



## Good Governance Matters: A New Look at the Problem of Enforcing Foreign Arbitral Awards

### Remarks

of

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I think that it is generally assumed in the commercial world today that arbitration trumps litigation in the area of effective and efficient dispute resolution. International institutions engaged in judicial reform have identified the lack of attention to developing arbitration and other alternative dispute mechanisms as a weakness of existing judicial reform programs. Some judicial reformers aim to promote arbitration as a strategy to unclog crowded court dockets and provide speedy, and therefore cost efficient, justice in developing countries.<sup>1</sup> This strategy is premised on the hope that arbitration would help ensure certainty, predictability, fairness and timeliness—all of which have been identified as key elements in dispute resolution that facilitate the flow of foreign direct investments.

Arbitration's promise to resolve disputes promptly and at less cost is particularly attractive to developing countries where the average time it takes to resolve a case in the courts can extend up to 10 or 15 years, and where the court process itself is viewed to be very formal and expensive. Arbitration is also widely promoted as a silver bullet that can make complex conflict of law issues—jurisdiction; foreign state immunity; enforcement of judgments, all of which would hamper the effective dispute resolution of international commercial contracts through domestic courts—disappear. I am sure that these, as well as a host of other reasons in favor of arbitration, sound familiar. These are the same reasons behind the widespread adoption of numerous of international agreements aimed at promoting arbitration in this new world without borders.

*The New York Convention: Increasing trade flows, but not enforcement of arbitral awards*

Foremost among these agreements is the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1956 (the "New York Convention"), which was conceived as a means to overcome the problem of enforcing arbitral awards. In 2003, 133 states were parties to the New York Convention, making it one of the most widely accepted and important conventions governing international commerce. An important benefit resulting from its virtually universal adoption include the fact that all member states are required to enforce arbitral awards issued outside their own jurisdiction without having their own courts review the substance of the award. In theory, the New York Convention decreased the risk of non-enforcement of foreign arbitral awards by restricting a state party's refusal to enforce the award on reasons of public policy.

What has been the effect of the New York Convention in promoting international trade and investment worldwide? A recent study of 15 of the 24 countries that originally signed the New York Convention found that countries that had ratified the convention were able to improve their position in international trade flows.<sup>2</sup> The study emphasized that a country's ratification of

the New York Convention, particularly without reservation, conveyed a willingness to enforce contracts impartially that resulted in an increase in its export of locally manufactured goods.

But how effective has the New York Convention been in fulfilling its original mandate-- ensuring the enforcement of foreign arbitral awards? The reality is that enforcement of foreign arbitral awards remains a major challenge in many jurisdictions. Even if arbitration tribunals solve the problem of effective dispute resolution, this does not ensure compliance with the final ruling. A losing party who wishes to frustrate enforcement of the award may rely on a home country's institutions to avoid contractual liability. The domestic institutions in a party's home country become the fallback option for effective contract enforcement. Uncertainty about the reliability of these institutions ultimately affects the other party's willingness to trade with firms from that country.

### *Good governance matters*

This underscores the key role that domestic institutions play in the framework of international arbitration. If domestic courts and judges remain unfamiliar with the substance and mechanics of the New York Convention and international arbitral practice or are weak or prone to corruption, enforcement of arbitral awards may be defeated on spurious "public policy" grounds. Where domestic institutions are weak, arbitral awards will not be shielded from the problems that would otherwise plague claims litigated in a foreign court. Even in a globalized world, where most companies have done, or will do international business, one cannot be insulated from the negative impact of "bad" or ineffective legal institutions—not even by seeking recourse in the New York Convention or other international institutions, or by championing arbitration as an alternative to many developing countries' legal systems. To partake of the benefits promised by arbitration, we must ensure that strong, effective domestic institutions are in place.

Indonesia's experience with the New York Convention and implementing foreign arbitral awards illustrates this point. Indonesia ratified the New York Convention in 1982. Prior to that, the Dutch Civil Code that had remained in force after Indonesia's independence stipulated that judgments of foreign courts, including arbitral courts, could not be enforced in Indonesia. Academics have linked Indonesia's ratification of the New York Convention with an initial improvement in the public's perception of the quality of its legal institutions (particularly its willingness to enforce contracts) and a corresponding rise in international trade flows (measured by an increase in Indonesia's export of manufactured goods) during the first half of the 1980s.<sup>3</sup>

And yet, this early improvement in the public's perception of Indonesia's willingness to enforce contracts, as well as the related rise in international trade flows, proved unsustainable when, notwithstanding Indonesia's ratification of the New York Convention, the Indonesian Supreme Court blocked enforcement of foreign arbitral awards on the ground that implementing regulations codifying procedures for the enforcement of foreign arbitral awards had not yet been promulgated. These regulations were issued in 1990—10 years after Indonesia signed the New York Convention, and eight years since its ratification.

As expected, the Supreme Court's issuance of the implementing regulations was again followed by a marked improvement in the public's perception of the quality of legal institutions and Indonesia's willingness to enforce contracts. Academics linked this subsequent improvement, which began in the early 1990s, with the issuance of implementing regulations to the New York Convention, the Supreme Court's subsequent decisions upholding the enforcement of foreign arbitral awards, and the government's reform of existing investment and commercial laws to support Indonesia's growing commercial activities. They concluded that, while ratifying the New York Convention may send a strong signal of a willingness to enforce contracts and play by international rules, failure to comply with these rules could undermine a country's credibility as a trading partner, consequently decreasing its participation in international trade flows. "Regaining credibility may require more than just signaling. Instead, it might call for tangible reforms at home and a track record of implementing them."<sup>4</sup>

The lesson here is clear: good governance matters, in enforcing foreign arbitral awards, facilitating international trade, and in improving a country's economic development.

### *Arbitration and the ADB*

Since 1995, the Asian Development Bank (ADB) has recognized the relationship between good governance and economic development. ADB's Office of the General Counsel (OGC) has, in close partnership with the regional departments of the ADB, initiated and administered over 70 projects focusing on improving the institutional framework of its developing member countries (DMCs). Our bank is extensively involved in judicial reforms, in shaping new laws for emerging market economies and assisting countries that wish to participate more actively in international trade. In implementing these reforms, we aim to help improve the business climate in DMCs.

Even as these attempts at promoting good governance have a crucial effect on the enforcement of foreign arbitral awards in our DMCs, we are studying how we can promote the use arbitration and other alternative dispute mechanisms more directly. Arbitration interests us because of the benefits it might have for a country's economy, particularly in its ability to attract foreign direct investment and participate more actively in international trade. Moreover, over 40% of the 3,000 or so arbitration cases worldwide relate to assets in Asia. Our efforts are further encouraged by evidence from Singapore, Hong Kong and Malaysia that suggests that arbitration has made a significant difference in enhancing investor comfort, where arbitration procedures are clearly established, judges fully trained and executing agencies well developed.

We are presently proposing an inter-regional study that would examine the current constraints in turning arbitration into a more effective dispute resolution mechanism and identifying ways by which these constraints could be overcome. Some of the issues we wish to explore are: What makes enforcement of foreign arbitral awards difficult in our DMCs? What are the incentives and disincentives in accepting arbitration as an alternative dispute resolution mechanism? Is arbitration really more cost effective, and if not, what are the ways to make it more so? Are there cultural factors that discourage the use of arbitration as a means of resolving disputes, and if so, how do we address them?

Partnerships will be essential to the success of this endeavor, and gatherings such as these, from which we can learn from the ideas and experiences of practitioners, are important. We look forward to learning lessons from all of you—lessons that are so urgently needed by the developing world.

Thank you.

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\*Arthur M. Mitchell is the General Counsel of the Asian Development Bank. The opinions expressed herein do not necessarily represent the views of the Management of ADB.

<sup>1</sup>Richard E. Messick, *Judicial Reform and Economic Growth: What a Decade of Experience Teaches* (2004).

<sup>2</sup>David Berkowitz, J. Moenius & K. Pistor, *Legal Institutions and International Trade Flows*, 26 MICH. J. INTL. LAW 15, 35 (2004).

<sup>3</sup>*Id.* at 27.

<sup>4</sup>*Id.* at 35.