

Follow up to the ECOFIN October 2006

Towards improved judicial efficiency for financial services claims: recommendations

In 2007 we conducted a survey entitled “Efficiency of judicial systems for financial services claims” in which you answered a questionnaire designed to assess the efficiency of courts in your jurisdiction in dealing with claims filed by financial institutions. As you know, the survey is part of our work to respond to ECOFIN’s invitation in October 2006 to “monitor and assess the relevant institutional features that hinder the efficient functioning of the financial system, and to pursue efforts aimed at improving the financial market framework conditions”. The ‘efficiency’ of the judicial system is clearly a part of that institutional back-drop.

Indeed, the financial markets may only properly function if the legal foundations that support market activity are strong and robust. That strength is founded mainly on the efficiency of the judicial system. As millions of transactions are concluded daily on the financial markets market participants must be able to rely on the courts to ensure prompt and adequate performance of those contracts. Moreover, the courts can play a significant role in helping financial markets develop and remain competitive by responding and adapting to market needs and conditions. It is not surprising therefore that a recent survey has identified a “fair and predictable legal environment” as the second most important criterion determining a financial centre’s competitiveness¹.

Your responses give some indication of areas where courts may not be as efficient as they could be, particularly from the perspective of creditors and investors. We realise however that it is difficult to provide precise information in this area². We have therefore also consulted other published reports on judicial systems and efficiency.

These reports³ are principally the following:

- The World Bank’s “Doing Business” 2006, a global survey on conditions for doing business in around 140 countries⁴;
- The Council of Europe’s European Commission for Efficiency of Justice (CEPEJ) Reports of April 2005 (2002 Data) and 2006 (2004 data);
- The European Commission (DG J&IA) Study No JA/AS/2002 “Making more efficient the enforcement of judicial decisions in EU”, 18 February 2004 by Prof. B. Hess, University of Heidelberg⁵;

¹ “Sustaining New York’s and the US’ Global Financial Services Leadership”, a joint report by the Major of the City of New York and the US Senate, January 2007.

² I.e. domestic courts do not generally provide data on annual number or category of claims.

³ Note some of these reports deal with judicial efficiency only generally or obliquely

⁴ One of the indicators used in this survey is the duration of enforcement, expressed as the total number of calendar days needed to recoup on a bounced cheque, i.e. a simple fixed amount claim.

⁵ The study covers those areas of judicial activity such as enforcement orders, attachments, garnishee orders that impact on cross border activity.

- The European Commission's 'European Judicial Network in Commercial and Civil Matters'⁶.
- Freshfields Bruckhaus Deringer "Litigating in Europe", a series of booklets outlining commercial legal proceedings in each of the EU countries where the firm has an office.

We are open to suggestions for other possible sources of information.

Whilst there are undoubtedly difficulties in compiling accurate data on court claims and judicial efficiency - for example there are no common definitions of what constitutes a civil/ financial services claim or no mandatory rules dictating by when a court should issue judgment and hence no accepted 'benchmarks' - the EFMLG can make a valuable contribution in this important area for creditors by making targeted **recommendations** to decision makers.

In our view, the following recommendations could be usefully made to the ECOFIN on the basis not only of the available data but also members' own professional experience, which is anecdotal evidence and thus of added value. For each recommendation the rationale is explained and the evidence on which it is based set out.

It is intended to present the recommendations to the ECOFIN (or the EFC) if possible at the official meeting in September 2008. In view of their subject matter, we envisage the recommendations, although presented to the Finance Ministers, will also be read by EU Ministers of Justice. In this manner, we intend to highlight the significance of well functioning, efficient and responsive judicial systems for the development of financial markets in the EU. To our knowledge this has not been done before at this level.

Rationale and introduction to the recommendations

The functioning of the court system is undoubtedly an institutional feature that can hinder the efficient functioning of the financial system.

Financial markets need strong underlying legal and administration of justice infrastructure in order to remain efficient and competitive. One of the fundamental roles played by courts is credit protection. Financial institutions often appear as creditors in court proceedings. If the courts are weak on credit protection and institutions are hindered by inefficient courts from enforcing their credit claims, they will incur a cost for late credit recovery and will thus not be able to fully pass on benefits of their products to clients⁷. On a macro economic level also, poor enforcement leads to capital not being allocated efficiently in the market.

⁶ This includes a general description of each member state's judicial system and court procedure. http://ec.europa.eu/civiljustice/adr/adr_ger_en.htm

⁷ According to the Chairman of the Italian Banking Association, the higher legal costs incurred for late credit recovery in Italy represents 1% point more in the interest rate required by Italian banks on loans

Any jurisdiction that is seriously interested in a developed financial market should therefore strive to improve the conditions in which creditors can enforce claims in the courts.

By ‘claim’ we mean a simple monetary claim, for instance for repayment of an unsecured consumer or business loan, to recover on a bounced cheque or to collect on a letter of credit; and we include both contested and non contested claims, in other words whether or not the judgment comes after a trial (further only “claim”). If this is not the case, it is specified what the claim is.

1. Duration to judgment

Rationale

The reasons for considering the duration to judgment as an area for improvement are threefold.

First, it is matter of public concern, including of the financial community. There is a general perception – particularly amongst creditors - that civil court proceedings for obtaining and enforcing judgments are too slow⁸. Creditors’ experience of the courts at first contact is important. In our view, what is most likely to effect creditor confidence in the efficiency of the courts is the time the court takes to issue judgment at first instance.

Second, the right to “a fair trial within a reasonable time” is in any event one of the most important principles related to the proper and efficient functioning of the courts is related to. This principle is enunciated in Article 6 of the European Convention of Human Rights, and also in Article 47 of the Charter of Fundamental rights of the EU⁹. Thus if the length of proceedings is excessive, this becomes not only a matter of economic rationale but also one of basic human rights. It is revealing that the most frequent ground for applications to the European Court for Human Rights is the excessive length of civil proceedings in the applicant’s jurisdiction. It is interesting that such complaints are not only made against developing member states, but also frequently against EU member states¹⁰.

Third, financial litigation tends to rely only or principally on documentary evidence. Contrary to other areas of law (e.g. criminal law, family law etc.) the burden of proof in financial litigation is relatively lighter and the proceedings therefore speedier.

to non financial clients (source, ABI (2002) p. 21. Quoted on page 19, Commission draft working document: ‘Impact assessment on directive on cross border transfer of registered office’, SEC (2007) 177.

⁸ See CEPEJ Reports 2005 and 2006.

⁹ See the Council of Europe’s “European Commission for efficiency of justice” (CEPEJ) Report of 2006.

¹⁰ For example Austria, Czech Republic.

Responses

According to the information from your responses to the questionnaire the jurisdictions¹¹ may be categorised into three groups as regards how expeditiously they deal with claims. In all cases the time lines are only estimates.

The first group

In jurisdictions such as UK, Ireland, Germany, Sweden, first instance courts are able to issue a judgment on a claim from within a few weeks to a few months of the date of filing of the claim with the court office. For example, in the UK, a default judgment is reported to take on average 21-35 days to obtain, and a summary judgment¹² (available on most civil actions) may be expected within 3-6 weeks of the application. Even if the case goes to trial, the first judgment may be expected within twelve months.

The second group

In a larger group - the broad mean - composed of jurisdictions such as France, Spain, Finland, Czech Republic, Switzerland¹³ and the Netherlands¹⁴, the courts are able to issue a first judgment roughly between six (best case scenario) to eighteen months (worst case) of the date of filing of the claim.

The third group

Finally, there are a few jurisdictions, Italy, Slovenia where the courts do not appear able to issue a judgment on a claim until anything from 3 to 4 years after the date of filing. In Greece it is reported to take 1 1/2 to 2 1/2 years to issue judgment on an unsecured loan - although the courts are able to issue judgment on a bounced cheque within up to one month.

Other supporting evidence

These 'rankings' broadly tally with information from other international organisations. Two organisations have surveyed judicial efficiency in any detail: the World Bank and the Council of Europe.

¹¹ Note the responses did not cover all EU jurisdictions; additional information on non responding jurisdictions comes from the above cited reports

¹² I.e. where the claimant only needs to prove that he has a 'prima facie' case, that is a reasonable prospect of succeeding at trial, without the merits of the claim being considered in detail.

¹³ The World Bank's "Doing Business" 2006 and the CEPEJ Reports 2005 and 2006 also rank Portugal, Austria and other C&EE member states in this middle category, so that on this evidence the second group may be said to be the largest of the three.

¹⁴ Dutch court proceedings on the merits of a claim typically take between 2 months to 2 years (source: Freshfields Bruckhaus Deringer: "Litigating in Europe: the Netherlands", page 1.

The World Bank¹⁵ ranks Ireland and UK 1st and 2nd respectively in the EU in terms of ease of doing business, whereas it ranks Italy 21st jointly with Czech Republic¹⁶, and Slovenia 16th. ‘Doing business’ is a general term which includes as an indicator the duration to enforcement of a simple claim, such as recovery on a bounced cheque.

The Council of Europe’s European Commission on Efficiency of Justice (CEPEJ), reports that the courts of the third group jurisdictions take the longest of all Council of Europe member states to issue first judgments in employee dismissal and divorce proceedings¹⁷. This tends to confirm the previous information on length of proceedings in these jurisdictions.

Moreover, other academic research¹⁸ and anecdotal evidence¹⁹ confirms that in the third group of jurisdictions it takes much longer than in the others for creditors to obtain recovery.

In conclusion, it is clear that in the third group of countries, the estimated time from date of filing of a claim to the date of judgment is too long judged against the European ‘mean’. These jurisdictions are failing to meet creditors’ expectations regarding length of proceedings. If we take as a benchmark a period of six months within which courts should be able to issue judgment, then also in the second group of countries, there is room for improvement in reducing the duration to judgment.

Recommendation:

There is considerable empirical and anecdotal evidence that in certain EU member states it takes several years for a first instance court to make judgment on a claim.

In the interests of improving the enforceability of creditor claims and the consistency of enforcement across EU the concerned member states should be encouraged to put the necessary resources and mechanisms in place to reduce as much as possible the delay at first instance between filing of claim and issue of judgment. These jurisdictions should also be encouraged, if necessary to reform their civil procedure in a way that would help to reduce that delay.

¹⁵ World Bank’s ‘Doing Business’ 2006.

¹⁶ Czech Republic is ranked last in EU for length of bankruptcy proceedings, 9.2 years (source: World Bank “Doing Business” 2006; also cited in Table A13 of Commission working document on IA of Directive on cross border transfer of registered office).

¹⁷ CEPEJ Report 2006 (2005 data)

¹⁸ DG JIA Study No JA/AS/2002 “Making more efficient the enforcement of judicial decisions in EU”, 18 February 2004, Report on enforcement of judgments in EU by Prof. B. Hess, University of Heidelberg.

¹⁹ ABI (2002) p. 21: “empirical evidence show credit recovery delays are much longer in Italy than in the rest of Europe: six years as compared to one.”

As a rough benchmark of efficiency, a creditor should not have to wait more than 6 months for a judgment on his claim. Member states should seriously consider establishing procedural periods and monitoring tools so that it is ensured that the duration to judgement is kept to a reasonable period, for example 6 months²⁰.

2. Enforceability of first instance judgment - executory judgments

Rationale

Once the judgment is issued it is equally important to creditors that it can be expeditiously enforced.

A creditor should not have to incur undue additional cost and delay at the enforcement stage when he has won on the substance of his case. In fact, it is not worth being successful in litigation at considerable time and cost, if the judgment and the costs cannot be enforced.

One of the means of creditor protection against protracted enforcement is the institution of the executory judgment. In other words the claimant should have the right to apply for provisional execution of the ruling against the debtor even if it is not yet in force, for instance because it has been appealed. This right should exist - particularly to be able to provisionally enforce debt actions - unless the court stays execution upon request of the debtor. The creditor would be required to show proof of irreparable damage if provisional execution of his claim was not granted.

The risk of the executory judgment being wrongly enforced can be variously dealt with, for example by making it dependant on the claimant lodging a temporary guarantee or security with the court. If the claimant is not successful on appeal, the amount of guarantee or security becomes due and payable. Alternatively, the amount of the enforced claim could be repaid at a later stage of the proceedings should the appeal court reverse the first instance judgement.

The right to apply for executory judgment should be distinguished from interim relief in urgent cases. All surveyed jurisdictions appear to have provisions on interim relief. However, it should be further investigated whether in practice these provisions always provide an effective remedy for creditors²¹.

Responses

According to your responses to the questionnaire, the vast majority of surveyed jurisdictions have some form of executory judgment²². The creditor can thus enforce judgment even if it is not yet final.

²⁰ For instance, the French government is considering introducing such a maximum period for first instance civil proceedings [tbc].

²¹ See further below: Other areas for improvement

²² Only Czech Republic and Slovenia do not permit executory judgement.

In a number of jurisdictions, such as Belgium, in practice the enforcing party will wait until the time for lodging an appeal has elapsed. This is because the filing of an appeal usually stays the enforcement of the judgment²³.

However there are a few jurisdictions such as Czech Republic, Slovenia²⁴, Austria, and Italy that do not recognise executory judgment. These jurisdictions require the judgment to be final and unappealable before it can be enforced and therefore do not allow interim enforcement of non final instance judgments.

Recommendations:

The competent national administrations of those member states which currently do not permit executory judgment should consider (in the interests of creditor protection) introducing this legal institution into their civil procedure rules.

The fact of an appeal being lodged against a judgment should not automatically stay execution.

Monetary claim judgments and interim injunctions should be immediately enforceable.

3. Specialised courts

Rationale

Financial institutions do not rely on the courts simply as creditors of simple monetary claims. The legal issues arising in the daily operation of the financial markets are often complex. Financial institutions often rely on complex and not always fully transparent instruments such as non traded derivatives, credit default swaps, collateralised debt obligations, which may not be easily comprehended by non specialist judges. In addition, globalisation has introduced an extra layer of complexity in the form of increasingly multi jurisdictional disputes. Finally financial market contracts do not exist in a vacuum but are entered into within the context of a particular established market practice, custom or accepted behaviour, that require the full understanding of the presiding judge. This work requires judges who have a more specialised knowledge of capital markets instruments. Specialised courts should help to ensure the consistency of judgments on complex financial market issues in the interests of legal certainty. They should also help to speed up the resolution of such disputes between financial institutions.

There is therefore a strong case to be made for EU jurisdictions to have additional courts that specialise in complex or high value commercial and financial cases, to which market parties may submit their contractual disputes.

²³ Freshfields Bruckhaus Deringer: “Litigating in Europe: Belgium”

²⁴ At least not for first instance judgments.

The responses

The responses indicate that in the majority of jurisdictions financial or commercial claims are handled by the general civil courts.

The only jurisdictions that have specialised courts, or specialised divisions of courts, to deal with complex or high value commercial or financial market cases are the UK, Ireland, France, and to some extent Spain (for some special proceedings) and Switzerland (some cantons only).

Some other jurisdictions where such cases are handled by the general civil courts ensure that the courts have specialised chambers to which judges are assigned by the president of the court to deal with certain types of proceedings, for example bankruptcy or promissory notes/bills of exchange. There are no chambers however hearing specifically financial services cases. This is the case in for example Germany, Austria and Czech Republic. Generally speaking this tends to be the approach also of the other Central and Eastern European jurisdictions.

Recommendations:

The competent national administrations of those member states which currently do not have specialised commercial and financial courts should consider introducing such courts into their judicial systems, at first instance level.

Alternatively, such member states should ensure that their appeal courts have a specialised chamber or division of the court to deal with complex or high value commercial and financial cases.

4. Arbitration

Rationale

Judicial proceedings in financial market cases are often protracted and costly. It therefore makes sense that financial institutions are offered alternative methods of dispute resolution. Arbitration is a tried and tested method of resolving complex, technical disputes. It is particularly suited to resolving disputes involving capital and financial markets and instruments. Its main advantage are that it is more time efficient – decisions are given mostly within 2-3 months - and less costly than court proceedings, with a flat fee upon registering the claim. Under the 1958 New York Convention arbitral awards can also be recognised and enforced in many more countries than is the case for judgements, especially outside of the EU.

The responses indicate however that jurisdictions are divided as regards the level of use of arbitration for resolving disputes between financial institutions.

Arbitration is reported to be frequently used by financial institutions, particularly for complex or international disputes, in UK, Germany, and to a lesser extent in the

Czech Republic and Greece. In Spain, the bankers' association offers an institutional arbitration system for inter-bank disputes which has proved a highly efficient and discreet means of dispute resolution.

In the other surveyed jurisdictions arbitration by financial institutions is reported to be rare or uncommon.

There may be several reasons for this relative lack of enthusiasm from the financial community. It may be that Eurozone financial institutions prefer to go to the London or New York courts to resolve their cross border capital market disputes, because of the internationally recognised expertise of these courts, and the fact that standard market documentation is often subject to English or New York law.

In any case, this diversity in approach reduces the efficiency of arbitration as a method for resolving cross border disputes between financial institutions generally in the EU. The possibility should therefore be explored to develop a pan European arbitration procedure specifically for financial and capital market institutions.

In the absence of specialised financial markets courts (see above) a pan European arbitration procedure might be particularly attractive for institutions with cross border activity spanning several jurisdictions. Such institutions could be encouraged to amend their contractual documentation by specifying an arbitration clause in favour of an independent pan European arbitration procedure separate from any stock exchange.

One possible model is EuroArbitration²⁵. EuroArbitration, set up in 2000, administers pan European arbitration procedures that are available to all EU capital market institutions. Other procedures may also be considered as models for European wide arbitration but these may be less neutral as they are usually attached to a particular exchange or international organisation²⁶.

Recommendation:

The national administrations of Member States should adopt all measures conducive to foster arbitration procedures to resolve disputes as an alternative to domestic court proceedings, in areas such as capital markets, wholesale market operations, derivatives trading, and multi-jurisdictional transactions.

EuroArbitration could serve as a model for such procedure, which financial institutions could opt into by amending their contractual documentation to include an appropriate arbitration clause. Such initiative, besides being *communautaire* and jurisdictionally neutral might be an effective alternative to long and costly judicial proceedings in complex capital markets related disputes.

²⁵ www.Euroarb.org

²⁶ E.g. the ICC's DOCDEX procedure offers dispute resolution concerning documentary credit (letters of credit) to international banks and other financial institutions. Applicants must sign up to the ICC rules (UCP 500) as condition of using this service.

5. Default interest

The responses indicate that most jurisdictions have in place a 'default' interest rate for monetary debts fixed by law or regulation. The 'default' rate is payable by the debtor in the event that he fails to pay the claim when due. The default interest thus increases the amount of the overall claim with each day that the debtor delays payment.

The default rate is usually set a few basis points above the official central bank rate. The applicable rate is assessed by the judge and apart from EC Directive 2000/35 on measures to combat late payment in commercial transactions, default interest rates are not otherwise harmonised across the EU jurisdictions.

The jurisdictions are divided on how effective the default rate is in dissuading debtors from protracting proceedings as a means of delaying payment. It is probably more effective in those jurisdictions where the duration to judgment is relatively short.

Recommendation:

An appropriate default interest rate should be set in legislation or regulation, as a means of discouraging the debtor from delaying payment of the adjudicated claim.

The possibility should be explored of a single converged default rate for the Eurozone countries. The rate should be based on the official ECB rate plus certain basis points sufficient to dissuade the debtor from protracting the proceedings as a means of delaying payment. A further possibility to be considered is to have one rate until first instance judgment is rendered and a higher rate thereafter, to incentivise prompt payment and to limit appeals to well grounded cases.

6. Other possible areas for improvement

There are other issues which may merit further consideration. They may be retained in the list of recommendations, depending on how strongly you feel about them.

- **Availability and effectiveness of interim relief in urgent cases**

Alongside enforcement of the judgment, creditors need to be protected in urgent cases from the risk that the judgment even if obtained may be worthless. For instance because there is a real risk that the debtor will imminently transfer his assets in the period between date of judgment and enforcement. Interim relief measures (e.g. asset freezing orders, interim injunctions, and other forms of provisional enforcement) may be carried out prior to judgment or even prior to start of proceedings. To obtain interim relief the applicant must prove that enforcement would be otherwise difficult or impossible.

The civil procedure rules of all of the EU jurisdictions include some form of interim relief.

It is however equally important for creditors that these measures are effectively and reasonably used in practice. For instance,

- The courts should be able to make decisions on interim relief upon very short notice, as these are by definition urgent cases;
- The courts should not subject applications to unreasonable or particularly burdensome conditions;
- Generally, interim relief should be widely available in commercial litigation and should not be restricted to too narrow a range of cases.

- **Simplified or accelerated procedures; payment orders and small claims**

The responses indicate that all surveyed jurisdictions have such summary procedures, so this may not be a critical area.

In some jurisdictions however - particularly in the new Member states and where the small claims procedure is available to all claimants - the threshold for the small claims procedure should be periodically re-assessed upwards (for example in line with domestic GDP). In this way simplified procedures could be apply to a wider number of cases.

The introduction of an institutional arbitration procedure with simplified evidence rules and no right of appeal should also be considered for certain types of cases or those where the value of the claim does not exceed a set monetary threshold.

- **Centralising enforcement outside the courts**

The responses show that most jurisdictions assign the civil courts with the task of enforcement. However, courts are generally perceived to be slow and inefficient in enforcing judgments²⁷. In fact, the nature of the enforcement process is more economic than legal as it involves the realisation of assets. Thus, there is a case for judges supervising the process but not being the main actors in it. Courts also tend to be over-burdened with cases.

Alternative schemes to enforcement through the courts should be seriously considered. For example, as in Sweden, the enforcement of payment orders is centralised with one state agency. The advantage of this model is that it permits process management, has a number of synergies and liberates the judiciary from non-legal tasks.

It may also be considered to introduce a centralised database of enforceable claims.

²⁷ CEPEJ Report 2006

- **Improved publicity of judgments**

A further question is whether judgments relating to financial market cases are sufficiently publicised. In view of the importance of legal certainty to the financial community, it may be considered whether courts need to be encouraged to make their judgments more widely and easily available. Particularly if there were to be more specialised courts handling financial services claims, there is a case for improved publication of such specialised judgments. Increased availability of judgments should help to ensure the consistency of jurisprudence. Also, the greater the certainty of judicial interpretations, the lesser the number of future claims.

It should be considered to create a centralised, publicly available database of all financial market related judgments from domestic courts (appeal or higher) in the EU.
