The Status of the Enforceability of U.S. Judgments in the Context of the Hague Convention June 2004

The issues of enforceability of U.S. judgments by non-U.S. courts has been raised by the U.S. insurance and reinsurance industry as a significant factor in the policy debate regarding the reduction or elimination of collateral requirements for unauthorized reinsurers assuming U.S. risk.

The proponents of collateral reduction/elimination have suggested that this issue is without merit – that U.S. judgments are consistently enforceable in non-U.S. jurisdictions, or at least in certain EU jurisdictions.

Before the participants in this debate can move forward toward a resolution – there must first be a common ground on which to acknowledge that a problem with enforcement exists.

Definition of the Problem

The U.S. insurance and reinsurance industry have produced a number of documents expressing concern about the enforceability of non-U.S. judgments by non-U.S. courts when those judgments contain an element of punitive or other non-economic damages, treble or other multiple damages, or when such orders have been entered pursuant to a default judgment.

Background on the Hague Convention

The United States is not a party to any convention (treaty) that requires recognition and enforcement of judgments. In 1992 the U.S. proposed that the Hague Conference in Private International Law undertake work on a Convention addressing these issues. Negations did not begin until 1996 and after seven years failed to produce a consensus draft. A Special Commission was then convened to draft a revised Convention for consideration at the next conference scheduled to begin January 2005. A draft on exclusive choice of court agreements was distributed May of 2004.

There are at least two outstanding problems with the current draft Convention. Article 10 would enable a court presented with a judgment for enforcement to refuse to recognize "non-compensatory damages, including exemplary or punitive damage," as well as "excessive damages," consisted with the law of that jurisdiction. The implications for insurance and reinsurance business of this exception are many, including, e.g., protection for adjudications of bad faith and applicability of the exception to claims that are covered under primary and excess insurance policies or reinsurance agreements.

Article 16 would allow Member States the opportunity to declare that the Convention does not apply to certain types of matters. For example, Canada has insisted that the draft

provide that a Member State may declare that it will not apply the Convention to agreements relating to asbestos matters. Similarly, China has proposed a limitation for "natural resources" and "joint venture" matters. In view of the plethora of insurance and reinsurance related matters concerning asbestos and "natural resources," these are troubling proposals.

Position of Non-U.S. Delegates to the Hague Convention and Advisors

U.S. delegates to the Hague Convention have confirmed that EU (including UK) delegates have publicly expressed the position that U.S. judgments for punitive damages **are not** currently enforceable in EU jurisdictions.

Indeed, this position has been confirmed by the City of London Law Society Financial Law Sub-Committee. In their Submission to the Hague Conference on Private International Law, dated April 2004, (hereinafter London Law Society Submission) the following statements were made:

1. "If a convention were to be concluded the changes that we wish to see are:

   . . . the rules on damages need to be re-cast to enable a court to refuse to enforce a non-compensatory award whether or not such damages are recoverable in the forum. This could be done by enabling each state on ratification (but not after) to enter a reservation in respect of the recognition and enforcement of judgments for such types of damages. This is a particular concern for businesses in the United Kingdom as punitive (and, in limited cases, multiple) damages are recoverable under English law. As currently drafted, Article 10 of the Convention is likely to permit U.S. punitive awards to be enforceable in England despite the fact that non-compensating awards are, in practice, rare in England and are always modest in amount." (See London Law Society Submission, pages 1 – 2.)

2. "The recoverability in England of U.S. awards for excessive and punitive damages will lead to limitless uninsurable liability and may have extremely serious economic consequences for the insurance sector." (See London Law Society Submission, p.2)

3. "Article 10 intends to address the concern of most non-U.S. jurisdictions of being required to recognise and enforce under the Convention non-compensatory damages, in particular, punitive damages and multiple damages. As currently drafted, the proposals will not achieve their aim and open the prospect of vast uninsurable liabilities for English companies. A Convention that requires English courts to enforce such awards would have extremely serious economic consequences, in particular, for the insurance sector." (See London Law Society Submission, page 14.)

4. "As explained below non-compensatory damages (including punitive and multiple) awards are available under English law. The position is the same in

other common law jurisdictions (Australia, Canada, New Zealand). Civil law jurisdictions generally prohibit such awards. However, the awards made by courts (particularly juries) in the United States present a very serious concern for the whole of the commercial community. . . Several states of the United States also award punitive damages for breaches of contract. This is a particular concern for the insurance industry as very large awards of punitive damages have become common in most States of the United States in recent years for "bad faith." In practice, bad faith often approximates to negligence by the insurer in settling or defending a claim by a policyholder." (See London Law Society Submission, page 15.)

5. "Unlike the position in England, courts in the United States imply a covenant of good faith and fair dealing in contracts. This implied covenant has been used as the basis for developing a cause of action in tort for breach of the contractual duty of good faith. The result is that tortuous remedies (including punitive damages) are available for breaches of contract. Although tortuous remedies appear to be generally available in most states for certain breaches of contract, the focus of much litigation appears to have included insurance companies… This significantly expands the potential liability of the insurer… Crucially important is the insurer's liability for any judgment exceeding its policy limits. Consequential or extracontractual damages may further include awards for emotional distress, lost income and related economic loss. No distinction seems to be drawn between claims made by private individuals and companies under business-to-business insurance contracts. The difficulties that such claims have caused has been widely recognised in the United States. There has been an 'explosion of first-party bad faith insurance litigation.'" (See London Law Society Submission, pages 18 –20.)

6. Noting the wording of Article 10 in the current draft of the Convention, the London Law Society Submission at page 26 states:

> The problem with the drafting of this provision is that punitive damages and multiple damages exist under English law with the result that Article 10 may require English courts to recognize such awards generally.
> . . . The same injustice will exist for defendants domiciled in other Member States that have assets in the United Kingdom that could be attached to meet a punitive or multiple U.S. award. (See London Law Society Submission at page 28.)

7. "Awards comparable to those in the U.S. are wholly unknown in England, and would almost certainly be held to contravene the European Convention on Human Rights." (See London Law Society Submission, page 29.)

The London Law Society Submission goes on to address the problem of non-compensatory awards, recognizing that one solution is to require enforcement of a U.S. judgment only to the extent that the recognizing jurisdiction had the ability to make such awards. (See page 29.) The Society opines that while this would be an improvement to Article 10, they ultimately reject such a reciprocity test. (See page 29.)

Instead, the Society suggests states could be required to declare, when they ratify the Convention, whether they will recognize judgments for non-compensatory damages. If a State declares that it will recognize such judgments, its courts would be required to enforce such awards and "would be precluded from relying on public policy as a ground to object to the non-compensatory part of the award." (See page 30.)

A second alternative put forth by the London Law Society was a complete exclusion of non-compensatory damages from the scope of the Convention, requiring courts to enforce only the compensatory portion of any award. (See page 31.)

A third option set for the by the Society was to impose a cap or limit on the enforceability of non-compensatory damages e.g. a fixed amount or as a percentage of compensatory damages. They observed that this approach might also result in the enforcement of large awards and suggested use of both a multiple test and a fixed cap with enforcement limited to the lower amount. (See page 31.)

The Resolution

In light of the overwhelming evidence above, no argument can, in good faith, be made that the UK would recognize and enforce non-compensatory damages awarded in the Untied States. Now that it is unequivocally established that there exists a problem – perhaps we can finally move forward with steps aimed at resolution. This could include altered positions in the context of the Hague Convention negotiations or bilateral treaties on recognition and enforceability. Until such time as U.S. judgments are consistently enforceable in non-U.S. courts, the U.S. industry and their regulators are unlikely to agree to a reduction of collateral.