

## STRATEGIES FOR ASSET RECOVERY FROM MAINLAND CHINA

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### ABSTRACT

China is forging itself into a global financial center for investment and slowly retooling its courts to handle cross-border civil and commercial disputes. But China currently lacks an adequate legal infrastructure necessary to assure non-Chinese investors of their substantive rights. China's attractively high growth investment opportunities combined with the absence of much needed legal remedies have been a recipe for massive investor losses. Facing the great legal uncertainty, practitioners have developed innovative equity and debt holder strategies for asset recovery from Mainland China.

This Comment provides an analytic review of these strategies. It focuses on the use of equitable receivers to control onshore assets through offshore corporate structures and a judgment recognition and enforcement mechanism that relies on treaties or de facto reciprocity with China. The Comment also discusses the emergence of the Chinese judiciary's quasi-lawmaking power through development of the Guiding Cases system—a case-based framework that implicates the notion of judicial precedent in China. There is a hope that the guiding cases could improve the efficacy of Chinese courts in deciding cross-border disputes and provide foreign investors with greater legal assurance by giving precedential value to cases that enforce investor rights.

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### I. INTRODUCTION

“He who can modify his tactics in relation to his opponent and thereby succeed in winning, may be called a heaven-born captain.”<sup>1</sup> -Sun Tzu

The Belt and Road Initiative (BRI) is the People’s Republic of China’s (China) plan to modernize and connect the Eurasian continent by creating an extensive logistics and transport network that links Asia, Europe, the Middle East, and Africa.<sup>2</sup> In October 2017, at the 19th National Congress of the Communist Party of China,

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1. SUN TZU, *THE ART OF WAR* 25 (Lionel Giles trans., Simon & Brown 2010) (1910). Sun Tzu was a Chinese army general whose teachings about tactical combat and warfare have been studied for more than 2,400 years. MEGHAN COOPER, *SUN TZU* 5–6 (2018).

2. Huileng Tan, *China Wrote Belt and Road Initiative into the Party Constitution. That Makes it Riskier than Ever*, CNBC (Oct. 31, 2017, 11:45 PM), [www.cnbc.com/2017/10/31/china-wrote-belt-and-road-initiative-into-the-party-constitution.html](http://www.cnbc.com/2017/10/31/china-wrote-belt-and-road-initiative-into-the-party-constitution.html).

the Communist Party integrated the BRI into its Constitution—enshrining the BRI and underscoring the Party’s commitment to building China into a hub that connects trade and investment throughout Eurasia.<sup>3</sup>

In implementing the BRI, Chinese courts are expected to enhance international judicial assistance in order to resolve cross-border disputes arising from BRI-related activities, to facilitate the “free flow of economic factors,” and to increase connectivity.<sup>4</sup> Further, because China has only concluded a judgment recognition and enforcement (JRE)<sup>5</sup> arrangement with one common law jurisdiction—Hong Kong (H.K.)—international judicial assistance in China would constitute a significant development in cross-border cooperation.<sup>6</sup>

This Comment discusses the impact of the BRI on the efficacy of Chinese courts in resolving cross-border disputes, including JRE of foreign judgments and foreign bankruptcy judgments. China is deploying greater capital abroad—the country became a net capital exporter in 2014 when its outward direct investment outnumbered capital inflows.<sup>7</sup> Outward direct investment related to the BRI reached

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3. *Id.*; see also Brenda Goh & John Rutwich, *Pressure on as Xi’s ‘Belt and Road’ Enshrined in Chinese Party Charter*, REUTERS (Oct. 24, 2017, 7:26 AM), <https://www.reuters.com/article/us-china-congress-silkroad/pressure-on-as-xis-belt-and-road-enshrined-in-chinese-party-charter-idUSKBNICT1IW> (discussing amendment of charter); *The 19th CPC National Congress and the ‘Belt and Road Initiative’*, OBOREUROPE, <http://www.oboreurope.com/en/19th-cpc-national-congress/> (last visited Sept. 23, 2018) (stating that enshrining Chinese-style socialism in the CCP constitution will ensure the continuation of the “Belt and Road” initiative).

4. See Jie Huang, *Chinese Court Recognizes US Commercial Money Judgment*, LETTERS BLOGATORY (Sept. 4, 2017), <https://lettersblogatory.com/2017/09/04/chinese-court-recognizes-us-commercial-money-judgment> (arguing that a recent decision by a Chinese court to recognize and enforce a U.S. judgment is significant for mutual judgment recognition and enforcement (JRE) between China and the United States).

5. See Susan L. Stevens, *Commanding International Judicial Respect: Reciprocity and the Recognition and Enforcement of Foreign Judgments*, 26 HASTINGS INT’L & COMP. L. REV. 115, 117–120 (discussing the concept of judicial recognition and enforcement as rooted in the historical doctrine of reciprocity).

6. Huang, *supra* note 4; see also Zuigao Renminfayuan Guanyu Neidi yu Xianggang Tebiexingzhengqu Fayuan Xianghu Renke he Zhixing Dangshiren Xieyi Guanxia de Minshangshi Anjian Panjue de Anpai (最高人民法院关于内地与香港特别行政区法院相互认可和执行当事人协议管辖的民商事案件判决的安排) [Arrangements of the Supreme People’s Court on the Mutual Enforcement of Arbitral Awards between the Mainland and the Hong Kong Special Administrative Region] (promulgated by Supreme People’s Court, July 3, 2008, effective Aug. 1, 2008), CLI3.1WN9FL6B(EN) (Lawinfochina). This Comment refers to Mainland China when discussing Chinese law and China, generally, because the local domestic law governing JRE in Mainland China differs from the law in China’s special administrative regions, Hong Kong and Macau.

7. *China Now a Net Capital Exporter*, CHINA DAILY (Jan. 21, 2015, 2:08 PM), [www.chinadaily.com.cn/business/chinadata/2015-01/21/content\\_19367818.htm](http://www.chinadaily.com.cn/business/chinadata/2015-01/21/content_19367818.htm). For definition of “outward direct investment,” see *Outward Direct Investment—ODI*, INVESTOPEDIA, [www.investopedia.com/terms/o/outward\\_direct\\_investment.asp](http://www.investopedia.com/terms/o/outward_direct_investment.asp) (last visited Sept. 23, 2018) (defining outward direct investment as a tool for expanding domestic operations into a foreign country, especially where these countries present more favorable business opportunities).

14.4% of total outward direct investment in the first quarter of 2017.<sup>8</sup> As it sends greater capital abroad through the BRI, China is retooling its arbitration regime to handle foreseeable cross-border disputes arising in countries affected by the BRI.<sup>9</sup>

Chinese arbitration institutions—in lieu of official JRE treaties—are poised to gain more experience in cross-border dispute resolution.<sup>10</sup> China's approach to arbitration is also partially changing in response to the BRI.<sup>11</sup> For example, China's leading arbitral institution, the China International Economic and Trade Arbitration Commission (CIETAC),<sup>12</sup> adopted new rules to handle investment arbitration cases against the Chinese government, which are expected to increase in number due to the BRI.<sup>13</sup>

Changes to promote and safeguard China's outward investment through arbitration and international judicial assistance are part of a larger development in the modernization of China's approach to global investment and treatment of foreign investors. The trend towards greater openness and legal assurance appears to be improving the success of nontraditional and JRE recovery strategies for investments located in Mainland China as well.<sup>14</sup> As a matter of course, enforcing an international arbitration award outside of its original jurisdiction is easier than enforcing a judgment rendered by a foreign court.<sup>15</sup> This is especially true of foreign

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8. *China's March Outbound Direct Investment Slumps 30.1pc to US\$7.11b*, SOUTH CHINA MORNING POST (Apr. 18, 2017, 2:01 PM), [www.scmp.com/news/china/economy/article/2088471/chinas-march-outbound-direct-investment-slumps-301pc-us711b](http://www.scmp.com/news/china/economy/article/2088471/chinas-march-outbound-direct-investment-slumps-301pc-us711b).

9. See Zhiwei Lin, *Belt and Road a Turning Point for Arbitration in China?*, CHINA BUS. L. J. (Oct. 16, 2017), [www.vantageasia.com/belt-road-turning-point-arbitration-china](http://www.vantageasia.com/belt-road-turning-point-arbitration-china) (arguing that Chinese arbitration institutions will receive better recognition by optimizing governance structures and taking advantage of their geographic proximity to the Belt and Road).

10. *Id.*

11. See Caroline Simson, *New Rules Enacted by Chinese Arbitral Institution*, LAW360 (Sept. 20, 2017, 2:42 PM), [www.law360.com/articles/965859](http://www.law360.com/articles/965859) (stating that new arbitration rules taking effect on Oct. 1, 2017, come in response to the increasing number of investment arbitration cases being brought against the Chinese government).

12. *CIETAC Publishes Rules for Investor-State International Investment Arbitration*, DAVIS POLK 1 (Oct. 27, 2017), [www.davispolk.com/files/2017-10-27\\_cietac\\_publishes\\_rules\\_for\\_investor-state\\_international\\_investment\\_arbitration.pdf](http://www.davispolk.com/files/2017-10-27_cietac_publishes_rules_for_investor-state_international_investment_arbitration.pdf).

13. Simson, *supra* note 11.

14. See Daniel Chia & Annette Liu, *Singapore and Chinese Courts Agree on Reciprocal Enforcement of Commercial Judgments*, MORGAN LEWIS (Sept. 14, 2018), <https://www.morganlewis.com/pubs/singapore-and-chinese-courts-agree-on-reciprocal-enforcement-of-commercial-judgments> (“[F]oreign parties now have a wider range of recovery strategies against Chinese parties and assets.”).

15. See HERBERT SMITH FREEHILLS, *DISPUTE RESOLUTION AND GOVERNING LAW CLAUSES IN CHINA-RELATED COMMERCIAL CONTRACTS 2* (7th ed. 2016) (explaining that while arbitration outside Mainland China is generally a better option for non-Chinese parties than arbitration inside Mainland China, it is not always an available option); See Dan Harris, *China Enforces United States Judgment: This Changes Pretty Much Nothing*, HARRIS BRICKEN: CHINA L. BLOG (Sept. 5, 2017), <https://www.chinalawblog.com/2017/09/china-enforces-united-states-judgment-this-changes-pretty-much-nothing.html> (explaining that despite a Chinese court's recognition of a U.S.-rendered judgment, Chinese courts will still be reluctant to recognize foreign judgments).

judgments in Mainland China,<sup>16</sup> although there is some evidence supporting the view that Chinese courts are beginning to grant JRE on foreign judgments.<sup>17</sup> This Comment focuses on the emerging recovery strategies for non-Chinese equity and debt holders of Mainland China investments that potentially allow harmed investors to pursue recovery options that were previously foreclosed or unexplored. Practitioners conscious of the idiosyncrasies of the Chinese legal system may be able to secure relief for their clients using American-style litigation in tandem with Chinese-style channels for dispute resolution.

It is further important to note that while China positions itself as a capital exporter, it remains a highly attractive destination for global investment,<sup>18</sup> enticing foreign investors with aggressive growth in public equity<sup>19</sup> and alternative investments.<sup>20</sup> Though China's gross domestic product (GDP)<sup>21</sup> growth cooled from a high of approximately 13% in 1994,<sup>22</sup> its economy grew 6.9% in the first quarter

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16. See Dan Harris, *How to Sue a Chinese Company. Part III. Litigation Strategies and Enforcing Judgments*, HARRIS BRICKEN: CHINA L. BLOG (Nov. 10, 2010), [https://www.chinalawblog.com/2010/11/litigation\\_strategies\\_us\\_companies\\_hold.html](https://www.chinalawblog.com/2010/11/litigation_strategies_us_companies_hold.html) (“U.S. judgments have virtually no value in China.”).

17. See Huang, *supra* note 4 (providing two examples where Chinese courts granted JRE of foreign judgments based on the principle of JRE reciprocity, including one judgment from the United States).

18. See Shuiyu Jing, *China Still Most Attractive Destination for FDI in 2017*, CHINA DAILY (Mar. 1, 2017, 7:31 AM), [www.chinadaily.com.cn/business/2017-03/01/content\\_28385510.htm](http://www.chinadaily.com.cn/business/2017-03/01/content_28385510.htm) (stating that foreign direct investment in China is expected to grow more than 15% in 2017 because economic and trade conditions have improved and China is relaxing laws on foreign investment in more segments of the economy).

19. See Evelyn Cheng, *These Chinese Tech Stocks are Even Hotter than FANG*, CNBC (Aug. 7, 2017, 4:13 PM), [www.cnbc.com/2017/08/07/these-chinese-tech-stocks-are-even-hotter-than-fang.html](http://www.cnbc.com/2017/08/07/these-chinese-tech-stocks-are-even-hotter-than-fang.html) (indicating the Chinese technology sector leads the globe in growth based on the strength of consumer-based e-commerce). For a definition of “public equity,” see *Difference Between Private and Public Equity*, INVESTOPEDIA, <https://www.investopedia.com/articles/investing/030415/difference-between-private-and-public-equity.asp> (last visited Sept. 23, 2018) (stating that public equity includes mutual funds, 401(k)s, and IRAs, and is the most commonly understood type of capital among lay persons).

20. See Robert Kosowski, *Reforms in China Further Open Way to Alternative Investments Funds and Their Strategies*, IMPERIAL COLLEGE BUSINESS SCHOOL (Oct. 14, 2013), [www.imperial.ac.uk/business-school/intelligence/research-blog/reforms-in-china-further-open-way-to-alternative-investments-funds-and-their-strategies](http://www.imperial.ac.uk/business-school/intelligence/research-blog/reforms-in-china-further-open-way-to-alternative-investments-funds-and-their-strategies) (stating that Chinese reforms allowing foreign hedge funds to raise capital in China will bring more alternative investment opportunities for foreigners to invest in Mainland China). For a definition of “alternative investment,” see *Alternative Investment*, INVESTOPEDIA, [www.investopedia.com/terms/a/alternative\\_investment.asp](http://www.investopedia.com/terms/a/alternative_investment.asp) (last visited Sept. 23, 2018) (stating that alternative investments include private equity and hedge funds but not conventional investments such as stocks and bonds).

21. See *Gross Domestic Product—GDP*, INVESTOPEDIA, [www.investopedia.com/terms/g/gdp.asp](http://www.investopedia.com/terms/g/gdp.asp) (last visited Sept. 12, 2018) (“Gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period.”).

22. *GDP Growth (Annual %)*, THE WORLD BANK, <https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?end=2017&locations=CN&start=1>

of 2017—a rate that U.S. Secretary of the Treasury Steve Mnuchin described as being “quite high”<sup>23</sup> relative to growth experienced in more financially developed countries.<sup>24</sup> Spurred by China’s expanding economy, the Morgan Stanley Capital International (MSCI) China Information Technology Index, comprised of Chinese technology stocks, more than doubled the S&P 500’s Technology sector in 2017.<sup>25</sup> Seeking high growth opportunities, the world’s largest hedge-fund—Bridgewater Associates LP—plans to open a massive investment fund in China to buy and sell assets there.<sup>26</sup>

Even traditionally risk-averse institutional investors are chasing higher returns with foreign investment strategies.<sup>27</sup> For example, U.S. public pension funds are trying to invest in foreign stocks in order to make up lost ground on pension liabilities following the setbacks of the financial crisis.<sup>28</sup> By 2012, 17% of the National Conference on Public Employee Retirement Systems’<sup>29</sup> members’ funds

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994 (last visited Sept. 23, 2018).

23. Brittany De Lea, *China’s Economy Slowing, Still a Powerhouse & Important Ally: Mnuchin*, FOX BUSINESS (June 6, 2017), <https://www.foxbusiness.com/politics/chinas-economy-slowng-still-a-powerhouse-important-ally-mnuchin>.

24. See *Gross Domestic Product, 1st Quarter 2017 (Second Estimate); Corporate Profits, 1st Quarter 2017 (Preliminary Estimate)*, U.S. DEP’T COMM.: BUREAU ECON. ANALYSIS (May 26, 2017, 8:30 AM), <https://www.bea.gov/news/2017/gross-domestic-product-1st-quarter-2017-second-estimate-corporate-profits-1st-quarter> (showing U.S. GDP growth was 1.2% in the first quarter of 2017).

25. Cheng, *supra* note 19; see generally *Standard and Poor’s 500 Index—S&P 500*, INVESTOPEDIA, <https://www.investopedia.com/terms/s/sp500.asp> (last visited Sept. 10, 2018) (“The Standard & Poor’s Index—S&P 500 is a market-capitalization-weighted index of the 500 largest U.S. publicly traded companies by market value.”).

26. Rob Copeland et al., *Bridgewater to Launch Big Investment Fund in China, Three Decades in the Making*, WALL ST. J. (Sept. 8, 2017, 6:25 PM), [www.wsj.com/articles/bridgewater-to-launch-big-investment-fund-in-china-three-decades-in-the-making-1504909558?mg=prod/accounts-wsj](http://www.wsj.com/articles/bridgewater-to-launch-big-investment-fund-in-china-three-decades-in-the-making-1504909558?mg=prod/accounts-wsj); see also Tae Kim, *World’s Largest Hedge Fund Bridgewater Reportedly Raising Large New China Fund*, CNBC (Sept. 10, 2017, 4:09 PM), [www.cnbc.com/2017/09/10/ray-dalios-bridgewater-reportedly-raising-large-china-fund.html](http://www.cnbc.com/2017/09/10/ray-dalios-bridgewater-reportedly-raising-large-china-fund.html) (stating that Bridgewater Associates LP received approval for a venture that will raise money to invest and sell assets in China).

27. See Omar Mohammed, *Normally Risk-Averse US Pension Funds are Starting to Bet Big on Africa*, QUARTZ (May 12, 2015), <https://qz.com/403216/normally-risk-averse-us-pension-funds-are-starting-to-bet-big-on-africa> (providing an example of one of the largest U.S. pension funds that is considering investing 2% to 3% of its assets in Africa).

28. See Mary Williams Walsh, *Public Pension Funds are Adding Risk to Raise Returns*, N.Y. TIMES (Mar. 8, 2010), [www.nytimes.com/2010/03/09/business/09pension.html?pagewanted=all&mcubz=3](http://www.nytimes.com/2010/03/09/business/09pension.html?pagewanted=all&mcubz=3) (finding that because 60-40 mixtures of stocks and bonds have not performed as anticipated, public pension funds have averaged only 3% per year between 2000 and 2010, falling behind their expected performance).

29. See generally RAFAEL SILVEIRA, *ALTERNATIVE INVESTMENTS: STRIKING THE BALANCE BETWEEN GROWTH TOMORROW AND LIQUIDITY TODAY* (2014) (describing The National Conference on Public Employee Retirement Systems (NCPERS), the largest trade association for public sector pension funds, holding a portfolio of approximately \$4 trillion in pension assets for 21 million public employees and retirees).

were invested in foreign equities.<sup>30</sup> Surveys indicate that U.S. public pension funds are expressing interest in increasing their overall alternative investment allocations.<sup>31</sup>

However, some investors are wary of Chinese firms.<sup>32</sup> Between 2000 and 2011, a rash of U.S.-listed Chinese firms accused of accounting irregularities or outright fraud<sup>33</sup> caused \$50 billion in investor losses on U.S. stock markets.<sup>34</sup> Due to enforcement risks involving U.S.-listed Chinese firms, U.S. shareholder litigation for investor losses tended to settle for comparatively low amounts.<sup>35</sup> Foreign creditors and bondholders investing in China through offshore holding entities have experienced mixed results protecting their investments, particularly in bankruptcy or default situations.<sup>36</sup> These individuals have at times lost their entire investment when the Chinese operating firm is located in Mainland China.<sup>37</sup>

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30. See MARC I. GROSS, U.S. PENSION FUNDS FOREIGN INVESTMENT RECOVERY ACT 4 (2013), [www.ncpers.org/files/Mark%20Gross.pdf](http://www.ncpers.org/files/Mark%20Gross.pdf) (detailing the challenges facing U.S. pension funds, including funding gaps, risks of fraud, and diversification that requires purchasing foreign stock).

31. See SILVEIRA, *supra* note 29, at 4 (stating that 72% of state and local pension funds surveyed are considering increasing their alternative investment allocations and almost half are considering increasing their exposure to private equity).

32. See M Rochan, *AgFeed Scam Making American Investors Wary of US-Listed Chinese Stocks*, INT'L BUS. TIMES (Dec. 24, 2013), [www.ibtimes.co.uk/agfeed-scam-making-american-investors-wary-us-listed-chinese-stocks-1430180](http://www.ibtimes.co.uk/agfeed-scam-making-american-investors-wary-us-listed-chinese-stocks-1430180) (describing wariness after a U.S. Securities and Exchange Commission probe into alleged securities violations by AgFeed Industries, a bankrupt China-based pork producer).

33. See Alexandra Stevenson & Matthew Goldstein, *Bounty Hunter Tracks Chinese Companies that Dupe Investors*, N.Y. TIMES (Mar. 15, 2016), [www.nytimes.com/2016/03/16/business/dealbook/bounty-hunter-tracks-chinese-companies-that-dupe-investors.html](http://www.nytimes.com/2016/03/16/business/dealbook/bounty-hunter-tracks-chinese-companies-that-dupe-investors.html) ("Many of the Chinese companies were soon engulfed in accounting irregularities or allegations of outright fraud."); see also, Jason Raznick, *Is China MediaExpress a Fraud? Part 1*, FORBES (Feb. 7, 2011, 11:16 AM), [www.forbes.com/sites/benzingainsights/2011/02/07/is-china-mediaexpress-a-fraud-part-1/#15666f5a3f42](http://www.forbes.com/sites/benzingainsights/2011/02/07/is-china-mediaexpress-a-fraud-part-1/#15666f5a3f42) ("This is a Chinese reverse merger company that I believe was likely created with the intention of bilking American investors[.]").

34. Katia Dmitrieva, *'China Hustle' Warns Next Big Crisis Born in Reverse-Merger Mud*, BLOOMBERG (Sept. 8, 2017, 12:01 AM), [www.bloomberg.com/news/articles/2017-09-08/-china-hustle-warns-next-big-crisis-born-in-reverse-merger-mud](http://www.bloomberg.com/news/articles/2017-09-08/-china-hustle-warns-next-big-crisis-born-in-reverse-merger-mud).

35. See Symposium, *Chinese Companies and U.S. Class Actions: Securities Litigation and Product Liability*, 23 CARDOZO J. INT'L & COMP. L. 727, 738 (2015) (suggesting that enforcement risk and difficulties in prosecuting securities litigation involving the Chinese company factor into low settlement amounts); see also Kevin LaCroix, *Cornerstone Research: Aggregate and Average Securities Suit Settlements Surged in 2015*, THE D&O DIARY (Mar. 29, 2016), [www.dandodiary.com/2016/03/articles/securities-litigation/cornerstone-research-aggregate-and-average-securities-suit-settlements-surged-in-2015](http://www.dandodiary.com/2016/03/articles/securities-litigation/cornerstone-research-aggregate-and-average-securities-suit-settlements-surged-in-2015) (detailing that the proportion of settlements of \$2 million or less was at the highest level in eighteen years in 2015, largely as a result of increased settlements related to Chinese reverse mergers).

36. LaCroix, *supra* note 35.

37. See *Financial Restructuring in Asia*, HOULIHAN LOKEY (May, 2014), [https://hl.com/email/pdf/2014/HL\\_MM\\_Asia\\_Restructuring\\_2014.pdf](https://hl.com/email/pdf/2014/HL_MM_Asia_Restructuring_2014.pdf) (comparing the likely vastly different outcomes in the LDK Solar and Suntech cases to emphasize the importance of

Recovering an investment in Mainland China without an arbitration agreement is not a guarantee,<sup>38</sup> but it may be achieved through nontraditional or JRE strategies. For example, equity holders may be able to use a corporate governance strategy to recover by collapsing offshore entities to reach valuable assets located in Mainland China.<sup>39</sup> In addition, debt holders and offshore creditors may also take advantage of offshore corporate structures to secure judgments in key jurisdictions that have JRE treaties or de facto reciprocity with China.<sup>40</sup> Alternately, investors and creditors may find success through out-of-court negotiations.<sup>41</sup>

This Comment will review prevalent investor-loss scenarios related to investing in China to examine and recommend cutting-edge equity and debt holder strategies for asset recovery in Mainland China. Part II will analyze the corporate governance strategy—breaking down the Chinese reverse merger crisis, the emergence of the equitable receiver remedy, and the offshore corporate architecture of Chinese reverse merger firms (CRMs)—to show that a court-appointed receiver's powers provide a viable tool for investment recovery in Mainland China. Part III will analyze recent case law to understand how courts apply such strategies to offshore structures. Part IV will focus on JRE strategies for debt holders—noting landmark cases that seem to indicate Chinese courts are modernizing their approach to JRE and insolvency to meet the challenges of global investment. Finally, Part V will examine the development of China's guiding case system to consider how the case-based framework is evolving within China's civil law culture and how it may impact future litigation in Mainland China. This Comment concludes by stating that non-Chinese investors should be aware of heightened risks pertaining to investing in Mainland China and that those practitioners seeking to recover investments located there without resorting to arbitration should prepare a comprehensive recovery theory to avoid dissipation of their assets.

## II. CORPORATE GOVERNANCE STRATEGY FOR EQUITY HOLDERS

Part II will provide background on the Chinese reverse merger crisis—detailing how Chinese firms seeking international funding and prestige listed on U.S. stock exchanges and how CRMs caused massive investor losses after delisting. Part II will also cover typical corporate structures used by CRMs and discuss how a court-

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communication in reaching a negotiated settlement on an involuntary bankruptcy of a Mainland China firm).

38. See Jason Hsu, *Judgment Unenforceability in China*, 19 FORDHAM J. CORP. & FIN. L. 201, 201 (2013) (explaining that Chinese courts rarely recognize and enforce foreign judgments).

39. See Pierre-Luc Arsenaault et al., *China*, in THE PRIV. EQUITY REV. 2, 171 (Apr., 2012), [www.kirkland.com/siteFiles/Publications/PrivateEquityReview\\_0612.pdf](http://www.kirkland.com/siteFiles/Publications/PrivateEquityReview_0612.pdf) (stating that if investments are structured offshore, private equity investors may benefit from “double-dip” economics).

40. See Andrew McGinty & Chris Dobby, *Will the Chinese Courts Grant “Back Door Recognition” to Overseas Insolvency Practitioners?*, LEXOLOGY (Jan. 27, 2015), [www.lexology.com/library/detail.aspx?g=f5c6aa02-ee2-41eb-b75d-165d9be70b9b](http://www.lexology.com/library/detail.aspx?g=f5c6aa02-ee2-41eb-b75d-165d9be70b9b) (noting that China's highest court shall issue a ruling to recognize and enforce the judgment of an overseas court in accordance with international treaties and on the basis of mutuality).

41. *Financial Restructuring in Asia*, *supra* note 37.



appointed receiver may be able to take control of a CRM's corporate structure and place harmed investors in a strategic position to recover value.

### A. *The Rise of CRMs*

In China, publicly listed firms fall into three main categories: A-shares, B-shares, and H-shares.<sup>42</sup> The A-shares market accounts for 95% of tradable shares in China.<sup>43</sup> Historically, only Chinese citizens could purchase these renminbi-denominated<sup>44</sup> shares of Mainland China-based firms that trade on the Shanghai and Shenzhen stock exchanges.<sup>45</sup> In 2003, the China Securities Regulatory Commission (CRSC) opened the domestic A-shares market to select foreign investors using the Qualified Foreign Institutional Investor (QFII) license scheme<sup>46</sup>—granting qualified foreign investor applicants<sup>47</sup> access to Mainland China's domestic capital markets. As of 2016, 279 multinational financial institutions had QFII licenses.<sup>48</sup> QFII license holders can invest in A-shares, bonds, and domestic investment funds.<sup>49</sup>

Many emerging markets have used the QFII licensing scheme, including Taiwan and Korea.<sup>50</sup> The first QFII quotas were granted in 2003 and are the most frequently employed means of gaining direct access to Mainland China's securities

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42. Mark Mobius, *The ABCs of China's Share Markets*, CNBC (Oct. 16, 2012, 10:20 PM), [www.cnbc.com/id/49441597](http://www.cnbc.com/id/49441597).

43. See Oscar Teunissen et al., *Recent Trends for Alternative Fund Investments in China*, 2 PWCALTERNATIVES, no. 5, 2007, at 1–2, [www.pwc.com/us/en/tax-services-multinationals/assets/pwc\\_alternative\\_china\\_041607.pdf](http://www.pwc.com/us/en/tax-services-multinationals/assets/pwc_alternative_china_041607.pdf) (noting that while China has a complicated share structure and that foreign investors have restricted access to the A-shares market, these investors are offered a generally favorable tax regime).

44. See *CNY (China Yuan Renminbi)*, INVESTOPEDIA, [www.investopedia.com/terms/forex/c/cny-china-yuan-renminbi.asp](http://www.investopedia.com/terms/forex/c/cny-china-yuan-renminbi.asp) (last visited Mar. 11, 2018) (confirming the term “Renminbi” as the official name of the Chinese currency introduced in 1949 and “Yuan” as a unit of that currency).

45. See *A-Shares*, INVESTOPEDIA, [www.investopedia.com/terms/a/a-shares.asp](http://www.investopedia.com/terms/a/a-shares.asp) (last visited Sept. 12, 2018) (“A-shares are shares of mainland China-based companies, and these were historically only available for purchase by mainland citizens because China restricts foreign investment.”).

46. Samuel Shen & Jason Subler, *China Speeds Up QFII Approvals amid Signs of Capital Outflow*, REUTERS (Dec. 29, 2011, 3:08 AM), <https://www.reuters.com/article/us-china-qfii/china-speeds-up-qfii-approvals-amid-signs-of-capital-outflow-idUSTRE7BS08J20111229>.

47. See *Qualified Foreign Institutional Investor—QFII*, INVESTOPEDIA, <https://www.investopedia.com/terms/q/qualified-foreign-institutional-investor-qfii.asp> (last visited Sept. 23, 2018) (describing the prerequisites for acceptance as a licensed investor, including transferring and converting a certain amount of currency to local currency, and for fund management companies, a requirement of U.S. \$5 billion in assets during the most recent accounting year).

48. *QFII Facts and Figures*, SHANGHAI STOCK EXCH., <http://english.sse.com.cn/investors/qfii/listandquota> (last visited Sept. 12, 2018).

49. Teunissen et al., *supra* note 43, at 3.

50. STEWART ALDCROFT, UNDERSTANDING RQFII—THE GREAT “DOOR OPENER” FOR CHINA ACCESS 2 (2014), *available at* [https://www.citibank.com/mss/docs/online\\_understanding\\_rqfii.pdf](https://www.citibank.com/mss/docs/online_understanding_rqfii.pdf).

markets.<sup>51</sup> In 2012, the market cap of QFII-held equities only accounted for 1.09% of the market cap in the domestic A-shares market.<sup>52</sup> By comparison, institutions hold 80% of equity market cap in the United States.<sup>53</sup> In 2012, China raised its QFII investment quota to \$80 billion<sup>54</sup>—inviting greater foreign investment.<sup>55</sup> As of 2017, China's QFII investment quota was \$89 billion.<sup>56</sup>

The A-shares market has the largest number of Chinese firms of any stock exchange, providing QFIIs with unique investment opportunities, including exposure to smaller firms and sectors.<sup>57</sup> However, foreign investment restrictions have caused some quality Chinese firms to avoid Mainland China's most important capital market<sup>58</sup> and seek public listings on foreign stock exchanges, including U.S.- and H.K.-based markets.<sup>59</sup> China issues only one type of stock, thereby precluding corporate structures such as value adjusted mechanisms (VAMS) that use stock class differentiation, and likely encouraging Chinese firms to incorporate internationally.<sup>60</sup>

Due to environmental constraints, some capital-starved Chinese firms have opted to list on foreign stock exchanges to tap into foreign capital.<sup>61</sup> Even large state-owned enterprises based in Mainland China and incorporated internationally, such

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51. *Id.*

52. *QFII Investment Quota to Be Increased by 50 Billion U.S. Dollars*, CHINA SEC. REG. COMM'N (Mar. 4, 2012), [www.csrc.gov.cn/pub/csrc\\_en/OpeningUp/RelatedPolicies/QFII/201212/t20121210\\_217805.html](http://www.csrc.gov.cn/pub/csrc_en/OpeningUp/RelatedPolicies/QFII/201212/t20121210_217805.html).

53. Charles McGrath, *80% of Equity Market Cap Held by Institutions*, PENSIONS & INVESTMENTS (Apr. 25, 2017, 11:45 AM), [www.pionline.com/article/20170425/INTERACTIVE/170429926/80-of-equity-market-cap-held-by-institutions](http://www.pionline.com/article/20170425/INTERACTIVE/170429926/80-of-equity-market-cap-held-by-institutions).

54. *Qualified Foreign Institutional Investor—QFII*, *supra* note 47 (stating that China raised its QFII investment quota to \$80 billion in 2012).

55. See Teunissen et al., *supra* note 43, at 3 (“In August 2006, the original QFII rules were updated to lower the qualification criteria and improve other restrictions. The result has aroused a great deal of interest and encouraged applications from fund managers for new investment quotas.”).

56. *QFII Quotas Rise to US\$89 Billion*, STANDARD (Feb. 28, 2017, 11:03 AM), [www.thestandard.com.hk/breaking-news.php?id=85481](http://www.thestandard.com.hk/breaking-news.php?id=85481).

57. See Mobius, *supra* note 42 (stating that tourism, Chinese pharmaceuticals, and alcoholic beverages are examples of industries that are exclusively available on the A-shares market).

58. See Teunissen et al., *supra* note 43, at 3 (explaining that China did not allow access to foreign investors to the A-shares market until 2002).

59. See Mobius, *supra* note 42 (noting that some Chinese firms are traded in the London Stock Exchange and American Stock Exchanges); see also Teunissen et al., *supra* note 43, at 2 (providing that Chinese firms listed on the Singapore Stock Exchange are called “S-shares”).

60. See generally D. SUTHERLAND & B. MATTHEWS, ‘ROUND TRIPPING’ OR ‘CAPITAL AUGMENTING’ OFDI? CHINESE OUTWARD INVESTMENT AND THE CARIBBEAN TAX HAVENS 13 (2009) (explaining that a VAM is a structure through which a preferred stock can be exchanged for a greater number of common shares if the firm does not achieve agreed upon financial milestones).

61. Teunissen et al., *supra* note 43, at 2.

as PetroChina,<sup>62</sup> are listed as H-shares on the H.K. Stock Exchange.<sup>63</sup> For foreign investors who may not hold QFIIs but want to participate in China's expanding economy, "red chips" are a popular form of equity.<sup>64</sup> The environmental benefits of listing outside of China, combined with strong investor demand for exposure to Chinese firms, resulted in an increase in the practice of listing abroad.<sup>65</sup>

Between 2000 and 2011, hundreds of Chinese firms seeking "more readily available capital, less rigid listing criteria, and . . . greater recognition and prestige" listed on U.S. stock exchanges.<sup>66</sup> Listing on a senior stock exchange, such as the New York Stock Exchange (NYSE) or Nasdaq Stock Market (NASDAQ), potentially attracts capital from large pools of investors and creates a liquid market<sup>67</sup> outside of China for Chinese shareholders,<sup>68</sup> such as the firm's executives who hold shares. However, instead of using an initial public offering (IPO),<sup>69</sup> many private Chinese firms used reverse mergers<sup>70</sup> to become publicly listed on U.S. stock exchanges, this method proving to be faster and cheaper than an IPO.<sup>71</sup> This

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62. *PetroChina*, FORBES, <https://www.forbes.com/companies/petrochina/#79c83bf841e1> (last visited Sept. 23, 2018) ("PetroChina Co. Ltd. engages in exploration, development, production and sale of crude oil and natural gas.").

63. Teunissen et al., *supra* note 43 at 2–3.

64. See *Red Chip*, INVESTOPEDIA, [www.investopedia.com/terms/r/redchip.asp](http://www.investopedia.com/terms/r/redchip.asp) (last visited Sept. 14, 2018) (defining red-chip companies as those based in Mainland China but incorporated internationally, listed on the H.K. stock exchange, and expected to meet the filing and reporting requirements of that exchange); see also Teunissen et al., *supra* note 43, at 2–3 (stating that red-chip companies have at least 30% of their aggregate shares held either directly by Mainland China companies or indirectly through companies controlled by them).

65. See SUTHERLAND & MATTHEWS, *supra* note 60, at 19.

66. See Meg Utterback & Melissa Anderson, *Rise in Securities Class Actions Against US-listed Chinese Companies*, KING & WOOD MALLESONS (Oct. 27, 2015), [www.kwm.com/en/au/knowledge/insights/rise-securities-class-actions-us-listed-chinese-companies-20151027](http://www.kwm.com/en/au/knowledge/insights/rise-securities-class-actions-us-listed-chinese-companies-20151027) (arguing that the prestige to Chinese companies resulting from listing on U.S. stock exchanges presents valuable leverage when dealing with domestic clients); see also *Chinese Delistings on U.S. Exchanges*, TRADING CHINA (Sept. 30, 2012), <http://china.fixyou.co.uk/2012/09/chinese-delistings-on-us-exchanges.html> (stating that China is a country where business success is largely tied to networking and that status and prestige are thus important assets for a new business to possess); see also Edmund L. Andrews, *Charles Lee: How Well Do Chinese Reverse Mergers Perform?*, STAN. GRADUATE SCH. BUS. (Nov. 14, 2013), [www.gsb.stanford.edu/insights/charles-lee-how-well-do-chinese-reverse-mergers-perform](http://www.gsb.stanford.edu/insights/charles-lee-how-well-do-chinese-reverse-mergers-perform) (noting that many of the CRMs could not go public in China due to domestic restrictions).

67. See *Liquid Market*, INVESTOPEDIA, [www.investopedia.com/terms/l/liquidmarket.asp](http://www.investopedia.com/terms/l/liquidmarket.asp) (last visited Sept. 12, 2018) ("In a liquid market, it is easy to execute a trade quickly and at a desirable price because there are numerous buyers and sellers.").

68. *Chinese Delistings on U.S. Exchanges*, *supra* note 66.

69. See *Initial Public Offering—IPO*, INVESTOPEDIA, [www.investopedia.com/terms/i/ipo.asp](http://www.investopedia.com/terms/i/ipo.asp) (last visited Sept. 28, 2018) (defining an IPO as the first time that the stock of a private company is offered to the public).

70. A reverse merger is also known as a "reverse takeover." See *Reverse Takeover—RTO*, INVESTOPEDIA, [www.investopedia.com/terms/r/reversetakeover.asp](http://www.investopedia.com/terms/r/reversetakeover.asp) (last visited Sept. 28, 2018) ("A reverse takeover is a type of merger that private companies use to become publicly traded without resorting to an IPO.").

71. See Francine McKenna, *After China Fraud Boom, Nasdaq Steps Up Scrutiny of Shady*

approach also allowed private Chinese firms to skirt the share registration review normally performed by the Securities & Exchange Commission (SEC) during an IPO, “since the private company was merging with a shell [firm] that had already gone through that process, typically for another purpose a long time before.”<sup>72</sup> Ultimately, the expediency of the reverse merger listing technique contributed to the Chinese Reverse Merger crisis.

### **B. CRMs “Going Dark” and Abandoning Shareholders**

By 2008, 602 U.S.-listed CRMs submitted annual financial statements required by the SEC.<sup>73</sup> But between 2010 and 2012, over fifty CRMs were delisted from U.S. stock exchanges because many stopped filing reports with the SEC.<sup>74</sup> Others faced allegations of fraud: overstating revenue, fabricating contracts, and diverting funds to executives.<sup>75</sup> The NYSE and NASDAQ have since put controls in place to make reverse merger listings less susceptible to fraud,<sup>76</sup> although some critics believe that gaps in regulation still exist.<sup>77</sup>

Delisted CRMs erased billions of dollars in stock market value<sup>78</sup>—destroying \$26.5 billion in market capitalization between 2010 and 2012 alone.<sup>79</sup> Delisted

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*Listings*, MARKETWATCH (June 20, 2016, 11:10 AM), [www.marketwatch.com/story/after-china-fraud-boom-nasdaq-steps-up-scrutiny-of-shady-listings-2016-06-20](http://www.marketwatch.com/story/after-china-fraud-boom-nasdaq-steps-up-scrutiny-of-shady-listings-2016-06-20) (“Private Chinese companies pursued reverse mergers to gain access to U.S. capital markets more quickly and cheaply than via an initial public offering, or IPO.”).

72. *Id.* For a definition of a shell corporation, see *Shell Corporation*, INVESTOPEDIA, [www.investopedia.com/terms/s/shellcorporation.asp](http://www.investopedia.com/terms/s/shellcorporation.asp) (last visited Sept. 23, 2018) (defining a shell corporation as a corporation without active business operations but which may be incorporated to raise funds or engage in a hostile takeover of another business).

73. SUTHERLAND & MATTHEWS, *supra* note 60, at 8.

74. *Chinese Delistings on U.S. Exchanges*, *supra* note 66; see *SEC Form 10-Q*, INVESTOPEDIA, [www.investopedia.com/terms/1/10q.asp](http://www.investopedia.com/terms/1/10q.asp) (last visited Sept. 12, 2018) (“The SEC form 10-Q is a comprehensive report of a company’s performance that must be submitted by all public companies to the Securities and Exchange Commission. In the 10-Q, firms are required to disclose relevant information regarding their financial position.”); see also *10-K*, INVESTOPEDIA, [www.investopedia.com/terms/1/10-k.asp](http://www.investopedia.com/terms/1/10-k.asp) (last visited Sept. 12, 2018) (“A 10-K is a comprehensive summary report of a company’s performance that must be submitted annually to the Securities and Exchange Commission (SEC).”).

75. David Barboza & Azam Ahmed, *China to Wall Street: The Side-Door Shuffle*, N.Y. TIMES (July 23, 2011), [www.nytimes.com/2011/07/24/business/global/reverse-mergers-give-chinese-firms-a-side-door-to-wall-st.html](http://www.nytimes.com/2011/07/24/business/global/reverse-mergers-give-chinese-firms-a-side-door-to-wall-st.html).

76. See McKenna, *supra* note 71 (explaining that the SEC approved new rules in 2011 for the three major U.S. exchanges—including the NYSE and NASDAQ—that toughened listing standards for companies going public through a reverse merger).

77. See Dmitrieva, *supra* note 34 (noting the concern of the director of ‘The China Hustle,’ Jed Rothstein, who believes that SEC measures, including deregistering some companies and filing class action lawsuits against others, are unable to prevent larger, more sophisticated firms from committing fraud).

78. Barboza & Ahmed, *supra* note 75.

79. Mathew Miller & Stephen Aldred, *Amboq Setback Teaches Baring a Lesson in China Investing*, REUTERS (June 18, 2013, 12:46 AM), [www.reuters.com/article/ambow-baring/ambow-setback-teaches-baring-a-lesson-in-china-investing-idUSL3N0EP2TV20130618](http://www.reuters.com/article/ambow-baring/ambow-setback-teaches-baring-a-lesson-in-china-investing-idUSL3N0EP2TV20130618); see also Dmitrieva, *supra* note 34 (stating that Chinese executives and their enablers stole \$50 billion during

CRMs particularly harmed large investors who sought exposure to Chinese growth through U.S.-listed Chinese firms.<sup>80</sup> U.S. federal securities laws require publicly traded firms to comply with ongoing disclosure requirements.<sup>81</sup> When a firm is delisted, however, shareholders cannot access current financial information, preventing them from making informed decisions about their investment.<sup>82</sup>

U.S. stock exchanges initiated many of the CRM delistings,<sup>83</sup> but some firms delisted themselves voluntarily.<sup>84</sup> Voluntary delisting, also known as “going dark,” may suspend or terminate the firm’s public reporting requirements.<sup>85</sup> By failing to report the firm’s information, delisting creates an illiquid market for the firm’s shares, causing the stock price to crash.<sup>86</sup> One study shows that delayed quarterly filings to the SEC increases information asymmetry that produces a significantly negative reaction in stock price.<sup>87</sup> While one commentator suggests that a CRM will try everything possible to keep its public listing to avoid embarrassment in China,<sup>88</sup> another commentator points out that some CRMs were delisted voluntarily, causing a significant drop in stock price and enabling a low-cost insider privatization of the firm.<sup>89</sup> In 2011, having generated millions of dollars from U.S. investors,<sup>90</sup> over forty

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the Chinese Reverse Merger scandal).

80. See Dmitrieva, *supra* note 34 (“Investors wanted to tap the world’s second-largest economy and the foreign firms were seeking cash.”).

81. *Form 10-Q*, U.S. SEC. AND EXCH. COMM’N, [www.sec.gov/fast-answers/answersform10qhtm.html](http://www.sec.gov/fast-answers/answersform10qhtm.html) (last visited Sept. 12, 2018); see also *10-K*, *supra* note 74 (defining another type of disclosure, 10-K, required by the SEC).

82. David Graff & Shveta Kakar, *Chinese Companies “Going Dark”: Finally Accountable to U.S. Hedge Funds and Other Shareholders*, 7 HEDGE FUND L. REP. 1 (2014).

83. See *Chinese Delistings on U.S. Exchanges*, *supra* note 66 (discussing how U.S. stock exchanges send notices to Chinese companies being delisted).

84. Graff & Kakar, *supra* note 82 (describing that firms formally “delist” by filing with the SEC).

85. See Ted Farris, “Going Dark”—Voluntary Delisting and Deregistration Under the Securities Exchange Act of 1934—The Attractions of the “Dark Side,” DORSEY (Mar. 17, 2009), [www.dorsey.com/newsresources/publications/2009/03/going-dark—voluntary-delisting-and-deregistrati\\_](http://www.dorsey.com/newsresources/publications/2009/03/going-dark—voluntary-delisting-and-deregistrati_) (describing the regulatory effect of deregistering under the terms of the Securities Exchange Act).

86. See *Illiquid*, INVESTOPEDIA, [www.investopedia.com/terms/i/illiquid.asp](http://www.investopedia.com/terms/i/illiquid.asp) (last visited Sept. 12, 2018) (“Illiquid refers to the state of a security or other asset that cannot easily be sold or exchanged for cash without a substantial loss in value.”); see also Graff & Kakar, *supra* note 82 (providing an example of stock prices dropping after a company went dark).

87. See, e.g., Eli Bartov & Yaniv Konchitchki, *How Missing SEC Filing Deadlines Affects a Company’s Stock Value*, CLS BLUE SKY BLOG (Nov. 27, 2017), <http://clsbluesky.law.columbia.edu/2017/11/27/how-missing-sec-filing-deadlines-affects-a-companys-stock-value>.

88. See *Chinese Delistings on U.S. Exchanges*, *supra* note 66 (“A Chinese company with a delisting notice will always pull all strings possible to maintain their senior exchange listing, not for the best of its foreign shareholders but for their very own survival.”).

89. Graff & Kakar, *supra* note 82; see also Farris, *supra* note 85 (noting “going private transactions” as an option frequently pursued by shareholders or third-party purchasers).

90. Graff & Kakar, *supra* note 82.

CRMs went dark and took themselves private.<sup>91</sup> While CRMs delisted for a variety of reasons, the delistings created information gaps<sup>92</sup> uniformly designed to harm outside shareholders by preventing fundamental analysis models from being utilized—causing investors to lose out.<sup>93</sup>

Fundamental analysis models a firm's future performance by conducting a quantitative analysis of the firm's revenue, expenses, assets, liabilities, and other financial data.<sup>94</sup> Generally, a lack of financial data makes the value of a delisted or "self-darkened" firm difficult to assess.<sup>95</sup> Although a delisted firm may own valuable assets, unless the investor is a company insider or can successfully appraise the firm's business operations from afar, the average investor will struggle to discern the firm's underlying value.<sup>96</sup> When allegations of fraud can drive down prices of CRMs' shares, some private equity firms shrewdly target CRMs for their underestimated assets and take them private.<sup>97</sup> The value of a delisted CRM is particularly difficult to assess because the firm officers, often located in Mainland China, may be unresponsive to shareholders' requests for information concerning the firm's financial health.<sup>98</sup>

The pursuit of fair market value led litigators to employ innovative strategies using novel judicial remedies to assist investors in exiting their positions from Chinese companies that have "self-darkened."<sup>99</sup> *Deutsch v. ZST Digital Networks*,<sup>100</sup>

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91. Edmund L. Andrews, *Charles Lee: How Well Do Chinese Reverse Mergers Perform?*, STAN. GRADUATE SCH. BUS.: INSIGHTS BY STAN. BUS. (Nov. 14, 2013), [www.gsb.stanford.edu/insights/charles-lee-how-well-do-chinese-reverse-mergers-perform](http://www.gsb.stanford.edu/insights/charles-lee-how-well-do-chinese-reverse-mergers-perform).

92. See Graff & Kakar, *supra* note 82.

93. See James Early & Ben McClure, *Introduction to Fundamental Analysis*, INVESTOPEDIA, [www.investopedia.com/university/fundamentalanalysis](http://www.investopedia.com/university/fundamentalanalysis) (last visited Aug. 19, 2018) (providing background on fundamental analysis, including quantitative and qualitative analysis); see also Dmitrieva, *supra* note 34 (calculating loss by investors of \$50 billion).

94. See Early & McClure, *supra* note 93 (providing background on fundamental analysis, including quantitative and qualitative analysis).

95. Slav Fedorov, *What Happens to a Company's Stock Price After Delisting?*, POCKET SENSE (Apr. 19, 2017), <https://pocketsense.com/happens-companys-stock-price-after-delisting-4844.html>; Graff & Kakar, *supra* note 82.

96. Fedorov, *supra* note 95.

97. See John Hempton, *Those Clever People at China Fire and Security and Bain*, BRONTE CAPITAL (May 28, 2011), <http://brontecapital.blogspot.com/2011/05/those-clever-people-at-china-fire-and.html> (calling Bain's 2011 acquisition of CRM, China Fire and Security a "true bargain"); see also Arsenault et al., *supra* note 39, at 58–68 (concluding that following negative research reports and shareholder lawsuits, stock prices of CRMs plummeted, sparking private equity investors to privatize U.S.-listed CRMs to relist them in markets where Chinese companies' stock prices are typically higher); see generally Andrews, *supra* note 91 ("[O]ne Chinese reverse merger, China Green Agriculture, had been 'unduly tarnished' and was now 'grossly undervalued.'").

98. See Robert W. Seiden, Esq., *Recovering Assets & Enforcing Judgments in China Using Offshore Means*, OFFSHORE ALERT (May 2, 2016), [www.offshorealert.com/uploadedFiles/Events/OffshoreAlert\\_Conferences/2016/miami/Recovering-Assets-and%20Enforcing%20Judgments-in%20China%20Using%20Offshore%20Means.pdf](http://www.offshorealert.com/uploadedFiles/Events/OffshoreAlert_Conferences/2016/miami/Recovering-Assets-and%20Enforcing%20Judgments-in%20China%20Using%20Offshore%20Means.pdf) (explaining that it can be challenging for shareholders to contact company officials in Mainland China when the CRM goes dark); Fedorov, *supra* note 95.

99. Graff & Kakar, *supra* note 82.

100. *Deutsch v. ZST Dig. Networks, Inc.*, No. 8014-VCL, 2018 Del. Ch. LEXIS 191, at \*1

the first case of its kind,<sup>101</sup> used Delaware laws that protect shareholders to pioneer a judicial solution of appointing a receiver to manage the assets of a solvent company.<sup>102</sup> *Deutsch* provides the blueprint for equity holders seeking to recover value from CRMs with potentially valuable assets located in Mainland China.<sup>103</sup>

### **C. Court Orders Extraordinary Remedies Against a CRM in *Deutsch v. ZST Digital Networks***

In 2012, plaintiff-investors (Scott) filed a securities class action in California against ZST Digital Networks (ZSTN), a Delaware corporation with its principal place of operation in Mainland China.<sup>104</sup> The district court upheld part of the complaint that alleged ZSTN and its officers reported “dramatically different” financial results to the SEC and to the equivalent Chinese authority—the State Administration of Industry and Commerce (SAIC).<sup>105</sup> *Scott v. ZST Digital* settled for \$1.7 million, awarding an estimated \$0.40 per share to class members.<sup>106</sup>

Separately, after ZSTN went dark,<sup>107</sup> Peter Deutsch, an American investor who owned 3.9 million shares of ZSTN stock, brought an action under 8 Del. C. § 220 in the Delaware Court of Chancery.<sup>108</sup> Section 220 grants shareholders the right to demand an inspection of the stock corporation’s books and records,<sup>109</sup> providing minority shareholders in corporations with concentrated ownership substantial rights to information.<sup>110</sup> This right to information protects minority shareholders from

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(Del. Ch. 2018).

101. See Graff & Kakar, *supra* note 82 (explaining the reasoning behind *Deutsch v. ZST Digital Networks Inc.* and how it affected the industry).

102. *Deutsch*, 2018 Del. Ch. LEXIS 191, at \*9–11.

103. See Graff & Kakar, *supra* note 82 (“The ZST action has proved to be a potent precedent, invoked by other investors to reach several quick and profitable negotiated settlements with U.S. companies with offshore operations.”).

104. *Scott v. ZST Digital Networks, Inc.*, 896 F. Supp. 2d 877, 879–94 (C.D. Cal. 2012).

105. *Id.* at 889.

106. Notice of Proposed Settlement of Class Action, Motion for Attorneys’ Fees and Expenses, and Settlement Fairness Hearing at 1, *Scott v. ZST Dig. Networks, Inc.*, No. 11-CV-03531-GAF (C.D. Cal. Apr. 12, 2013), <http://shareholdersfoundation.com/case/zst-digital-networks-inc-nasdaq-zstn-investor-securities-class-action-lawsuit-05062011>.

107. Ted Farris, *Delaware Court Authorizes Seizure of Chinese Company’s Assets in Books and Records Case*, DORSEY (Apr. 9, 2013), [www.dorsey.com/newsresources/publications/2013/04/delaware-court-authorizes-seizure-of-chinese-com\\_\\_](http://www.dorsey.com/newsresources/publications/2013/04/delaware-court-authorizes-seizure-of-chinese-com__) (identifying ZSTN’s action through the August 2012 filing of a Form 15 with the SEC).

108. *Deutsch v. ZST Dig. Networks, Inc.*, No. 8014-VCL, 2018 Del. Ch. LEXIS 191, at \*6–7 (Del. Ch. 2018).

109. 8 Del. C. 1953, § 220(b); *but see* EDWARD P. WELCH ET AL., FOLK ON THE DELAWARE GENERAL CORPORATION LAW § 220.01 (2017) (“[A]n order under section 220 should be ‘circumscribed with rifled precision[.]’”); Stephen A. Radin, *The New Stage of Corporate Governance Litigation: Section 220 Demands—Reprise*, 28 CARDOZO L. REV. 1287, 1340 (2006) (explaining the rights afforded to shareholders under Section 220).

110. Edward B. Rock & Michael L. Wachter, *Waiting for the Omelette to Set: Match-Specific Assets and Minority Oppression*, in CONCENTRATED CORPORATE OWNERSHIP 201, 238–39

oppression and defends against unfair dealing by ensuring the reasonable expectations of the minority are satisfied.<sup>111</sup>

Before commencing the Section 220 action, Deutsch requested access to the books in a communication to ZSTN.<sup>112</sup> Through its legal counsel, ZSTN offered Deutsch the opportunity to inspect the firm's records at its principal office in Mainland China.<sup>113</sup> Deutsch refused to travel to China—insisting the records be produced in Delaware or New York—and subsequently brought the Section 220 action.<sup>114</sup> After ZSTN failed to respond to the Section 220 action demanding inspection of the records in Delaware, the court entered default judgment against the company in December 2012.<sup>115</sup>

The default judgment ordered ZSTN to produce extensive financial disclosure records in Delaware, including records connected to its delisting.<sup>116</sup> When ZSTN failed to comply with the initial order, Deutsch filed a motion for contempt.<sup>117</sup> Deutsch's motion requested contempt sanctions to establish an option to put<sup>118</sup> his shares of ZSTN stock for \$8.21 per share and appoint a receiver pursuant to 8 Del. C. § 322 to enforce ZSTN's compliance with the court's order.<sup>119</sup> The court granted Deutsch's motion—calling the remedies of a put right and receivership “exceptional,” but appropriate given plaintiff's “persuasive justifications” and ZSTN's failure “to appear, much less respond to or oppose, the motion for contempt.”<sup>120</sup>

In 2013, Deutsch exercised the put option to sell his shares of ZSTN stock at the established book value<sup>121</sup> of \$8.21 per share.<sup>122</sup> At the time, ZSTN shares were trading on the NYSE for \$1.39.<sup>123</sup> The exercised put option required ZSTN to buy back Deutsch's shares for over \$30 million based on ZSTN's purported book value

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(Randall K. Morck ed., 2000), [www.nber.org/chapters/c9010.pdf](http://www.nber.org/chapters/c9010.pdf) (breaking down various shareholder rights at state and federal levels).

111. See WELCH, *supra* note 109, §§ 170.06, 220.01 (defining “oppression of minority stockholders” and indicating that the purpose of section 220 is to provide shareholders with a means of reasonably obtaining information).

112. Deutsch, 2018 Del. Ch. LEXIS 191, at \*6.

113. *Id.*

114. *Id.* at \*6–7.

115. *Id.* at \*7.

116. *Id.*

117. *Id.* at \*8.

118. See *Put Option*, INVESTOPEDIA, [www.investopedia.com/terms/p/putoption.asp](http://www.investopedia.com/terms/p/putoption.asp) (last visited Sept. 12, 2018) (“A put option is an option contract giving the owner the right, but not the obligation, to sell a specified amount of an underlying security at a specified price within a specified time.”).

119. Deutsch, 2018 Del. Ch. LEXIS 191, at \*8.

120. Order Granting Plaintiff's Motion for Contempt at 1, *Deutsch v. ZST Dig. Networks, Inc.*, No. 8014-VCL (Del. Ch. 2013).

121. *Book Value*, INVESTOPEDIA, [www.investopedia.com/terms/b/bookvalue.asp](http://www.investopedia.com/terms/b/bookvalue.asp) (last visited Sept. 12, 2018) (“Book value is . . . the net asset value of a company, calculated as total assets minus intangible assets (patents, goodwill) and liabilities.”).

122. Deutsch, 2018 Del. Ch. LEXIS 191, at \*8.

123. Farris, *supra* note 107.



derived from the balance sheet included in its September 2011 quarterly report—its last filing before going dark.<sup>124</sup> However, ZSTN failed to pay Deutsch the required consideration for his shares.<sup>125</sup>

Consequently, since the usual methods of enforcement were exhausted, the court appointed an equitable receiver to use all appropriate action to ensure ZSTN's compliance with its obligation to pay Deutsch \$8.21 per share.<sup>126</sup> Receivership is a remedy available to a security taker if the security giver is not in liquidation, and equitable receivers are to represent the interests of the holder of the floating charge.<sup>127</sup> This extraordinary remedy “has its roots in the law of equitable execution used by the English Chancery Courts in cases where the creditor could not seize the debtor's property through execution at law, garnishment or attachment.”<sup>128</sup> Courts are inclined to appoint equitable receivers in a variety of situations, such as to enforce justice or when it is otherwise convenient to do so.<sup>129</sup>

Judgments against Chinese companies in favor of creditors of entities using offshore structures are often in vain because the Chinese companies fail to pay voluntarily, forcing the court to appoint an equitable receiver.<sup>130</sup> An equitable receiver has broad powers that enable plaintiffs to use a corporate governance approach—such as changing the ownership structure of offshore firms—to pursue multi-jurisdictional strategies to capture assets and create substantial recoveries for equity holders.<sup>131</sup>

Upon accepting the appointment, the receiver in *Deutsch* gained full authority and control over ZSTN's property and assets with the power to seize, deal, or

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124. *See id.* (explaining that ZSTN's last record 10-Q filing was the basis for this amount).

125. *Id.*

126. *Deutsch*, 2018 Del. Ch. LEXIS 191, at \*9.

127. *See* MOURANT OZANNES, THE THINGS A SECURITY TAKER NEEDS TO KNOW ABOUT RECEIVERSHIP UNDER BVI LAW 5 (2006), [https://www.mourant.com/2016-guides/the-things-a-security-taker-needs-to-know-about-receivership-under-bvi-law-\(updated\).pdf](https://www.mourant.com/2016-guides/the-things-a-security-taker-needs-to-know-about-receivership-under-bvi-law-(updated).pdf) (stating that receivers take possession and control of assets for a security taker); *see Floating Charge*, INVESTOPEDIA, [www.investopedia.com/terms/f/floating\\_charge.asp](http://www.investopedia.com/terms/f/floating_charge.asp) (last visited Sept. 12, 2018) (“A floating charge is a security . . . that has an underlying asset or group of assets which is subject to change in quantity and value. . . . Floating charge securities allow business owners to access capital secured with dynamic or circulating assets.”).

128. *Focus on Insolvency Law: Court Appoints Equitable Receiver in the Absence of Security*, FRASER MILNER & CASGRAIN LLP (July 2008), <https://s3.amazonaws.com/documents.lexology.com/8bed01e5-d7e5-4941-9025-a1a1f2793b14.pdf>.

129. *See* Marcia McFarlane, *Appointment of Receivers in the British Virgin Islands*, HARNEYS (Apr. 13, 2016), <http://www.harneys.com/insights/appointment-of-receivers-in-the-british-virgin-islands/> (providing examples of when BVI courts are willing to appoint receivers).

130. *See Hidden Assets: Using Equitable Receivers to Secure Recovery*, WALKERS (May 12, 2016), [http://www.walkersglobal.com/images/Publications/News/2016/05.12.2016\\_Hidden\\_Assets\\_HongKong.pdf](http://www.walkersglobal.com/images/Publications/News/2016/05.12.2016_Hidden_Assets_HongKong.pdf) (summarizing recent developments in receivership and the power it affords those appointed).

131. Graff & Kakar, *supra* note 82.

dispose.<sup>132</sup> The court specifically noted that the receiver's powers extended to China.<sup>133</sup> The extraordinary remedies ordered in *Deutsch* encouraged courts across the country to take action, with courts in Delaware and Nevada having already appointed receivers in over twenty Chinese Reverse Merger cases.<sup>134</sup> This trend is understandable because the appointment of an equitable receiver is useful if the debtor holds assets through complex offshore corporate structures, as CRMs often do.<sup>135</sup>

#### *D. Typical Offshore Architecture Used by CRMs*

CRMs commonly use a wholly foreign-owned enterprise (WFOE) structure<sup>136</sup> that features a Cayman Islands or British Virgin Islands (CBVI) holding company to facilitate international funding and an intermediary subsidiary firm with direct control over Chinese subsidiaries.<sup>137</sup> Chinese firms that use offshore structures tend to be smaller private businesses in growth industries that are trying to sidestep “the institutional constraints in [China’s] capital markets.”<sup>138</sup> Similarly, CRMs use offshore structures to spread into international markets and to raise capital from international investors to fund operations and domestic expansion.<sup>139</sup> In 2006, 47.5% of offshore foreign direct investment<sup>140</sup> (FDI) into China came from both the Cayman Islands and the British Virgin Islands—with the British Virgin Islands having a greater input than the Cayman Islands.<sup>141</sup> One commentator alluded to how the complex corporate structures available in CBVI contributed to the Chinese

132. *Deutsch*, 2018 Del. Ch. LEXIS 191, at \*11–12 (Del. Ch. 2018); see *Focus on Insolvency Law: Court Appoints Equitable Receiver in the Absence of Security*, *supra* note 128 (detailing an equitable receiver’s various powers over the property in question).

133. *Deutsch*, 2018 Del. Ch. LEXIS 191, at \*9–10.

134. See THE SEIDEN GROUP, <http://www.seidenlegal.com/attorneys.html> (last visited Sept. 12, 2018) (listing various cases in which one law firm alone established equitable receivers in Delaware and Nevada).

135. See McFarlane, *supra* note 129 (“This tool becomes very helpful where the debtor holds assets through a number of corporate entities.”); *Hidden Assets: Using Equitable Receivers to Secure Recovery*, *supra* note 130 (“The appointment of equitable receivers over a company through which a judgment debtor’s assets are held can be a useful tool to realise those assets for full value and for the benefit of the claimant.”).

136. Look Chan Ho, *Cross-Border Restructuring of Chinese and Indonesian Businesses*, INT’L INSOLVENCY INST. (June 2016), <http://www.iiiglobal.org/sites/default/files/18471394v1%20-%20Cross-Border%20Restructuring%20of%20Chinese%20and%20Indonesian%20Businesses%20-%20Look%20Chan%20Ho.PDF>; SUTHERLAND & MATTHEWS, *supra* note 60, at 14–15.

137. SUTHERLAND & MATTHEWS, *supra* note 60, at 14–15.

138. See *id.* at 20–21 (showing the common industries Chinese firms try to exploit: semiconductor, business services, computer programming, and pharmaceutical preparations).

139. See *id.* (stating that foreign capital is often used to fund growth in China).

140. *Foreign Direct Investment—FDI*, INVESTOPEDIA, <http://www.investopedia.com/terms/f/fdi.asp> (last visited Sept. 12, 2018) (“Foreign direct investment (FDI) an investment made by a company or individual in one country in business interests in another country.”).

141. See SUTHERLAND & MATTHEWS, *supra* note 60, at 4 (analyzing the relationships between China and the Cayman Islands and British Virgin Islands).

reverse merger crisis:

While the capital raised in CBVI may well flow back to China, the corporate structures developed in CBVI are more familiar to international investors and may provide opportunities for these companies also to move, in the longer term, more aggressively into other international markets. There are already examples of CBVI registered Chinese firms undertaking takeovers of firms on other international stock exchanges . . . .<sup>142</sup>

Until recently, Chinese firms could easily enjoy special tax holidays offered to foreign investment enterprises by using offshore entities for “round-tripping.”<sup>143</sup> “Round-tripping” usually involves registering a holding firm in the Cayman Islands as the parent of a Chinese firm and manipulating the firm’s capital and equity to make the entity look foreign.<sup>144</sup> Chinese firms could bring capital back into China as a foreign investment and receive preferential treatment on the foreign capital by first channeling the capital out of China through offshore entities.<sup>145</sup> However, between 2004 and 2006, offshore capital investment into China dwarfed China’s outflow investment to CBVI—creating around \$16.5 billion in net investment from CBVI into China.<sup>146</sup> Positive net investment into China from CBVI suggests that significant amounts of international capital are making their way into Mainland China through offshore entities.<sup>147</sup>

A study of U.S.-listed Chinese firms shows that around 76% of the firms studied use a Cayman Islands firm as the ultimate holding firm.<sup>148</sup> The Cayman Islands is one of the most attractive offshore locations for a CRM to incorporate its holding firm because there are lower incorporation costs and firms can amend charter documents quickly.<sup>149</sup> Furthermore, the Cayman Islands provides Chinese firms the ability to offer an IPO on both the U.S. and H.K. stock exchanges—a feature that several other offshore locations do not have.<sup>150</sup>

With around 40% of the firms in the study using a Cayman Islands holding firm with a British Virgin Islands subsidiary that directly controls subsidiaries in

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142. *Id.* at 21.

143. *See id.* (stating that the authors have seen government attempts to end “round-tripping”).

144. Yadong Luo & Rosalie L. Tung, *International Expansion of Emerging Market Enterprises: A Springboard Perspective*, J. OF INT’L BUS. STUD. 481, 482 (2007).

145. *See* SUTHERLAND & MATTHEWS, *supra* note 60, at 6 (arguing that by targeting foreign investment, firms may create greater value than had they remained solely on domestic exchanges).

146. *See id.* at 18–19 (adding that these figures are most likely underestimates, for they do not consider Chinese firms trading in markets other than the U.S. market).

147. *See id.* at 18 (analyzing the net flow of capital from CBVI to Hong Kong and China).

148. *See id.* at 13 (identifying fifty-five out of seventy-two firms in the study as located in the Cayman Islands).

149. FRED M. GREGURAS & DAVID W. LIU, AN UPDATED LOOK AT DOING BUSINESS IN CHINA VIA CAYMAN ISLANDS 4 (June 3, 2003), [http://www.fenwick.com/FenwickDocuments/Doing\\_Business\\_in\\_China.pdf](http://www.fenwick.com/FenwickDocuments/Doing_Business_in_China.pdf).

150. *See* SUTHERLAND & MATTHEWS, *supra* note 60, at 17 (explaining that this offers greater flexibility and maximum value to firms); *see also* GREGURAS & LIU, *supra* note 149, at 1 (listing the countries of domicile from which companies can list on the H.K. Stock Exchange).

Mainland China, offshore ownership structures of CRMs are complex.<sup>151</sup> One commentator considered whether using a British Virgin Islands intermediary entity allows the firm to better camouflage its round-tripping activity but concluded that, more likely, “it creates greater anonymity and secrecy for the controlling shareholders using this type of control chain.”<sup>152</sup> Due to the complexity of typical Chinese Reverse Merger corporate structures, concealment of assets is a built-in risk for non-Chinese investors seeking to recover, but the swift action of a receiver may help quell the risk of asset dispersal.<sup>153</sup>

### III. APPLYING THE CORPORATE GOVERNANCE STRATEGY TO AN OFFSHORE STRUCTURE

Recent case law in offshore jurisdictions is enhancing the powers of the receivership for offshore asset tracing.<sup>154</sup> Courts in CBVI are “proactively developing their jurisdiction in relation to equitable receivership in circumstances where there are potentially sham entities involved, or attempts being made to conceal assets from the reach of creditors.”<sup>155</sup> CBVI courts are moving towards a modern approach of “look[ing] through corporate structures to the practical reality of who actually controls an asset,” which expands the scope of assets over which a claimant may seek enforcement.<sup>156</sup>

A receiver may be appointed over a myriad of asset classes,<sup>157</sup> but a well-drafted receiver application can ensure the appointment gives the receiver power over shares in the holding firm.<sup>158</sup> A well-drafted receiver application enables disputed shares to rest with the receiver, giving the receiver power to vote those shares and control over the corporate structure.<sup>159</sup> Because CRMs commonly place assets into CBVI holding firms, using “a receiver to take control of the corporate structure and move ‘downstream’ to the assets is a particularly potent strategy.”<sup>160</sup>

Under the internal affairs doctrine,<sup>161</sup> a shareholder that has a sufficient equity

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151. See SUTHERLAND & MATTHEWS, *supra* note 60, at 14 (calling this structure the most common form found in the study).

152. *Id.* at 18.

153. See, e.g., *Deutsch v. ZST Dig. Networks, Inc.*, No. 8014-VCL, 2018 Del. Ch. LEXIS 191, at \*17–18 (Del. Ch. 2018).

154. See *Hidden Assets: Using Equitable Receivers to Secure Recovery*, *supra* note 130 (stating that recent litigation allows assets to be held in a trust or foundation for equitable receivers); see also *McFarlane*, *supra* note 129, at 2 (granting the receiver greater power of revocation of a trust than the settlor).

155. *Hidden Assets: Using Equitable Receivers to Secure Recovery*, *supra* note 130.

156. *Id.* at 2.

157. See *McFarlane*, *supra* note 129, at 2 (“Receivers may be appointed over shares, LLP interests, bank accounts, contractual rights, rights reserved under a trust or beneficiary entitlement.”).

158. *Id.*

159. *Id.*

160. *Id.* at 1.

161. See *Edgar v. Mite Corp.*, 457 U.S. 624, 645 (1982) (defining the internal affairs doctrine as limiting one state to regulate a particular corporation’s internal affairs).

interest in an offshore holding firm, as defined by the firm's corporate governance documents, can generally assume control of the subsidiary by appointing board members that will govern under the interests of the shareholder.<sup>162</sup> This strategy can help a minority equity holder access and secure assets beyond CBVI "without the additional and often alien concept of receiver recognition."<sup>163</sup>

Although an appointment of a receiver supplants the power of corporate directors over assets subject to the receiver's control, it does not automatically remove directors from office.<sup>164</sup> Consequently, directors retain residual powers on issues not covered by the receivership, unless further actions are taken to remove directors from office.<sup>165</sup> When applied to CRMs, corporate directors may attempt to "break the chain" in a WFOE to manipulate the ownership structure by selling or transferring subsidiaries or their assets to insiders or third-parties, thus placing them "outside the claim of ownership . . . to devalue the operations and hinder takeover" by an equitable receiver.<sup>166</sup>

However, using receivership to vote shares to remove and replace directors may permit a minority equity holder to achieve a position of strategic value and reduce the risk of asset dissipation.<sup>167</sup> Directors of the holding firm and directors of all subsidiaries can be removed and replaced, as resolved and ratified, through the written consent of an equitable receiver in the name and on behalf of the firm.<sup>168</sup> However, an equitable receiver must act swiftly and enact sweeping resolutions, as the boards of a CRM's subsidiaries may attempt to manipulate ownership of assets.<sup>169</sup> Such resolutions can remove and replace corporate officers through an entire WFOE structure, changing control of subsidiaries in multiple jurisdictions at the same time.<sup>170</sup>

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162. See Seiden, *supra* note 98 (stating that courts will not interfere with these appointments because they are legal exercises of corporate shareholder rights).

163. McFarlane, *supra* note 129, at 2; see Seiden, *supra* note 98 (explaining the advantages of corporate takeover via board replacement over relying on foreign judgments).

164. MOURANT OZANNES, *supra* note 127, at 5.

165. *Id.*

166. See Seiden, *supra* note 98 (using "break the chain" to illustrate the connections between the holding company and the subsidiaries).

167. See *id.* (analyzing post-judgment remedies).

168. See, e.g., Written Consent of the Court-Appointed Receiver for China Nutrifruit Group Limited (July 24, 2015) (on file with author) [hereinafter Written Consent] (demonstrating how court-appointed receivers can remove board members). See generally Seiden, *supra* note 98 (describing how receivers can function like majority shareholders).

169. See generally Seiden, *supra* note 98 (describing how a large shareholder can manipulate company assets).

170. See, e.g., Written Consent, *supra* note 168 (showing that receivers can replace corporate officers of subsidiaries in multiple jurisdictions).

***A. Sino Clean Energy, Inc. v. Seiden—Corporate Governance Strategy in Action***

In May 2014, a Nevada state court appointed Robert Seiden, Esquire,<sup>171</sup> the receiver of Sino Clean Energy, Inc. (Sino), after a group of U.S. investors requested the appointment when Sino went dark and caused economic losses.<sup>172</sup> Sino is a Chinese Reverse Merger holding firm incorporated in Nevada with subsidiaries in Mainland China that produce coal-water slurry.<sup>173</sup> The Sino bankruptcy case synthesizes the corporate governance strategy in the Chinese Reverse Merger context and shows some of the more creative techniques a receiver can employ when former firm insiders meddle with the recovery process.

In May 2015, the receiver filed criminal charges with H.K. police alleging that Sino's chairman, Baowen Ren, fraudulently backdated a transfer of shares in Sino's H.K. subsidiary to a British Virgin Islands firm that Ren controlled—pilfering Sino and its shareholders—without the receiver's permission or knowledge.<sup>174</sup> Despite attempts by the receiver's agents to resolve issues with Ren, Ren refused to settle or comply with the court's receivership orders.<sup>175</sup>

In 2014, the court-appointed receiver installed a new board of directors at the Sino holding firm in Nevada.<sup>176</sup> Soon after, however, former board members, acting by and through Ren, filed a Chapter 11 petition for bankruptcy on behalf of the firm.<sup>177</sup> The receiver, Seiden, moved to dismiss, and the bankruptcy court granted the motion—a decision the former Sino directors later appealed.<sup>178</sup> In the Chinese Reverse Merger context, in addition to establishing board control over the U.S.-based holding firm, controlling the board of the operating firm in China allows the receiver to go into Mainland China as the legal owner of operating assets “standing

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171. THE SEIDEN GROUP, *supra* note 134 (detailing that Seiden has vast experience with integrity monitoring and has been appointed receiver over twenty times in the United States); *see also* Stevenson & Goldstein, *supra* note 33 (“Robert W. Seiden is a Wall Street bounty hunter. He tracks down executives of Chinese companies that listed on stock exchanges in the United States and then blew up.”).

172. *Sino Clean Energy Inc. v. Seiden*, 565 B.R. 677, 679–80 (D. Nev. 2017); *BVI Shell Company Allegedly Used to Steal US and Chinese Shareholder Interests in Energy Firm*, CARIBBEAN NEWS NOW! (June 26, 2015), <https://www.caribbeannewsnow.com/2015/06/26/bvi-shell-company-allegedly-used-to-steal-us-and-chinese-shareholder-interests-in-energy-firm/>.

173. *Sino Clean Energy Inc.*, 565 B.R. at 679–80; *Sino Clean Energy, Inc. Prospectus*, NASDAQ (Dec. 21, 2010), <https://www.nasdaq.com/markets/spos/filing.ashx?filingid=7820499>; *see BVI Shell Company Allegedly Used to Steal US and Chinese Shareholder Interests in Energy Firm*, *supra* note 172 (describing the corporate structure of Sino Clean Energy); *see also* Markus Aarnio, *Sino Clean Energy Poised to Double Production Capacity in 2012*, SEEKING ALPHA (Jan. 15, 2012, 7:45 AM), <https://seekingalpha.com/article/319701-sino-clean-energy-poised-to-double-production-capacity-in-2012> (describing Sino Clean Energy as the fifth largest producer of coal-water slurry fuel by sales in China).

174. *BVI Shell Company Allegedly Used to Steal US and Chinese Shareholder Interests in Energy Firm*, *supra* note 172.

175. *Id.*

176. Written Consent, *supra* note 168.

177. *Sino Clean Energy Inc.*, 565 B.R. at 680.

178. *Id.*

in the shoes of the company.”<sup>179</sup> Accordingly, before January 2015, the Nevada court-appointed receiver reported removal and replacement of the board of directors of Sino’s operating firm in Mainland China with an American chairman.<sup>180</sup>

In February 2016, a Nevada district court judge overseeing the same action held Ren in criminal contempt for repeatedly violating its receivership orders.<sup>181</sup> In addition to an outstanding civil *per diem* penalty of \$500 ordered in June 2015, the court ordered a bench warrant to imprison Ren for his contempt.<sup>182</sup> The court ordered Ren to be jailed until he transferred Sino’s official corporate seal, known as a “chop,”<sup>183</sup> to the receiver.<sup>184</sup> The court also held Ren’s illegal transfer of Sino’s assets to be invalid.<sup>185</sup> The receiver stated that the bench warrant would be sent to Interpol in Beijing, along with a request for assistance from Chinese authorities to arrest Ren.<sup>186</sup>

Meanwhile, the ongoing bankruptcy case against Sino also affected its existing contractual liability. The appointment of a receiver can change who possesses control over a firm, but it does not affect the corporate existence of a firm, which means the firm continues to be liable for its existing contracts after the appointment of a receiver.<sup>187</sup> According to the January 2015 report, the receiver communicated with Sino’s suppliers, business partners, and its customers around the globe, contacted Sino’s Chinese banks to change signatories and gain control over accounts, put in place an interim management team to run day-to-day operations, and selected an independent auditor to advise on the economic state of Sino and its subsidiaries.<sup>188</sup>

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179. Michael Rapoport, *Court Appointee Chases (and Finds) Investor Cash that Vanished in China*, WALL ST. J. (June 21, 2015, 4:28 PM), <https://www.wsj.com/articles/court-appointee-chases-and-finds-investor-cash-that-vanished-in-china-1434918506>.

180. *U.S. Court-appointed Receiver for Sino Clean Energy Inc. (Nasdaq “SCEI”) Taking Control of Chinese Company*, PR NEWSWIRE (Jan. 25, 2015), <https://www.prnewswire.com/news-releases/us-court-appointed-receiver-for-sino-clean-energy-inc-nasdaq-scei-taking-control-of-chinese-company-300018796.html>.

181. *U.S. Court Orders China Businessman Jailed for Defying Court-Appointed Receiver and Judge’s Order to Cede Control of the Company to the Receiver*, PR NEWSWIRE (Feb. 29, 2016), <https://www.prnewswire.com/news-releases/us-court-orders-china-businessman-jailed-for-defying-court-appointed-receiver-and-judges-order-to-cede-control-of-the-company-to-the-receiver-300228158.html>.

182. *Id.*

183. Dezan Shira & Assocs., *Company Chops in China: What are They and How to Use Them*, CHINA BRIEFING (May 10, 2017), <http://www.china-briefing.com/news/2017/05/10/use-of-company-chops-in-china.html> (explaining that “the chop” is mandatory to do business in Mainland China and functions as the company’s official signature).

184. *U.S. Court Orders China Businessman Jailed for Defying Court-Appointed Receiver and Judge’s Order to Cede Control of the Company to the Receiver*, *supra* note 181.

185. *Id.*

186. *Id.*

187. *British Virgin Islands—Restructuring and Insolvency*, OGIER (Nov. 4, 2013), [www.ogier.com/publications/british-virgin-islands-restructuring-and-insolvency](http://www.ogier.com/publications/british-virgin-islands-restructuring-and-insolvency).

188. *U.S. Court-appointed Receiver for Sino Clean Energy Inc. (Nasdaq “SCEI”) Taking Control of Chinese Company*, *supra* note 180.

In *Sino Clean Energy, Inc. v. Seiden*, former directors of Sino appealed the dismissal of their 2015 bankruptcy petition—arguing that federal bankruptcy law preempts a receiver appointed under state law from barring a corporation from filing for bankruptcy.<sup>189</sup> In January 2017, the Court affirmed the bankruptcy court's dismissal because appellants did not have authority to file for bankruptcy on behalf of Sino at the time of the petition.<sup>190</sup>

The court found the appellants' argument unpersuasive because the receiver removed appellants in 2014—installing a new board of directors more than a year before appellants filed their bankruptcy petition in 2015.<sup>191</sup> The court's order did not affect a corporation's right to file for bankruptcy but prevented a former board of directors from filing by holding that only a corporation's current board of directors can file for bankruptcy.<sup>192</sup> The district court's decision demonstrates that a court-appointed receiver is unequivocally empowered to reconstruct the board of directors of a Chinese Reverse Merger holding firm based in the United States. Moreover, the *Sino Clean Energy, Inc.* saga shows that a court-appointed receiver with control of a Chinese Reverse Merger corporate structure can capably affect its Mainland China-based management at the operating business level as well.<sup>193</sup>

### **B. Sino-Environment Technology Group Limited v. Thumb Env-Tech Group (Fujian) Co., Ltd.: Signaling Stronger Rights for Offshore Creditors and Investors**

This section will further explore the topic of corporate control by discussing a landmark case involving a non-Chinese parent company's right to control its Mainland China subsidiary.<sup>194</sup> Significantly, in this case the highest court in China recognized the authority of an insolvency officer appointed by a foreign court to act on behalf of the parent company.<sup>195</sup> As will be discussed, this may have potential

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189. *Sino Clean Energy Inc. v. Seiden*, 565 B.R. 677, 679 (D. Nev. 2017).

190. *See id.* at 681, 683 (finding that Nevada law gives a corporation's *current* board of directors exclusive power to file for bankruptcy); *see also* Richard Levin, *Recent Developments in Bankruptcy Law*, JENNER & BLOCK ¶ 4.1.a (July 2017), <https://jenner.com/system/assets/assets/10294/original/Recent%20Developments%20in%20Bankruptcy%20Law%20-%20July%202017.pdf> (“State law here authorizes the current directors to authorize a filing.”).

191. *Sino Clean Energy*, 565 B.R. at 681.

192. *Id.* at 677; Levin, *supra* note 190.

193. *See generally U.S. Court-appointed Receiver for Sino Clean Energy Inc. (Nasdaq “SCEI”) Taking Control of Chinese Company*, *supra* note 180.

194. *See McGinty & Dobby*, *supra* note 40 (describing the background of this case as a battle between the parent company's offshore court-appointed insolvency officers and the subsidiary's former board members).

195. Xinjiapo Zhonghua Huanbao Keji Jituan Youxian Gongsi yu Damuzhi Huanbao Keji Jituan (Fujian) Youxian Gongsi Gudong Chuzi Jiufen'an (新加坡中华环保科技集团有限公司与大拇指环保科技集团(福建)有限公司股东出资纠纷案), *translated in Sino-Environment Technology Group Ltd. v. Thumb Env-Tech Group (Fujian) Co., Ltd.*, at 15–16 (Sup. People's Ct. 2014) (China), [http://www.insol.org/emailer/Apr\\_2015\\_downloads/Document%209.pdf](http://www.insol.org/emailer/Apr_2015_downloads/Document%209.pdf). [hereinafter *Sino-Environment v. Thumb Env-Tech*].



implications for court-appointed receivers seeking to exert control over subsidiaries located in Mainland China.<sup>196</sup>

In 2010, the High Court of Singapore (Singapore High Court) placed Sino-Environment Technology Group Ltd. (Sino-Env), a Singaporean corporation, into judicial management.<sup>197</sup> The Singapore High Court appointed two judicial managers to take control of Sino-Env's businesses and property to "continue its operation, and (or) achieve more favorable realization of the company's assets than through [resorting to] dissolution."<sup>198</sup> Sino-Env's assets included Thumb Env-Tech Group Co., Ltd. (Fujian Thumb), its wholly-owned subsidiary, located in Mainland China.<sup>199</sup>

In 2010, Fujian Thumb commenced an action against its parent seeking to compel Sino-Env to perform its shareholder obligation of making capital contributions to Fujian Thumb.<sup>200</sup> In 2011, the judicial managers of Sino-Env passed written resolutions to replace the legal representative and directors of Fujian Thumb.<sup>201</sup> In Mainland China, the legal representative holds a key role with the power to act and contract on behalf of the firm and is tasked with embodying the true aims of the firm.<sup>202</sup> Under Chinese law, "the sole shareholder of a WFOE has the right to remove and replace the legal representative by written resolution."<sup>203</sup> However, in order to become effective, the changes may need to be registered with the relevant Administration of Industry and Commerce (AIC) office.<sup>204</sup> Interestingly, registering these changes at the AIC may also require the cooperation of the incumbent legal representative.<sup>205</sup>

In this case, the incumbent legal representative of Fujian Thumb registered at the AIC remained aligned with incumbent management and continued pursuing the litigation against Sino-Env for outstanding capital contributions.<sup>206</sup> In parallel litigation, Sino-Env "pursued a number of actions seeking to compel the existing management and local AIC to recognise the appointment of the new legal representative."<sup>207</sup> In 2012, the Higher People's Court of Fujian Province (Fujian Court), asserting jurisdiction,<sup>208</sup> issued an order freezing assets of Sino-Env related

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196. McGinty & Dobby, *supra* note 40.

197. Sino-Environment v. Thumb Env-Tech, *supra* note 195, at 4.

198. *Id.*

199. *Id.* at 10.

200. *Id.* at 2.

201. McGinty & Dobby, *supra* note 40.

202. *Id.*

203. *Id.*

204. *Id.*

205. *See id.* (explaining that, in some cases, an AIC might refuse to recognize a new legal representative appointed by the sole shareholder of a WFOE, instead trusting the outgoing legal representative only).

206. *Id.* at 2.

207. McGinty & Dobby, *supra* note 40.

208. Sino-Environment v. Thumb Env-Tech, *supra* note 195, at 2.

to certain amounts it allegedly owed to Fujian Thumb.<sup>209</sup> Sino-Env appealed the Fujian Court decision to the Supreme People's Court (SPC).<sup>210</sup>

In 2014, *Sino-Environment Technology Group Limited v. Thumb Env-Tech Group (Fujian) Co., Ltd.* came before the SPC.<sup>211</sup> The court dismissed Fujian Thumb's claim for capital contributions and ruled on three key points.<sup>212</sup> First, it found that the power to represent a party in litigation in Mainland China is determined according to the law of the jurisdiction where the respective firm is incorporated.<sup>213</sup> Because Sino-Env was a legal person incorporated in Singapore and was placed into judicial management and later into liquidation by Singaporean courts, the judicial managers and liquidators could represent Sino-Env in the litigation in Mainland China.<sup>214</sup> In the same vein, the court found that the power to represent a Mainland China firm in litigation was a matter of Chinese law.<sup>215</sup> Therefore, being a Chinese legal person, Fujian Thumb could rightfully sue its parent, and Sino-Env could not force Fujian Thumb to withdraw from litigation without the acquiescence of Fujian Thumb's legal representative.<sup>216</sup> Second, the court found that for external matters involving third parties, the incumbent representative registered with the AIC must prevail over the legal representative appointed by the judicial managers who had not yet registered with the AIC.<sup>217</sup> Third, however, the court found that between a parent and its subsidiary "[a] valid resolution for removal and appointment of the legal representative passed by the shareholder should prevail and have the legal effect of changing the legal representative [of a Mainland China subsidiary] for internal purposes."<sup>218</sup>

The internal purposes distinction made the resolution passed by Sino-Env's judicial managers to change Fujian Thumb's legal representative binding, even without registering the change with the relevant AIC.<sup>219</sup> Since the legal representative appointed by the judicial managers was opposed to continuing the litigation, Fujian Thumb could not continue its litigation for capital contributions against Sino-Env.<sup>220</sup> However, the external and internal distinction could mean that third parties dealing with the Mainland China subsidiary may recognize the authority

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209. McGinty & Dobby, *supra* note 40.

210. Sino-Environment v. Thumb Env-Tech, *supra* note 195, at 1; McGinty & Dobby, *supra* note 40; see *Introduction*, THE SUPREME PEOPLE'S COURT OF THE PEOPLE'S REPUBLIC OF CHINA (July 16, 2015), [http://english.court.gov.cn/2015-07/16/content\\_21299713.htm](http://english.court.gov.cn/2015-07/16/content_21299713.htm) ("The Supreme People's Court is the highest trial organ in the country and exercises its right of trial independently. It is also the highest supervising organ over the trial practices of local people's courts and special people's courts at various levels.").

211. Sino-Environment v. Thumb Env-Tech, *supra* note 195, at 13.

212. McGinty & Dobby, *supra* note 40.

213. Sino-Environment v. Thumb Env-Tech, *supra* note 195, at 13.

214. *Id.*

215. *Id.* at 13–14.

216. *Id.*

217. McGinty & Dobby, *supra* note 40 (paraphrasing the court's conclusion on the issue of which legal representative has priority with respect to dealings with other Chinese companies).

218. McGinty & Dobby, *supra* note 40.

219. Sino-Environment v. Thumb Env-Tech, *supra* note 195, at 15.

220. *Id.*

of the incumbent legal representative until the AIC registration is formally changed.<sup>221</sup>

The SPC's decision in *Sino-Environment* signals that the highest court in Mainland China recognizes "the powers and role of offshore shareholders under local law in the jurisdiction of appointment and will respect those powers."<sup>222</sup> Although Mainland China is a civil law jurisdiction without binding precedent and *Sino-Environment* is not legally binding on lower courts, in practice SPC decisions are "highly persuasive and are likely to be followed by local courts."<sup>223</sup> Although *Sino-Environment* involves the formal recognition of court-appointed insolvency officers, this case may be helpful in the Chinese Reverse Merger context for court-appointed receivers seeking to act on behalf of an offshore holding firm.<sup>224</sup> Receivers could rely on the example of insolvency to argue that Chinese courts should also recognize the rights of receivers to act on behalf of their companies based on the laws of the appropriate jurisdiction of incorporation.<sup>225</sup> Furthermore, a risk-averse Chinese judge may be more inclined to recognize an assertion to act on behalf of an offshore firm "when supported by a court order confirming the authority of the representative to act."<sup>226</sup> In the Chinese Reverse Merger context, such an order is not typically sought on a receivership because the subsidiary firm rarely challenges the appointment in a foreign court.<sup>227</sup>

Receiver recognition is generally considered an "alien concept."<sup>228</sup> However, recognition of appointed receivers has been successful in offshore jurisdictions where the receiver meets strict standards for legal standing.<sup>229</sup> Although *Sino-Environment* does not represent an "overnight sea change,"<sup>230</sup> the recognition of the right of an insolvency officer appointed under the law of a foreign jurisdiction to exert control over its Mainland China subsidiary may signal stronger rights for

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221. McGinty & Dobby, *supra* note 40.

222. *Id.*

223. *Id.*

224. *See id.* (arguing that this interpretation would be consistent with the strict reading of the SPC decision).

225. *Id.*

226. *Id.*

227. McGinty & Dobby, *supra* note 40; *see* Webinar: *How to Trace Dirty Money: Coordinating Legal and Investigative Fact Finding to Recover Hidden Assets*, KOBRE & KIM, MINTZ GROUP (Nov. 13, 2017), <https://www.brighttalk.com/webcast/15055/284719/how-to-trace-dirty-money> (referring to a case where a state court appointed receiver facilitated a recovery in Mainland China); *see also* Email from Carrie A. Tandler, Lawyer, Kobre & Kim, to author (Dec. 5, 2017) (on file with author) (confirming the existence of such a case, but unable to disclose more because it is sealed).

228. McFarlane, *supra* note 129.

229. Paul Richard Brown & Eric S. Rein, *Jurisdictional Land Mines Facing Receivers in Pursuing Claims in Foreign Jurisdictions*, KARR TUTTLE CAMPBELL (June 20, 2016), <https://www.karrtuttle.com/jurisdictional-land-mines-facing-receivers-pursuing-claims-foreign-jurisdictions/#> (providing tests developed from offshore case law for determining receiver's legal standing for recognition in a foreign country).

230. McGinty & Dobby, *supra* note 40.

offshore creditors and investors. As the next section will explain, in addition to these rights, investors may employ other methods and mechanisms that allow for recovering assets from Mainland China.

#### IV. JUDGMENT-CREDITOR STRATEGIES FOR RECOVERING IN MAINLAND CHINA

The United States and China represent the first and second largest global economies, respectively.<sup>231</sup> In 2017, U.S. FDI in China was \$107.6 billion and China's direct investment in the United States was \$39.5 billion.<sup>232</sup> Because the countries have never formally agreed to a reliable mechanism for JRE between their courts,<sup>233</sup> U.S. judgments are not readily enforceable in Mainland China through private international law.<sup>234</sup> The U.S. Supreme Court's decision in *Asahi Metal Indus. Co. v. Superior Court of Cal.*<sup>235</sup> raised concerns that foreign manufacturers could evade liability by concentrating their operations outside the jurisdiction of U.S. courts.<sup>236</sup> These concerns seem to apply by analogy to JRE in the Chinese Reverse Merger context, too, since CRMs often use an offshore holding firm for international funding while operating assets are owned by Mainland China subsidiaries.

In practice, U.S. jurisdictions<sup>237</sup> that have adopted the Uniform Foreign Money Judgments Recognition Act or similar statutes will recognize and enforce a final

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231. Alanna Petroff, *Britain Crashes Out of World's Top 5 Economies*, CNN MONEY (Nov. 22, 2017, 1:00 PM), <http://money.cnn.com/2017/11/22/news/economy/uk-france-biggest-economies-in-the-world/index.html>.

232. *The People's Republic of China: U.S.-China Trade Facts*, U.S. TRADE REPRESENTATIVE, <https://ustr.gov/countries-regions/china-mongolia-taiwan/peoples-republic-china> (last visited on Sept. 25, 2018).

233. See Huang, *supra* note 4 (stating that other than with Hong Kong, China has never concluded a JRE treaty with a common-law jurisdiction); see generally Yuliya Zeynalova, *The Law on Recognition and Enforcement of Foreign Judgments: Is It Broken and How Do We Fix It?*, 31 BERKELEY J. INT'L L. 150, 150–51 (2013) (noting that the United States and Mainland China have not concluded a treaty governing JRE or official agreement for reciprocity, and that the New York Convention only applies to arbitral awards).

234. Dan Harris, *US Courts for Chinese Litigants. The Year in Review*, HARRIS BRICKEN: CHINA L. BLOG (Jan. 1, 2012), [www.chinalawblog.com/2012/01/us\\_courts\\_for\\_chinese\\_litigants\\_the\\_year\\_in\\_review.html](http://www.chinalawblog.com/2012/01/us_courts_for_chinese_litigants_the_year_in_review.html); see Huafang Zhu & Jiayun Shi, *Enforcement of Foreign Judgments in China*, TIAN TONG & PARTNERS (2017), <http://www.tiantonglaw.com/enforcement-of-foreign-judgments-in-china/> (stating that sources of Chinese law regarding enforcement of foreign judgments consist of the following: treaties to which China is a party, legislation, interpretations of laws, and case law); see also Hsu, *supra* note 38, at 201 (stating that the unenforceability of U.S. money judgments has a negative effect on trade between countries).

235. *Asahi Metal Indus. Co. v. Superior Court of Cal.*, 480 U.S. 102, 116 (1987) (determining that California was estopped by the 14<sup>th</sup> Amendment Due Process Clause from exercising personal jurisdiction over Asahi).

236. Antonio F. Perez, *The International Recognition of Judgments: The Debate Between Private and Public Law Solutions*, 19 BERKELEY J. INT'L L. 44, 66 (2001).

237. See Hsu, *supra* note 38, at 205 n.20 (explaining that, in the absence of a federal law or a treaty, state law governs enforcement of foreign judgments in U.S. courts).

judgment<sup>238</sup> from a Chinese court,<sup>239</sup> as a principle of Comity of Nations.<sup>240</sup> Although damages and specific performance are available remedies under Chinese law,<sup>241</sup> the same cannot be said with any certainty about Chinese courts recognizing and enforcing U.S. judgments.<sup>242</sup> Sources of Chinese law that govern JRE of foreign judgments in Mainland China include: (i) bilateral or multilateral treaties to which China is a party,<sup>243</sup> (ii) Chinese laws and regulations,<sup>244</sup> (iii) interpretations of the Civil Procedure Law issued by the SPC of China,<sup>245</sup> and (iv) SPC case law or opinions.<sup>246</sup>

The appearance of asymmetry and the perception of an emerging liability issue deriving from changing global trade flows has created pressure in the United States for a global approach to recognition and enforcement of judgments as a trade

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238. See Harris, *supra* note 234 (noting that in *Hubei Gezhouba v. Robinson*, the U.S. court rejected defendant's argument that a Chinese judgment should not be recognized because of lack of reciprocity between the United States and China, as it is not one of the grounds on which the court may refuse JRE under the Uniform Foreign Judgment Recognition Act).

239. *Your Company Can Be Sued in China and That Matters*, HARRIS BRICKEN: CHINA L. BLOG (Nov. 22, 2015), [www.chinalawblog.com/2015/11/your-company-can-be-sued-in-china-and-that-matters.html](http://www.chinalawblog.com/2015/11/your-company-can-be-sued-in-china-and-that-matters.html); see Harris, *supra* note 234 (discussing how a U.S. court did not question the propriety of enforcing a Chinese judgment).

240. See Zeynalova, *supra* note 233, at 151 (explaining that the principle of Comity of Nations encourages the common law and individual states to recognize foreign judgments in American courts, but foreign countries may choose not to reciprocate); see also Hsu, *supra* note 38, at 206 n.27 (noting that *Johnston v. Compagnie Generale Transatlantique* held that *Hilton v. Guyot*, which vocalizes the importance of extending protection of law to a nation's citizens and other persons under the protection of its laws, is not binding authority, because JRE is a matter of state law under the *Erie* Doctrine, but the state court nevertheless applied principles of comity, as discussed in *Hilton*).

241. Zhu & Shi, *supra* note 234.

242. Harris, *supra* note 234.

243. See Zhu & Shi, *supra* note 234 (noting that treaties are an applicable source of law regarding enforcement of foreign judgments by Chinese courts); see, e.g., Jie Huang, *Interregional Recognition and Enforcement of Civil and Commercial Judgments: Lessons for China from US and EU Laws* 72 (2010) (unpublished S.J.D. dissertation, School of Law, Duke University) (on file with Duke Law Theses and Dissertations) (stating that Italy and Mainland China concluded a JRE Treaty that became effective in 1995); but see Dan Harris, *China Enforces United States Judgment: This Changes Pretty Much Nothing*, HARRIS BRICKEN: CHINA L. BLOG (Sept. 5, 2017), [www.chinalawblog.com/2017/09/china-enforces-united-states-judgment-this-changes-pretty-much-nothing.html](http://www.chinalawblog.com/2017/09/china-enforces-united-states-judgment-this-changes-pretty-much-nothing.html) (explaining that the SPC refused JRE of an Australian judgment, despite an existing agreement between Australia and Mainland China, because there was no international treaty on mutual recognition and enforcement).

244. Zhu & Shi, *supra* note 234 (listing relevant applicable Chinese legislation: the Civil Procedure Law (2012), the General Principles of Civil Law (1986), and the Law on the Application of Law for Foreign-related Civil Relations).

245. See *id.* (explaining that the SPC's interpretations are considered authoritative and that Chinese courts will typically refer to the SPC's interpretation of the Civil Procedure Law of 2015).

246. See *id.* (recognizing that because China is a civil law country, precedents are not primary sources of law). However, SPC opinions are usually followed by lower courts, and sometimes a Letter of Reply issued by the SPC to a lower court can be determinative in whether a JRE is permitted in Mainland China. *Id.*

problem.<sup>247</sup> The following sections describe investor recovery in the cross-border insolvency context and explain how judgment-creditors may use JRE treaties, de facto JRE reciprocity, and Singapore High Court case law to recover value from their investments in Mainland China.

### A. Cross-border Insolvency Gives Rise to JRE Problem

To quote an American Chief Executive Officer, “capitalism without bankruptcy is like Christianity without hell.”<sup>248</sup> As the Chinese economy enjoyed its meteoric rise and attracted “more and more foreign-related investment enterprises . . . cross-border failures of enterprises also came to China.”<sup>249</sup> Lacking a formal bankruptcy process for much of its history, Mainland China’s past treatment of foreign creditors was checkered and plagued by local protectionism.<sup>250</sup>

Since 2007, when the new Enterprise Bankruptcy Law of the People’s Republic of China<sup>251</sup> (EBL 2007) came into effect—replacing EBL 1986—the bankruptcy process has improved reliability,<sup>252</sup> especially for creditors of Chinese bankrupts,<sup>253</sup> but leaves unanswered questions for creditors of non-Chinese bankrupts whose assets are located in Mainland China.<sup>254</sup> Under EBL 2007, a creditor can apply for

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247. YONGQIAN XU & HAIZHENG ZHANG, CHINA’S NEW ENTERPRISE BANKRUPTCY LAW: CONTEXT, INTERPRETATION AND APPLICATION (MARKETS AND THE LAW) 323 (Rebecca Parry ed., 2010) (indicating that because of “the increasing integration of the global economy,” “globalized production and distribution of goods and services renders it unavoidable that China will encounter more and more cross-border insolvency cases”).

248. Editorial, *An Industry in Turbulence*, L.A. TIMES, Dec. 6, 2002, § 2, at 16 (quoting former Eastern Airlines CEO Frank Borman).

249. XU & ZHANG, *supra* note 247, at 324.

250. See RICHARD C. PEDONE & HENRY H. LIU, THE EVOLUTION OF CHINESE BANKRUPTCY LAW: CHALLENGES OF A GROWING PRACTICE AREA 2 (2010) (stating that commentators have posited theories on the rarity of bankruptcy cases in China and noting the large impact of local governments in deciding whether a business should pursue bankruptcy); see also Chris Devonshire-Ellis, *Local Political Involvement When Liquidating China Based Assets*, CHINA BRIEFING (Apr. 19, 2010), [www.china-briefing.com/news/2010/04/19/local-political-involvement-when-liquidating-china-based-assets.html](http://www.china-briefing.com/news/2010/04/19/local-political-involvement-when-liquidating-china-based-assets.html) (remarking that local Chinese governments have political interests in businesses and describing an example of how one Chinese subsidiary of a Cayman-based company refused to recognize the jurisdiction of Cayman courts); see also XU & ZHANG, *supra* note 247, at 327 (explaining that because of a lack of formal bankruptcy law in Mainland China, the H.K. receiver in *LMK* had to deal with the local Chinese government, but was still able to secure assets and distribute them in the H.K. bankruptcy proceeding).

251. *Reform of the Bankruptcy Regime in the People’s Republic of China*, TANNER DE WITT (Sept. 2017), [www.tannerdewitt.com/reform-of-the-bankruptcy-regime-in-the-peoples-republic-of-china](http://www.tannerdewitt.com/reform-of-the-bankruptcy-regime-in-the-peoples-republic-of-china) (stating that China did not have a formal bankruptcy regime before the enactment of EBL 2007, which introduced concepts such as the appointment of an independent administrator, a creditor committee, and the option to restructure as an alternative to winding up and cross-border JRE of bankruptcy rulings and judgments).

252. See PEDONE & LIU, *supra* note 250, at 3 (explaining that SPC officials recognize China’s need to develop judicial expertise in bankruptcy by establishing special departments and courts to deal with bankruptcy proceedings).

253. See *Reform of the Bankruptcy Regime in the People’s Republic of China*, *supra* note 251 (highlighting the conditions surrounding JRE of foreign bankruptcy judgments under EBL 2007).

254. See *id.* (explaining that where conditions under Article 5 of EBL 2007 are met,

an involuntary bankruptcy filing, which, if approved,<sup>255</sup> allows the creditor to pursue reorganization or liquidation proceedings that are binding on a Chinese bankrupt's property and estate situated in and outside of Mainland China.<sup>256</sup>

The *Guangdong International Trust Investment Corporation (GITIC)* bankruptcy case in 2000—the first case concerning the bankruptcy of a large Chinese financial state-owned enterprise under EBL 1986<sup>257</sup>—demonstrated that Chinese courts are very sensitive to the principle of creditor equality in cross-border insolvency.<sup>258</sup> In *GITIC*, the Guangdong People's High Court (Guangdong Court) dismissed the judgment creditor's application for JRE of a default judgment ordered against GITIC by the H.K. High Court for a debt owed by its H.K. subsidiary, GITIC Hong Kong (GITIC HK).<sup>259</sup>

In 1998, GITIC HK entered voluntary liquidation in Hong Kong, while the parent company, GITIC, declared bankruptcy in accordance with EBL 1986 in the Guangdong Court in 1999.<sup>260</sup> Using its discretion, the Guangdong Court refused to recognize or enforce the judgment against GITIC because GITIC opened its bankruptcy proceeding in Mainland China, and was pursuing a universal collection and distribution of all its assets, which included amounts owed by GITIC HK.<sup>261</sup> The Guangdong Court prevented the judgment creditor from attaching the debt owed by GITIC HK to GITIC based on the principle of equitable treatment of all creditors—depriving the judgment creditor's application of preference over other creditors of GITIC<sup>262</sup>—since JRE of “[the High Court of Hong Kong] garnishee order would

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creditors of a non-Chinese bankrupt company may enforce a foreign bankruptcy ruling or judgment against a debtor whose assets are situated in Mainland China).

255. See Steven J. Arsenault, *The Westernization of Chinese Bankruptcy Law Through the Lens of the UNCITRAL Legislative Guide to Insolvency Law*, 27 PENN. ST. INT'L L. REV. 45, 49–50 (stating that an involuntary bankruptcy application, which undergoes a fifteen-day review period, must be filed in place of debtor's residence).

256. *Id.* at 49–53 (explaining that EBL 2007 criteria are different from insolvency under U.S. law in two ways: 1) U.S. law requires no particular degree of economic distress to seek bankruptcy protection; and 2) although bankruptcy under U.S. law triggers an automatic stay, under EBL 2007, a Chinese court's acceptance of a filing triggers an automatic stay that continues only until a receiver is appointed to manage the debtor's property and does not prevent new litigation from being filed so long as it is filed in the People's Court with jurisdiction over the proceeding); see also XU & ZHANG, *supra* note 247, at 335–40 (providing an example of the extraterritorial effect of Chinese bankruptcy in the *GITIC* bankruptcy case).

257. Jingxia Shi, *A Summary of the Position on Cross-Border Insolvency in China*, INT'L INSOLVENCY INST. 1, [www.iiiglobal.org/sites/default/files/8-\\_China\\_on\\_Cross.pdf](http://www.iiiglobal.org/sites/default/files/8-_China_on_Cross.pdf).

258. XU & ZHANG, *supra* note 247, at 336.

259. *Id.* at 338.

260. *Id.* at 336.

261. *Id.* at 338.

262. See *id.* at 338–39 (noting that the Guangdong Court granted GITIC's application to stay proceedings, including the execution of judgments); see also Shi, *supra* note 257, at 2 (“As the first case recognizing the bankruptcy proceeding in the Mainland, it may produce very positive implications on China's future judicial practice on cross-border insolvency, particularly requiring Chinese courts to treat all creditors fairly.”).

interfere with that process.”<sup>263</sup> As such, “all creditors [of GITIC] in the same rank, whether Chinese or foreign, obtained dividends under the *pari passu* principle.”<sup>264</sup>

While the *GITIC* case was decided in accordance with EBL 1986, at the time, it was the largest bankruptcy in Chinese history,<sup>265</sup> making the Guangdong Court’s reasoning on the principle of creditor equality potentially helpful for understanding the considerations of Chinese courts when exercising discretion on JRE of foreign bankruptcy judgments. This is especially true since “the recognition of foreign bankruptcy proceedings [in Mainland China] largely falls into the ambit of exercising the judge’s discretion.”<sup>266</sup> The *GITIC* case, adjudicated against the legal backdrop of EBL 1986, bodes well for the future of cross-border insolvency involving Chinese courts because the Guangdong Court treated worldwide creditors fairly.<sup>267</sup> It should further be noted that while not central to the Guangdong Court’s reasoning, *GITIC* evidenced the extraterritorial nature of declaring bankruptcy in China and its effect on a Chinese bankrupt’s assets situated outside of Mainland China.<sup>268</sup>

However, while EBL 1986 allowed the *GITIC* case to treat worldwide creditors of a Chinese bankrupt fairly, EBL 2007 did little to improve the lot of creditors of non-Chinese bankrupts.<sup>269</sup> Imprecise language in EBL 2007’s Article 5 controls the JRE of foreign bankruptcy judgments in Mainland China.<sup>270</sup> Article 5 leaves the creditor of a non-Chinese bankrupt whose assets are in Mainland China with an unclear and challenging path to recovery.<sup>271</sup>

Where any legally effective judgment or ruling made by a foreign court involves any debtor’s assets within the territory of the People’s Republic of China and if the creditor applies to or requests the people’s court to confirm or enforce it, the people’s court shall, according to the relevant international treaties that China has concluded or acceded to or according to the principles of reciprocity, conduct an examination thereon and, when believing that it does not violate the basic principles of the laws of the

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263. XU & ZHANG, *supra* note 247, at 338.

264. *Id.*

265. *Id.* at 335.

266. *Id.* at 340.

267. See Shi, *supra* note 257, at 2 (“As the first case recognizing the bankruptcy proceeding in the Mainland, it may produce very positive implications on China’s future judicial practice on cross-border insolvency, particularly requiring Chinese courts to treat all creditors fairly.”).

268. See generally XU & ZHANG, *supra* note 247, at 338–40; see *Reform of the Bankruptcy Regime in the People’s Republic of China*, *supra* note 251 (“[A]rticle 5 [of EBL 2007] also seeks to extend to assets of the debtor located outside of PRC . . . . [I]t is uncertain whether this unilateral provision of the PRC legislature will be given effect by a foreign court including ones from the UK, US or Australia.”).

269. See *Reform of the Bankruptcy Regime in the People’s Republic of China*, *supra* note 251 (“[I]t is uncertain what the true effects of the EBL will yet be for bringing the PRC more in line with international procedures on bankruptcy matters.”).

270. See *id.* (“On its face, the conditions under article 5 are quite onerous, and the court has substantial discretion to interpret the conditions and decide whether they have been satisfied before permitting the recognition of a foreign court ruling.”).

271. *Id.*



People's Republic of China, does not damage the sovereignty, safety or social public interests of the state, does not damage the legitimate rights and interests of the creditors within the territory of the People's Republic of China, grant confirmation and permission for enforcement.<sup>272</sup>

Under Article 5, three conditions must be met for JRE of a judgment from a bankruptcy proceeding outside of China: (i) relevant treaties or reciprocal relations between the other state and China;<sup>273</sup> (ii) the foreign bankruptcy proceeding does not violate China's state sovereignty, national security, and social and public interest;<sup>274</sup> and (iii) the foreign bankruptcy proceeding does not impair the lawful rights of creditors in China.<sup>275</sup>

In other words, the two major hurdles for the creditor of a non-Chinese bankrupt with assets in Mainland China are reciprocity and discretion by the Chinese court.<sup>276</sup> For JRE of a foreign bankruptcy judgment in Mainland China, a creditor must first establish that the country where the bankruptcy proceeding occurred has a JRE treaty with China or will provide JRE on a Chinese ruling.<sup>277</sup> In addition, the creditor must convince the Chinese court "that enforcement of the foreign judgment or ruling on bankruptcy does not harm the interests and rights of anyone" in China.<sup>278</sup>

### ***B. Chinese Court Uses JRE Treaty in B&T to Recognize a Foreign Bankruptcy Judgment***

In 1992, China and Italy concluded the Treaty on Judicial Assistance in Civil Matters between the People's Republic of China and the Republic of Italy (Sino-

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272. Zhonghua Renmin Gongheguo Qiye Pochan Fa (中华人民共和国企业破产法) [Enterprise Bankruptcy Law of the People's Republic of China] (promulgated by Standing Comm., Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2007), *translated in* <http://en.pkulaw.cn/display.aspx?cgid=c169182ebd58903ebdfb&lib=law> (last visited Oct. 17, 2018) (China).

273. *See Reform of the Bankruptcy Regime in the People's Republic of China*, *supra* note 251 (noting that the creditor must establish that the jurisdiction where bankruptcy proceedings take place has a treaty with China or will reciprocate JRE of a Chinese judgment).

274. *See id.* (explaining that Chinese courts have substantial discretion in deciding whether to permit JRE of a foreign judgment); PEDONE & LIU, *supra* note 250, at 2 (arguing after the adoption of EBL 2007, compensation for employees of state-owned enterprises seeking bankruptcy continues to be an important issue); Laura He, *Chinese Bankruptcies to Rise Sharply this Year with More 'Zombie' Firms Allowed to Die, Fitch Says*, SOUTH CHINA MORNING POST (Aug. 10, 2017), [www.scmp.com/business/banking-finance/article/2106283/chinese-bankruptcies-rise-sharply-year-more-zombie-firms](http://www.scmp.com/business/banking-finance/article/2106283/chinese-bankruptcies-rise-sharply-year-more-zombie-firms) ("There is little evidence yet the government is willing to tolerate the job losses and the drag on economic growth that would accompany the bankruptcy of large 'zombie' enterprises[.]"). *But see* Li Shuguang, *Conference Report*, 4 INSOL WORLD 32 (2016) (arguing that Chinese officials recognize the importance of further improving the bankruptcy process to rehabilitate "Zombie Companies," which incur losses and rely on support of Chinese government to stay afloat).

275. *Reform of the Bankruptcy Regime in the People's Republic of China*, *supra* note 251.

276. *Id.*

277. *Id.*

278. *Id.*; *see* XU & ZHANG, *supra* note 247, at 340 (discussing the GITIC court's reasoning on creditor equality).

Italy JRE Treaty).<sup>279</sup> The Sino-Italy JRE Treaty covers judicial assistance in civil and commercial matters, providing that civil decisions issued by a court in a contracting member state are granted JRE by the other member state pursuant to the law of the judgment-rendering region.<sup>280</sup>

In 2000, B&T Ceramic Group s.r.l. (B&T) successfully petitioned a Chinese court to recognize the validity of a bankruptcy judgment issued by an Italian court in Milan.<sup>281</sup> Per the Italian bankruptcy order, the Italian bankrupt's assets should have been fully delivered to B&T, which purchased the bankrupt's assets wholesale.<sup>282</sup> The assets included a 98% share in a joint venture, Nanhai Nassetti Pioneer Ceramic Machine Co. Ltd. (Nanhai Nassetti), located in Mainland China.<sup>283</sup> Under the Sino-Italy JRE Treaty, the Italian court could exercise jurisdiction over the B&T case because the Italian bankrupt was domiciled in Italy.<sup>284</sup>

When B&T petitioned the Guangdong Foshan Intermediate People's Court (Foshan Court) for recognition and enforcement of the Italian bankruptcy judgment, the Foshan Court heard the case, recognizing the validity of the bankruptcy judgment and the Adjudication Order on the Transfer of Confiscated Assets by the Italian court.<sup>285</sup> The Foshan Court found the Italian court's rulings "conformed to the condition for recognition and decisions made by foreign courts that were specified in the Sino-Italy Treaty and other relevant Chinese laws . . . [and that the rulings] would be honoured in [Mainland] China."<sup>286</sup>

The B&T case serves as a landmark decision in which a Chinese court unprecedentedly and formally recognized the validity of a foreign bankruptcy judgment.<sup>287</sup> B&T shows that Chinese courts place great importance on the existence of a JRE treaty. The Sino-Italy JRE Treaty, which does not explicitly deal with bankruptcy,<sup>288</sup> "laid a foundation [for the Foshan Court] to recognize the Italian bankruptcy judgments."<sup>289</sup>

Recognition is a prerequisite for complete JRE, but "[t]he realization of substantive rights largely relies on enforcement."<sup>290</sup> However, the Foshan Court

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279. XU & ZHANG, *supra* note 247, at 329.

280. See JIE HUANG, INTERREGIONAL RECOGNITION AND ENFORCEMENT OF CIVIL AND COMMERCIAL JUDGMENTS: LESSONS FOR CHINA FROM US AND EU LAW 72–73 (2010) (containing the relevant language of Article 20 and Article 21 of the Sino-Italy JRE Treaty).

281. XU & ZHANG, *supra* note 247, at 329.

282. *Id.*

283. *Id.* at 330.

284. See HUANG, *supra* note 280, at 73 (explaining the Italian bankrupt was domiciled in Italy and therefore the court has jurisdiction per Article 22 of the Sino-Italy treaty).

285. XU & ZHANG, *supra* note 247, at 331.

286. *Id.*

287. *Id.* at 332.

288. See *id.* at 332–33 (analogizing Sino-Italy JRE Treaty to Articles 265 and 266 of the 1991 CPL (as amended in 2007)).

289. *Id.* at 332.

290. XU & ZHANG, *supra* note 247, at 334. However, "according to the 1991 CPL (as amended in 2007) and other relevant Chinese laws, the recognition and enforcement of foreign judgments and decisions are separate things." *Id.*

declined to resolve B&T's request to turn over the 98% share in Nanhai Nasseti<sup>291</sup> because the Italian bankrupt's shares in Nanhai Nasseti were transferred to a bona fide transferee.<sup>292</sup> The bifurcation of recognition and enforcement is consistent with the Civil Procedure Law (CPL) "(as amended in 2007) and other relevant Chinese laws [that stipulate that] the recognition and enforcement of foreign judgments and decisions are separate things."<sup>293</sup>

Although *B&T* was decided before the adoption of EBL 2007, it may provide insight into "the elements that might be taken into account by a Chinese court when it is requested to recognize a foreign bankruptcy judgment" pursuant to EBL 2007's Article 5.<sup>294</sup> The Foshan Court's use of a general JRE treaty—covering civil and commercial matters—to recognize a foreign bankruptcy judgment may serve as a bellwether, showing that even "a treaty [for general judicial assistance] . . . between China and the relevant foreign jurisdiction[] will still be significant, due to the lack of specifics of Article 5."<sup>295</sup>

Judgment finality is a requirement for JRE in Mainland China,<sup>296</sup> but whether a judgment truly is final is determined under the law of the judgment-rendering region.<sup>297</sup> In principle, Chinese courts<sup>298</sup> would not review the merits of the decisions rendered by foreign courts in considering whether the grounds for refusal of recognition and enforcement are present.<sup>299</sup> However, "when considering whether the foreign judgment is consistent with the basic principles of the laws or public policy of China, Chinese courts may have to look into the merits of the judgments."<sup>300</sup>

Outwardly conforming to general practice, "[t]he Foshan Court in the [*B&T*]

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291. *See id.* (stating the Foshan Court in *B&T* suggested that the applicant could pursue its rights by filing another application using its decision as the legal basis, but that ultimately, the applicant relied on diplomatic instead of judicial means).

292. *See id.* at 330 (explaining that after its primary shareholder declared bankruptcy in Italy, the Nanhai Nasseti business continued to operate in China because firm insiders orchestrated a disputed share transfer to a third party, which changed the firm's ownership under Chinese law and destroyed the Italian bankrupt's stake).

293. *Id.* at 334.

294. *Id.* at 332.

295. *Id.* at 333; *see ZHU & SHI, supra* note 234 (noting which countries have entered into bilateral judicial assistance treaties on civil or commercial matters with China).

296. *See HUANG, supra* note 280, at 72 (stating that Mainland China and Macao defer to the law of the judgment-rendering region on finality, but Hong Kong applies its own law to decide the finality of a sister-region judgment).

297. *See id.* at 72 ("Mainland law does not define the meaning of 'legally effective, enforceable or final' for JRE purposes.").

298. *See ZHU & SHI, supra* note 234 (explaining that the JRE process is handled by two separate divisions of courts in Mainland China: recognition of foreign judgments is controlled by the division on foreign-related commercial matters, and enforcement is controlled by the enforcement division, but that an applicant for JRE of a foreign judgment can apply for both at the same time).

299. *Id.* at 6.

300. *Id.*

case reviewed and examined the documents submitted by the applicant and relevant procedural materials, without touching upon substantive matters.”<sup>301</sup> However, on the “most controversial aspect of this case”—the illegal transfer of shares—the Foshan Court “left the enforcement matters to other proceeding[s] which the applicant might initiate.”<sup>302</sup> The Court’s inaction on this issue had the effect of a judicial review that discounted the merits of the Italian court’s final judgment, since it affected B&T’s substantive rights, albeit temporarily, as B&T “finally realized its substantive rights through diplomatic approaches.”<sup>303</sup>

However, it may be that the Foshan Court’s decision to decline enforcement was not the function of a discretionary determination or that granting JRE would violate principles of Chinese law, sovereignty, security, and social and public interests.<sup>304</sup> Rather, it would seem the Foshan Court found that complete JRE comported with those principles, as the court recognized the validity of the Italian bankruptcy judgment and left the door open to further legal proceedings on the issue of enforcement.<sup>305</sup> Alternatively, because the Foshan Court decided *B&T* before EBL 2007 was adopted, its decision to decline to enforce might be attributable to the court’s inexperience with bankruptcy matters involving complex issues.<sup>306</sup> Nevertheless, *B&T* is a milestone for cross-border insolvency in Mainland China because it represents an observable improvement in the judicial practice of cross-border insolvency matters.<sup>307</sup> Part IV (C) will discuss two examples of JRE in Mainland China based on the principle of de facto JRE reciprocity. De facto JRE reciprocity is an emerging pathway for JRE of a foreign judgment in Mainland China.

### C. Establishing De Facto JRE Reciprocity for JRE in Mainland China

As Chinese courts improve their handling of cross-border insolvency matters, another budding strategy for extraterritorial JRE in Mainland China is de facto JRE reciprocity.<sup>308</sup> Article 5 of EBL 2007 may allow for JRE of a foreign bankruptcy judgment based on a JRE treaty, as discussed in Part IV (B), but it also allows for de facto JRE reciprocity based on a previous JRE of a Chinese judgment by the country whose court issued the judgment seeking JRE in Mainland China.<sup>309</sup> Currently, only two examples of this exist, each consisting of a pair of cases, but neither example involves JRE of a foreign bankruptcy judgment.<sup>310</sup>

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301. XU & ZHANG, *supra* note 247, at 334.

302. *Id.*

303. *Id.*

304. *See* HUANG, *supra* note 279, at 98 (discussing the grounds on which a Chinese court could refuse JRE).

305. *See id.* at 94 (stating that the Foshan Court first determined that there were no grounds for refusal, according to the terms of the bilateral treaty with Italy).

306. *See* XU & ZHANG, *supra* note 247, at 332 (remarking that the *B&T* case was the first of its kind).

307. Shi, *supra* note 257, at 2.

308. *See generally* Huang, *supra* note 4 (discussing de facto JRE reciprocity).

309. *Id.*

310. *See id.* at 3 (explaining that while China does not have a formal precedent system, the

Chinese courts may grant JRE of a foreign judgment based on de facto JRE reciprocity where “the judgment-rendering jurisdiction has recognized and enforced a Chinese judgment before.”<sup>311</sup> The principle of de facto JRE reciprocity examined in the following discussion may be applicable to JRE of a foreign bankruptcy judgment per Article 5 of EBL 2007.<sup>312</sup>

In 2014, the Singapore High Court granted JRE of a judgment on a contract dispute issued by the Suzhou Intermediate People’s Court (Suzhou Court) in Jiangsu Province, located in Mainland China.<sup>313</sup> In *Giant Light Metal Technology (Kunshan) Co Ltd v. Aksa Far East Pte Ltd*, the Singapore High Court held it would recognize the Chinese judgment because the defendant voluntarily consented to Suzhou Court jurisdiction by appearing in that court.<sup>314</sup> Since the action in *Giant Light* was in assumpsit, for a fixed sum of money, the Singapore High Court found the Chinese judgment constituted an enforceable debt claim<sup>315</sup> and ordered the defendant pay the Chinese judgment sums as ordered by the Suzhou Court.<sup>316</sup>

In 2016, the Nanjing Intermediate People’s Court (Nanjing Court), also located in Jiangsu Province, granted JRE of a judgment on a contract dispute issued by the Singapore High Court.<sup>317</sup> In *Kolmar v. SUT EX Group*, the Nanjing Court recognized and enforced a commercial money judgment issued by the High Court.<sup>318</sup> Though Mainland China and Singapore have not concluded a JRE treaty, the Nanjing Court found the judgment issued by the High Court should be granted JRE in Mainland China, as “the Singapore High Court had recognized and enforced the civil judgment made by the Suzhou Intermediate People’s Court of Jiangsu Province” in the *Giant Light* case, and JRE would not violate principles of Chinese law, sovereignty, security, and social and public interests.<sup>319</sup>

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SPC provides guidance to lower courts, and lower courts may refer to SPC cases for guidance in their adjudication).

311. *Id.* at 2; see generally Jessica Fel, *Chinese Court Recognizes a US Commercial Judgment for the First Time Based on Principle of Reciprocity*, HERBERT SMITH FREEHILLS (Sept. 22, 2017, 2:15 PM), <https://hsfnotes.com/asiadisputes/2017/09/22/chinese-court-recognises-a-us-commercial-judgment-for-the-first-time-based-on-principle-of-reciprocity>.

312. See generally Huang, *supra* note 4.

313. *Id.*

314. *Giant Light Metal Technology (Kunshan) Co. Ltd. v. Aksa Far East Pte Ltd.*, (2014) SGHC 16, at ¶¶ 31–53, [www.singaporelaw.sg/sglaw/laws-of-singapore/case-law/free-law/high-court-judgments/15488-giant-light-metal-technology-kunshan-co-ltd-v-aksa-far-east-pte-ltd-2014-sghc-16](http://www.singaporelaw.sg/sglaw/laws-of-singapore/case-law/free-law/high-court-judgments/15488-giant-light-metal-technology-kunshan-co-ltd-v-aksa-far-east-pte-ltd-2014-sghc-16) (explaining that the defendant voluntarily consented to jurisdiction of the Suzhou Court for purposes of recognition and enforcement of PRC judgment by appearing in PRC court, and that after appearing, defendant could not challenge jurisdiction) (Sing.).

315. See *id.* at ¶ 63 (“[T]he nature of the enforcement action at common law is put down as a reason for the requirement that only foreign judgments for a fixed sum of money may be enforced.”).

316. *Id.* at ¶ 79.

317. Huang, *supra* note 4.

318. *Id.*

319. Zhang Ni, *The Supreme Law Issued the Second Batch of Typical Cases Involving the Construction of the “Belt and Road.”* CHINA NEWS AGENCY (May 15, 2017, 5:09 PM), [www.chinanews.com/gn/2017/05-15/8224293.shtml](http://www.chinanews.com/gn/2017/05-15/8224293.shtml).

*Kolmar* was the first time a Chinese court granted JRE on a commercial judgment issued by a Singaporean court.<sup>320</sup> *Kolmar* was also the first time a Chinese court recognized “the existence of a relationship of reciprocity between China and Singapore.”<sup>321</sup> The de facto JRE reciprocity observed between Mainland China and Singapore, established in *Giant Light* and *Kolmar*, may indicate a limited application.<sup>322</sup> Both judgments are concerned with contract disputes, and the courts involved in each case are the same, in the instance of the Singapore High Court, or from the same province in Mainland China.<sup>323</sup>

Significantly, in 2017, the SPC included *Kolmar* in its Belt and Road Typical Cases literature, in which the SPC provides principles derived from selected cases to guide lower courts adjudicating disputes that might arise from China’s BRI.<sup>324</sup> In the Typical Case Guidance for *Kolmar*, the SPC stated that *Kolmar* “not only has landmark significance in the mutual recognition and enforcement of commercial judgments [between] China and Singapore but also will powerfully advance the realization of judicial cooperation in the area of mutual recognition and enforcement of civil and commercial judgments between countries along the Belt and Road.”<sup>325</sup> These developments coincide with Singapore signing onto the BRI in 2017,<sup>326</sup> and seem to indicate a pro-JRE outlook for JRE based on de facto reciprocity.<sup>327</sup> Signs

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320. Gao'er Jituan Gufen Youxian Gongsi Shenqing Chengren he Zhixing Xinjiapo Gaodeng Fayuan Minshi Panjue'an (高尔集团股份有限公司申请承认和执行新加坡高等法院民事判决书) [Kolmar Group AG, A Case of an Application for the Recognition and Enforcement of a Civil Judgment of the High Court of Singapore], translated in *China Guiding Cases Project*, STANFORD L. SCH., <https://cgc.law.stanford.edu/wp-content/uploads/sites/2/2017/08/CGCP-BR-English-Typical-Case-13.pdf> (last visited Oct. 17, 2018).

321. *Id.*

322. See Huang, *supra* note 4 (demonstrating the parallels of the cases and explaining *Kolmar*'s limitations in issues Chinese courts have in future JRE).

323. *Id.*

324. See *The Belt and Road Initiative, China Guiding Cases Project*, STAN. L. SCH., <https://cgc.law.stanford.edu/belt-and-road> (last visited Sept. 8, 2018) (providing that in 2015, the SPC released sixteen BRI typical cases to show advanced and responsive approaches and to reinforce the overall progression of the BRI); see also Mark Jia, *Chinese Common Law? Guiding Cases and Judicial Reform*, 129 HARV. L. REV. 2213, 2217 (2016) (“The typical case’s primary purpose has not been the clarification of statutory ambiguity, but rather the promotion of ‘the correct application of well-established doctrine.’”) (quoting Taisu Zhang, *The Pragmatic Court: Reinterpreting the Supreme People’s Court of China*, 25 COLUM. J. ASIAN L. 1, 8 (2012)); see also Ni, *supra* note 319 (“According to reports, the people’s courts have . . . played a very good guiding role in unifying the standards of the referee and improving the rules.”).

325. Kolmar Group AG, A Case of an Application for the Recognition and Enforcement of a Civil Judgment of the High Court of Singapore, *supra* note 320.

326. See *Singapore, China Sign MOU for Belt and Road Initiative Dispute Mediation*, CHANNEL NEWSASIA (Sept. 19, 2017), [www.channelnewsasia.com/news/singapore/singapore-china-sign-mou-for-belt-and-road-initiative-dispute-9226612](http://www.channelnewsasia.com/news/singapore/singapore-china-sign-mou-for-belt-and-road-initiative-dispute-9226612) (stating that Singapore and China signed a Memorandum of Understanding (MOU) to facilitate valuable, long-term international investments).

327. See Huang, *supra* note 4 (“Chinese courts should enhance international judicial assistance and promote JRE with countries alongside the ‘One Belt and One Road.’ Although China has never explicitly included the U.S. into its ‘One Belt and One Road’ Initiative, *Liu Li v. Tao*

of momentum for a more encompassing form of de facto JRE reciprocity are coming into view, even for judgment-rendering jurisdictions outside of the scope of China's BRI.

In 2017, the Wuhan Intermediate People's Court (Wuhan Court) granted JRE of a judgment on a contract dispute issued by the Los Angeles Superior Court.<sup>328</sup> In *Liu Li v. Tao Li*, the Wuhan Court, which is in the Hubei Province of Mainland China, recognized and enforced a commercial money judgment based on de facto JRE reciprocity.<sup>329</sup> The Court found that a relationship of reciprocity between the United States and Mainland China was established when a U.S. federal court granted JRE of a Chinese judgment in 2009,<sup>330</sup> and that JRE of the *Liu Li* judgment would not violate Chinese law, sovereignty, security, and social public interests.<sup>331</sup>

In the 2009 case, *Hubei Gezhouba Sanli an Industrial Co., Ltd. et. al. v. Robinson Helicopter Co., Inc.*, the U.S. District Court for the Central District of California granted JRE of a judgment on tort damages for product liability issued by the Higher People's Court of Hubei Province.<sup>332</sup> *Robinson Helicopter* was the first time a U.S. court granted JRE of a judgment issued by a Mainland China court.<sup>333</sup>

After *Robinson Helicopter* but before *Liu Li*, it was unclear whether Chinese courts would grant JRE of a judgment issued by a U.S. state court based on the principle of reciprocity since the district court in *Robinson Helicopter* was a U.S. federal court.<sup>334</sup> However, the Wuhan Court's decision in *Liu Li* shows the Chinese court did not differentiate between federal and state court when finding that *Robinson Helicopter* established a relationship of reciprocity between the United States and Mainland China,<sup>335</sup> as it granted JRE of a judgment issued by a state court

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*Li* . . . reflects this pro-JRE momentum.”); see also Jeremy Andrews et al., *Life after Brexit—How the UK and China Can Both Benefit from the New Global Regime on Jurisdiction Agreements and Judgments*, DLA PIPER (Nov. 16, 2017), <https://www.dlapiper.com/en/newzealand/insights/publications/2017/11/life-after-brexit-uk-china-new-global-regime> (describing how the Supreme People's Court supported the *Kolmar* outcome and theory of de facto reciprocity, connecting it precisely to China's BRI).

328. Liuli yu Taoli deng Shenqing Chengren he Zhixing Waiguo Fayuan Minshi Panjue Jifufen'an (刘利与陶莉等申请承认和执行外国法院民事判决纠纷案) [*Liu Li v. Tao Li et al. for Recognition and Enforcement of a Civil Judgment of a Foreign Court*] (June 30, 2017), CLI.C.9347048(EN) (Lawinfochina).

329. *Id.*

330. See Huang, *supra* note 4 (explaining that reciprocity has been established between China and the United States through the recognition and enforcement of a Chinese judgment).

331. *Liu Li v. Tao Li et al. for Recognition and Enforcement of a Civil Judgment of a Foreign Court*, *supra* note 328.

332. Huang, *supra* note 4.

333. *Id. But see Your Company Can be Sued in China and that Matters*, *supra* note 239 (explaining that *Robinson Helicopter* concerned a U.S. defendant who previously asserted that only China had jurisdiction to hear the case).

334. See Harris, *supra* note 234 (addressing uncertainty over whether a Chinese court would recognize a state court judgment compared to a federal judgment).

335. Huang, *supra* note 4.

per the principle of reciprocity.<sup>336</sup>

Interestingly, subject matter differences between the *Robinson Helicopter* and *Liu Li* judgments did not hinder JRE based on reciprocity,<sup>337</sup> as *Robinson Helicopter* concerned tort damages and *Liu Li* concerned a contract dispute.<sup>338</sup> This may be a departure from *Giant Light* and *Kolmar*, where subject matter consistency seemed to be important for establishing a precedent that could trigger JRE based on reciprocity.<sup>339</sup> “This development is significant because it helps to clarify how Chinese court[s] would interpret de facto reciprocity.”<sup>340</sup> The Wuhan Court in *Liu Li* seems to take a more liberal approach in identifying *Robinson Helicopter* as establishing a relationship of reciprocity allowing for JRE reciprocity.<sup>341</sup>

While Chinese courts have only granted JRE based on de facto reciprocity in two pairs of cases, the Wuhan Court’s more liberal approach to JRE on the *Liu Li* judgment in 2017 is exciting, because it confirms that a relationship of reciprocity between the United States and Mainland China exists at some level.<sup>342</sup> Perhaps it is a relationship of reciprocity that can grow cooperatively and someday shed its commodified de facto label. “Although China has never explicitly included the U.S. into its ‘One Belt and One Road’ initiative, *Liu Li v. Tao Li and Dong Wu* benefits from and reflects this pro-JRE momentum.”<sup>343</sup> For practitioners, *Liu Li* seems to expand the framework for what establishes de facto JRE reciprocity with Mainland China.<sup>344</sup> Supposing the Chinese standard for reciprocity was as liberal as it appears in *Liu Li*, JRE of a foreign bankruptcy judgment based on de facto JRE reciprocity might be possible under Article 5 of the EBL 2007 if the Chinese court finds that JRE would not violate Chinese law, sovereignty, security and social public interests, and that the foreign bankruptcy proceeding does not impair the legal rights of other creditors.<sup>345</sup>

There remains an open question on the geographic scope of de facto JRE reciprocity.<sup>346</sup> In both *Kolmar* and *Liu Li*, “the Chinese court found reciprocity where the foreign court had previously recognized a judgment issued by a Chinese court located within the same province.”<sup>347</sup> These jurisdictional connections may be coincidental or not—the implications are unknown.<sup>348</sup> However, “there would seem

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336. *Id.*

337. *Id.*

338. *Id.*

339. *Id.*

340. *Id.*

341. Huang, *supra* note 4.

342. *Id.*

343. *Id.*

344. *Id.*

345. See *supra* notes 257–264 and accompanying text for a discussion on the requirements for bankruptcy proceedings outside of China.

346. See generally Matthew Sava & Ning Zhang, *A New Era of Reciprocity: Trends in Foreign-Judgment Recognition in China*, REID & WISE LLC (Nov. 30, 2017, 6:09 PM), [www.reidwise.com/blog/2017/11/30/a-new-era-of-reciprocity](http://www.reidwise.com/blog/2017/11/30/a-new-era-of-reciprocity).

347. *Id.*

348. *Id.*



to be no compelling reason for the reciprocity inquiry to be province-specific.”<sup>349</sup> This view is supported by the fact that “China is a unified country and its judicial system is centralized . . . [C]ourts in Hubei province can recognize and enforce a U.S. judgment, [and] no law explicitly bans courts in the nearby Hunan province or other provinces to recognize and enforce other U.S. judgments.”<sup>350</sup> Rather, the SPC appears to be promoting a cross-province jurisprudence, as it began creating circuit courts in 2015 to handle multi-provincial cases to resolve “cross-regional” issues—establishing six circuits to cover twenty-six provinces and municipalities.<sup>351</sup>

## V. LOOKING TO THE FUTURE

### A. *China’s Guiding Case System and its Potential Future Impact as a Source of Law*

China’s national political structure does not feature a separation of powers doctrine; rather, its government is ultimately controlled by the National People’s Congress (NPC).<sup>352</sup> The NPC exclusively has the power to check and supervise the judiciary and executive.<sup>353</sup> Similarly, the local people’s congresses, which act as local organs of state power, may exercise control over the local people’s courts.<sup>354</sup> Under Article 128 of the Chinese Constitution, the SPC is accountable to the NPC and its Standing Committee,<sup>355</sup> and “all local people’s courts at various levels are responsible to their respective people’s congresses.”<sup>356</sup>

The Chinese Constitution does not provide the Chinese judiciary with the power to make or interpret law.<sup>357</sup> Article 45 of the Legislative Law of China explicitly provides the power to interpret law to the Standing Committee of the NPC in situations where the meaning or application of a provision in the law needs further clarification.<sup>358</sup> “This principle applies to laws, regulations, and rules made at national and local levels by legislatures, ministries, commissions, local government and their various branches[,] . . . [and] does not leave much room for judicial

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349. *Id.*

350. Huang, *supra* note 4.

351. Mo Zhang, *Pushing the Envelope: Application of Guiding Cases in Chinese Courts and Development of Case Law in China*, 26 WASH. INT’L L.J. 269, 277 (2017).

352. *Id.* at 274.

353. *See id.* at 275 (explaining that the Chinese Constitution mandates that the SPC is supervised by the NPC).

354. *See id.* at 276 (“Members of the judicial committees of local people’s courts at various levels are appointed and also can be removed by the standing committee of the people’s congress at the corresponding level, upon the recommendation of the president of that courts [sic].”).

355. *Id.* at 275 (“The NPC . . . has the power to elect and remove the President of the Supreme People’s Court (equivalent to the Chief Justice of U.S. Supreme Court) . . . . [T]he Standing Committee of the NPC has the power to appoint or remove, upon the recommendation of the President of the Supreme People’s Court, the vice-presidents, judges of the Supreme People’s Court, and the members of its judicial committee.”).

356. Zhang, *Pushing the Envelope*, *supra* note 351, at 275.

357. *Id.* at 278.

358. *Id.* at 277.

interpretation.”<sup>359</sup> However, Article 46 provides that the SPC may make a request to the Standing Committee to interpret the *application* of law, if the issue involves the “specific application of law in the adjudication at the courts.”<sup>360</sup> This narrow exception to judicial interpretation is reserved solely for China’s highest court.<sup>361</sup>

Because the line between interpreting law and interpreting the application of law is difficult to define, the question remains whether the SPC’s interpretation of the application of law constitutes lawmaking.<sup>362</sup> This ambiguity may allow the SPC to exercise quasi-lawmaking power through its interpretation of the application of law, but the notion of judicial interpretation is a flashpoint between the legislatures and the judiciary.<sup>363</sup>

The SPC interprets statutes in four ways: (i) interprets national laws; (ii) creates model rules and opinions; (iii) issues specific decisions to change previous interpretations; and (iv) replies to requests from provincial-level high courts.<sup>364</sup> In the Provisions on the Work of Judicial Interpretation (2007 Provisions), the SPC “clearly instructed all people’s courts that the judicial interpretations should have legal effect.”<sup>365</sup> Article 27 of the 2007 Provisions “specifically requires that the people’s courts cite the judicial interpretation in their judicial documents if the adjudication is made on the basis of the interpretation,” but, “if a people’s court simultaneously cites the law and the judicial interpretation as the basis of the judgment, the court shall cite the law first and then the judicial interpretation.”<sup>366</sup>

The 2007 Provisions and the “legal effect” described signify the SPC’s attempt to treat judicial interpretation as a binding source of law.<sup>367</sup> In this regard, “it seems inaccurate to hold that the Supreme People’s Court does not have the power to make law . . . or at least has a quasi-law making power.”<sup>368</sup> Practically, the SPC’s judicial

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359. *Why There is No Case Law in China*, TROUTMAN SANDERS (July 13, 2015), [www.troutman.com/why-there-is-no-case-law-in-china-07-13-2015](http://www.troutman.com/why-there-is-no-case-law-in-china-07-13-2015).

360. Zhang, *supra* note 351, at 277–79 (indicating that a commonly encountered question is “whether the judicial interpretation can be deemed as law”).

361. Sava & Zhang, *supra* note 346; Zhang, *supra* note 351, at 278.

362. *See* Zhang, *supra* note 351, at 279–84 (discussing judicial interpretation dealing with the issue with which the law is concerned and providing an example of the SPC’s 2015 Interpretation on the Application of Civil Procedure Law of China, in which the SPC interpreted the application of Article 18(1) of the amended CPL of 2012 to provide clarity surrounding the law’s use of the phrase “major cases”). “Major cases involving foreign elements . . . shall include cases in which the subject matter in dispute involves a large amount of money and complicated circumstances, or cases having significant impacts, such as a case where one side has a large number of parties concerned.” *Id.*

363. *Id.* at 279–81 (“[T]he legislatures seem very sensitive about being offended by the judiciary, and in many cases appear to be antagonistic to possible intrusion by the judiciary into legislative areas during judicial proceedings that involve the application of law.”).

364. Sava & Zhang, *supra* note 346; Zhang, *supra* note 351, at 285.

365. Zhang, *supra* note 351, at 284.

366. *Id.* at 286.

367. *See id.* at 286–87 (clarifying that the result of the 2007 Provisions is that the Supreme People’s Court interpretation is binding, because it submits a draft opinion to the NPC, but the SPC does not undermine the power of the legislature).

368. *Id.* at 287.

interpretations on the application of law tend to have a normative effect on lower courts.<sup>369</sup> Yet historically, only judicial interpretations of national laws were widely disseminated, so judicial interpretations by the SPC have only received limited exposure.<sup>370</sup>

Compared with the SPC's legal effect on the interpretation of the application of law, the legal effect of the cases published by the SPC is more difficult to ascertain.<sup>371</sup> The SPC does hear appeals from the provincial-level high courts, but its decisions are only persuasive and have no precedential value, so lower courts continue to be influenced by "the heavy hand of bureaucracy."<sup>372</sup> However, "there has been a trend among the Chinese courts to use higher court decisions as guidelines if not precedents."<sup>373</sup> Additionally, because there is no law explicitly prohibiting the use of judicial precedent, the SPC "has certain flexibility to be able to infuse the published cases with legal significance that would affect the trials in the people's courts."<sup>374</sup> In recent years, the SPC has expanded its role in providing guidance to all Chinese courts on issues where "the law is abstract or the case is complex."<sup>375</sup>

In 1985, the SPC started publishing typical cases in its official publication, the *Gazette of the Supreme People's Court* (Gazette).<sup>376</sup> "In 2004, the SPC began to test the waters by adding a new section to published cases in the Gazette that contained legal rules abstracted from each case."<sup>377</sup> Additionally, the SPC "also began publishing more cases that focused on filling statutory holes rather than merely restating or explicating well-established doctrine."<sup>378</sup> In 2005, the SPC announced "the construction of a guiding cases system as a formal policy objective for the court."<sup>379</sup> Ultimately, the guiding case system's formal architecture was defined by two complementary documents, the Provisions of the Supreme People's Court Concerning Work on Case Guidance (2010 Provisions) and the Detailed Implementing Rules on the Provisions of the Supreme People's Court Concerning Work on Case Guidance (Implementing Rules).<sup>380</sup>

Within the guiding case system, the SPC created an office "responsible for collecting, selecting, and reviewing the cases recommended."<sup>381</sup> With approval, the guiding cases are distributed to all of the High People's Courts, published in the

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369. Sava & Zhang, *supra* note 346.

370. *Id.*

371. Zhang, *supra* note 351, at 287.

372. Sava & Zhang, *supra* note 346.

373. *Id.*

374. Zhang, *supra* note 351, at 287.

375. *Id.*

376. Jia, *supra* note 324, at 2216.

377. *Id.* at 2218.

378. *Id.*

379. *Id.* at 2218–19.

380. See Zhang, *supra* note 351, at 288 (outlining the selection mechanism for guideline cases).

381. *Id.* at 289.

Gazette, the People's Court Daily, and on the SPC website.<sup>382</sup> While technically the guiding cases are not legally binding, the Implementing Rules strongly urge lower courts to reference relevant guiding cases by citing a guiding case's "main points of adjudication" when adjudicating similar cases.<sup>383</sup> Pursuant to Article 10 of the Implementing Rules, and with the goal of achieving uniform application of law, "the courts at all levels shall cite the [relevant] guiding cases in their judgment reasoning."<sup>384</sup> The courts should also note "if the parties or their lawyers in the case have cited the guiding case in their arguments or defense."<sup>385</sup> However, the courts may not use the guiding case as the legal basis for their judgments.<sup>386</sup>

There is general agreement that the judgment of a guiding case is only binding on the parties involved in that case.<sup>387</sup> However, there is debate over whether the main points of adjudication and judgment reasoning in a guiding case have any legal effect on future similar cases.<sup>388</sup> Among the Chinese legal community, the requirement to cite guiding cases in the judgment reasoning is seen as moving "beyond the normal scope of reference because it makes citing the relevant guiding cases mandatory," which raises the question of whether guiding cases may someday be treated as an independent source of law.<sup>389</sup> However, the Implementing Rules legitimize the use of and citation to guiding cases in lower court decisions, while only supporting the use of guiding cases as an aid to judicial reasoning and the more tempered "view that guiding cases were binding de facto but not de jure."<sup>390</sup> A

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382. *Id.*; see *Supreme People's Court Gazette Enters the 21<sup>st</sup> Century*, SUPREME PEOPLE'S COURT MONITOR (Mar. 5, 2017), <https://supremepeoplescourtmonitor.com/2017/03/05/supreme-peoples-court-gazette-enters-the-21st-century> (showing how the SPC took steps to increase accessibility to the Gazette through its website that was launched in 2017, which includes the guiding cases and other selected judgments from cases decided by the SPC that reflect the SPC's view on those issues, increasing SPC transparency by showing which lawyers frequently practice before the court and providing information on the SPC judges).

383. See Zhang, *supra* note 351, at 299–300 ("[T]he application of guiding cases as reference in similar cases is compulsory. But what the compulsory reference would mean to the people's court inevitably becomes an issue that faces not only the Supreme People's Court but also the country in general."); see also *id.* (discussing when courts are required to refer to guiding cases).

384. See Zhang, *supra* note 351, at 272–73 ("The purpose is to make guiding cases the model cases that contain the typical practices of people's courts in adjudicating similar cases and help apply the law in the way that is desired to achieve uniformity.").

385. *Id.* at 301.

386. See *id.* at 272–73 (discussing whether requiring reference to the guiding case in judgment reasoning has binding effect and if a judgment differing from a guiding case can be appealable as erroneous in the application of law).

387. *Id.* at 300.

388. See *id.* at 299–300 (providing that the de facto binding effect is an argument in the middle of the spectrum, which views guiding cases as building greater understanding through a culture of judicial compliance in legal reasoning). "With respect to the similarity, the Supreme People's Court is silent about how it should be determined. According to a scholarly opinion, similarity shall include (a) similar fact; (b) similar legal relations; (c) similar disputes; or (d) similar legal issues involved. The question, however remains because it is still disputable whether all the four aspects must be present in order to find the similarity or any of the four would suffice." *Id.* at 299.

389. Zhang, *supra* note 351, at 273.

390. Jia, *supra* note 324, at 2224.

survey of nearly 4,000 Chinese judges and lawyers on the legal effect of the guiding cases showed a diversity of opinion on the matter, but “revealed . . . that the majority regards the guiding cases as having de facto binding effect.”<sup>391</sup>

Notwithstanding the apparent preference for de facto binding effect, one study finds that guiding cases have only been cited about 241 times, and that only twenty-five of the fifty-six guiding cases published as of 2015 were cited, with most of the citations arising out of adjudications at the trial and intermediate people’s courts.<sup>392</sup> Furthermore, only 27% of the citations were made by the adjudicating judge, while 73% were made by the parties involved.<sup>393</sup> Low citation rates could be due to several factors, including “the lack of pertinent guiding cases, poor broadcasting, judges’ or lawyers’ ignorance, or judicial timidity.”<sup>394</sup> Nevertheless, the SPC is continuously building its system of publication of guiding cases and typical cases to improve transparency and awareness.<sup>395</sup> Recent data indicating progress in usage shows that judges frequently apply the “spirit” of the guiding cases without making explicit citations.<sup>396</sup> However, “[f]or guiding cases to take cultural root, judges and litigants will have to not just apply them but also do so rigorously.”<sup>397</sup>

Additionally, legislative support would strengthen the SPC’s efforts to promote usage of the guiding cases, as the “people’s courts appear hesitant to apply the guiding cases without statutory provisions.”<sup>398</sup> Accordingly, both the SPC and NPC “are expected to adopt certain rules to materialize the guiding cases and elaborate their application to cement the status of the guiding cases and ensure their authoritative force.”<sup>399</sup> Assuring the authority of the guiding cases would provide substantive benefits for legal education and training, allow the SPC to assist the legislature to fill statutory gaps and develop the law, and limit the discretionary power of the lower courts in applying the law.<sup>400</sup>

China’s guiding case system may be a welcomed development for practitioners who are used to the common law doctrine of binding judicial precedent and find themselves litigating in Mainland China. The guiding case system, while still in its infancy, could ultimately result in “a merger of civil law tradition with common law practice”—forming “a system of case law with Chinese Characteristics.”<sup>401</sup> As the SPC pushes beyond its role of interpreting the application of law and builds out a case-based framework to guide lower courts, the guiding case system could become

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391. Zhang, *supra* note 351, at 300–01.

392. *Id.* at 301–02.

393. *Id.* at 302.

394. Jia, *supra* note 324, at 2226.

395. *White Paper: Judicial Transparency of Chinese Courts*, CHINA DAILY (Feb. 27, 2017, 2:31 PM), [http://www.chinadaily.com.cn/china/2017-02/27/content\\_28361599\\_7.htm](http://www.chinadaily.com.cn/china/2017-02/27/content_28361599_7.htm).

396. Jia, *supra* note 324, at 2226–27.

397. *Id.*

398. Zhang, *supra* note 351, at 302.

399. *Id.* at 303.

400. *Id.* at 304–06.

401. *Id.* at 305.

an influential force in the development of legal trends in Mainland China.<sup>402</sup> If a form of common law practice with increased predictability could replace the current system, mystified practitioners would not have to read SPC cases like they were tea leaves. Allowing judicial precedent to take root in China's legal culture would create a greater sense of legal certainty.

## VI. CONCLUSION

China's outreach through the BRI is causing it to modernize its approach to cross-border cooperation to manage the challenges brought on by global investment. Chinese courts and arbitral institutions will continue to gain experience in cross-border matters as the BRI advances and cross-border activity increases. China's outward stance appears to also be contributing to the improved efficacy of its courts in handling JRE of foreign judgments and foreign bankruptcy judgments. However, as discussed in Part IV, SPC case law becoming a source of law is a promising contemplation but far from certain. Therefore, to be most effective, the recovery strategies discussed in this Comment may need to be flexible and combined to form a comprehensive recovery theory that adapts to contemporary Chinese legal trends.

The Sino Clean Energy saga shows that the corporate governance strategy of using a court-appointed receiver to affect the management of a CRM's operating business in Mainland China can be successful.<sup>403</sup> This strategy might be equally or more effective in conjunction with SPC case law or JRE strategy. For example, in *Sino-Environment*, the SPC recognized the authority of an insolvency officer appointed by a foreign court. This allows parallels to be drawn between an insolvency officer and a court-appointed receiver. Based on these parallels, Chinese courts could potentially recognize the authority of court-appointed receiver of an offshore holding firm. Conceivably, a foreign court-appointed receiver with control of an offshore holding firm could try to convince a Chinese court to recognize the receiver's authority to exercise control over its Mainland China operating subsidiary based on *Sino-Environment*. In the Chinese reverse merger context, this could be a worthwhile endeavor because receiver recognition could enhance recovery.

Contemporary Chinese legal trends will undoubtedly shape the viability of certain comprehensive recovery theories, especially for those relying on the development of SPC case law. For example, the SPC decided *Sino-Environment* in 2014, but did not publish it as a guiding case or typical case.<sup>404</sup> On the other hand, the SPC published *Kolmar* in the BRI typical cases literature in 2017. In *Kolmar*, Mainland China acknowledged a relationship of reciprocity with Singapore built upon Singapore's JRE of a Chinese judgment in the 2014 case, *Giant Light*.<sup>405</sup>

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402. *Id.* at 304.

403. *Sino-Environment v. Thumb Env-Tech*, *supra* note 195, at 16.

404. *Id.*

405. *See* *Kolmar Group AG, A Case of an Application for the Recognition and Enforcement of a Civil Judgment of the High Court of Singapore*, *supra* note 320 (“[B]ecause the High Court of Singapore has enforced a civil judgment of a court in China, [any] court in China, may, on the basis of the principle of reciprocity, recognize and enforce a Singaporean court's civil judgment that meets [certain] requirements.”).

However, consider, hypothetically, if *Giant Light* (2014) pre-dated *Sino-Environment* (2014), would the SPC have decided *Sino-Environment* by JRE based on the principle of de facto reciprocity? Since Singapore is part of the BRI, would that have made a difference? Perhaps, *Sino-Environment* would have been published as a BRI typical case, instead of *Kolmar*, and what impact would that have on the recognition of insolvency officers (and court-appointed receivers) from countries along the Belt and Road and beyond?

As an engine for high growth, China will continue to be an attractive destination for foreign capital. Although China appears to be modernizing its approach to global investment, non-Chinese investors should be aware of the heightened risks related to investing in Mainland China. The Chinese reverse merger crisis caused massive economic harm, and very little could be done in the way of substantial recovery on most Chinese Reverse Merger investments without herculean efforts by court-appointed receivers. Therefore, at this time, practitioners seeking to recover investments from Mainland China without the use of arbitration should prepare a comprehensive recovery theory to secure corporate control quickly and avoid asset dissipation—charting out a path with the surest footing based on advantages gleaned from Chinese legal trends.