

**LIMITATIONS TO ARBITRABILITY BASED ON THE INTEREST OF THE STATE
WITH A SPECIAL FOCUS ON HUNGARY**

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Abstract

This thesis addresses questions that arise in connection with arbitrability in general and particularly with arbitrability as a limitation to the power of the tribunal and the parties to resolve a case through arbitration. The evaluation is made focusing on those limitations that are justified by the interest or perceived interest of the state, with a particular attention to the recent legislations enacted by Hungary and the relation to such legislation to bilateral and multilateral international treaties. By analyzing specifically the limitations to arbitrability of disputes, where national asset would be subject to the arbitration, the paper draws the conclusion that from one point of view the solution adopted by Hungary might, in a short run, be able to “protect” national asset by way of ensuring state control over the disputes. However, such restrictive approach could easily trigger harmful side effects as well, that could be detrimental to the position of Hungary in terms of international investments.

Introduction

Arbitration is a type of dispute settlement, which provides a great amount of autonomy for the parties. Additionally, state control over arbitration is rather limited and is confined to basic questions such as validity and existence of an arbitration agreement. Consequently, there has always been a perceptible intention of states to reserve certain areas for the domain of state justice. This links us to the notion of arbitrability, which has always been in the center of discussions on arbitration, since „arbitrability” is what bounds together the autonomy of the parties and the exclusive power of the state to adjudicate legal disputes.

The thesis addresses questions that arise in connection with arbitrability in general and particularly with arbitrability as a limitation to the power of the tribunal and the parties to resolve a case through arbitration. The evaluation is made focusing on those limitations that are justified by the interest or perceived interest of the state, with a particular attention to the recent legislations enacted by Hungary and the relation to such legislation to international treaties.

The first chapter discusses the notion of arbitrability in general, revealing the essence of the concept and the functions and effects it may have. This part outlines those stages where the issue of arbitrability may be raised during an arbitration procedure.

The second chapter concerns arbitrability as a limitation and also deals with the different levels and sources of limitations.

The third chapter addresses those limitations to arbitrability, where the source of such limitations is the interest or perceived interest of the state. By descriptive analysis, the chapter tries to demonstrate through examples from different national legislations, how the specific limitation is realized within the different legal systems. The evaluation of this notion is carried out from three

different perspectives (i) when the asset is located within the territory of the state (ii) when the asset is owned by the state (iii) when the state is a party to the procedure.

The last chapter deals with limitations to arbitrability under Hungarian law, with a special focus to those limitations, the purpose of which was the protection of the interest of the state. It will be demonstrated that the recent legislation of Hungary raises serious concerns not only from the perspective of national law, but also from an international legal perspective, which might have further detrimental effect to Hungary.

Chapter 1: Concept of Arbitrability

It is undisputable that arbitrability is a cornerstone notion of arbitration and arbitration law. The significance behind this concept stems from the fact that „arbitrability” is what bounds together the opposing poles of the autonomy of the parties and the exclusive power of the state to adjudicate legal disputes.¹

1.1 Definition of Arbitrability

However, despite its significant role, the definition of this concept is not yet close to be determined and/or unified. The New York Convention defines arbitrability as disputes „*capable of settlement by arbitration*.”² Nevertheless, the question arises, what the notion of arbitrability really covers?

The answer to this question seems to be challenging, since the definitions created by national laws and scholars, attempting to capture this notion, show a big scale of variety. First, the thesis gives examples of different national attempts, how arbitrability is governed by statutory provisions. Then presents the definitions developed by scholars and professionals in pursuit of capturing the notion of arbitrability.

¹ Loukas A. Mistelis & Stavros L. Brekoulakis eds., *Arbitrability. International and Comparative Perspectives*, (Hague: Kluwer Law International, 2009), 121.

² New York Convention Arts. II(1) and V(2) (a)

1.2 Statutory Definitions

In **Germany** the German Code of Civil Procedure governs the issue of whether a dispute is capable of settlement by arbitration³. In pursuant to the German law, a claim having an economic interest can be subject to arbitration.

In the **United States** the Federal Arbitration Act (FAA) adopted in 1925, deals with matters related to arbitration. The FAA does not use the term “arbitrability”. Furthermore, it is to be pointed out that the term “arbitrability” under the FAA, covers not only whether a dispute is capable of settlement by arbitration under the applicable law. Arbitrability in the United States also relates to the issue what disputes falls within the scope of an arbitration agreement.

France (Code Civil, 1804)

“Article 2059. One can arbitrate with respect to all rights of which one can dispose freely.

Article 2060. One cannot submit to arbitration questions of status and capacity of persons, questions relative to divorce and separation, or questions respecting controversies that concern public entities or public establishments and more generally any matter that concerns the public order. However, public establishments of an industrial or commercial character can by decree be authorized to arbitrate.”⁴

Japan (Arbitration Law No.138 of 2003)

“Article 13. (Effect of Arbitration Agreement)

(1) Unless otherwise provided by law, an arbitration agreement shall be valid only when its subject matter is a civil dispute that may be resolved by settlement between the parties (excluding that of divorce or separation) ”⁵

³ § 1030 German Code of Civil Procedure

⁴ Tibor Varady and John J. Barcelo III. et al., *International Commercial Arbitration: A Transnational Perspective*, 4th ed., (USA:West, 2006) 256.

⁵ Ibid.

1.3 Definitions in Legal Literature

Di Pietro for instance differentiates between „subjective” and „objective” arbitrability:

„arbitrability is a „ratione materiae” notion, which is normally referred to as „objective” arbitrability as it is independent of the quality of the parties or their will. It is distinguished from the so-called „ratione personae” or „subjective” arbitrability, which is concerned with the capacity of the parties to submit disputes to arbitration.”⁶

This is supported by other professionals stating that national laws often restrict states or state entities to enter into arbitration agreements (subjective arbitrability). While there are also limitations based on the subject matter of the dispute (objective arbitrability). It is to be added that *„certain disputes may involve such sensitive public policy or national interest issues that it is accepted that they may be dealt only by the courts.”⁷*

In the meantime some writers perceive arbitrability as a contractual, while others see it as a jurisdictional issue. Youssef approaches arbitration from a contractual perspective as follows:

„an objective notion, arbitrability is ...the fundamental expression of the freedom to arbitrate. It defines the scope of the parties’ power of reference or the boundaries of the right to go to arbitration in the first place.”⁸

While Brekoulakis stresses that:

„arbitrability is.... a specific condition pertaining to the jurisdictional aspect of arbitration agreements....a condition precedent for the tribunal to assume jurisdiction over a particular dispute (a jurisdictional requirement), rather than a condition of validity of an arbitration agreement (contractual requirement).”⁹

⁶ Ibid, 257.

⁷ Katarína Chovancová, “Arbitrability,” *Institute of International and European Law*, accessed March 5, 2014, <http://www.paneurouni.com/files/sk/fp/ulohy-studentov/2rocnikmgr/arbitrability-students-version.pdf>

⁸ Loukas, Brekoulakis, *Arbitrability*, 49.

⁹ Ibid, 39.

Perception of arbitrability in a wider sense can be tracked in some US court decisions. For instance in *Howsam v. Dean Witter Reynolds, Inc.* case where the dispute was brought before the Arbitration National Association of Securities Dealers, the court used the term arbitrability including questions of the existence, validity, and scope of any arbitration agreement¹⁰. However, some critics question the above approach and consider arbitrability as a notion being completely separate from „jurisdiction”, which not only precedes the evaluation of jurisdictional issues conceptually, but also time-wise¹¹.

Hunter and Redfern argue that arbitrability is not to be related to any concern with the jurisdiction over a particular dispute but rather shall be seen more as a „*general enquiry as to whether the dispute is of the type that comes within the domain of arbitration.*”¹² This is also supported by Graves and Davydan claiming that:

„*This same term, “arbitrability,” is more typically used on a very limited basis to address the issue of whether the subject matter of a given claim may be arbitrated.*”¹³

Within the ambit of the above approach arbitrability is regarded as a „*primordial question*”¹⁴, the evaluation of which shall precede any and all other issues related to arbitration. In

¹⁰ S. Kroll, L.A. Mistelis, et. al eds., *International Arbitration and International Commercial Law: Synergy, Convergence and Evolution*, Chapter 8 – Competence-Competence and Separability American Style, p. 161.

¹¹ Loukas, Brekoulakis, *Arbitrability*, 49

¹² Alan Redfern and Martin Hunter eds., *Law and Practice of International Commercial Arbitration*, 3rd ed., (London: Sweet&Maxwell, 1999), 148.

¹³ Kroll, Mistelis, *International Arbitration and International Commercial Law*, 161.

¹⁴ Louksa, Brekoulakis, *Arbitrability*, 48.

this sense, arbitrability shall be evaluated by examining only whether or not the subject matter of the arbitration falls within the list of categories of those disputes, which are deemed to necessitate State monopoly and State justice. Jurisdiction shall only become relevant at a later stage, and only to determine the authority and power to rule on a specific dispute. Arbitrability in this sense is only to determine which types of disputes may be subject to arbitration proceeding and which belong to the exclusivity of the courts.

What can be derived from the above is that arbitrability determines the confines within which a case is capable of settlement by arbitration or not. Within this concept, however, distinction can be made between subjective and objective arbitrability. Based on subjective arbitrability, arbitration and arbitrability could be challenged on the basis of status and legal capacity of the parties, while objective arbitrability relates to the subject matter of the dispute. Objective arbitrability raises the question of whether or not a dispute may be subject to arbitration under the applicable law.

1.4 Functions of Arbitrability

Arbitrability may also be perceived as the inability to object against the jurisdictional power granted to an arbitration tribunal.¹⁵ Based on the preceding consideration, some scholars associate arbitrability with two effects (functions). The positive effect of arbitrability is that it confers jurisdictional power to an arbitral tribunal excluding the power of the state to adjudicate the matter. The negative function of arbitrability is that it places an obligation and duty incumbent upon state courts to accept and recognize the jurisdictional power of the arbitration court.¹⁶ This negative

¹⁵ Ibid, 121.

¹⁶ Loukas, Brekoulakis, *Arbitrability*, 122.

function is usually realized through an obligation of a state court to examine whether it has jurisdiction over a certain dispute. If it finds that there is an existing and valid arbitration agreement, the court shall decline jurisdiction and refer the parties to arbitration.

1.5 Arbitrability and the Kompetenz-Kompetenz Doctrine

The doctrine of competence-competence means that it is the right of an arbitral tribunal to decide on its own jurisdiction and to rule on jurisdictional objections. This notion is a significant aspect of arbitration law and is closely linked to the issue of arbitrability.

Walt¹⁷ highlights the benefit of the doctrine by stressing the procedural and financial advantages of applying the competence-competence principle. As Walt argues:

„ the marginal cost of having an arbitrator determine the scope of the arbitration clause is low, while allocating the determination to a court, another decision maker, requires an additional transaction and an extra cost.”¹⁸

Due to the above advantageous effects, the worldwide recognition of the principle is significant although not universal.¹⁹ International treaties also recognize the doctrine and it is implemented into many national laws as well.

Article II (3) of the New York Convention sets forth that:

“The Courts of the Contracting State, when seized of an action in a matter in respect of which the parties have made an agreement within the meaning of this article, shall, at the request of one of the parties, refer the parties to arbitration, unless it finds that the said agreement is null and void, inoperative or incapable of being performed”.

¹⁷ Steven Walt, "Decision by Division: The Contractarian Structure of Commercial Arbitration," Rutgers Law Rev., vol. 51 (1999),

¹⁸ Ibid, 369.

¹⁹ For instance the FAA under US law does not recognise the Kompetenz-Kompetenz doctrine, therefore in the U.S. law arbitrability shall be decided by courts. See. Loukas, Brekoulakis, *Arbitrability*, 148.

The cited rule of the New York Convention qualifies as the mirroring provision of the notion of competence-competence, since in order to enable arbitration tribunals to rule on their own jurisdiction, the courts shall refrain from interfering with such issues. This side of the doctrine is also known as the „*negative effect of the principle competence-competence*”²⁰, claiming that the arbitrators shall be the „*first judges of their own jurisdiction*”.

Additionally, Article 6 (2) of the ICC Arbitration Rules and Article 16 of the UNCITRAL Arbitration Rules also govern such principle.

Article 16 (1) and (3) of the UNCITRAL Model Law provides:

“(1)The arbitral tribunal may rule on its own jurisdiction, including any objections with respect to the existence or validity of the arbitration agreement. For that purpose, an arbitration clause which forms part of a contract shall be treated as an agreement independent of the other terms of the contract. A decision by the arbitral tribunal that the contract is null and void shall not entail ipso jure the invalidity of the arbitration clause.

[...]

(3) If the arbitral tribunal rules as a preliminary question that it has jurisdiction, any party may request, within thirty days after having received notice of that ruling, the court specified in article 6 to decide the matter, which decision shall be subject to no appeal; while such a request is pending, the arbitral tribunal may continue the arbitral proceedings and make an award”.

It shall be pointed out that by limiting the court review at the outset of the procedure to “*prima facie verification*”²¹ of the validity and existence of the arbitration agreement and postponing it to the enforcement stage also entails that the arbitration tribunal has an essential role in evaluating objective and subjective arbitrability of a dispute.

²⁰ Gaillard, D. Di Pietro eds., *Negative Effect of Competence-Competence: The Rule of Priority in Favor of the Arbitrators* in *Enforcement of Arbitration Agreements and International Arbitral Awards: The New York Convention in Practice*. (Cameron May, 2009), 257.

²¹ Ibid, 262.

Chapter 2: Arbitrability to Be Seen as a Limitation

Arbitration has always been a private dispute settlement procedure, where the autonomy of the parties prevailed. Additionally, courts are allowed to overrule the award delivered by an arbitral tribunal or an arbitrator only within strict confines, which provides the court with a rather limited right of revision concerning arbitration. Due to this characteristic, states have certainly less control over disputes that are subject to arbitration procedure, especially if the arbitration takes place abroad. For these reasons, states historically and traditionally tend to delimit the scope of arbitration cautiously in areas where a “strong public interest is at stake”²² As it was articulated by Charalambos “*Arbitrability in essence limits the power of an arbitral tribunal and the power of the parties as to what subject matter can be arbitrated.*”²³

2.1 Nature of Limitation

States continuously differentiated between the area of public interest and fields where such interest is relatively weak in the course of determining what matters can be subject to arbitrate. This stems from the concern inherent in the way of thinking of sovereign states, that certain disputes should be reserved for judicial power of state courts.²⁴ In this sense some see arbitrability to be national by nature²⁵ meaning that it is the national law which is to establish in advance the

²² Varady, Barcelo, *International Arbitration: A Transnational Perspective*, 253.

²³ Loukas, Brekoulakis, *Arbitrability*, 122.

²⁴ *Ibid*, 4.

²⁵ Hunter, Redfern, *Law and Practice*, 148.

„*domain of arbitration*”²⁶ vis-à-vis State justice.²⁷ It is the right of each state to determine in accordance with its own political, economical and social environment, which type of disputes are to be reserved for being adjudicated by its own national courts. This is usually a balancing exercise by the State between the domestic interest that might be attached to a specific type of dispute and the overall public interest in supporting the development of trade and international commerce, as well as the swift and quick settlement of legal disputes.²⁸

Traditionally, states “protected” similar areas from arbitration. The list of the most common “*domaine réservé*” compiled by states²⁹ includes labor and consumer disputes, some kind of intellectual property disputes, tax matters, criminal law issues, matters related to personal status of the parties etc.

Additionally, it is important to note that besides excluding certain subject matters from arbitration, states often protect “sensitive areas” by setting limitations as to the parties of the dispute (for instance national laws may exclude arbitration if the state or state entities are party to the dispute).

2.2 Sources and Levels of Limitation

Sources of limitations may be differentiated based on the purpose and motivation behind the limitation, which may be very diverse in different national systems. The source of a limitation under national law or on international level may be the protection of the general interest of the

²⁶ Loukas, Brekoulakis, *Arbitrability*, 48.

²⁷ Ibid, 4.

²⁸ Redfern, Hunter, *Law and Practice*, 148.

²⁹ Loukas, Brekoulakis, *Arbitrability*, 51.

State (for instance inarbitrability of tax matters or disputes where the state would be party to arbitration) or collective social interest (typical example is the categories of disputes with contractually weaker parties, such as consumer disputes or labor disputes) or fundamental ethical norms (for instance bribery contracts and other criminal law matters)³⁰. On the other hand, the limitation may occur on different levels. Traditionally, the limitations to arbitrability emanate from national laws.³¹ However, limitation to arbitrability may also emanate from international law.³²

2.3 Challenging Arbitrability

The restrictive nature of arbitrability may well be captured by the fact, that parties to a dispute may raise the issue of arbitrability for the purpose of avoiding that a specific matter be resolved by arbitration. The parties may refer to the issue of arbitrability at various stages during the process of resolution of the dispute, which stages correspond to the major phases of dispute resolution and enforcement procedure.

Varady differentiates between four points when the arbitrability issue can be raised:

„before a national court deliberating whether to enforce an arbitration agreement; before the arbitrators themselves as they try to decide the scope of their competence; before a court, generally in the country where the arbitration has taken place, in an action to set aside the award, and finally, before a court asked to recognize and enforce the award.”³³

³⁰ Ibid, 123.

³¹ See supra note 28, at 148

³² For instance International Convention on Civil Liability for Oil Pollution Damage of 1969; Vienna Convention on Civil Liability for Nuclear Damagae of 1963, Uniform Rules concerning the Contract for International Carriage of Passengers and Luggage by Rail

³³ Varady, Barcelo., *International Arbitration: A Transnational Perspective*, 255.

As regards the first stage, it shall be pointed out that, pursuant to the New York Convention national courts shall examine whether the parties have an arbitration agreement, and in the event of such agreement, courts shall establish lack of jurisdiction and refer the parties to arbitration.³⁴ Nevertheless, if the court – upon the motion of one of the parties – reveals that the arbitration agreement is defective, it shall decline enforcement of the arbitration agreement of the Parties. Certainly, the issue of arbitrability may be raised before the arbitral tribunal as well, which was sought by one of the parties to resolve the dispute. As discussed above, the doctrine of competence-competence confers on the tribunal power to rule on its own jurisdiction, when it is challenged or the issue of subjective or objective inarbitrability is raised.

When the arbitral tribunal delivered its decision, procedure for the setting aside of an arbitral award normally is commenced by the losing party, stating that the dispute at hand is not arbitrable. The last moment of dispute settlement procedure is the recognition and enforcement of the arbitral award. Article V of the New York Convention governs the issue of arbitrability within this final stage, where inarbitrability may be used as a ground for dismissing the motion of the winning party to enforce the award.

³⁴ Article II(3) of the New York Convention

Chapter 3: Limitation Based on the Protection of the Interest or Perceived

Interest of the State

Although international trend tends to show an expansion of the scope of arbitration and there can be experienced an intention of different national governments to apply arbitrability in a wider sense³⁵, the issue of arbitrability is still associated with controversy and remained within the center of the field of arbitration. The continuous attention directed to the matter of arbitrability can be explained by the restrictive nature of arbitrability, which is capable of depriving the parties of their power to control all aspects related to their dispute.

As it has been previously detailed, limitations to arbitrability is mainly an issue of national law and means a sensitive balancing exercise between the interest of the state and the autonomy of the parties. In a pursuit of protecting justifiable interests of the state, governments use national legislation to exclude or limit the parties' freedom to choose arbitration as a dispute settlement mechanism.

In the past, dispute resolution remained within the private sphere, rather than the public field. Different communities had their own internal rules to settle disputes between parties to the disputed matter. Until the 18th century, state courts were only one of the numerous forums the parties could turn to, in order to have their dispute resolved.³⁶

³⁵ As Youssef states „with the development of arbitral practice in the last 25 years, the public policy exception has gradually eroded. Progressively, courts in the U.S. and Europe started to reduce the role of public policy in the definition of arbitrability, and as a defence to enforcement under Art. V (2) (a) of the New York Convention (NYC).” Karim Youssef: Death of Arbitrability In. Loukas, Brekoulakis, *Arbitrability*, 51.

³⁶ Murat Sümer. Jurisdiction of Sovereign States and International Commercial Arbitration: A Bound Relationship, Ankara Barosu, accessed March 3, 2014, <http://www.ankarabarusu.org.tr/site/AnkaraBarReview/tekmakale/2008-2/8.pdf>

However, this situation remarkably changed following the development of “modern sovereign states”, which were striving to unify and take over control of the judicial system. As Sümer explains:

„After judgment began to be perceived as an entirely public interest, there was not enough room for alternative dispute resolutions (in any form rather than litigation) in the national law systems.”³⁷

However, due to the need triggered by dramatically evolving modern commercial transactions and relations, arbitration always remained to be an alternative to settlement of disputes by state courts. Thus, the role of arbitration significantly strengthened during the 20th century.³⁸ On the other hand, states have been attempting to protect the essence of their sovereignty, and for this reason always carefully drew up the confines of the zone within which arbitration may supersede adjudication by the state.

Sümer sets out three essential elements of a sovereign state:

„These are territory (land), people (nation) and recognition by other sovereign states. It is a supreme authority over a geographic region and group of people.”³⁹

The protection of the sovereignty of the state is closely related to the jurisdiction of national courts as „*exclusivity of jurisdiction is emphasized as a key element of sovereignty*”⁴⁰. Therefore, sovereign states created and continuously set up various legislative limitations to arbitrability, in order to ensure state control over certain disputes where the interest or the perceived interest of the

³⁷ Ibid, 4.

³⁸ Ibid, 4.

³⁹ Ibid, 7.

⁴⁰ Ibid, 5

state can be detected. These limitations may be evaluated from three perspectives (i) the property or asset is located within the territory of the state (ii) the asset or property is owned by the State and finally (iii) state is a party to the arbitration procedure.

3.1 The Property or Asset Is Located within the Territory of the State

As it was highlighted above, territory of a state is one of the three elements that constitute the notion of state sovereignty. Consequently, states implement various solutions with a view to protect land and immovable property situated within their own territory. One obvious mean is to reserve state control over adjudication in disputes, the subject matter of which is immovable property, situated within the state concerned.

It shall be highlighted that this matter does not only relate to the discussion on arbitration versus state courts, as the same approach can be detected in international private law rules determining the exclusive jurisdiction of courts of a state over courts of another state.⁴¹

A remarkable example is Article 22 of the Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (hereinafter referred to as „Brussels I. Regulation”). The referred article of the Brussels I Regulation, being directly applicable in the member states of the EU, sets forth that:

*“The following courts shall have exclusive jurisdiction, regardless of domicile:
1. in proceedings which have as their object rights in rem in immovable property or tenancies of immovable property, the courts of the Member State in which the property is situated.”*

⁴¹ This notion is recognized as „parallelism between arbitrability and the international rules on exclusive jurisdiction” See In. A Uzelac: *(In)arbitrability and exclusive jurisdiction. Parallels that matter*, In. *International Arbitration and International Commercial Law*, ed. S. Kröll, L.A. Mistelsi et al (Wolters Kluwer,) 463

Inarbitrability regarding matters related to in rem rights can be detected in several national legal systems. One remarkable example is Croatia, where disputes on rights in rem regarding immovable property shall fall within the exclusive jurisdiction of state courts. As Uzelac details⁴² the 2001 Law on arbitration created a system distinguishing between domestic and international arbitration. Under Croatian law, irrespective of the subject matter of the case, arbitration agreements are valid, provided the venue of the arbitration remains within the territory of Croatia.⁴³ However, the rules on exclusive jurisdiction determined by national law shall apply to agreements where the venue of arbitration is in a foreign state (i.e. arbitration agreements falling outside the scope of national law). With this solution the Croatian arbitration law „*equalizes requirements for the transfer of jurisdiction to foreign courts with the requirements for the transfer of jurisdiction to foreign arbitration tribunals.*”⁴⁴ These limitations are twofold. One category concerns the subject matter of the dispute (*ratione materiae*) and the other category relates to the capacity and status of the parties (*ratione personae*).

One ground for objective (in)arbitrability under Croatian law is the abovementioned exclusive jurisdiction related to immovable property.⁴⁵ As stressed by Uzelac, an arbitration agreement in conflict with national rules is null and void, thus an arbitration agreement on in rem rights would entail the following consequences:

⁴² Ibid, 457.

⁴³ The only additional condition to be met is the „dispositive nature of the dispute”. Ibid, 458.

⁴⁴ Ibid, 463.

⁴⁵Uzelac highlights that Croatian law provides for exclusive jurisdiction of state courts regarding „*disputes regarding property rights and other rights in rem regarding immovable property; disputes about trespassing on immovable property, disputes concerned with the rent or lease of immovable property, disputes regarding tenancies or the use of housing apartments or business premises, disputes regarding immovable property as an object of inheritance.*” Ibid, 460.

- if an action would be filed with a court regarding the same dispute between the same parties, it would have to establish that the arbitration agreement is null and void and assume its jurisdiction, and dismiss the objection of the defendant regarding jurisdiction,
- the award of the arbitral tribunal would not be recognized, the court sought by any of the parties to have the award recognized should find that the dispute is inarbitrable and therefore should reject such request;
- the court shall refuse the enforcement of the award as well.

In light of the above considerations, the Commercial Court in Zagreb, Croatia rejected the enforcement of a Swiss arbitral award where the dispute related to a contract for lease of a land at a Croatian port.⁴⁶ The reason was the „lack of subject matter arbitrability”⁴⁷.

On the other hand, in one of its decision the ICC pointed out the importance of the evaluation whether a certain dispute, relating to immovable property in Croatia, should qualify as a dispute covered by the exclusive jurisdiction of state courts. The ICC, in accordance with the narrow interpretation of the relevant rules by the Supreme Court of Croatia⁴⁸, held that the dispute of the parties – although related to Croatian immovable property – shall not fall under the rules excluding

⁴⁶ Decision of the Commercial Court in Zagreb no. Ovr-3101/07-15.

⁴⁷ A Uzelac: *(In)arbitrability and exclusive jurisdiction*, 452.

⁴⁸ In two decisions the Supreme Court of Croatia adopted a narrow interpretation of a dispute „arisen out of the lease or rent of immovables....situated on the territory of the Republic of Croatia.” The Supreme Court held that the exclusive jurisdiction rule under Article 56 of the Private International Law Act of Croatia does not cover disputes concerning claims regarding contractual rights in relation to immovable property. See Award on Jurisdiction of the ICC under No. 17235/GZ

international arbitration, since the claims were not based on a right in rem but was rather contractual rights.⁴⁹

Likewise the Croatian system, Hungary also excludes international arbitrability regarding matters related to immovable property situated in the territory of Hungary. Section 2 (3)-(4) of the Arbitration Act sets forth that:

“(3) In litigations which affect domestic property-related in rem rights, as well as leases or lease contracts, and which arise from a contract between parties registered solely in Hungary, or by default, have a business establishment in Hungary – so long as Hungarian law should be applied for the contract - only a Hungarian based permanent court of arbitration may proceed, with the application of its own rules of procedure. (4) The language of the arbitration procedure in paragraph (3) is Hungarian.”

Based on the above provision of the Arbitration Act, in litigations, commenced following 13 June 2012, only domestic arbitration may take place and the arbitral tribunal may only proceed pursuant to its own procedural rules in the event of a dispute arising from a contractual relationship between Hungarian seated parties in relation to property law, rental or lease contract, concerning a real estate situated within the territory of Hungary. One additional condition is that the applicable law shall be Hungarian law. It shall be pointed out that, as opposed to the Croatian system⁵⁰, under Hungarian law it is not enough to have the venue of the arbitration within the state, but the Hungarian based permanent court of arbitration may proceed with the application of its own rules of procedure. Additionally, the language of the procedure shall be Hungarian as well.

⁴⁹ Ibid, 14.

⁵⁰ As Uzelac pointed out „the ban on foreign arbitration in cases where exclusive jurisdiction is provided does not have an impact on the ability of the parties to agree on a „domestic’ arbitration in which foreign arbitrators would arbitrate, foreign language would be used and foreign law would be applicable to the substance of the dispute. Equally, the parties may in such cases agree on foreign or international arbitration rules (e.g. the UNCITRAL Rules) and the arbitration may be administered by foreign arbitral institutions (e.g. by the ICC); yet the legal seat of such arbitration should be in Croatia.”In. Uzelac, (In)arbitrability and exclusive jurisdiction, 460.

What most probably gave rise to the more stringent rules in Hungary is that the limitation to international arbitrability under the Arbitration Act – unlike the Croatian system⁵¹ – is only applicable in the event the parties to the dispute are Hungarian and the law applicable to the substance of the dispute is Hungarian as well, which makes the matter to be exclusively domestic in nature. This means that in case the dispute falls within the ambit of Section 2 (3) of the Arbitration Act, the parties may not agree on foreign arbitration (for instance the ICC in Paris or the Vienna International Court of Arbitration in Vienna).

Additionally, there were attempts also in Russia to exclude arbitration in disputes related to immovable property. The Supreme Court of Russia turned to the Constitutional Court in relation to the enforcement of two arbitral awards in disputes concerning immovable property. The Supreme Court of Russia argued before the Constitutional Court that matters concerning transfer of property rights fall within the sphere of public interest and therefore are inarbitrable.⁵²

It is evident that the abovementioned rules and attempts of national laws actually limit the autonomy of the parties and narrow the possibility of stipulating international arbitration. Some could view inarbitrability of disputes related to immovable property as an unnecessary limitation and intervention into the autonomy of the parties. While others see it to be a justifiable interest of the state to protect the immovables situated within its own territory by maintaining state monopoly in resolution of disputes of this kind. Whether the solutions adopted by the different states are adequate to protect their justifiable interest vested in immovable property may also be subject to debate.

⁵¹ In Croatia the arbitration is domestic if the venue of the arbitration is in Croatia

⁵² Dmitry Davydenko, *Immovable Property Disputes – Non-Arbitrable in Russia?*, *Cis Arbitration Forum*, accessed March 10, 2014, <http://cisarbitration.com/2011/03/22/immovable-property-disputes-%E2%80%93-non-arbitrable-in-russia/>

3.2 The Asset or Property Is Owned by the State

Another dimension of the protection of the interest of the State is when the asset or property, being subject to the dispute, is owned by the State. Hungary for instance excludes arbitration (both domestic and international) in respect of disputes related to national asset. Under Hungarian law neither ad hoc nor permanent arbitration tribunal may proceed in disputes where the subject-matter of the dispute is a national asset by definition of Act CXCVI of 2011 on National Assets, situated in an area within the boundaries of Hungary, including the rights, claims and privileges related to such asset.

Although this approach adopted by Hungary might provide more effective protection for these “sensitive subjects” by way of ensuring more extensive state control over these assets, however, the situation created by Hungary raises certain concerns stemming from international and constitutional law perspectives. Further details on this matter are addressed by chapter 4 of this paper.

3.3 The State Is a Party to the Arbitration Procedure

It is often problematic if a State is a party to an arbitration procedure due to the fact that the submission to the jurisdiction of a foreign forum might be perceived by the state to infringe upon its sovereignty and would deprive the state from the „safer” judicial settlement of its dispute. Additionally, it is a widely known phenomenon that „State arbitrations”⁵³ (arbitrations involving a State as a party) are significantly different from ordinary commercial arbitrations where only private parties are involved due to the public interest associated with such state arbitrations.

⁵³ “Revising the UNCITRAL Arbitration Rules to Address State Arbitration,” *Center for International Environmental Law and International Institute for Sustainable Development*, accessed March 11, 2014, http://www.iisd.org/pdf/2007/investment_revising_uncitral_arbitration.pdf

First, nationals of a State are interested in the result of the arbitration, which implies the need, amongst others to ensure transparency and public participation. Depending on which position the State took in an arbitration procedure, allegations of misconduct by the State is usually subject to the procedure, which certainly attracts the attention of the public.

Second, State arbitrations have an inevitable effect on State budget, which effect is often significant due to the fact that State arbitrations tend to concern large monetary liability.⁵⁴ The motivation behind creating objective arbitrability grounds by national legislations regarding matters where public interest is strong (for e.g. consumer and labor disputes etc.) can be detected even more strikingly when the State is a party to a dispute. Consequently, it is not unfamiliar in the different national legislations to adopt rules excluding or limiting the involvement of the state and/or state entities in arbitration procedure.⁵⁵

In Kazakhstan, for instance, the Domestic Arbitration Law⁵⁶ governs certain disputes that cannot be subject to arbitration. The Domestic Arbitration Law is applicable if the arbitration proceeding is between Kazakh private or legal persons and the seat of arbitration is in Kazakhstan (domestic arbitration). These non-arbitrable disputes include disputes where state or state entities are party to the dispute. However, the Law of 28 December 2004 on International Commercial Arbitration (ICA Law) does not regulate such prohibition.

⁵⁴ Ibid, 3.

⁵⁵ It is worth to note that limiting state arbitrations was also attempted by Hungary, however, such attempt remained unsuccessful.

⁵⁶ The Law of 28 December 2004 on Arbitration Courts

Consequently, it seems from the above that Kazakhstan excludes State arbitration only in domestic disputes, when the seat of the arbitration is in Kazakhstan⁵⁷.

Lithuania also implemented some limitations to arbitrability of state arbitrations. In the event of disputes where one of the parties is the State or a state entity or municipal company (except the Bank of Lithuania) prior consent of the state or the body that established such entity is needed.⁵⁸ However, one may be able to find examples to the contrary as well. Under Bulgarian law there is no restriction regarding the persons who may be a party to arbitration.⁵⁹ A state or a state entity may be party to arbitration both in international and domestic arbitration⁶⁰.

Besides the national laws governing arbitrability issue concerning State arbitrations, there is another remarkable issue related to State arbitration that needs to be dealt with, and it is the doctrine of „state immunity”. Although it does not closely relate to the issue of arbitrability, however, sometimes the effect of “state immunity” is the same as inarbitrability, i.e. a good faith party may not be able to receive justice by way of arbitration despite the conclusion of an arbitration agreement.

State immunity is a recognized notion of international law. It usually takes the form of a defense used by an unsuccessful state or state entity being party to international arbitration. This notion is aimed at preventing that an unsuccessful state would be obliged to submit itself to the jurisdiction of a foreign state or forum as well as having its property executed by a foreign forum.

⁵⁷ James H. Carter ed., *The International Arbitration Review*, 3rd ed., (UK, Law Business, 2012), 306

⁵⁸ *Ibid*, 322.

⁵⁹ See Article 19 (1) of the Civil Procedural Code of Bulgaria

⁶⁰ Article 3 (3) of the Law on International Commercial Arbitration (1988)

What makes this concept difficult to capture is the absence of uniform rules being applicable to „state immunity”.

There are two forms of state immunity, absolute immunity or restrictive immunity. If a state has absolute immunity the state is entitled to sovereign immunity unless it expressly waives such immunity in an international treaty or in a specific dispute. However, as States started to engage themselves into commercial activities more intensively, the early absolute immunity doctrine became obsolete and resulted in the occurrence of the restrictive theory.⁶¹ Restrictive immunity differentiates between sovereign acts (*acta jure imperii*) of the state and acts of commercial nature (*acta jure gestionis*). Distinguishing between these spheres of actions is essential, since some national laws claim immunity to the State only if the dispute concerns sovereign acts whilst no immunity of the State is recognized if the dispute concerns commercial activities.⁶²

It shall also be pointed out that from the perspective of international arbitration, difference shall be made between immunity of the state from jurisdiction of state courts related to arbitration and immunity from enforcement of an arbitral award.

While many states acknowledge immunity of the states from jurisdiction, states are rather reluctant to extend such immunity to enforcement and execution proceedings.⁶³ This may lead to a situation

⁶¹ Alexis Blane, “Sovereign Immunity as a Bar to the Execution of International Arbitral Awards,” Research Gate, accessed March 12, 2014, http://www.researchgate.net/publication/228174158_Sovereign_Immunity_as_a_Bar_to_the_Execution_of_International_Arbitral_Awards

⁶² Ibid, 460.

⁶³ In the US a difference is made between jurisdictional and executional immunity. The reason was that “[A]t the time the FSIA was passed, the international community viewed execution against a foreign state’s property as a greater affront to its sovereignty than merely permitting jurisdiction over the merits of an action.” This approach was also copied by European States as well.

that a party may be successful during an arbitration procedure, however, it could face serious difficulties, when trying to enforce such arbitral awards against a state.

Chapter 4: Limitation to Arbitrability Based on the Interest of the State with a Special Focus on Hungary

This chapter places a special focus on Hungary and the way that Hungarian national law governs limitations to arbitrability in general and in particular based on the interest of the state.

4.1 General Overview on Limitations under Hungarian Law

Act LXXI of 1994 on Arbitration is the major piece of legislation governing arbitration in Hungary. The UNCITRAL model law served as a basis for the Arbitration Act, both in terms of structure and its content. The Arbitration Act applies to national, permanent, and ad hoc arbitration and separately deals with international arbitration.

In accordance with the Hungarian arbitration regime, disputes are to be settled through arbitration provided that: (i) at least one of the parties is professionally engaged in business activities; and (ii) the legal dispute arises out of or in connection with this activity; (iii) based on the subject matter of the dispute, the parties are free to submit the dispute to arbitration; and (iv) arbitration was stipulated in an arbitration clause or arbitration agreement.⁶⁴

The abovementioned positive requirements set by the Arbitration Act determine the preconditions of a dispute to be heard by an arbitral tribunal. On the other hand, these positively formulated conditions also determine the confines of arbitration. Besides these implicit “limitations”, the Arbitration Act expressly sets out those types of disputes, where arbitrability is limited or completely excluded.

For the purpose of this paper, a difference is made between rules of the Arbitration Act, where arbitrability excluded or limited in view of the interest of the state (in a narrow interpretation) and

⁶⁴ Section 3 (1) of the Arbitration Act

those cases where certain types of disputes are excluded from the scope of arbitration due to other public interest.

4.2 Inarbitrability under the Arbitration Act Based on Other Public Interest

The Arbitration Act sets out those types of cases that are not arbitrable and where the State preserves its exclusive right for adjudication. The starting point of these kinds of limitations of arbitrability under Hungarian law is to be found under Section 4 of the Arbitration Act⁶⁵. This provision of the Arbitration Act provides for three categories of disputes where limitations to arbitrability shall apply (i) proceedings governed in Chapters XV-XXIII of the CPC (ii) any cases where the subject matter of the dispute qualifies as a national asset by definition of Act CXCVI of 2011 on National Assets, situated in an area within the boundaries of Hungary, including the rights, claims and privileges related to such asset (iii) cases where settlement of a dispute within the framework of arbitration is not permitted by law.

In accordance with the ministry reasoning attached to the Arbitration Act, limitations under Section 4 are needed when the subject matter and the parties to the dispute would be in line with the positive conditions of arbitration as determined by the Arbitration Act⁶⁶, however, the special features of the legal relationship justifies the exclusive jurisdiction of ordinary state courts.

⁶⁵ The proceedings governed in Chapters XV-XXIII of the Code of Civil Procedure (hereinafter referred to as “CPC”), may not be settled by arbitration - whether the ad hoc or permanent arbitration tribunal is seated inside or outside of Hungary -, or any cases where the subject-matter of the dispute is a national asset by definition of Act CXCVI of 2011 on National Assets, situated in an area within the boundaries of Hungary, including the rights, claims and privileges related to such asset, furthermore, the cases where settlement of a dispute within the framework of arbitration is not permitted by law.

⁶⁶ See Section 3 (1) of the Arbitration Act

4.2.1 Special Proceedings Governed by the CPC

As referred above, Section 4 of the Arbitration Act expressly excludes arbitration in the event of proceedings governed in Chapters XV-XXIII of the CPC. The concerned chapters of the CPC govern special litigious and non-litigious proceedings where the special nature of the dispute, the specific characteristics attached to them and/or the special protection to be granted to one of the parties made the legislator to extract these procedures from the scope of arbitration. (It shall be noted that non-litigious proceedings shall fall outside the scope of our evaluation, since arbitration is to be deemed as an alternative to litigious matters.⁶⁷⁾

Chapter XV-XVIII applies to special **proceedings related to personal status**, namely matrimonial proceedings⁶⁸, actions for the establishment of paternity or origins⁶⁹, actions related to parental custody⁷⁰, and proceedings for placement under guardianship or conservatorship.⁷¹ The concept behind excluding arbitrability regarding these disputes are to be explained by the very nature of arbitration and arbitrability. Disputes of this kind have nothing to do with any business activity of the parties, they relate only to the personal status of the parties. It is a common international approach that matters related to personal status shall not be subject to the freedom of the parties to choose forum. These types of disputes are normally excluded from arbitrability and shall be subject to the exclusive competence of the State.

⁶⁷ This is reflected under Section 3 (1) of the Arbitration Act

⁶⁸ Chapter XV of the CPC

⁶⁹ Chapter XVI of the CPC

⁷⁰ Chapter XVII of the CPC

⁷¹ Chapter XVIII of the CPC

Chapter XIX of the CPC governs **order for payment procedures**. Since this type of procedure – although is a non-litigious one – is aimed at validating pecuniary claims in a simpler way, and since under specific circumstances⁷² these procedures may turn into litigious proceedings, the Supreme Court had to clarify the relation between order for payment procedures and arbitration. In its decision under No. BH 2003.506 the Supreme Court confirmed and held that it is not permitted to issue order for payment within an arbitration procedure.

Linked to the above, it is to be added that the CPC prescribes that under a threshold of one million Hungarian forints a pecuniary claim shall only be validated by way of having recourse to the order for payment procedure.⁷³ Thus, the question arises whether or not this would entail that the pecuniary claims below the one million thresholds, are *prima facie* excluded from arbitration even if the underlying agreement included agreement on arbitration. In other words, does the CPC provide for a special exclusion ground regarding arbitrability in respect of pecuniary claims below one million forints? Some writers are of the view that the referred rule of the CPC should exclude arbitrability regarding the „low amount” claims⁷⁴. This approach would even be supported by

⁷² For e.g. if the other party raises objection against the order for payment procedure.

⁷³ See Section 314 (1) of the CPC: *„Any overdue claim of a pecuniary nature only, whose amount calculated according to Sections 24 and 25 does not exceed one million forints may be recovered by way of an order for payment procedure specified in Section 313 only, or by way of the means specified in Section 127, or in an action based on the assessment of the Teljesítésigazolási Szakértői Szerv (Body of Experts for the Certification of Compliance), provided that the defendant has a known home address or habitual residence in Hungary, or a registered office or fixed establishment (hereinafter referred to collectively as “address of summons”), and the pecuniary claim does not originate from an employment relationship, public servant and civil servant relationship, service relationship, work-related cooperative legal relationship or from a free-lance contractor legal relationship.”*

⁷⁴ László Tóth, “Arbitrable Cases under Hungarian Law (A választottbíróság elé vihető ügyek a magyar jogban),” accessed March 10, 2014, <http://www.law.klte.hu/jogimuhely/extra%20issue/T%20F3th%20L%E1szl%20-%20A%20v%E1lasztottb%20EDr%20F3s%E1g%20el%E9%20vihet%20FCgyek%20a%20magyar%20jogban.pdf>

reasonable economical considerations, since the relatively high costs of arbitration could be discouraging and uneconomical in the event of pecuniary claims having a low amount.

However, on the other hand, such interpretation could lead to an unreasonable restriction on the parties' freedom to decide on the forum of their dispute and could deprive a valid arbitration agreement of the parties from its effect.

Nevertheless, the adoption of the Act L of 2009 on the Order for Payment Procedure cured this controversial situation by implementing into the CPC a rule creating the possibility to turn to arbitration even regarding those pecuniary claims where the application of order for payment procedure is mandatory.

Administrative actions are governed under Chapter XX of the CPC. The purpose of these actions is the judicial review of administrative decisions. This means that the parties are not free to settle the subject matter of the dispute, which would anyway be a precondition of arbitration under Section 3 (1) of the Arbitration Act. The rationale behind this exclusion category is that the State is not keen on passing the control over a public matter to an arbitral tribunal. However, it shall also be noted that Anglo-Saxon legal systems are not unfamiliar with for .e.g. permitting arbitration procedures regarding disputes concerning social security relationship.⁷⁵ Nevertheless, this approach is completely extraneous and alien within continental legal systems.

Rules on Actions for media remedy are to be found under Chapter XXI. The litigious part of the procedure shall not be subject to arbitration, since the dispute primarily concerns the personal status and not the economical interest of the aggrieved party.

The final category under the CPC is the Action relating to **employment contracts or other similar legal relationships**, which is governed by Chapter XXIII of the CPC. There could be

⁷⁵ Éva Horváth: General Rules of the Act on Arbitration in light of the Practice. Jogtudományi Közlöny, 1995. Volume 4, 175.

multiple supporting arguments for excluding this category of disputes. First and foremost it is ambiguous, whether or not this category of disputes would or could conceptually be in line with the general criteria of arbitration, namely that the dispute needs to have a business nature, since these disputes do not directly concern economical activity, but rather affect in general the internal conditions of the carrying out of such activity. However, what is even a more striking characteristic of these disputes is the disparity of the position of the parties. Consequently, the protection of the employee, being the weaker party, could justify the extent of the limitation concerning the freedom of the parties to choose the forum of their dispute.

What may create a problem regarding these disputes is the qualification of the legal relationship serving as the basis. The reason is that very often an employment relationship shows correlations and similarities with other types of legal relationships, for instance mandate agreement or works contracts and it is also common that contracts include a mix of civil law and labor law elements. The qualification of the legal relationship has a special significance in these cases, since the claim may be evaluated by the arbitration court to the merits only if the dispute is not of labor law nature.

This is reflected in the practice of the Court of Arbitration attached to the Hungarian Chamber of Commerce and Industry (hereinafter referred to as CAHCCI). The CAHCCI established lack of competence when the private individual claimant submitted a declaratory action regarding the unlawful nature of the decision of the supervisory board of the defendant business association, terminating the employment relationship of the claimant.⁷⁶

⁷⁶ László Újlaki: Exclusion of arbitration in the event of labor disputes. In. *Gazdaság és Jog*, 2001/2. , 22-23.

However, it is an interesting point to stress, that unlike in Hungary and other continental legal systems⁷⁷, labor arbitration has a long historical background in the US and a well settled procedure.⁷⁸ The US Supreme Court has been a guardian of labor arbitration in the past decades and for this purpose it has established through its landmark decisions, called as *Steelworkers Trilogy*⁷⁹ the following judicial doctrine related to labor arbitration.

The first principle is that “*arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute, which he has not agreed so to submit*”⁸⁰ This doctrine recognizes the fact, that the authority and power of the arbitral tribunal to resolve a dispute is derived from the mere fact, that the parties agreed in advance to provide such power to the arbitration court.

The second doctrine is that the issue of arbitrability shall be subject to judicial determination. While the third principle is that the court when deciding whether the parties have agreed to vest in the arbitration court the power to resolve their dispute, the court shall not touch upon the merits of the case. Finally, in order to ensure the expansion of arbitrability, the US regime even provides for

“*presumption of arbitrability*” in the sense that “*an order to arbitrate the particular grievance should not be denied unless it may be said with positive assurance that the arbitration clause is not susceptible of an interpretation that covers the asserted dispute. Doubts should be resolved in favor of coverage.*”⁸¹

⁷⁷ For instance Slovakia determines labour disputes inarbitrable as well.

⁷⁸ Loukas, Brekoulakis, *Arbitrability*. 152

⁷⁹ *United Steelworkers of America v. American Manufacturing Co.*, 363 U.S. 564, 80 S Ct 1343, 4 L. Ed. 2d 1403 (1960) ; *United Steelworkers of America v. Warrior & Gulf Navigation Co.*, 363 U.S. 574, 80 S Ct. 1347, 4 L. Ed. 2d 1409 (1960), *United Steelworkers of America v. Enterprise Wheel & Car Corp.*, 363 U.S. 593, 80 S Ct 1358, 4 L. Ed. 2d 1424 (1960)

⁸⁰ *AT&T Technologies, Inc. v. Communications Workers of America*, 475 U.S. 643, 106 S Ct

⁸¹ Timothy J. Heinsz, *Grieve It Again: Stare Decisis, Res Judicata and Collateral Estoppel in Labour Arbitration*, 38 BC L. Rev. (1997) 275, 277, <http://lawdigitalcommons.bc.edu/bclr/vol38/iss2/>

Additionally, the concept of efficiency also can be raised as a supportive argument in favor of labor arbitration. Heinsz argues that, the enormous numbers of collective bargaining agreements that are concluded in the US, undeniably and unstoppably trigger violations or alleged infringements every day. Channeling such disputes into court proceedings would significantly overload the judicial system, and could lead to prolonged judicial processes. Besides, resolving such disputes would require specialized knowledge from judges dealing with the individual labor disputes. These problems⁸² seem to be properly addressed within the system of labor arbitration, where professional labor arbitrators deal with these kind of disputes on a daily basis.

4.2.2 Arbitration is Not Permitted by Law

Section 4 of the Hungarian Arbitration Act includes a catch all provision which sets forth that arbitration shall be excluded, where settlement of the dispute by arbitration is not permitted by law. One example of this category is a consumer protection rule contained in the New Civil Code⁸³, which sets forth that an arbitration stipulation shall be deemed as an unfair contractual term in the event of consumer disputes, if the stipulation on exclusive arbitration was not individually negotiated by the Parties. Consequently, the New Civil Code renders those consumer disputes inarbitrable, where the arbitration clause of the agreement was not negotiated by the parties. It needs to be stressed that consumer protection has long been a significant and much-discussed matter in many states and by many governments. Due to the significant numbers of consumers and the political influence they are able to trigger, legislators in many states devoted a special attention to consumer disputes.

⁸² Ibid

⁸³ Act No. V. of 2013 on the New Civil Code of Hungary

What makes this topic sensitive is the need to balance between contractual and procedural autonomy of the parties and the protection afforded to the “weaker party”. It is apparent that consumers, due to their special status and position, shall be afforded a certain degree of special protection, especially when the consumers have no other alternatives, but to accept the terms and conditions of a contract, as determined by the other party. This is specifically applicable in the event of adhesion contracts i.e. contracts where “*the consumer may either accept or decline the offer as a whole*”.⁸⁴ If a consumer faces an experienced professional entity when entering into a legal transaction, the chance of the consumer to negotiate any disadvantageous condition is relatively low. In the event of a transaction having international elements, the situation is even worse and raises multiple concerns.

Nevertheless, opinions differ regarding what shall qualify as a proper and effective protection of consumers. The European Court of Human Rights (hereinafter referred to as *ECHR*) held in several cases that judicial proceedings were not in line with the requirement to ensure a fair trial, in view of the lengthy procedures and complexity of rules associated with a litigation. In the judgment delivered in the *Sümerli v. Germany* case the Grand Chamber of the ECHR held that “*German procedural law does not safeguard effective instruments for the protection of rights enshrined in the European Convention on Human Rights.*”⁸⁵

In response to these concerns, the promotion of alternative dispute resolution mechanisms, including arbitration, could be an evident solution. However, despite the intense strengthening of arbitration, especially on an international level, arbitration is still associated with less control and

⁸⁴ Alexander J. Belohlavek, Arbitrability Limitation in Consumer Disputes: Consumers’ Protection as Legal And Economic Phenomenon, Risk governance & Control: financial markets& institutions, Volume 1, Issue 3, 2011, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2344154

⁸⁵ Ibid

relatively low level of legal safeguards for the parties. Opponents argue that arbitration could jeopardize the right of the consumer to fair trial, offers limited possibilities for review and adversely affect the access of the consumer to information.⁸⁶ Furthermore, another point of criticism relates to the fact that professionals are more experienced with arbitration proceedings due to their frequent involvement in such dispute, which creates an inevitable advantage over their consumers. Thus, protection of the “weaker party” might be problematic in arbitration⁸⁷.

What is inevitable is that national consumer legislations intend to create a balance within the unequal relationship. However, the extent to which a professional market player may apply its dominance when negotiating an agreement and the restrictions to this negotiating power is very diverse.

For instance, in the US system the freedom of the parties prevails over the need for protection of the consumer. The protection of the weaker party is subordinated to the autonomy of will. In the meanwhile, the European system always attempts to safeguard the party to a dispute that is considered to be “weaker”.⁸⁸

The approach adopted by the EU is reflected in Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts (hereinafter referred to as Consumer Directive), which sets forth that a term which has not been individually negotiated shall be deemed unfair if it has an object or effect of

⁸⁶ Ibid, 29.

⁸⁷ Nevertheless, it is also remarkable that there are arguments claiming that in majority of the cases it is the professional party who needs protection against consumers who are unwilling to pay or in a delay with payment. Additionally, it is the professional who needs to be safeguard from consumers abusing their special protection afforded by national laws. Ibid.

⁸⁸ DRAHOZAL, C. et FRIEL, R. (2005) A Comparative View of Consumer Arbitration. 2005, Vol. 2, p. 135.

*“excluding or hindering the consumer's right to take legal action or exercise any other legal remedy, particularly by requiring the consumer to take disputes exclusively to arbitration not covered by legal provisions, unduly restricting the evidence available to him or imposing on him a burden of proof which, according to the applicable law, should lie with another party to the contract.”*⁸⁹

As indicated above, Section 6:104 of the new Civil Code precisely implements the rule of the Directive. Attention shall be drawn to the fact that prior to the enactment of the new Civil Code, the implementation of the said rule of the Directive was done by Governmental Decree 18/1999. (II. 5.) on unfair terms in the consumer contracts, which included a different text compared to the new Civil Code. Due to the equivocal wording of the Governmental Decree, the practice of the national courts regarding this issue was rather controversial prior to the date of entering into force of the New Civil Code⁹⁰.

The Metropolitan Court of Appeal in its decision published under No. BH2012.67 ruled that the unfair nature of an arbitration clause in consumer contracts shall not be evaluated, since Section 7 (2) of the Old Civil Code⁹¹ makes it possible for the parties to make such stipulation. On the other hand, the Court of Appeal of Szeged was of the view⁹² that such arbitration clause could be subject to evaluation, however, such stipulation shall not qualify to be unfair due to Section 1 (1) of the Governmental Decree. Furthermore, the Metropolitan Court took a third stance, namely

⁸⁹ Clause 1 q) of Annex 1 of Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts, Official Journal L 095 , 21/04/1993 P. 0029 – 0034

⁹⁰ 15 March 2014

⁹¹ It offers arbitration as a method for dispute settlement.

⁹² Pf.I.20.398/2012/2.

that an arbitration clause within a consumer contract is a priori unfair, no further evaluation is needed.⁹³

Consequently, for the sake of unifying the controversial approaches followed by the different courts, the Supreme Court delivered a decision under No. 3/2013. PJE, which ruled in favor of the New Civil Code in the sense that it established that an arbitration clause, being a general term or a term not having been individually negotiated in a consumer contract, shall qualify as an unfair term. The Supreme Court also held that the court shall take notice of such unfair term ex officio, however, the invalidity of the term shall only be established, if the consumer – upon the call of the court – refers to such invalidity.

The rationale behind the latter procedural solution is that the court, in line with the Hungarian procedural rules, shall notice ex officio if a claim shall not be enforced before court⁹⁴, including a possible arbitration clause as well. In this regard, the court shall notify the consumer on the unfair nature of the term and shall ask the consumer by providing a deadline – together with a notification on the legal consequences – whether it intends to refer to such term. If the consumer does not respond within the given deadline or does not wish to refer to the unfair nature of the term, the court shall reject the statement of claim without summons or terminate the lawsuit. If however, the consumer challenges the unfair term in a timely manner, the court shall deliver a judgment to the merits of the case.

⁹³ 57.Pf.637.436/2012/3.

⁹⁴ See Section 130 of the CPC

4.3 Limitation to Arbitrability under the Arbitration Act

Based on the Interest of the State

As it was detailed above, states may have several justified or unjustified, actual or perceived interest that might motivate governments to use national legislation as a tool to exclude from the sphere of arbitration those disputes that concern such state interest. The Hungarian system, in its pursuit of protecting “state interest” implemented two out of three approaches of inarbitrability outlined in Chapter 3 of the thesis (the asset is located at the territory of the state, the asset is owned by the state or the state is a party to the dispute).

4.3.1 Limited Arbitrability Related to Immovable Property

As detailed above, the Arbitration Act excludes the possibility to turn to international arbitration in the event of disputes arising from a contractual relationship between Hungarian seated parties in relation to property law, rental or lease contract, concerning a real estate situated within the territory of Hungary, if the applicable law is Hungarian law.⁹⁵

As it is apparent from the cited provision, Section 2 (3) of the Arbitration Act does provide for inarbitrability of the specified disputes only on international level, only excludes the availability of international arbitration concerning disputes defined under Section 2 (3) of the Arbitration Act.

In addition to the considerations already detailed under point 3.1 of this paper, the question arises, whether or not the parties may escape from the restriction set by Section 2 (3) of the Arbitration Act by way of stipulating foreign law as applicable to their dispute, in view of the fact

⁹⁵ Section 2 (3) of the Arbitration Act

that the cited provision of the Arbitration Act only covers those disputes, where the applicable law is Hungarian.

The answer to the above question seems to be negative in light of the Hungarian court practice. A published arbitral award (VB1998.3) ruled that foreign law may only be stipulated if a foreign person, asset or right is involved, i.e. foreign law may only be chosen if the dispute has a foreign element. This position then was affirmed by the Győr Court of Appeals in its decision published under No. BDT2007. 1544. In this case, two companies incorporated in Hungary concluded a contract whereby their disputes would be settled in the Netherlands because the stakeholders of one company were Dutch entrepreneurs. The court decided that since both companies were domiciled in Hungary, and their contract was to be performed in Hungary, there was no foreign element in their legal relationship and thus no foreign law may be stipulated.

Since Section 2 (3) of the Arbitration Act covers disputes where Hungarian parties and Hungarian real property is involved, it is reasonable to assume that majority of the disputes falling under Section 2 (3) of the Arbitration Act are of domestic nature only. In light of the above decisions of the Hungarian courts the stipulation of a law other than the Hungarian, in such domestic disputes would not be permissible under Hungarian law. Thus, domestic arbitration forum would be the sole option in these disputes based on the Arbitration Act.

4.3.2 Inarbitrability Related to National Asset

The last significant moment, in relation to arbitration legislation, took place on 1 January 2012, when the new Act No CXCVI of 2011 on National Asset (hereinafter referred to as NAA) entered into force. This piece of legislation attracted a storm of controversy within the arbitration community, since Section 17 (3) of the NAA and respectively Section 4 of the Arbitration Act

excludes arbitration (both domestic and international) in respect of disputes related to national asset⁹⁶.

It is to be borne in mind that Section 38 of the Fundamental Law of Hungary sets forth that the State property shall be deemed national asset and it also articulates the overriding necessity to protect such national asset.⁹⁷

However, opponents argue that the adopted legislation is an inappropriate tool to reach the otherwise correct and justifiable purpose of protecting the national asset.⁹⁸

4.3.2.1 Background

Legislative action, aiming at protection of State property and asset has long been subject to continuous debate. Prior to the adoption of the above quoted provision of the NAA, several other attempts were made to this effect. However, these preceding efforts had been frustrated due to the controversial standpoints and the numerous objections stemming from and members of the arbitration community and judicial professionals.

⁹⁶ Section 4 of the Arbitration Act: *„The proceedings governed in Chapters XV-XXIII of the Code of Civil Procedure (hereinafter referred to as “CPC”), may not be settled by arbitration - whether the ad hoc or permanent arbitration tribunal is seated inside or outside of Hungary -, or any cases where the subject-matter of the dispute is a national asset by definition of Act CXCVI of 2011 on National Assets, situated in an area within the boundaries of Hungary, including the rights, claims and privileges related to such asset, furthermore, the cases where settlement of a dispute within the framework of arbitration is not permitted by law.”*

⁹⁷ Section 38 (1) of the Fundamental Law of Hungary sets forth that: *„The property of the Hungarian State and of municipal governments shall be considered national assets. National assets shall be managed and protected for the purpose of serving the public interest, satisfying common needs and preserving natural resources, taking also into account the needs of future generations. The requirements for safeguarding and protecting national assets, and for the prudent management thereof, shall be laid down in an implementing act.”*

⁹⁸ László Kecskés and Józsefné Lukács eds, *Book of the Arbitrators* (Budapest, HVG ORAC, 2012), 213.

From July 2011 several attempts had been made to adopt legislation that would have created a ground for inarbitrability of state arbitrations by way of excluding arbitration regarding cases where state and local governments would have been party to the dispute. The first step of this approach was the draft legislation submitted on 14 June 2011⁹⁹. This proposal intended to implement into the Arbitration Act the following:

„[...]It is not permitted to turn to arbitration in proceedings governed by Chapter XXVI¹⁰⁰ of the CPC, if the party to the lawsuit is the Hungarian State, local government, state budget entity, authority with national scope and authorities having independent regulatory powers and business association where a majority shareholding is owned directly or indirectly by the above or directly or indirectly managed by or controlled by the above.”¹⁰¹

Subsequent to the submission of the above draft legislation, several other amendment proposals were submitted, aiming at slightly modifying the wording of the proposed legislation.¹⁰² Additionally and more importantly, several objections were articulated in relation to the contemplated legislative action, arguing that the envisaged legislation would clearly infringe not only constitutional law but also European Union law and would be against the related international law standards and practice.¹⁰³

Furthermore, the proposed legislation was found to be unreasonable by experts claiming that the high profile investment projects are typically and historically those types of disputes where

⁹⁹ The draft was submitted by Dr. István Balsai, former chairman of the Constitutional Committee of the Parliament, currently holding a position as a constitutional judge.

¹⁰⁰ Chapter XXVI of the CPC governs high profile actions where the sum exceeds 400 million forints.

¹⁰¹ Draft legislation submitted on 14 June 2011 by Dr. István Balsai, FIDESZ politician.

¹⁰² The proposal of Cser Palkovics Tamás was submitted on 20 June 2011, János Lázár submitted an amendment proposal on 4 July 2011

¹⁰³ Public letter sent by István Varga, University professor at ELTE University, Faculty of Law to the governmental and parliamentary executives. In: Kecskés, Lukács, *Book of the Arbitrators*,. 190-197.

the arbitration is recognized and applied, consequently the limitation in this respect cannot be justified.¹⁰⁴

Finally, after several months and hesitation from the side of the government, most probably due to the widespread social and professional pressure, the proposals were not implemented into the Arbitration Act.

However, surprisingly, without any longer preparation work the Parliament adopted the NAA on 23 December 2012, including the rule on exclusion of the arbitration regarding disputes related to national asset, which, in its effect is almost identical to the idea of inarbitrability of disputes where the state is a party.

4.3.2.2 Definition of National Asset

Section 17 (3) of the NAA sets forth that a dispute the subject matter of which is a national asset located on Hungarian territory, together with any right, claim or demand attached to such a national asset that additionally falls under is inarbitrable.

Attention shall be drawn to the fact that NAA defines national asset as follows:

1. § (1) This law governs the preservation and protection of state and local government-owned property (henceforth: national wealth), the requirements of responsible management over national wealth, the exclusive property of state and local governments, the limits and conditions on the control of national wealth and the state and local government's exclusive economic activities.

(2) The national wealth includes:

- a) the state or local government's exclusive property*
- b) things owned by the state or local government that is not covered in a)*
- c) financial assets of state and local governments and any shares owned by them*
- d) any property values to which the state and local governments have a right, which the law specifies as property value*
- e) the airspace above the area enclosed by Hungary's borders*

¹⁰⁴Kecskés, Lukács, *Book of the Arbitrators*, 193.

- f) emission units and air traffic emission units in accordance with the law on the trade of the emission units of greenhouse gases, as well as the Kyoto units, in accordance with the law of the implementation framework of the United Nations Framework Convention on Climate Change and the Kyoto Protocol.*
- g) cultural properties registered, owned and housed in public collections upheld by the government (museums, archives, image and sound-archives operating as public collections, and libraries)*
- h) archeological artifacts*
- i) national data assets, in accordance with the law on the increased protection of government records, covered by the national data asset*

2. § The scope of this Act does not apply to the following items although they fit the definition of national wealth:

- a) financial wealth of persons and agencies covered by the fiscal administration*
- b) claims and payment obligations*
- c) social insurance and the financial wealth of the separated governmental funds and*
- d) national data assets in accordance with the 1. § of subsection (2) of section i), considering especially the 16. § subsection (4).*

4.3.2.3 Relation to bilateral international treaties

Currently, there are over forty bilateral investment protection treaties concluded by Hungary, where Hungary undertook the obligation to enable the resolution of the potential disputes arising out of bilateral investment treaties by way of arbitration.

Normally, these bilateral treaties stipulate the jurisdiction of the International Center for Settlement of Investment Disputes (hereinafter referred to as *ICSID*) or an ad hoc arbitration court under the United Nations Commission on International Trade Law (hereinafter referred to as *UNCITRAL*).

Critics argued that Section 17 (3) of the NAA violates the said bilateral investment treaties, since Hungary, when entering into these treaties, undertook the obligation directly and also indirectly, regarding its entities, to make possible and allow arbitration as a form of dispute resolution. Consequently, the above obligation cannot be overruled by any subsequent national

legislation.¹⁰⁵ Linked to this it shall be pointed out that under Hungarian law any infringement of international law and international agreements at the same time constitutes an infringement of Hungarian constitutional law, which shall be subject to the evaluation of the Constitutional Court. Article Q of the Fundamental Law determines the overriding obligation of Hungary to respect international law.¹⁰⁶ This includes that Hungary shall ensure the harmony between national law and international treaties concluded by Hungary. The above is underpinned and confirmed by a series of landmark decisions of the Constitutional Court, which determine that execution and enforcement of international treaties concluded by Hungary is a constitutional requirement.

In its resolution No. 30/1990 (XII.15.) the Constitutional Court held that any conflict between national law and international treaties amount to a breach of fundamental rights of citizens, therefore the Hungarian State shall comply with its obligation arising out of the Constitution if it adopts national rules to cure the situation in line with the Constitution.

Additionally, in the decision No. 7/2005. (III.31.) the Constitutional Court ruled that the legal system of Hungary shall ensure the conformity of national law with obligations stemming from international law. This constitutional requirement not only entails the obligation to ensure that national law is not in contradiction to international law, but also requires the legislator to adopt those rules necessary for complying with obligations under international law. Due the overlap

¹⁰⁵ Kecskés, Lukács, *Book of the Arbitrators*, 213.

¹⁰⁶ „(1) *In order to create and maintain peace and security, and to achieve the sustainable development of humanity, Hungary shall strive for cooperation with every nation and country of the world.*
 (2) *Hungary shall ensure harmony between international law and Hungarian law in order to fulfill its obligations under international law.*

(3) *Hungary shall accept the generally recognized rules of international law. Other sources of international law shall become part of the Hungarian legal system by publication in the form of legislation.”*

between international law and constitutional law, the right is vested in the Constitutional Court to evaluate whether a national law infringes upon international law.

Consequently, and as a result of the above controversy, a constitutional complaint was filed with the Constitutional Court¹⁰⁷ in 2012, claiming that Section 17 (3) of the NAA violates numerous bilateral investment treaties, and other international treaties, as well as the Fundamental Law itself and requested the Constitutional Court to set aside the disputed provision of the NAA. In the course of its evaluation¹⁰⁸, the Constitutional Court distinguished between (i) cases where the arbitration is made available by the bilateral treaties for disputes between one contracting state and the investor of another contracting state, and (ii) where arbitration is stipulated for disputes between the contracting states themselves.

Regarding the first category, the Constitutional Court held that¹⁰⁹ the concerned provision of the NAA does not infringe upon any bilateral investment protection treaty, since the rule concerned shall be applied together with Section 17 (1) of the NAA (*„The provisions of this Act shall not affect legitimate rights and obligations acquired in good faith prior to the entering into force of this Act”*) in the event of agreements between Hungary and an investor of the other contracting state, already being effective on the date when the disputed provision of the NAA entered into force.¹¹⁰

¹⁰⁷ The complaint was filed by Máté Szabó ombudsman

¹⁰⁸ The scope of the evaluation of the Constitutional Court was confined to the Treaty signed on 18 May 2007, in Baku, between the Republic of Hungary and Azerbaijan concerning the encouragement and reciprocal protection of investment (published under Act No. CVIII of 2007). The Constitutional Court explained that the concerned bilateral investment treaties are based on a model law treaty developed by the UN, therefore the text of the different treaties allegedly have been violated by NAA are almost identical to each other.

¹⁰⁹ Resolution of the Constitutional Court published under No. 14/2013 (VI. 17.) in the National Law Gazette.

¹¹⁰ The NAA entered into force on 1 January 2012.

The interpretation adopted by the Constitutional Court raises problems from several aspects. The fact that the Constitutional Court felt the need to formulate „constitutional requirement” entails that Section 17 (3) of the NAA alone, without the “guidance” of the Constitutional Court would be in conflict with international requirements. Nevertheless, the Constitutional Court did not eliminate this problem, only shifted the obligation of ensuring the lawful nature of the disputed rule to the sphere of judicial enforcement. However, this solution might not be adequate to reassure international investors, who are discouraged from further Hungarian investments by the current situation.

Additionally, in the minority report attached to the resolution of the Constitutional Court¹¹¹ it is validly argued that all the bilateral investment treaties entitle the investor to submit a dispute to arbitration during the whole term of the bilateral treaty. Hungary therefore, by way of entering into the bilateral treaty undertook the obligation for the future to enable the investors of the other contracting state to choose the dispute resolution forum unilaterally. However, the ruling issued by the Constitutional Court only offers protection for those investment agreements, which were concluded prior to 1 January 2012, with a view to preserve the existing arbitration agreements and to avoid retroactive legislation. However, no protection is offered for those investors who would like to stipulate arbitration in the future based on the bilateral investment treaties concluded by Hungary. Nevertheless, Section 17 (1) of the NAA has no correlation of any kind with the obligation of Hungary, related to arbitration assumed for the future. It does not concern the general legal possibility, stemming from the international treaty, to choose arbitration.

The above problem could be cured by an interpretation of Section 17 (1) of the NAA that the term “*right acquired in good faith*” would cover the legal opportunity that is granted to

¹¹¹ It was submitted by Dr. Egon Dienes-Oehm constitutional judge

potential investors by existing investor protection treaties. However, the ruling provided by the Constitutional Court does not allow for such a broad interpretation, thus it explicitly states that Section 17 (1) of the NAA shall apply to already existing agreements between the investor and the state.

As regards the second category, the Constitutional Court placed the issue of inarbitrability under the NAA and the Arbitration Act out of the scope of the international treaties and held that disputes and arbitration agreement between the contracting states do not fall within the scope of NAA and the Arbitration Act, therefore, the concerned inarbitrability rule not applicable to disputes of this kind.

4.3.2.4 Relation to Other International Treaties

Besides the bilateral international treaties, Hungary has also signed other multilateral international treaties, which govern matters related to international arbitration. Consequently, it is requisite to evaluate the relation of Section 17 (3) of the NAA to these international treaties as well. It shall be highlighted that the above exercise was done by the Constitutional Court and its findings were published in its resolution under No. 14/2013. (VI. 17.).

European Convention on International Commercial Arbitration (Geneva 21 April 1961)

Hungary is a signatory of the Geneva Convention. Article II of the Convention sets forth that:

- “1. In cases referred to in Article I, paragraph 1, of this Convention, legal persons considered by the law which is applicable to them as "legal persons of public law" have the right to conclude valid arbitration agreements.*
- 2. On signing, ratifying or acceding to this Convention any State shall be entitled to declare that it limits the above faculty to such conditions as may be stated in its declaration. “*

Additionally, Article I paragraph 1 of the Geneva Convention provides that:

*“This Convention shall apply:
 (a) to arbitration agreements concluded for the purpose of settling disputes arising from international trade between physical or legal persons having, when concluding the agreement, their habitual place of residence or their seat in different Contracting States;
 (b) to arbitral procedures and awards based on agreements referred to in paragraph 1(a) above.”*

It is noteworthy that Hungary did not make any reservation regarding arbitration agreement concluded by public legal entities in relation to national asset, when acceded to the Geneva Convention. Consequently, the question arises whether the rule prohibiting arbitration in relation to national asset is in line with the Geneva Convention and whether the status of Hungary regarding the Convention can be upheld and justified in light of Section 17 (3) of the NAA.

The Constitutional Court when answering the above question found that the exclusion of “*pro futuro*” arbitration agreement by the NAA and the Arbitration Act might be problematic under the Geneva Convention. However, the Constitutional Court, instead of setting aside the disputed national legislation, circumvented the issue by arguing that since it is permitted to withdraw from the Geneva Convention, it is up to Hungary to decide whether to (i) withdraw from the Geneva Convention or (ii) to withdraw from the Convention and accede to it again with an account being taken of the NAA and the Arbitration Act.

New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (10 June 1958)

Hungary has also acceded to the New York Convention. Article II Point 1 of the New York Convention provides that:

„Each Contracting State shall recognize an agreement in writing under which the parties undertake to submit to arbitration all or any differences, which have

arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not concerning a subject matter capable of settlement by arbitration.”

Opponents of the new rules of arbitrability argued that¹¹² the new restrictions under the NAA and the Arbitration Act are indirectly against the New York Convention, since Hungary submitted its public entities to arbitration under the Geneva Convention without any reservation. Thus, further argument was articulated that the term “*subject matter capable of settlement by arbitration*” cannot be construed in a way that its content would be subject to the sole discretion of each states and the development of national law, since such interpretation would erode the significance and status of international treaties.

As a result of evaluation of whether the new arbitrability rules comply with the New York Convention, the Constitutional Court held that no infringement of the Convention may be established. By saying so the Constitutional Court argued that Article II of the New York Convention covers already existing arbitration agreement, therefore, by the correct application of Section 17 (1) of the NAA (*legitimate rights and obligations acquired in good faith prior to the entering into force of this Act shall not be affected by the new arbitrability rules under the NAA*) any violation of the Convention can be avoided.

Convention on the Settlement of Investment Disputes between States and Nationals of Other States
(Washington, 1965)

Article 25 and 26 of the Washington Convention provides that:

“Art. 25.

1. The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by that

¹¹² See submission of Máté Szabó the ombudsman of fundamental rights to the Constitutional Court.

State) and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre. When the parties have given their consent, no party may withdraw its consent unilaterally.

2. "National of another Contracting State" means:

(a) any natural person who had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration as well as on the date on which the request was registered pursuant to paragraph (3) of Article 28 or paragraph (3) of Article 36, but does not include any person who on either date also had the nationality of the Contracting State party to the dispute; and

(b) any juridical person which had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration and any juridical person which had the nationality of the Contracting State party to the dispute on that date and which, because of foreign control, the parties have agreed should be treated as a national of another Contracting State for the purposes of this Convention.

3. Consent by a constituent subdivision or agency of a Contracting State shall require the approval of that State unless that State notifies the Centre that no such approval is required.

4. Any Contracting State may, at the time of ratification, acceptance or approval of this Convention or at any time thereafter, notify the Centre of the class or classes of disputes which it would or would not consider submitting to the jurisdiction of the Centre. The Secretary-General shall forthwith transmit such notification to all Contracting States. Such notification shall not constitute the consent required by paragraph (1).

Art. 26.

Consent of the parties to arbitration under this Convention shall, unless otherwise stated, be deemed consent to such arbitration to the exclusion of any other remedy. A Contracting State may require the exhaustion of local administrative or judicial remedies as a condition of its consent to arbitration under this Convention."

Compliance of the NAA and the Arbitration Act with the above rules of the Washington Convention was also subject to the revision of the Constitutional Court, which ruled that the correct application of the "*approval of that State*" governed by Article 25 (3) of the Washington Convention offers room for Hungary to ensure that the inarbitrability rules related to national asset would not entail the violation of the Washington Convention.

Summarizing the above, the new legislation on inarbitrability was steadily protected by the Constitutional Court against the attacks attempting to eliminate the said rules from the national legal system. However, the position of the Constitutional Court adopted in this matter did not seem to be adequate to close the debate on this issue. As the Constitutional Court held, disharmony between the disputed national laws and the international bilateral and multilateral treaties can be observed and critics argue that the infringement already occurred at the time the unlawful national rules came into force. However, the Constitutional Court, instead of ensuring the harmony between these two legal regimes by way of setting aside the unlawful national rules, believed to cure the problem by way of adopting “constitutional requirements”, which might be overly difficult to be followed by individuals being parties to a legal relationship.

4.3.2.5 Constitutional aspects

The debate on the inarbitrability associated with national asset also included arguments that Section 17 (3) of the NAA and Section 4 of the Arbitration Act is against the Fundamental Law (in addition to those violations mentioned in relation international law).

First, the arbitration community complained that the disputed rules are not precise since they confuse the subjective and objective side of the legal relationship to be governed and therefore violates the principle of legal certainty. Second, since the provisions concerned exclude the “arbitration procedure” itself and not the conclusion of arbitration agreement following the entry into force of the rule, it might give rise to an interpretation that it is not allowed either to turn to arbitration even based on those arbitration agreements that had been concluded prior to the date when the new rules came into force, i.e. the new rules allow an interpretation that could result in the retroactive effect of the disputed provisions.

Likewise with international law concerns, the Constitutional Court did not share the above concerns. The Constitutional Court relied again on Section 17 (1) of the NAA („*The provisions of this Act shall not affect legitimate rights and obligations acquired in good faith prior to the entering into force of this Act*”) and the constitutional requirement regarding these legitimate rights. Additionally, it held that the disputed statutory provisions are in line with the legal certainty principle.

4.3.2.6. Further considerations

In light of the debate triggered by the adoption of the rules on inarbitrability of disputes related to national asset, it seems to be reasonable to examine what future effects such legislation could have.¹¹³

Protected national asset

One positive effect of the new restrictions could be that the national asset is “protected” from foreign arbitration procedures, where the state control is restricted to a very limited extent. However, besides this, there are various “harmful” side effects associated with the new legislation.

Jurisdiction of foreign courts

It might be a potential threat that, by way of excluding arbitrability, foreign courts would have jurisdiction regarding a great number of disputes related to Hungarian national asset. This

¹¹³ A tailed evaluation of this matter is to be found in Kecskés, Lukács, *Book of the Arbitrators*, 224-230.

risk stems from the fact that as a general rule it is the seat or domicile of the defendant which constitutes jurisdiction of a court in a given dispute.

Potential procedures against Hungary within the ambit of investment protection

Investors that would be forced to avail themselves of judicial remedy in Hungary might claim damages based on investment protection treaties. Although the author is not aware of any procedure of this kind commenced against Hungary as of today, this might be a potential risk that Hungary need to face in the future.

Eroding the reputation of Hungary regarding investment protection

Due to the fact that the restriction under the NAA shows a clear turnaround as against the previous pro-arbitration approach of Hungary, it might be discouraging for investors to choose Hungary as a partner and venue for their investment. In the international investment arena arbitration is the commonly used way to settle disputes. If Hungary deprives international investors from this opportunity, it might have a detrimental effect on the number of future investment in Hungary.

Conclusion

This paper has examined the notion of arbitrability and its limitation in different national laws with a special focus to those limitations, where the source and motivation of the limitation was the interest or perceived interest of the state. In view of the fact that jurisdiction over a dispute has always been perceived to be one key element of the sovereignty, sovereign states created and continuously set up various legislative limitations to arbitrability, in order to ensure state control over certain disputes where the interest or the perceived interest of the state can be detected. This interest of the state has been viewed from three aspects (i) when the asset is to be found within the territory of the state (ii) the asset is owned by the state (iii) the state is a party to the proceeding. As it was demonstrated through different examples of national legal solutions, the limitations to arbitrability by national legislations are used by states as a tool to protect the interest of the state, however, sometimes the balancing exercise between the, otherwise legitimate, interest of the state and the freedom of the parties are difficult to be done and limitations often result in significant intervention into the autonomy of the parties.

Finally, the paper demonstrates the notion of limitations to arbitrability and its effects through the recent legislation of Hungary. By analyzing specifically the limitations to arbitrability of disputes, where national asset would be subject to the arbitration, the paper draws the conclusion that from one point of view the solution adopted by Hungary might, in a short run, be able to “protect” national asset by way of ensuring state control over the disputes. However, such restrictive approach could easily trigger harmful side effects as well, that could be detrimental to the position of Hungary within the international investment arena.

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