Kluwer Arbitration Blog

The Enforcement Chimera

Cameron Ford (Squire Patton Boggs) · Thursday, May 10th, 2018

"Enforcement" of arbitral awards is one of the main selling points of arbitration, with the perception being that nothing yet comes close to the New York Convention to enforce court judgments. The *Hague Convention on Choice of Court Agreements* will assist when adopted by more countries.

For now, the mere uttering of the incantation "enforceability" tends to quell any rebellious stirrings of interest in litigation. Yet it is not a quality I find highly persuasive except in very clear cases. Other than those situations, the spectre of the questionable enforceability of a court judgment is not particularly troubling. This is heresy for private practitioners who feel obliged to remove all risk, but can be a real consideration for in-house counsel struggling with time, cost and predictability of dispute processes.

Obviously not everyone feels this way, and there will be some industries and companies for whom the possibility of enforcement is important. These are where the debtor would not pay unless the judgment or award is enforceable and has assets readily available for execution. The ideal example of that situation is where the creditor holds security for the debt in a jurisdiction where execution is practically, as well as theoretically, possible.

Apart from those situations, I venture to suggest that the enforceability of awards can be overrated as a determinative factor in choosing dispute resolution methods. Four features of the contract landscape lead me to this view, namely the disputes iceberg, the procedural mountains, the enforcement pyramid and the judgment mirage.

The disputes iceberg

The vast majority of contracts never have serious disputes requiring resolution, and the vast majority of disputes are below the surface, being dealt with in-house without proceedings ever being issued and enforcement being necessary. Proportions will differ among companies and industries, but my experience is that around 1% of contracts have a real dispute and 1% of those require proceedings. With these ratios, enforcement does not loom large in the choice of resolution methods. Attention instead is focussed on mechanisms for negotiation and mediation before proceedings need to be commenced.

The procedural mountains

"Enforcement" needs to be unpacked into its constituent parts. It is comprised of three components – R, E, R:

• **Recognition** of the award by the court of the enforcing jurisdiction;

• **Execution** of the judgment by the local authorities;
• **Recovery** of funds as a result of execution.

Enforcement of an award can only be as effective as the weakest of these three distinct steps. It would be interesting to see statistics showing the number and value of awards (a) sought to be recognised, (b) recognised, and (c) for which some recovery was made.

Recognition

The irony of recognition of a foreign award by an enforcing court is that the parties are forced back to the very courts they tried to avoid by choosing arbitration. Of course, that will not always be the prime motive in selecting arbitration over litigation but it is often likely to be a significant factor. It might also be that recognition is being sought in a place which would not have been the jurisdiction had litigation been chosen: a debtor's assets might be spread around the world. True also that there may be fewer theoretical opportunities for problems in the enforcement process in the court than in a full trial, but no doubt there will still be opportunities, even if they only result in delay, appeals, opaque processes and curious results.

Whether the enforcing jurisdiction is supportive of arbitration or not, the mere differences in interlocutory processes, legal practices, standards of the profession and time to judgment can render the recognition process frustrating and, sometimes, practically ineffectual.

Execution

Once an award is recognised and made a judgment of the local court, it then falls to the local processes to execute the judgment – by bailiffs, sheriffs, police, private operatives, and so on, depending on the jurisdiction. Again, the creditor is subject to the vagaries of the jurisdiction it may have been trying to avoid. The characteristics of the jurisdiction that drove the parties to choose arbitration over the local courts usually means the execution processes are not as productive of results as those in developed countries.

Execution can be a frustrating process even when in mature jurisdictions such as Australia and even when executing a local judgment. You feel that the control you have had throughout the litigation has been lost and that you are now at the mercies of those who over whom you have no influence, control or even visibility. There is very little that can be done if the bailiff returns a writ of execution with the comments that it could not be executed, the debtor could not be found or had no assets against which to execute. At least in mature jurisdictions there is a certain amount of accountability in that a complaint could be made to appropriate authorities if need be and be taken relatively seriously.

How much more is the loss of control and visibility when execution is in a foreign country not known for its legal processes, with different language, procedures, culture and attitude to enforcement. There is virtually no accountability to a foreign creditor and the process can be utterly opaque.

Recovery

Stones do not yield blood. No execution process, no matter how diligent, will yield results if there are no recoverable assets. It is for this reason recovery of funds is dealt with separately from the execution process in this analysis. It is the *result* of execution, not *part* of the execution process.

The unfortunate fact is that debtors are often found to have no recoverable property at the end of the execution process, leaving creditors only with the unsatisfying options of liquidation or capitulation.

The enforcement pyramid

Separate from the components of enforcement is the question of whether enforcement is necessary to begin with. For many companies enforcement is necessary only in a minority of cases. This will vary among industries and companies, and some creditors will have the luxury of security to make enforcement worthwhile. Banks and insurers, for example, will not identify with these sentiments. For others, counterparties can be divided into three categories with the result that enforcement is:

• **not necessary** because the counterparty will honour a judgment or award regardless of its enforceability. Reputable companies concerned with their reputation and financial standing will pay judgment debts if they can. If they cannot, enforcement has little use. Further, some judgments against a debtor will be paid by its insurer in any event, rendering enforcement unnecessary. It is also the nature of things that the type of companies who would pay without enforcement holds the contracts of the highest value and risk: large, established, reputable companies tend to obtain the larger, riskier, longer term contracts This is not always the case, particularly with IT contracts, but it can be a general rule for parties in many fields.

A practical consideration is the individual creditor's contracting philosophy and the dispute resolution process it informs. A philosophy of non-contention, conciliation and preservation of relationships will usually inform a resolution process of genuine negotiation and meaningful mediation before formal proceedings. Even if it does not, such a philosophy will produce compromises and negate the need for enforcement. By its nature this will affect both the question of whether there is a judgment debt to be enforced and whether and how it is enforced.

The proportion of counterparties in this category will vary among industries but I suggest they would be at least, say, 30%, probably closer to 50% for some industries.

• **pointless** because the counterparty will have no recoverable assets or will be able to evade execution. Subject to industry variance, this could account for around 30% of counterparties;

• **necessary** because the debtor will have recoverable assets but will not pay unless forced to do so through the formal execution process. Again, depending on the industry, this could be 10%-30% of counterparties.

We can speak of an enforcement pyramid, with the broader base being the 50% or so of contracts where enforcement is **not necessary**, the middle layer of around 30% where enforcement is **pointless**, and the apex of around 20% for those contracts where enforcement is **necessary**, looking like this:

NECESSARY
P O I N T L E S S
N O T N E C E S S A R Y

The judgments mirage

Judgments may be enforced in some countries in a manner not too dissimilar from the enforcement of awards under the New York Convention. The Asian Business Law Institute's 2018 report on the *Recognition and Enforcement of Foreign Judgments in Asia* showed that the factors taken into

account in enforcing foreign judgments in those 15 countries are similar to those under the New York Convention. The major difference lies in eight of those countries requiring either a treaty with the judgment country or reciprocity of enforcement – Cambodia, China, Indonesia, Japan, Lao, Philippines, South Korea and Vietnam. The other seven countries being based on common law or having similar features, will enforce judgments without a treaty or reciprocity subject to the usual conditions – Australia, Brunei, India, Malaysia, Myanmar, Singapore and Thailand.

This is not to minimise the practical difficulties in enforcing judgments in those countries, but those difficulties may not be much greater than scaling the procedural mountains described above. It is interesting that in the 1949 edition of Dicey & Morris, the authors say that the New York Convention was intended to give the same degree of enforceability to arbitral awards as already existed for court judgments (I am indebted to Justice Quentin Loh of the Singapore Supreme Court for this snippet of information).

Summary
Enforcement is not a real concern for certain industries and companies where it will only be necessary for a minority of counterparties and, even where necessary, has a high chance of being ineffective because of the problems associated with recognition, execution and recovery in the debtor's country. Arbitration needs to concentrate on or create other unique features to attract parties where enforcement is not of particular concern.

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