's State Administration of Foreign Exchange ("S.A.F.E."),[62] which oversees foreign investment and transfers of currency, and whose approval would be required for any transfer of VisionChina's PRC assets.[63] The court ultimately found VisionChina in contempt in early February 2013, and ordered a fine of $250 and Gobi-Oak's counsel fees incurred in connection with the contempt order.[64]

4. Subsequent Appeal

In June 2013, the New York Appellate Division affirmed much of the lower court's decision, including the dismissal of VisionChina's

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58. *See* Order, S'holder Representative Servs., LLC v. VisionChina Media Inc., No. 650526/2011 (N.Y. Sup. Ct. July 31, 2012). VisionChina's appeal of the Transfer Order was denied. *See* Order Denying Motion to Stay, S'holder Representative Servs., LLC v. VisionChina Media Inc., No. M-3829 (N.Y. App. Div. Oct. 2, 2012).

59. *See* Defendants' Memorandum of Law in Opposition to Plaintiffs' Motion for Contempt at 1, S'holder Representative Servs., LLC v. VisionChina Media Inc., No. 650526/11 (N.Y. Sup. Ct. Nov. 1, 2012) [hereinafter Defendants' MOL].

60. *See* Affidavit of Thomas J. Kavaler in Support of Plaintiffs' Motion for Contempt, S'holder Representative Servs., LLC v. VisionChina Media Inc., No. 650526/11 (N.Y. Sup. Ct. Oct. 18, 2012).

61. *See* Defendants' MOL, *supra* note 59, at 9.

62. *See infra* note 117 and accompanying text.

63. *See* Defendants' MOL, *supra* note 59, at 1–2.

64. *See* Order to Punish for Contempt, S'holder Representative Servs., LLC v. VisionChina Media Inc., No. 650526/11 (N.Y. Sup. Ct. Feb. 1, 2013). VisionChina has since appealed the order for contempt. *See* Notice of Appeal, S'holder Representative Servs., LLC v. VisionChina Media Inc., No. 650526/11 (N.Y. Sup. Ct. Mar. 15, 2013).

actions and the summary judgment in favor of Gobi-Oak's breach of contract claims.[65]

Notably, however, the Appellate Division reversed the Attachment Order.[66] The Appellate Division found nothing in the record which indicated that S.A.F.E. would hinder an application by VisionChina to remit $60 million to Gobi-Oak.[67] Furthermore, the Appellate Division found nothing in the record indicating that VisionChina was "secreting property or removing it from New York," and also found that Gobi-Oak had not demonstrated that there was a "real identifiable risk" that VisionChina would be unable or unwilling to satisfy any adverse judgment against it."[68]

5. Conclusions

Regardless, as the lower court suggested, the need for the Attachment Orders and the Transfer Order would likely be obviated if U.S. judgments could be easily enforced in China (in this case, either the Transfer Order or else some future money judgment).[69] Instead, the court's concerns were realized, as VisionChina transferred only about $3 million into the escrow.[70] It is certainly possible that VisionChina was hindered by China's bureaucracy[71] and was unable to meet the tight deadlines established by the court.[72] On the other hand, VisionChina had over a year to produce sufficient assets, made no other attempts to

65. VisionChina Media Inc. v. S'holder Representative Servs., LLC, 967 N.Y.S.2d 338, 342 (App. Div. 2013).

66. *Id.* at 347.

67. *Id.* at 346 (citations omitted).

68. *Id.* at 346–47 (citations omitted).

69. *See* Preliminary Decision, *supra* note 41, at 20.

70. *See* Memorandum of Law in Support of Plaintiffs' Motion for Contempt at 4, S'holder Representative Servs., LLC v. VisionChina Media Inc., No. 650526/11 (N.Y. Sup. Ct. Oct. 18, 2012); *see also* Judgment for Partial Summary Judgment, S'holder Representative Servs., LLC v. VisionChina Media Inc., No. 650526/11 (N.Y. Sup. Ct. July 16, 2013) (awarding over $71 million to Gobi-Oak, which was not reduced by any escrow amounts, once the Appellate Division reversed the attachment orders).

71. An admittedly serious problem, see discussion *infra* Part III.A.

72. However, it does not appear that VisionChina ever requested an extension of time to satisfy the Attachment Orders. *See* Reply Memorandum of Law in Support of Plaintiffs' Motion for Contempt at 6 n.4, S'holder Representative Servs., LLC v. VisionChina Media Inc., No. 650526/11 (N.Y. Sup. Ct. Feb. 1, 2013).

satisfy the Attachment Orders from its Chinese assets,[73] opposed Gobi-Oak's suggestion to establish an escrow account in China denominated in RMB,[74] and proposed no alternative solutions.[75] Whatever the reason, it seems increasingly unlikely that Gobi-Oak will recover its $60 million, at least through U.S. courts.[76]

B. SECURITIES LITIGATION

Chinese corporations have also been subjected to securities class action litigation in the United States. Since 2011, an increasing number of Chinese companies have come under scrutiny by investors and the SEC.[77] However, settlements in such cases are both less frequent and smaller than in average federal securities class action lawsuits.[78] Some practitioners believe that this is a direct result of the difficulties of litigating and enforcing judgments against Chinese companies,[79] with some pointing out that Chinese companies have little incentive to litigate in the United States if they have few assets outside of China and have no intentions of expanding.[80]

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73. The first attachment order was issued on October 12, 2011. *See* Preliminary Decision, *supra* note 41, at 24. The second attachment order was issued on December 1, 2011. *See* Order of Attachment, *supra* note 57. The order for contempt was officially issued on February 1, 2013. *See* Order to Punish for Contempt, S'holder Representative Servs., LLC v. VisionChina Media Inc., No. 650526/11 (N.Y. Sup. Ct. Feb. 1, 2013).

74. *See* Defendants' MOL, *supra* note 59, at 14.

75. *See* Reply Memorandum of Law in Support of Plaintiffs' Motion for Contempt at 4, S'holder Representative Servs., LLC v. VisionChina Media Inc., No. 650526/11 (N.Y. Sup. Ct. Feb. 1, 2013).

76. Moreover, there are no known pending suits in China against VisionChina, which may indicate a lack of confidence in that nation's judicial system. *See* discussion *infra* Part III.B.

77. *See* Matthew Close, *Securities Litigation Against Chinese Companies: Next Stop Canada?*, BLOOMBERGLAW.COM, http://about.bloomberglaw.com/practitioner-contributions/litigation-against-chinese-companies/ (last visited Oct. 7, 2013).

78. *See* Seah, *supra* note 39.

79. *See, e.g.*, *id.* ("Mimi Yang, a Shanghai-based litigation counsel at Ropes & Gray, attributes the smaller settlements to the difficulty of litigating against Chinese companies. *She calls it the 'China discount,' explaining, 'It is very hard to enforce a U.S. judgment on China soil.*'") (emphasis added).

80. *See, e.g.*, *id.* (quoting Jerome Fortinsky, a Shearman Sterling attorney: "Chinese defendants who do not have assets in the U.S. are in a position where they can think about simply not engaging in the litigations. . . . *If they only have interests in China, or have no interest in expanding in the U.S., they can simply choose not to engage in litigation.*") (emphasis added).

1. ZST Digital Networks—California Litigation

A recent example has revolved around ZST Digital Networks, a Delaware corporation with its main offices in China.[81] ZST primarily supplies digital cable equipment and provides GPS services in China.[82] In October 2009, ZST filed registration documents with the SEC for an initial public offering that same month.[83] Over the next several years, ZST suffered from attacks by short-sellers and the resignation of its auditors.[84] Finally, in April 2011, shareholders filed a securities class action in the U.S. District Court for the Central District of California (the "California Action").[85] The complaint alleged that ZST had issued materially false and misleading information in its offering documents and SEC filings.[86] Eventually, the California Action was settled in March 2013, with the settlement finalized in August 2013.[87]

2. ZST Digital Networks—Delaware Litigation

While the California Action was underway, other shareholders brought a separate action against ZST in Delaware Court of Chancery,[88] demanding access to the company's books and records (the "Delaware Action").[89] As with the California Action, the plaintiffs in the Delaware Action sought access to company documents due to the allegations of fraud and concerns regarding changes in management.[90]

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81. *See* Complaint at ¶ 13, Scott v. ZST Digital Networks, Inc., No. 11-03531 (C.D. Cal. Apr. 25, 2011) [hereinafter ZST California Complaint].

82. *See id.*

83. *See id.* at ¶¶ 1–4.

84. *See* Michael Rapoport, *Novel Relief for China Woes*, WALL ST. J., Mar. 31, 2013, http://online.wsj.com/article/SB10001424127887324883604578394543306948924.html (summarizing the facts of the case and the decision).

85. *See* Scott v. ZST Digital Networks, Inc., No. 11-03531 (C.D. Cal. Apr. 25, 2011).

86. *See* ZST California Complaint, *supra* note 81, at ¶ 7.

87. *See* Memorandum & Order Regarding Motions for Final Approval of Class Action Settlement, Award of Attorney's Fees, and Reimbursement of Expenses, Scott v. ZST Digital Networks, Inc., No. 11-3531 (C.D. Cal. Aug. 5, 2013).

88. C.A. No. 8014 (Del. Ch. 2012).

89. *See* Verified Complaint for Inspection of Books and Records Pursuant to 8 Del. C. § 220, Deutsch v. ZST Digital Networks, Inc., C.A. No. 8014 (Del. Ch. Nov. 7, 2012).

90. *See id.* at ¶ 28.

On December 11, 2012, the court in the Delaware Action entered a final order requiring ZST to provide plaintiffs with access to books and records.[91] After failing to comply with the court's order, the court held ZST in contempt and granted the lead plaintiff a put option against the company's shares, which have continued to plunge.[92] As one professional explained, "[t]his likely is a strategy that provides paper satisfaction but no substantive satisfaction or relief for U.S. investors."[93] In fact, some professionals believe that there is an increasing trend among troubled Chinese companies to allow their U.S.-based securities to lose value so that they can be privately acquired at a lower cost.[94]

Perhaps more significantly, the court also appointed a receiver to access ZST's books and to obtain and liquidate property for the plaintiffs.[95] As of May 2013, the receiver claimed to have obtained control of ZST subsidiaries abroad and access to bank accounts in Hong Kong.[96] The receiver was also looking to access bank accounts in China.[97] Prior to that, the ZST receiver had obtained access to financial records in New York from ZST's auditor and from its executives.[98] The receiver has stated that he has sought to recover abroad assets on "multiple fronts."[99] While unclear if the receiver will ultimately be able to transfer ZST's assets back to the United States, the Court of Chancery's solution signals a possible alternative for U.S. parties seeking to enforce their judgments abroad.[100]

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91. *See* Final Order, Deutsch v. ZST Digital Networks, Inc., C.A. No. 8014 (Del. Ch. Dec. 11, 2012).

92. *See* Rapoport, *supra* note 84.

93. *Id.*

94. *See id.*

95. *See* Order Appointing Receiver, Deutsch v. ZST Digital Networks, Inc., C.A. No. 8014 (Del. Ch. Mar. 28, 2013).

96. *See* Rapoport, *supra* note 84.

97. *Id.*

98. *Id.*

99. *Id.*

100. Recently, ZST Digital has demonstrated a desire to settle the issue. The outcome of such discussions remains to be seen. *See* Michael Rapoport, *China's ZST Shows Willingness to Settle U.S. Investor's Suit*, WALL ST. J., Aug. 21, 2013, http://online.wsj.com/article/SB10001424127887323455104579017123633536390.html.

C. CHINESE DRYWALL CASES

A final example of judgment unenforceability against Chinese parties is the main Chinese Drywall case[101] where thousands of homeowners have complained of serious health issues and deterioration of their homes' infrastructure resulting from contaminated Chinese drywall.[102]

One lead case, *Germano v. Taishan Gypsum Co. Ltd.*, emerged in the United States District Court for the Eastern District of Louisiana.[103] As found by the court, Chinese drywall was used extensively in homes across the United States since as early as 2004.[104] Soon thereafter, homeowners started to complain of significant corrosion in their homes, as well as emissions of gases, followed by complaints of illnesses.[105] Once it was determined that the Chinese drywall was to blame, actions were filed in various state and federal courts, and eventually consolidated in Louisiana.[106]

Among the parties complained against were the Chinese manufacturer, European affiliates, and U.S. distributors.[107] Because the Chinese manufacturer did not appear in the litigation, the court granted a default judgment against it.[108] The court discussed and determined the damages due to various individual plaintiffs, ultimately awarding over $2.6 million in damages.[109]

However, as this Comment has discussed, receiving a judgment and enforcing a judgment are two very different issues. While settlements have been reached with both the U.S. distributor of the drywall[110] and,

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101. *See In re* Chinese Manufactured Drywall Prods. Liab. Litig., 706 F. Supp. 2d 655 (E.D. La. 2010).

102. *See* Leslie Wayne, *Thousands of Homeowners Cite Drywall for Ills*, N.Y. TIMES, Oct. 8, 2009, http://www.nytimes.com/2009/10/08/business/08drywall.html?pagewanted=all&_r=0. A great deal of ancillary litigation concerning defective Chinese drywall has developed, principally regarding insurance coverage.

103. 706 F. Supp. 2d 655 (E.D. La. 2010).

104. *See id.* at 659.

105. *See id.*

106. *See id.*

107. *See id.*

108. *See id.*; *see also* Arthur F. Roeca, *Damages in Toxic Tort Litigation*, *in* 2 TOXIC TORTS PRACTICE GUIDE § 23:14 (James T. O'Reilly ed., 2012).

109. *See* 706 F. Supp. 2d at 713.

110. *See* Katheryn Hayes Tucker, *Stinky Settlement: Lowe's to Pay $6.5M to Settle Claims Over Smelly Drywall*, CORPORATE COUNSEL (Aug. 18, 2010),

perhaps more significantly, a German affiliate of the Chinese manufacturer,[111] commentators generally agree that no plaintiffs are likely to recover from the Chinese manufacturers' Chinese assets.[112] Furthermore, there are no indications that these judgments have been or will be enforced in China.[113]

It thus seems plausible that these cases (and their attendant costs) would largely be obviated if the Chinese corporations had significant attachable assets in the United States.

III. FACTORS GIVING RISE TO JUDGMENT UNENFORCEABILITY IN CHINA

Foreign corporations have historically encountered numerous difficulties while doing business in China,[114] and judgment

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http://www.law.com/corporatecounsel/PubArticleCC.jsp?id=1202470199576&slreturn=20130220151906; *see also* Jef Feely & Allen Johnson Jr., *Chinese Drywall Maker to Pay Homeowners to Settle Contamination Lawsuits*, BLOOMBERG (Dec. 15, 2011), http://www.bloomberg.com/news/2011-12-15/chinese-drywall-maker-knauf-plasterboard-agrees-to-800-million-settlement.html (discussing the settlements paid by a German subsidiary of a Chinese drywall company in a related action).

111. *See* Feely & Johnson Jr., *supra* note 110; *see also* Allen Johnson Jr. & William McQuillen, *Chinese Drywall Accord to Repair Damaged Homes Wins U.S. Judge's Approval*, BLOOMBERG (Oct. 14, 2010), http://www.bloomberg.com/news/2010-10-14/chinese-drywall-accord-endorsed-by-judge-knauf-to-help-repair-300-houses.html.

112. *See* Andrew Martin, *Turning Point for Suits Over Chinese Drywall*, N.Y. TIMES, Oct. 12, 2012, http://www.nytimes.com/2012/10/13/business/chinese-drywall-lawsuits-at-a-turning-point.html?pagewanted=all; *see also Hearing on Holding Foreign Manufacturers Accountable*, *supra* note 36 ("[S]o many of the manufacturers have no assets in the U.S.").

113. *See generally* Dan Harris, *Chinese Drywall Cases. Show Me the Money!*, CHINA LAW BLOG (Apr. 21, 2009), http://www.chinalawblog.com/2009/04/chinese_drywall_taint_no_big_t.html ("US judgments are of virtually no value in China. Put simply, Chinese courts simply do not recognize them for anything. They cannot be converted to a Chinese judgment and they are not even evidence of anything. . . . Nothing has changed [in the drywall cases] and I cannot see how a US judgment against a Chinese drywall manufacturer will have any value, unless the Chinese drywall manufacturer has assets in the United States or in some third country that will enforce the US judgment.").

114. *See* Laurie Burkitt & Paul Mozur, *Foreign Firms Brace for More Pressure in China*, WALL ST. J., Apr. 4, 2013, http://online.wsj.com/news/articles/SB10001424127887323916304578400463208890042; *see also* The World Bank, *Economy Rankings,* DOING BUSINESS, http://www.doingbusiness.org/rankings (last

unenforceability may be yet another.[115] If U.S. parties could easily satisfy their judgments in China, it is likely that the cases discussed in Part II would have been resolved. This, however, is not the case, and several factors may explain why.

A. BUREAUCRACY AND PROTECTIONISM

A long cited difficulty of doing business in China has been navigating its bureaucracy,[116] which hinders the transfer of assets and impedes judgment enforcement. For example, one could plausibly accept VisionChina's assertions that it was hampered by the Chinese bureaucracy from transferring assets offshore to satisfy the Attachment Orders (or, later, an adverse judgment).[117] Bureaucratic interference is pervasive at all levels of the Chinese government, not the least of which is due to the fact that the government owns many companies important to their local communities,[118] and because of the broad discretion Chinese agencies are afforded for the interpretation of law.[119] As a result, China's bureaucracy creates obstacles to enforcement and raises

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visited Sept. 27, 2013); Linette Lopez, *The 10 Biggest Problems With Doing Business In China*, BUSINESS INSIDER, Oct. 24, 2011.

115. *See* Arthur Anyuan Yuan, *Enforcing and Collecting Money Judgments in China From a U.S. Judgment Creditor's Perspective*, 36 GEO. WASH. INT'L L. REV. 757, 758 (2004) (explaining that the "enforcement of foreign judgments in China has been notoriously difficult in recent years," and that a "large percentage of judgments, both domestic and foreign, are never enforced"); *see also* Kolker, *supra* note 35; Kuslan, *supra* note 18 ("Don't expect you can take an American judgment against a Chinese company to China and sue upon it. Your American judgment will not be recognized.").

116. *See* Stanley Lubman, *Looking for Law in China*, 20 COLUM. J. ASIAN L. 1, 41 (2006) ("The arbitrariness of China's bureaucracy is legendary among all who have encountered it, foreign and Chinese alike."); *see also* Josh Brown, *Bureaucracy In China an Issue but Profits Good*, WASH. TIMES, Mar. 22, 2011, http://www.washingtontimes.com/news/2011/mar/22/bureaucracy-in-china-an-issue-but-profits-good/.

117. *See State Administration of Foreign Exchange,* GOV.CN (Dec. 22, 2009), http://english.gov.cn/2005-10/09/content_75318.htm (one of S.A.F.E.'s principal duties is to regulate "foreign exchange transactions under capital account[s]").

118. *See* Mo Zhang, *International Civil Litigation in China: A Practical Analysis of the Chinese Judicial System*, 25 B.C. INT'L & COMP. L. REV. 59, 91 (2002) (explaining the impact of "government interference in favor of state-owned enterprises," which "may not sell or be forced to sell [their] assets to satisfy a court judgment").

119. *See* Lubman, *supra* note 116, at 41.

tremendous legal uncertainty for both foreign and domestic parties.[120] As will be discussed, this uncertainty increases the costs for parties doing business with China.[121]

A related problem in China has been protectionism, both by courts and agencies.[122] Indeed, there are indications that protectionism is an important reason why judgments (foreign and domestic) go unenforced in China.[123] Indeed, only about 20-50% of *Chinese* judgments are enforced in China[124] —it stands to reason that foreign judgments are even less likely to survive.[125] And in fact, commentators have cited protectionism as the main reason that U.S. parties have had difficulties in recovering in the Chinese Drywall cases.[126]

B. LEGAL SYSTEM

Related to both bureaucracy and protectionism, China is also infamous for its labyrinthine judicial process.[127] Chinese courts have

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120. *See id.* at 42 (positing that the main aspects of Chinese bureaucracy that promote legal uncertainty are personalized rule throughout the government hierarchy and the fragmented nature of the bureaucracy).

121. *See* discussion *infra* Part IV.

122. *See* Francisco Soler Caballero, *The New Environment in China: Adapting to the Changes in International Business Transactions*, *in* BEST PRACTICES FOR INTERNATIONAL BUSINESS TRANSACTIONS IN CHINA, (2011 ed.), *available at* 2011 WL 1572015. Of course, protectionism is a problem not limited to China, and may also provide China with more costs than benefits. *See generally* Robert W. McGee, *The Cost of Protectionism: Should the Law Favor Producers or Consumers?*, 23 GA. J. INT'L & COMP. L. 529, 555 (1993) (discussing the numerous costs for countries which enact protectionism policies, including "reduced standard[s] of living," lost employment, and social costs).

123. *See, e.g.*, Donald C. Clarke, *Power and Politics in the Chinese Court System: The Enforcement of Civil Judgments*, 10 COLUM. J. ASIAN L. 1, 41 (1996) ("Local protectionism is far and away the most frequently mentioned obstacle [to enforcement of Chinese civil judgments].").

124. *See id.* at 28 (finding that enforcement of domestic judgments in China stood at about 20-50%).

125. *See id.*

126. *See* 124 AM. JUR. *Trials* § 31 (2012) (noting that the few feasible remedies available to the Chinese Drywall plaintiffs are "extremely expensive [to obtain]" because "the process is difficult and cumbersome to American plaintiff's lawyers who are unfamiliar with the [relevant] laws and protocols," and that, moreover, the Chinese manufacturers may be protected by sovereign immunity) (footnotes omitted).

127. *See* Yuan, *supra* note 115, at 763 (noting that to "many foreigners (and probably to many Chinese as well), the People's Courts are mysterious, arbitrary, and unpredictable," and that it "would not be fair to blame foreigners for being 'biased,' as

been accused of abuses of discretion[128] and a general lack of independence.[129]

Chinese courts have similarly been accused of protectionism when refusing to enforce foreign judgments, particularly because recognition must first be made at the local level.[130] The inherent differences (and therefore, assumptions) between the judicial systems of the United States and China further exacerbate the issue of judgment unenforceability.[131]

USMJs may also be difficult to enforce because the United States and China do not have a treaty of reciprocity for the mutual enforcement of judgments.[132] This thesis holds particular weight because the absence of such a treaty is often cited as a reason denying enforcement of a judgment,[133] and because arbitration awards are generally enforced in China.[134]

Bureaucracy, protectionism, and a convoluted judicial system are well-known difficulties of doing business with China, and a number of other factors may contribute as well.[135] Moreover, even if a USMJ

Chinese law, especially in the context of enforcement of foreign judgments, is often sketchy, skeletal, and replete with ambiguity").

128. *See* Zhang, *supra* note 118, at 92 (explaining that lower courts will abuse their discretion, even in the enforcement of arbitral awards).

129. *See id.* (discussing the lack of judicial independence in China).

130. *See id.* at 91; *see also* NYC BAR SURVEY, *supra* note 29, at 25 ("[A] separate proceeding [at a local court] appears to be required before the recognition proceeding can be instituted.").

131. *See* Yuan, *supra* note 115, at 768 ("Because China is essentially a country with a civil-law tradition the basic understanding of the U.S.'s common law legal system should not be assumed.").

132. *See* Preliminary Decision, *supra* note 41, at 20; *supra* note 56 and accompanying text.

133. *See* NYC BAR SURVEY, *supra* note 29, at 19 ("If there is no [treaty of] reciprocity, the Chinese court can refuse to recognize the USMJ.").

134. Dan Harris, *Arbitration in China. Get Used to it*, CHINA LAW BLOG (Sept. 22, 2011) http://www.chinalawblog.com/2011/09/arbitration_in_china.html [hereinafter Harris, *Arbitration in China*] (explaining that "Chinese courts will almost certainly enforce your arbitration award by converting it into a court judgment").

135. *See* Yuan, *supra* note 115, at 758–59 (listing other factors that may give rise to judgment unenforceability, such as "the lack of judicial independence in China, . . . the unimaginable social consequences of bankrupting state-owned enterprises (SOEs), [and] the paucity of necessary legal provisions curbing debtor fraud and facilitating judgment collection").

creditor somehow bypasses all of these issues, Chinese parties can easily hide within China itself by transferring assets between bank accounts.[136]

The cases discussed in Part II are yet another reminder of the costs of doing business in China. However, these costs will not go unnoticed forever, and judgment unenforceability presents serious ramifications for business between the United States and China.

IV. RAMIFICATIONS OF JUDGMENT UNENFORCEABILITY

As trade and business increase between the United States and China,[137] incidents such as those discussed in Part II seem likely to rise as well.[138] However, as has been shown in Part III, USMJ creditors may encounter numerous difficulties when trying to satisfy their judgments against Chinese defendants.[139]

The net result of unenforceability is that Chinese parties in China are essentially judgment-proof. Some commentators have gone so far as to suggest that Chinese parties have taken advantage of this status by utilizing stalling tactics during litigation in the United States so that otherwise readily-attachable international assets can be transferred back to China.[140] It seems a rational (if disingenuous) choice to refuse to engage in, or to stall litigation, in the United States, if a Chinese corporation has little to lose by doing so.[141] For example, VisionChina

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136. *See* Zhang, *supra* note 118, at 91 (noting the difficulty in obtaining financial information about Chinese judgment debtors and who can easily evade judgments by transferring assets within the country).

137. *See* THE US-CHINA BUS. COUNCIL, CHINA AND THE U.S. ECONOMY: ADVANCING A WINNING TRADE AGENDA (2013), *available at* http://www.uschina.org/sites/default/files/uscbc-trade-agenda-report.pdf. China's growing importance in the global economy is clear. *See* Zhang, *supra* note 118, at 62 (noting that as China's economy expands, it has "generated more transnational business transactions and foreign investment").

138. *See generally* Dan Harris, *Why United States Lawsuits Against Chinese Companies Are Trending Up. Just Follow the Money.*, CHINA LAW BLOG (July 23, 2010) http://www.chinalawblog.com/2010/07/why_united_states_lawsuits_against_chinese_companies_are_trending_up_just_follow_the_money.html.

139. *See* discussion *supra* Part III.

140. *See* Dan Harris, *Chinese Drywall Litigation and Why Seizing Assets Is Very Different From Seizing Ships*, CHINA LAW BLOG (Feb. 28, 2010), http://www.chinalawblog.com/2010/02/chinese_drywall_and_the_halfas.html [hereinafter Harris, *Chinese Drywall Litigation*] (discussing possible defensive strategies that Chinese corporations may employ during U.S. litigation).

141. *See* Seah, *supra* note 39.

had few assets outside of China and was faced with a high likelihood of an adverse judgment.[142] It seems plausible that much of the escrow issue (and possibly, the case) could have been resolved had there been more attachable assets.[143] However, there is the worrying possibility that even those Chinese parties with significant U.S.-based assets may engage in stalling tactics during U.S. litigation to buy time to withdraw those assets.[144]

Ultimately, it is unlikely that individual Chinese parties will feel the effects of their actions. Instead, future parties (Chinese and U.S.) will bear the costs as a moral hazard problem develops.[145]

A. INCREASED TRANSACTION COSTS

As a general principle, economists favor the minimization of *unnecessary* transaction costs, which waste resources that may be better devoted elsewhere.[146] As discussed, transaction costs can arise from the uncertainty that is a consequence of unenforceability of judgments.[147]

It is clear that doing business with China can be quite difficult.[148] If business is further complicated because U.S. parties do not trust Chinese parties to satisfy their judgments, then transaction costs are likely to

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142. *See* Preliminary Decision, *supra* note 41, at 19.

143. *See generally id.*

144. *See* Harris, *Chinese Drywall Litigation, supra* note 140.

145. *See* Yuan, *supra* note 115, at 758 (noting that the "difficulty of enforcing foreign judgments has become a major concern of foreign business, and has diminished the confidence it may have had in China's judicial system").

146. *See generally* David M. Driesen & Shubha Ghosh, *The Functions of Transaction Costs: Rethinking Transaction Cost Minimization in a World of Friction*, 47 ARIZ. L. REV. 61, 105 (2005) ("We want to bring the parties to transactions together as cheaply as possible. In that sense, we do want to minimize transaction costs. But we want to reduce them to the lowest level needed to perform the function of facilitating sufficient communication to realize beneficial transactions. We do not really mean that we want to, or should, eliminate transaction costs. We mean that we want to realize transaction cost functions that we find important at the lowest possible price.").

147. *See, e.g.*, Jeff Sovern, *Toward A New Model of Consumer Protection: The Problem of Inflated Transaction Costs*, 47 WM. & MARY L. REV. 1635, 1644 n.30 (2006) (providing a compilation of articles defining and discussing transaction costs in the context of the Coase theorem); Michael I. Swygert & Katherine Earle Yanes, *A Primer On the Coase Theorem: Making Law in a World of Zero Transaction Costs*, 11 DEPAUL BUS. L.J. 1, 20 (discussing other sources of transaction costs).

148. *See* discussion *supra* note 114 and accompanying text.

rise.[149] Uncertainty and risk breed transaction costs, and judgment unenforceability is no different.[150] Because Chinese parties are effectively judgment-proof, mistakes made during transactions are more costly. Thus, more money must be expended to safeguard investments.[151] It also seems plausible that particularly wary investors would make these same demands of even those Chinese parties with significant easily-attachable assets.

Some commentators have labeled this phenomenon the "China discount."[152] The ultimate effect of this phenomenon is that U.S. parties become less competitive in China and Chinese parties become less attractive to U.S. investors.[153]

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149. *See* Friedrich Juenger, *The Recognition of Money Judgments In Civil and Commercial Matters*, 36 AM. J. COMP. L. 1, 4 (1988) [hereinafter Juenger, *Money Judgments*] (explaining that difficulties arising from recognition (and therefore, enforcement) of judgments "punishes private litigants and exacts a toll from international commerce," and therefore, to "protect their interests, parties engaged in multinational transactions must either resort to arbitration or insist on advance payments or guarantees, which increase the transaction costs of doing business abroad").

150. *See* Ramon E. Reyes, Jr., *The Enforcement of Foreign Court Judgments in the People's Republic of China: What the American Lawyer Needs to Know*, 23 BROOK. J. INT'L L. 241, 242 (1997) ("Creating a feeling of certainty and stability in law and procedure is necessary for a nation to succeed in encouraging foreign economic investment within its borders.").

151. *See* Yuan, *supra* note 115, at 782 (explaining that the additional measures that parties will be required to use to secure their assets "will surely increase the cost of doing business with China"). As an attorney for Gobi-Oak suggested, parties could try to demand the creation of an escrow account in the United States for the purposes of future payments (instead of relying on the Chinese party to pay out from its China-based assets), or insist on arbitration agreements, the awards of which will often be enforced in China. *See* discussion *infra* Part V.A.

152. *See* Seah, *supra* note 39; *see also supra* text accompanying note 78.

153. *See generally* David Patrick Eich, *Private Equity M&A In China*, *in* BEST PRACTICES FOR MERGERS AND ACQUISITIONS IN CHINA: LEADING LAWYERS ON UNDERSTANDING CHANGING LAWS AND TRENDS, NAVIGATING THE REVIEW AND APPROVAL PROCESS, AND IDENTIFYING THE KEY STEPS IN A SUCCESSFUL M AND A TRANSACTION (2008), *available at* 2008 WL 5689094 ("China is a highly regulated environment and serial acquirers that are familiar with M&A in more liberalized regulatory environments typically will be frustrated by the additional transaction costs entailed.").

B. ACCESS TO CAPITAL MARKETS

Companies in countries with a poor reputation of enforcing debts and judgments may find themselves facing barriers to access foreign capital.[154] As U.S. capital markets still seem to provide advantages that Chinese companies may wish to access,[155] it follows that a Chinese party which does not concede to a U.S. party's demands will be forced to accept less favorable terms (from that party or another) or else seek capital elsewhere.[156] This may be exacerbated by the fact that some U.S. financial institutions have been sued by USMJ creditors of Chinese companies, particularly in the securities litigation cases, for their failure to adequately investigate those companies.[157] These institutions may in turn demand greater disclosure from, or provide less favorable financing to, Chinese parties in the future.[158]

C. DIMINISHED ACCESS TO U.S. CONSUMERS

U.S. consumers, as in the Chinese drywall cases, also have some power over Chinese corporations who wish to sell to U.S. markets. Aside from greater product costs, which may result from using better materials, diminished profits from lowered margins, and outright

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154. *See generally* Charles K. Whitehead, *The Evolution of Debt: Covenants, the Credit Market, and Corporate Governance*, 34 J. CORP. L. 641, 652 (2009) ("A firm that repeatedly accesses the credit market has an economic interest to develop a reputation as a 'good' borrower. If the borrower can benefit (for example, through fewer covenants or a lower real cost of capital), then—even if not contractually obligated to do so—it has an incentive to act in a manner consistent with the lender's interests. Lenders may, in turn, begin to relax their reliance on covenants and monitoring in loans to borrowers with established reputations.").

155. *See* Seah, *supra* note 39 (noting that "certain Chinese companies, especially in the technology sector, may still see greater liquidity in the U.S., thanks to the larger U.S. investor and analyst community," and that it is "still easier to list in America than Asia").

156. *See* Yuan, *supra* note 115, at 782 (explaining that the difficulty in enforcing judgments in China "will naturally affect [foreign parties'] decision[s] to continue to invest in or trade with China").

157. *See* Seah, *supra* note 39 (discussing that USMJ creditors in securities litigation cases "have sought compensation from "investment banks that took U.S.-listed Chinese companies public" and "auditors that performed checks on disclosure").

158. *See generally id.* (noting that it may take time for United States investors "to regain confidence in Chinese companies").

product bans,[159] Chinese businesses may simply suffer from a negative reputation. Moreover, Congress has begun to investigate accountability issues with defective Chinese products.[160]

Thus, while it is possible that cases of USMJ unenforceability against Chinese parties may be discrete, increasing trade and business between the nations suggest otherwise.[161] Indeed, we may be seeing the ramifications of unenforceability already manifesting in the United States.[162]

V. SOLUTIONS TO UNENFORCEABILITY

Much of the problem of judgment unenforceability within China must be resolved by China itself. There is likely a limit to how much abuse international parties will take before withdrawing their business from China,[163] or before foreign governments interfere to protect their citizens' interests.[164] Judgment enforceability reform in China would also likely invite greater investment and international business by reducing transaction costs.[165] Fortunately, the United States and China appear to be cooperating on easing legal obstacles to business to some degree, such as through visiting programs for Chinese practitioners.[166]

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159. *See* Wayne, *supra* note 102 (noting that the Consumer Product Safety Commission has banned Chinese drywall from entering the U.S.).

160. *See, e.g.*, *Hearing on Holding Foreign Manufacturers Accountable*, *supra* note 36.

161. *See supra* note 137 and accompanying text.

162. *See* Seah, *supra* note 39 (noting that it may take time "for American investors to regain confidence in Chinese companies"); *see also* Yuan, *supra* note 115, at 782 ("[T]he failure to collect on judgments will generate direct losses for foreign parties, which will naturally affect their decision to continue to invest in or trade with China.").

163. *See* Linette Lopez, *A Group of American Investors Say They're Living a Nightmare Since They Sold Their Business to a Chinese Company*, BUSINESS INSIDER, Mar. 14, 2013 (quoting a general partner at Oak Investment Partners regarding the VisionChina case: "[I]f VisionChina does not meet its legal obligations, we believe China will be sending a message that it is a hostile, risky and unfair place for investment by foreign-owned businesses").

164. For example, the SEC has become involved in both the VisionChina and ZST Digital cases. *See, e.g.*, SECURITIES & EXCHANGE COMMISSION, *SEC Letter to VisionChina Requesting Financial Documents*, Dec. 14, 2012.

165. *See* discussion *supra* Part IV.A.

166. *See* U.S. DEP'T OF COMMERCE, FACT SHEET: 23RD U.S.-CHINA JOINT COMMISSION ON COMMERCE AND TRADE (Dec. 19, 2012) (describing the work of the U.S.-China Legal Exchange).

A. SOLUTIONS FOR PRACTITIONERS

1. Pre-Planning

Working with Chinese parties requires more careful forward planning and contract drafting than for comparable transactions in the United States.[167] For example, parties should seriously consider establishing escrow accounts outside of China from which payments would be disbursed.[168] This circumvents the problem of seeking to enforce money judgments in China by placing attachable assets elsewhere. Parties may also consider receiving full payments at closing (appropriately discounted), though cash flow limitations may obviously discourage such agreements.

2. Seizure of Assets

As has been discussed thoroughly throughout this Comment, enforcing a judgment against a Chinese party with few assets in the United States is a daunting task. However, seizure of assets nevertheless remains a possible (if unlikely) option—indeed, the efforts of the receiver in ZST may provide a valuable proof-of-concept for future parties.[169]

One practitioner has outlined several methods to attempt, such as by seizing assets that may be owed to the Chinese party by U.S. companies or by seizing assets in countries that will generally enforce USMJs.[170] Moreover, seeking enforcement of an arbitration award may prove to be more successful.

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167. *See* Janet Jie Tang, *What You Must Know Before Doing Mergers and Acquisitions in Mainland China*, *in* BEST PRACTICES FOR MERGERS AND ACQUISITIONS IN CHINA 1, 5 (2011 ed.), *available at* 2008 WL 5689090 ("[S]eeking solid legal advice is necessary in doing any China-based deal. Without full compliance with Chinese law, your deal may be challenged at any point of the transaction."). Nonetheless, additional transactions costs are preferable to litigation.

168. *See* Manuel E. Maisog, *Mergers and Acquisitions in China: Some Legal and Policy Perspectives for Business Strategists*, *in* BEST PRACTICES FOR MERGERS AND ACQUISITIONS IN CHINA 21 (2011 ed.), *available at* 2008 WL 5689095 ("Keep as much of the ownership and control structure offshore as possible.").

169. *See* discussion *supra* notes 95-99 and accompanying text.

170. Such as South Korea, Canada, or Hong Kong. *See* Dan Harris, *How to Collect on a U.S. Judgment Against a Chinese Company*, CHINA LAW BLOG (Aug. 17, 2010),

3. Arbitration Clauses

The inclusion of arbitration clauses is also recommended.[171] Arbitration has become the preferred mode of international commercial dispute resolution for a variety of reasons,[172] not least of which are the far greater enforceability of arbitral awards[173] and the greater likelihood that disputes will be resolved neutrally.[174] While there are some disadvantages inherent in the current paradigm of international commercial arbitration,[175] arbitration nonetheless remains the most effective means of keeping one's investments safe,[176] barring a major shift in U.S. and Chinese policy.

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http://www.chinalawblog.com/2010/08/how_to_collect_on_a_us_judgment_against_a_chinese_company.html.

171. *See generally* Harris, *Arbitration in China*, *supra* note 134.

172. *See* 81 AM. JUR. *Trials* § 3 (2001) ("Arbitration clauses are so commonly found in international contracts that the U.S. Supreme Court deemed them to be 'an almost indispensable precondition.'") (quoting Scherk v. Alberto-Culver Co., 417 U.S. 506, 507 (1974)).

173. *See* Eu Jin Chua, *The Laws of the People's Republic of China: An Introduction for International Investors*, 7 CHI. J. INT'L L. 133, 139 (2006) ("Arbitration also possesses a clear advantage over litigation [in China] as a result of the ability to enforce arbitration awards . . . ."); *see also* Am. Arbitration Ass'n, *New Study Reports Multinational Corporations Prefer International Arbitration to Litigation*, 61-JUL DISP. RESOL. J. 12, 12 (2006) (noting that among the most highly-rated reasons for preferring arbitration over litigation "is the enforceability of awards").

174. *See* 81 AM. JUR. *Trials* § 4 (2001). There are a number of other advantages to arbitration over litigation such as flexibility over procedures, informality, and greater likelihood of preservation of relationships. *See id.*

175. *See* Am. Arbitration Ass'n, *supra* note 173, at 12; *see also* 81 AM. JUR. *Trials* § 3 (2001) ("[D]isadvantages include the uncertainty of obtaining emergency interim relief, anxiety over a compromised result, limited discovery, difficulty in obtaining subpoenas, [and] narrow judicial review."). Studies also indicate that arbitration is generally only more cost-effective for larger and more complex cases. *See* Am. Arbitration Ass'n, *supra* note 173, at 12.

176. Of course, the effectiveness of arbitration is dependent on U.S. parties adhering carefully to the provisions outlined in their arbitration provisions. For example, even taking the seemingly innocuous and cautious action of answering a complaint in a Chinese judicial proceeding may invalidate an arbitration clause. *See* Chua, *supra* note 173, at 141 (discussing that the appropriate response in such a situation is to "challenge the jurisdiction of the court on the basis of the arbitration agreement").

B. TREATIES OF RECIPROCITY

As the VisionChina court noted, the United States and China do not have a treaty of reciprocity for the mutual enforcement of judgments.[177] In China (as with many other nations), the lack of such a treaty can be a reason to deny enforcement.[178] The absence of such a treaty also shifts the burden of demonstrating reciprocity onto U.S. parties,[179] who may have difficulty explaining the nuances of *Erie* doctrine to foreign courts.[180]

Ratification of such a treaty, however, could be difficult. A significant uncertainty is whether Congress truly has the constitutional power to ratify such treaties because of federalism concerns.[181] Bilateral and multilateral treaties have been proposed before (including with China) to no avail,[182] and the costs of ratifying a treaty may also arguably outweigh its benefits.[183] Some commentators also suggest that treaties of reciprocity with the United States are wanting because of the

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177. *See* Preliminary Decision, *supra* note 41, at 20.

178. *See* NYC BAR SURVEY, *supra* note 29, at 19–25 ("After a request to recognize a USMJ is made, the Chinese court will first enter its own judgment based on the principle of reciprocity. If there is no reciprocity, the Chinese court can refuse to recognize the USMJ.").

179. *See* Ronald A. Brand, *Enforcement of Judgments in the United States and Europe*, 13 J.L. & COM. 193, 200 (1994); *see also* Rachel B. Korsower, *Matusevitch v. Telnikoff: The First Amendment Travels Abroad, Preventing Recognition and Enforcement of a British Libel Judgment*, 19 MD. J. INT'L. L. & TRADE 225, 237 (1995) ("[T]he fact that the United States does not have a uniform federal law in this area makes it difficult for an American litigant to satisfy foreign reciprocity requirements.").

180. *See* Yuan, *supra* note 115, at 781.

181. *See* LOUIS HENKIN, FOREIGN AFFAIRS AND THE U.S. CONSTITUTION 238–39 (2d ed. 1996) (suggesting that an inevitable consequence of federalism is that states are charged with the enforcement of judgments); *see also* RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE U.S., *supra* note 26 (noting that, barring a treaty, "recognition and enforcement of foreign country judgments is a matter of State law" under the *Erie* doctrine).

182. *See, e.g.*, Letter from Edwin D. Williamson, Legal Advisor, U.S. Dep't of State, to Georges Droz, Secretary General, The Hague Conference (May 5, 1992) (Hague Conference Doc. No. L.c. ON No 15 (92)), *available at* http://www.state.gov/documents/organization/65973.pdf (proposing that the Hague Conference "resume work in the field of recognition and enforcement of judgments with a view to preparing a single convention to which Hague Conference Member States and other countries might become parties").

183. *See* Juenger, *Money Judgments*, *supra* note 149.

perception that U.S. courts too often grant excessive awards and disregard international law.[184] Finally, it is not obvious that China (or most nations) would even desire a treaty with the United States, because the status quo lies in their favor.[185]

Nonetheless, a treaty of reciprocity seems to be the most effective means of resolving the issue of judgment unenforceability in China.[186] While the constitutional issues remain unaddressed, the United States does have some treaties of reciprocity,[187] and any uniform law requiring enforcement could be restricted to foreign judgments (thus circumventing the federalism issues). Indeed, as Chinese judgments are already routinely enforced within the United States,[188] a uniform law would merely act as codification of the status quo.

The advantages of a treaty would also likely exceed its costs. Transaction costs will be reduced if there is greater certainty for both U.S. and Chinese parties that judgments will be enforced by way of a treaty.[189] While bureaucracy and local protectionism remain concerns, Chinese courts appear to respect the gravitas of an official treaty.[190] For example, arbitration awards, which are governed by the New York Convention, are already generally enforced in China.[191] An official treaty would also deprive courts of an excuse to deny judgment enforcement. Moreover, as trade between the United States and China continues to increase, it does not seem unreasonable to assume that cases of judgment unenforceability will increase as well. As such, the costs of not having treaties of reciprocity grow each year. And while

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184. *See* Nadja Vietz, *Will Your U.S. Judgment Be Enforced Abroad?*, WA. STATE BAR NEWS, Mar. 2009, at 15.

185. *See* Danford, *supra* note 20, at 417 (explaining that "given the ease with which foreigners can have their judgments recognized and enforced in U.S. courts, foreign governments have no incentive to enter into a judgments treaty with the United States because they have received a 'free ride' all along") (citations omitted); *see also* Yaad Rotem, *The Problem of Selective or Sporadic Recognition: A New Economic Rationale for the Law of Foreign Country Judgments*, 10 CHI. J. INT'L L. 505, 508 (2010).

186. *See* Yuan, *supra* note 115, at 781 ("The ideal and simple way to resolve this problem is for the United States and China to recognize reciprocity in a bilateral or multilateral treaty.").

187. *See, e.g.*, Treaty of Friendship, Commerce and Navigation, U.S.-S. Kor., Nov. 28 1956, 8 U.S.T. 2217; Treaty of Friendship, Commerce and Navigation, U.S-Greece, Aug. 3, 1951, 5 U.S.T. 1829. Notably, both of these treaties were enacted in the 1950s.

188. *See* discussion *supra* Part I.A.

189. *See* Juenger, *Money Judgments*, *supra* note 149.

190. *See generally* Harris, *Arbitration in China*, *supra* note 134.

191. *See id.*; *see also* Chua, *supra* note 173 and accompanying text.

China has some incentives to refuse such a treaty, the benefits to its domestic industries may be greater through increased exposure to the capital and consumer markets of the United States.

CONCLUSION

As trade and commerce between the United States and China increases, cases of judgment unenforceability are likely to rise. Judgment enforceability benefits parties from both nations, and a bilateral or multilateral treaty may be the best way to resolve the issue. A number of difficulties, however, have plagued prior efforts at such treaties. Until such a treaty is enacted, or China reforms its judgment enforcement practices, U.S. parties are advised to use great care in their international dealings.