

# ESTABLISHMENT OF THE MOST COMMON GROUND ON WHICH LOCAL ARBITRAL AWARDS BECOME UNENFORCEABLE IN SRI LANKA

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## ABSTRACT

*The parties select more adversarial arbitration process over other alternative dispute resolution methods mainly due to the enforceability of the arbitral award. If the arbitral award becomes unenforceable due to any reason, the selection of arbitral process is useless. In this scenario, a research was conducted specially to find out the most common ground on which local arbitral awards become unenforceable in Sri Lanka and to explore the reasons to occur the unenforceability under that most common ground with the expectation that this improved knowledge would assist to minimize the unenforceability of local arbitral awards.*

*The research was conducted under the quantitative research approach. A cross-sectional, retrospective and non-experimental study design was adopted. The local arbitration cases registered at the High Court-Colombo during 2009-2012 for the setting aside or for the enforcement of the awards and the courts had completed the proceedings were selected as the convenient sample. The sample contained 910 cases.*

*The data collection process was a two tiered process. In the first tier, a cross sectional survey was carried out at the High Court-Colombo to find out arbitral awards become unenforceable due to setting aside or refusal of the enforcement by the High Court. If the judgment of the High Court was appealed to the Supreme Court the judgment of the Supreme Court was also considered. Through the first tier of data collection, it was found that non adherence to the enforcement procedure is the most common ground on which local arbitral awards become unenforceable in Sri Lanka.*

*During the second tier of data collection, semi structured interviews were conducted with the parties who failed to enforce the arbitral award due to non adherence to enforcement procedure, those parties were mainly financial institutions and contained 16 organizations. Through the interviews it was found that performance defects of the legal counsel and the performance defects of the officer in charge of the case are the main reasons for the unenforceability of arbitral awards under the most common ground. Therefore it is recommended to establish proper reporting and monitoring systems within the organizations dealing with arbitration.*

**Keywords:** Arbitration; Setting Aside; Enforcement; Unenforceability.

## 1. INTRODUCTION

According to Arbitration Act No.11 of 1995 of Sri Lanka, there are two broad reasons which make local arbitral awards unenforceable in Sri Lanka. The first is the setting aside of arbitral awards by local courts under section 32 of the Arbitration Act. The second is the refusal to enforce the arbitral award by the local courts. The courts may refuse enforcement on non-adherence of the parties to the procedure laid down in section 31 or section 40 of the Act.

This paper presents the findings of a research conducted to establish the most common ground which leads to the unenforceability of local arbitral awards in Sri Lanka and to find out the reasons to occur the most common ground leading to unenforceability.

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## **2. BACKGROUND**

Mustill and Boyed (1989) described that misconduct of arbitrators, error on the face of the award, excess of jurisdiction by arbitrators, patent defects in the award, misunderstandings of one of the parties which prevented that party to present his case effectively, mistakes by arbitrators and fresh evidence which was not available at the hearing stage, leads to remit the award or to set aside the award by courts. The Court has the discretion to decide whether the setting aside of the award or the remitting is most appropriate remedy and to decide which part of the award to set aside or to remit. The court has to consider all the circumstances of the case, when exercising this discretion. A serious error or miscarriage of justice, in most of the cases will lead to setting aside of the award.

When considering the arbitration law in Sri Lanka, the grounds for invalidity or setting aside of an arbitral award are stated in section 32 of Arbitration Act No. 11 of 1995, and correspond generally to the provisions of the New York Convention 1958 (Amerasinghe, 2011). Kanag-Isvaran (2011) pointed out that as per Section 32 of the Act, an arbitration award made in Sri Lanka may be set aside by the High Court only on very specific, limited grounds.

Section 31 of Arbitration Act 1995 enacts that an application for recognition and enforcement of an arbitral award to be made to the appropriate High Court within 1 year of the expiry of 14 days period from the making of the award (Amerasinghe, 2011). In addition, s.31 of Arbitration Act No.11 of 1995, requires that the application to enforce the award to be accompanied by the original of the award or duly certified copy of the award and original of the arbitration agreement or duly certified copy of such agreement. If a document or part of a document above mentioned is written in a language other than the official language of the court or other than in English, a certified translation of the relevant document or such part to be submitted along with the application.

Further s.40 of the Arbitration Act No.11 of 1995 provides that every application to the High Court under the provisions of the Act is to be by way of petition and affidavit and all the parties to the arbitration other than petitioner should be named as respondents and shall be given the notice of the application. Therefore if the applicant does not adhere to the above described procedures required for the enforcement, the courts have the discretion to refuse the enforcement of the arbitral award.

Recognition and enforcement are essential elements in arbitration. If the winning party is not able to enforce the award, the whole process of arbitration is pointless (Nacimientto and Bamashov, 2010). Nacimientto and Bamashov (2010) further added that the parties will only recognize arbitration as a viable alternative to litigation, only if the arbitral award can be enforced with the equivalent effects as a state court's judgment.

In any of the events of setting aside or refusal to enforce the arbitral award, the effort given on the arbitral process will be in vain. Therefore it is important to identify the most common ground which leads to setting aside or refusal to enforce the arbitral awards in Sri Lanka. After identifying this most common ground it can be searched for the reasons to occur this most common ground.

By identifying the reasons for the most common ground leading to unenforceability of arbitral awards in Sri Lanka, it would be easy to find ways to minimize such adverse effects on arbitral awards. It would facilitate to save the value of resources spent on arbitral process and to uphold the arbitration practice in Sri Lanka.

## **3. AIM AND OBJECTIVES**

The aim of the study was focused to establish the status of enforcement of local arbitral awards in Sri Lanka. To achieve above aim, following objectives were set.

1. Determine the most common ground which leads to setting aside or refusal of enforcement of the local arbitral awards by local courts, where the arbitral proceeding were conducted under the purview of Arbitration Act No.11 of 1995.
2. Find out the reasons to occur above most common ground which leads to setting aside or refusal enforcement of local arbitral awards.

#### 4. RESEARCH METHODOLOGY

A preliminary investigation revealed that it is difficult to find out old arbitration case records at the High Court. Further it was found that enforcement and setting aside proceedings of arbitral awards at the High Court and Supreme Court take a considerable time. Therefore considering the access to data and finalization of the law suit on arbitral awards, it was decided to select a convenient sample. The convenient sample of the study was selected as arbitral awards based on arbitral proceedings commenced in Sri Lanka after the appointed date of the Arbitration Act No. 11 of 1995 and falling within the purview of the Arbitration Act and the arbitration cases registered at the High Court Colombo during 2009-2012 for the setting aside or for the enforcement of the arbitral awards and such arbitration cases were finalized by the courts. The sample contains 910 arbitration cases. To achieve the objectives, quantitative research approach with a retrospective, cross-sectional, non-experimental study design was adopted.

In addition, to achieve the second objective, semi structured interviews were conducted with the parties who failed to get the arbitral award enforced due to non-adherence to enforcement procedure. Interviewed parties were mainly financial institutions and banks and contained 16 organizations.

#### 5. DATA COLLECTION AND ANALYSIS

##### 5.1. AN OVERVIEW OF THE DATA COLLECTION

Table 1 gives a summary of completed arbitration cases by the High Court on local arbitral awards.

Table 1: Summary of Completed Cases by High Court on Local Arbitral Awards

Year	Completed cases on local arbitral awards	Applications for setting aside	Awards set aside	Applications for enforcement	Awards been refused to enforce	Awards become unenforceable and percentage of unenforceability
2009	204	1	0	203	4	4 1.96%
2010	405	4	1	401	3	4 0.99%
2011	196	3	2	193	6	8 4.08%
2012	105	0	0	105	14	14 13.33%
<b>Total</b>	<b>910</b>	<b>8</b>	<b>3</b>	<b>902</b>	<b>27</b>	<b>30</b> <b>3.30%</b>

As indicated in Table 1, 30 numbers of arbitral awards become unenforceable from 910 arbitral awards, either due to setting aside or refusal to enforce by the High Court. The percentage of unenforceability is very low in 2009 and 2010 with 1.96% and 0.99% respectively. The percentage is moderate in 2011 and recorded as 4.08%. However when considering the year 2012 the rejection rate is high and recorded as 13.33%. The overall result indicate that the percentage of unenforceable award as 3.30%.

##### 5.2. ANALYSIS OF ARBITRAL CASES BASED ON INDUSTRY

It is important to analyze the composition of the sample and how awards become unenforceable with respect to the relevant industry. Table 2 shows that 95.93% cases from the sample are belonging to financial and insurance industry. The contribution from construction industry is 1.87%. When considering the percentage of unenforceable awards, only 3.09% of awards become unenforceable in financial and insurance industry. However the percentage is considerably high for the construction industry, which is recorded as 11.76%.

Table 2: Categorization of Arbitration Cases Based on Industry

Industry	Total cases from 2009 to 2012	Percentage contribution of the industry	Awards become unenforceable	Percentage of unenforceable awards
Financial and insurance	873	95.93%	27	3.09%
Construction	17	1.87%	2	11.76%
Whole sale and retail	4	0.44%	0	0%
Real estate activities	5	0.55%	0	0%
Electricity, gas, steam and air conditioning supply	4	0.44%	0	0%
Transportation and storage	2	0.22%	1	50%
Manufacturing	1	0.11%	0	0%
Other	4	0.44%	0	0%

### 5.3. ANALYSIS OF ARBITRATION CASES BASED ON THE GROUND FOR REJECTION

One of main objectives of this study is to find out the most common ground on which local arbitral awards become unenforceable. Table 3 provides a categorization of arbitral cases based on the ground for rejection of the arbitral awards.

Table 3: Grounds Leading to Unenforceability of Arbitral Awards

Ground for setting aside or refusal to enforcement	Total for the category
Non adherence to enforcement procedure	17
Violation of due process	3
Excess of authority	1
Irregular constitution of the arbitral tribunal or irregularity of arbitral procedure	1
Award conflicts with the Public Policy	8

As per Table 3, it is clear that “non-adherence to enforcement procedure” is the most common ground which leads to unenforceability of local arbitral awards. From 30 numbers of unenforceable awards, the above ground is responsible for 17 awards to become unenforceable. The result given in Table 3 is graphically presented in Figure 1.

A close look at Figure 1 shows that 57% of unenforceable arbitral awards are belonging to non-adherence to enforcement procedure while public policy grounds lie next corresponding to 27% of unenforceable awards. Therefore the former is more than twice the size of latter. Violation of due process constitutes 10% of unenforceable awards while other two grounds constitute only 6%.

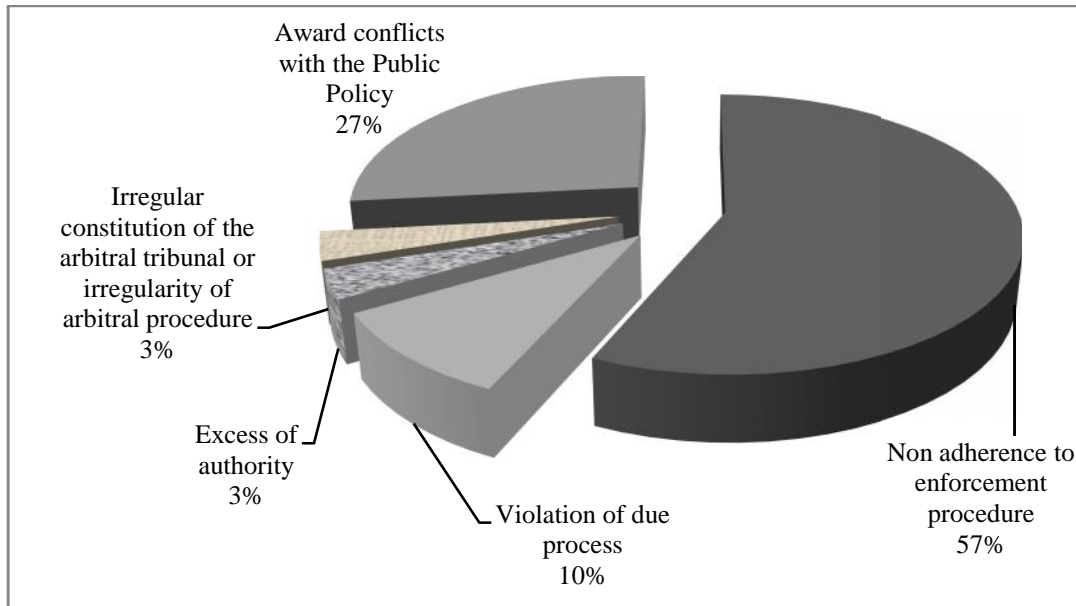


Figure 1: Grounds for Setting Aside or Refusal Recognition and Enforcement

The primary grounds to refuse the enforcement under non adherence to enforcement procedure are given in Table 4. This categorization is corresponding to the Arbitration Act. Figure 2 graphically presents the results of Table 4.

Table 4: Categories of the Default in Enforcement Process which Lead to Refusal of Enforcement

Category of the default	Number of cases
Not adhering legal principles or court procedures outside Arbitration Act	1
Not submitting arbitration agreement as required	6
Not submitting arbitral award as required	1
Not submitting a formal affidavit	1
Delay in application for enforcement	8

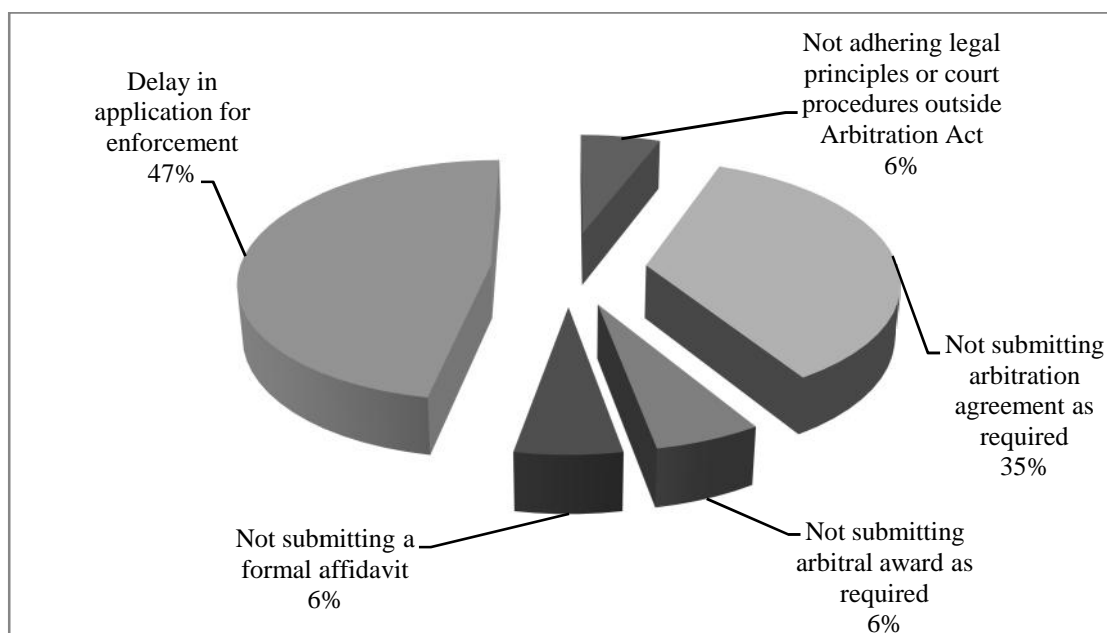


Figure 2: Refusal of Enforcement due to Non-adherence to Enforcement Procedure

#### 5.4. FINDING OUT THE REASONS TO OCCUR THE MOST COMMON GROUND LEADING TO UNENFORCEABILITY

During the second tier of data collection, the data collection process was aimed to find out the reasons for the most common ground leading to the unenforceability of arbitral awards. Table 5 summarizes the results of the interviews carried out. Figure 3 gives a graphical representation of the contribution of the reasons which leads to non-adherence to enforcement procedure.

Table 5: Result of the Interviews

Reasons for non-adherence	Numbers of cases
Performance defects of legal counsel	9
Not understanding the requirements of s.31 of the Arbitration Act	1
Failure of the company strategy on the award	1
Performance defects of the officer in charge of the case	3
Relevant officers are not knowing the actual reason	2

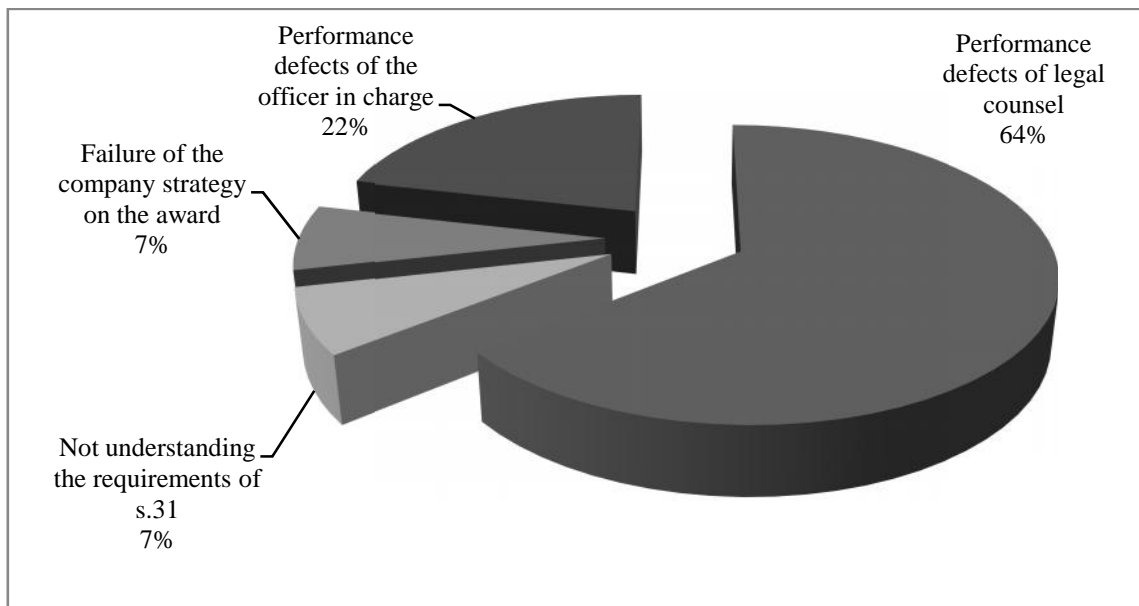


Figure 3: Reasons for Non-adherence to Enforcement Procedure

Figure 3 indicates that 64% of arbitral awards belonging to “non-adherence to enforcement procedure” become unenforceable due to the performance defects of the legal counsel. Performance defects of the relevant officer in charge (to follow up the case) are responsible for 22% of arbitral awards to become unenforceable in the category. Another 7% of arbitral awards become unenforceable due to failure of the company strategy on the arbitral award. Lack of understanding of the requirements of section 31 of the Act is responsible for 7% of arbitral awards to become unenforceable under this category.

Further as per Table 1 and Table 3, from 30 unenforceable arbitral awards, other than 3 arbitral awards been set aside and 17 arbitral awards become unenforceable under non-adherence to enforcement procedure, there are another 10 unenforceable arbitral awards. Those 10 arbitral awards become unenforceable due to refusal of enforcement under section 34 of the Arbitration Act. Further in the total sample of 910 cases only 8 cases are registered under section 32 and from those 8 cases only in the 3 cases above mentioned the arbitral awards have been set aside. Therefore it can be concluded that though there are ground for setting aside of arbitral awards, the parties involved in arbitral process do not obtain the precise usage of the provisions in section 32 of the Act for challenging arbitral awards. A close scrutiny of the data collection revealed that all the 10 cases where the arbitral awards were not challenged

under section 32 are from financial and insurance industry and the lessee or the borrower had not utilized their rights.

However in a recent case *Hatton National Bank vs. Sella Hennadige Chandrasiri (2015)*, the Supreme Court of Sri Lanka set aside the High Court judgment on the arbitration case HC/ARB/388/2011 whereby the High Court refused to enforce an arbitral award on the grounds mentioned in section 34 of the Act. In the Supreme Court judgment, it was held that section 34 of the Arbitration Act is for foreign arbitral awards and cannot be applied to local arbitral awards. This makes more pressure on the parties involving in arbitral process to exercise their right under section 32 of the Arbitration Act more vigilantly and promptly.

## 6. CONCLUSIONS AND RECOMMENDATIONS

Non-adherence to enforcement procedure is the most common ground which leads to the unenforceability of local arbitral awards in Sri Lanka. Performance defects of the legal counsel and officer in charge of the case are the main reasons for the non-adherence to enforcement procedure. These two reasons are responsible for 86% of the unenforceability within the non-adherence to enforcement procedure. Therefore it is important to establish proper reporting and monitoring systems within the organizations dealing with arbitration to follow up arbitral cases properly.

Borrowers and lessees of financial industry do not properly utilize the provisions in section 32 of the Arbitration Act, when the awards are having grounds for setting aside. As the Arbitration Act does not provide any other opportunity to prevent enforcement of unfair local arbitral awards, it is very important to utilize section 32 for setting aside. Therefore an awareness programme is to be carried out aiming the relevant strata of the society to improve their knowledge on the impact of arbitration agreement they sign when they obtain financial facilities and to improve their knowledge on the repercussion they would face if they do not utilize the provisions in Arbitration Act for their good. This is very important to uphold the arbitration practice in Sri Lanka as the financial and insurance industry constitutes around 95% of the arbitration cases referred to the courts.

During the interviews with finance companies and banks, most of them expressed that enforcement proceedings at courts become cumbersome and very time consuming. Due to these reasons one bank and one finance company have removed the arbitration clause from their loan and leasing agreements. This difficulty in enforcement process is a considerable drawback in the arbitration sphere in Sri Lanka. Therefore it is highly recommended that the government should take some steps to smoothen and speedup the enforcement proceedings of arbitral awards in the courts.

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