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The Pyramid Enforcement Scheme

Luke Eric Peterson (Investment Arbitration Reporter) · Saturday, October 22nd, 2011

Recent reports of the freezing of Russian government funds at the Stockholm Arbitration Institute may be premature, but it still remains possible that a Swedish bailiff could move to seize such funds.

At the time of this writing, a freezing request by German businessman Franz Sedelmayer remained under active review at a Swedish government debt enforcement agency.

Mr. Sedelmayer, you may recall, is the bearer of a real collector's item: a vintage 1998 arbitral award in which the Russian Federation was ordered to pay some $2.35 Million (US) for helping itself to the German businessman's St. Petersburg-based private security company.

Since 1998, Mr. Sedelmayer has made a second career out of enforcing that arbitral award. By his estimate, he has been involved in more than 70 litigations around the world, trying to identify and seize Russian assets, while defending against various legal actions brought by the Russian authorities against him.

More than one bailiff in Western Europe has broken into a cold sweat when tasked by Mr. Sedelmayer with slapping the handcuffs on Russian government assets. For a long time, the indefatigable German businessman accumulated plenty of anecdotes – including a quixotic bid to seize Russian cosmonaut gear at an international air show – but few liquid assets.

Recently, his luck has started to change, as he has begun to lay hands on certain buildings and real estate in Western Europe.

However, Mr. Sedelmayer's latest enforcement tactic – seizing Russian funds deposited at arbitration centres and law firms – should occasion some soul-searching amongst proponents of foreign investment protection standards.

If the successful claimant in an investment treaty arbitration is reduced to targeting deposits ponied up in other more recently initiated arbitrations, the entire enterprise takes on the contours of a classic pyramid scheme: with the contributions of later entrants used to pay off earlier participants.

Not only does this enforcement model appear deeply embarrassing for devotees of investment arbitration, its limits are also plainly apparent. Even if a bailiff agrees to seize arbitration deposits, and such a seizure is not quashed by the courts on sovereign immunity grounds, it can only offer succor to those with debts small enough to be satisfied by the deposits used to finance other arbitral

proceedings.

If a tiny award against a highly-globalized G8 economy can remain unpaid for more than a decade, what of those seeking larger sums from regimes that tend to stuff their cash into the sofa cushions, rather than scattering it beyond their borders?

One answer that has been bandied about in the Argentine context is for home governments – or all governments with an interest in binding dispute settlement – to bring diplomatic pressure to bear against dilatory debtors. However, this "re-politicization" of the dispute settlement process comes with all of the usual baggage. States expend precious diplomatic capital when they go to battle for investors-creditors on the foreign relations playing field. Sometimes that capital is worth spending. At other times it is not.

Another solution is to expect claimants to bear the cost of enforcement – either by carrying insurance which covers the risk of award-default, or by selling their awards at a discount to vulture funds or organizations specializing in debt-collection. This pathway may be attractive for some, but for bearers of modest awards it may be neither viable nor equitable. (Try explaining to the owner of an expropriated family business, that they should take a haircut *after* gambling everything and "winning" in arbitration.)

There may be no silver bullets when it comes to dealing with recalcitrant debtor states.

However, the fact that an arbitral award-creditor has been reduced to targeting deposits laid down in other arbitral proceedings strikes me as something of a watershed.

Mr. Sedelmayer's long struggle – and his increasingly audacious tactics – remind us that it is one thing to erect a system of 3,000+ international investment treaties, but quite another thing to make it work.

As the 15th anniversary of his arbitration victory looms, it is time to take some of the energy devoted to investment treaty rule-making and to re-focus it on the vexing question of enforcement.

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