Silence Is Not Submission: Chinese Court Refuses to Enforce U.S. Default Judgment Rendered in Breach of Arbitration Agreement

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ABSTRACT

In around 2019, a Chinese court in Hebei Province refused to enforce a US default monetary judgment from a California court on the grounds that a valid arbitration agreement was in place (*Sunvalley Solar Inc. v Baoding Tianwei Solarfilms Co. Ltd.* (2019) Ji 01 Xie Wai Ren No. 3). This decision underscored the court's reliance on the arbitration agreement's validity, even though a subsequent legislative proposal to include arbitration agreements as an indirect jurisdictional

filter in China's Civil Procedure Law (2023 Amendment) was ultimately not adopted.

Key takeaways:

- In around 2019, a Chinese court in Hebei Province refused to enforce a US default monetary judgment issued by a California court, on the grounds of the existence of a valid arbitration agreement between the parties (*Sunvalley Solar Inc. v Baoding Tianwei Solarfilms Co. Ltd.* (2019) Ji 01 Xie Wai Ren No. 3).
- The Hebei Court held that the arbitration agreement was valid under Chinese law (the law of the seat of arbitration), since the parties did not specify the law governing the arbitration agreement.
- The Chinese company's failure to appear in the California court did not constitute a waiver of the arbitration agreement, as the Hebei Court ruled that silence does not imply an intention to abandon arbitration.
- The proposed inclusion of "arbitration agreements" as one of the indirect jurisdictional filters in China's Civil Procedure Law (2023 Amendment) was ultimately not adopted, following legislative review which deemed it inappropriate to override foreign courts' determinations regarding the validity of such agreements.

What happens if a foreign court default judgment was rendered despite an arbitration agreement and is later submitted for recognition and enforcement in China?

A local Chinese court in Hebei Province refused to recognize and enforce such a default judgment issued by a California court in the United States, on the grounds that the US court lacked indirect jurisdiction due to the existence of a valid arbitration agreement (*Sunvalley Solar Inc. v Baoding Tianwei Solarfilms Co. Ltd.* (2019) Ji 01 Xie Wai Ren No. 3).

Although the full text of the judgment has not yet been made publicly available, a case brief is included in a recent commentary book – *Understanding and Application of the Conference Summary of the Symposium on Foreign-related Commercial and Maritime Trials of Courts Nationwide*[1] – authored by the

Fourth Civil Division of China's Supreme People's Court ('Understanding and Application').

This raises an interesting and complex question: How would Chinese courts assess the indirect jurisdiction of the court of origin today, in particular, when an arbitration agreement is involved?

I. Case background

In January 2011, Sunvalley Solar Inc.("Sunvalley"), a U.S. company, entered into an agreement with Baoding Tianwei Solarfilms ("BTS"), a Chinese company, for the manufacture of solar panels.

Sunvally later allegedly incurred damages due to defective equipment supplied by BTS and subsequently filed a lawsuit against BTS before the Superior Court of California, County of Los Angeles, US ("California Court").

On 7 Sept. 2017, the California court rendered a default judgment (no. KC066342) in favor of Sunvalley, awarding a total amount of USD 4,864,722.35 against BTS.

In 2019, Sunvalley filed an application before Shijiazhuang Intermediate People's Court, Hebei Province, China ("Hebei Court"), seeking the recognition and enforcement of the California judgment ("US Judgment").

II. Court's Reasoning

Upon review, the Hebei Court held that the jurisdiction of a foreign court over a civil case is a prerequisite for courts to lawfully exercise judicial jurisdiction and also forms the basis upon which a foreign civil judgment may acquire *res judicata* and become entitled to be recognized and enforced in other countries.

In this case, the key issue was whether the arbitration clause agreed upon by the parties was valid, and if so, whether it excluded the jurisdiction of the California Court. This issue was essential in deciding whether the US Judgment could be recognized and enforced by the Hebei Court.

First, the Hebei Court examined the validity of the arbitration clause. In this case, the parties had only agreed on the governing law of the main contract, which was the laws of California, under Art. 15, Paragraph 1 of the "Procurement Contract"., The parties, however, had not specified the law governing the arbitration agreement. Accordingly, the Court deemed the arbitration clause to be governed by the law of the seat of arbitration, which in this case Chinese law.[2] Under Art. 15, Paragraph 2 of the "Procurement Contract", the parties had clearly expressed their intention to resolve their disputes through arbitration. According to the said provision, disputes arising out of the contract shall be submitted to the China International Economic and Trade Arbitration Commission (CIETAC). As such, the Hubei Court held that the arbitration clause met the requirements of Art. 16 of China's Arbitration Law and was therefore valid.

Second, the Hebei Court considered whether BTS's default constituted a waiver of the arbitration agreement. According to Art. II, Para. 1 of the New York Convention, Contracting States are required to respect valid arbitration agreements. Such agreements are not only legally binding on the parties but also have the legal effect of excluding the jurisdiction of national courts. This principle is fully consistent with Art. 5 of China's Arbitration Law and Art. 278 of China's Civil Procedure Law (CPL), both of which clearly provide that a valid arbitration agreement excludes court jurisdiction. If the parties intend to waive the arbitration agreement afterward, such waiver must be clear, explicit and mutually agreed upon, in accordance with the general principle of contract modification. Mere non-appearance in court proceedings does not constitute a waiver of arbitration or submission to the jurisdiction of the California Court. In this case, the existence of a valid arbitration agreement remained unaffected by BTS's failure to respond to the California Court's summons. Accordingly, BTS's silence could not be construed as an intention to waive the arbitration agreement. Thus, the California Court was deemed to lack jurisdiction over the case.

Third, the Hebei Court interpreted Art. 289 of the CPL, which provides for the recognition of "[J]udgments and rulings made by foreign courts that have legal effect". The Court clarified that this refers specifically to judgments rendered by competent foreign courts. Judgments rendered by courts lacking jurisdiction, including in matters that should have been submitted to arbitration, do not qualify. Since the California Court issued its judgment despite the existence of a valid arbitration agreement, and without proper jurisdiction, the resulting US

judgment could not be recognized and enforced under Chinese law.

Accordingly, the Hebei Court refused to recognition and enforcement of the US judgment.

III. Comments

Clearly, the existence of a valid arbitration agreement was the decisive reason why the Hebei Court found that the California court lacked proper indirect jurisdiction and thus refused to recognize the judgment it rendered.

While it may seem straightforward that a valid arbitration agreement generally precludes litigation before court, the extent to which such an agreement influences the review of a foreign court's indirect jurisdiction raises a more nuanced and compelling question. This very issue was at the heart of legislative debates during the drafting of China's recently amended CPL ("2023 CPL"), which entered in force on 1 January 2024.

1. The jurisdiction filter once in the draft

Interestingly, the existence of a valid arbitration agreement was initially included as one of the filters for assessing the indirect jurisdiction of foreign courts in the 2023 CPL Draft Amendment (see Art. 303, Para. 4 of the 2022 CPL Draft Amendment on indirect jurisdiction). Similar judicial views pre-dating the Draft can also be found in Art. 47 of the "Conference Summary of the Symposium on Foreign-related Commercial and Maritime Trials of Courts Nationwide", as well as in the commentary on that Article authored by the Fourth Civil Division of the SPC in the Understanding and Application.

However, this proposed filter was ultimately removed from the final version of the 2023 CPL Amendment.

So why was this filter removed? We can find the answer in the legislative review report on the Draft, the "Report on the Review Results of the 'CPL Draft Amendment'" issued on Aug. 28, 2023, by the Constitution and Law Committee of the National People's Congress (NPC) to the NPC Standing Committee:

"[S]ome members of the Standing Committee suggested that Paragraph 4 was inappropriate. If the arbitration agreement has been deemed invalid by a foreign court and thus jurisdiction is assumed, Chinese courts should not easily deny the jurisdiction of the foreign court. It is recommended to delete it. The Constitution and Law Committee, after research, suggested adopting the above opinion and making corresponding amendments to the provision."

2. What now?

If this case were to occur today, how would a Chinese court approach it? In particular, if there were a valid arbitration agreement between the parties, would the court still assess the indirect jurisdiction of the foreign court based on that agreement, if so, how?

This brings us back to the current rules on indirect jurisdiction set out Art. 301 of the 2023 CPL. It is important to note that where the foreign judgments originates from a country that has entered into a bilateral treaty on judicial assistance with China, the indirect jurisdiction rules in the treaty – rather than those in the CPL – will govern the recognition and enforcement process.

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- *What's New for China's Rules on Foreign Judgments Recognition and Enforcement? – Pocket Guide to 2023 China's Civil Procedure Law (1)*
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Under Art. 301 of the CPL, China adopts a hybrid approach to assessing indirect jurisdiction, one that combines the law of the rendering court and the law of the requested court. Specifically, for a foreign judgment to be recognized and enforced by Chinese courts, the foreign rendering court must meet the following jurisdictional requirements:

(1) it first must have had jurisdiction under its own national laws;

(2) even if a foreign court had jurisdiction under its own national laws, it must

also maintain a proper connection with the dispute. If such a connection is lacking, the foreign court will still be considered incompetent for the purpose of recognition and enforcement in China.;

(3) The foreign court will also be deemed incompetent if its exercise of jurisdiction

a) violates Chinese courts' exclusive jurisdiction under 279 and Art. 34 of the 2023 CPL, or

b) contradicts a valid exclusive choice-of-court agreement between the parties

In the context of the hypothetical scenario involving an arbitration agreement, a Chinese court would primarily examine the situation under Art. 301, Para. 1 of the CPL. This provision requires the court to consider whether the foreign court properly determined the validity of the arbitration agreement in accordance with the law of the country where the judgment is rendered and thereby determine whether it had jurisdiction.

a) If the foreign court determined that the arbitration agreement was invalid and exercised jurisdiction accordingly under its own law, a Chinese court would generally not deny the foreign court's jurisdiction (unless it finds that the foreign court lacked proper connection with the dispute). This approach is also consistent with the legislative intent expressed by the NPC Constitution and Law Committee.

b) If the foreign court did not consider or address the validity of the arbitration agreement (as may occur, g., in a default judgment like in the Sunvalley case), how should the Chinese court evaluate the agreement's validity during the recognition and enforcement stage? This raises a key unresolved issue: Should it assess the validity of the arbitration agreement according to the rules of Chinese private international law, or instead refer to the conflict-of-law rules in the State of origin? The 2023 Civil Procedure Law does not provide a clear answer to this question. As such the issue remains to be tested in future cases.

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[1] The Fourth Civil Division of China's Supreme People's Court, Understanding and Application of the Conference Summary of the Symposium on Foreign-related Commercial and Maritime Trials of Courts Nationwide [Quanguo Fayuan Shewai Shangshi Haishi Shenpan Gongzuo Zuotanhui Jiyao Lijie Yu Shiyong], People's Court Press, 2023, pp. 332-333.

[2] Cf. Art. 18, 2010 Law of the People's Republic of China on Choice of Law for Foreign-related Civil Relationships (2010 Conflicts Act)