# 38 The Hungarian Constitutional Court's Judgment on Hungary's New Anti-Arbitration Rules

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## 38.1 Introduction

In 2011 and 2012, the Hungarian parliament excluded, the possibility to use arbitration for the settlement of disputes concerning (Hungarian) national property. Since the statutory definition of 'national property' is very wide and virtually covers all assets owned by Hungary,[1] these provisions, in essence, eliminated the possibility of stipulating arbitration in contracts concerning state property.

In 2013, the Hungarian Constitutional Court (CC), upon the request of the Commissioner for Fundamental Right, scrutinized the foregoing provisions as to whether they go counter to Hungary's international obligations, in particular the 1961 Geneva Convention, the 1958 New York Convention, the 1965 Washington Convention and the bilateral investment-protection treaties signed by Hungary (BITs).

The new provisions raised constitutional concerns from two perspectives. First, it was doubtful whether these rules comply with the treaty law on arbitration and the requirements of the Hungarian Fundamental Law, that is, whether they are acceptable as to substance (substantive concerns). Second, in case the provisions did not fall foul of the foregoing international norms, it was to be analyzed whether their temporal scope could have retrospective effects, thus resulting in an unconstitutional plight (concerns connected to temporal scope). Although these two facets were not analyzed by the CC separately, in the following these two points will be distinguished.

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1 Section 1(2) of Act CXCVI of 2011 on National Property.

## 38.2 The New (Anti-Arbitration) Provisions Adopted in 2011 and 2012

The new anti-arbitration regime rests on two pillars: a prohibition against persons (entities) having the right of disposition over national property to stipulate arbitration (either foreign, or Hungarian), embedded in Section 17(3) of the Act on National Property[2] (hereafter, by way of shorthand: Section 17(3)), and the pronouncement of disputes concerning national property to be non-arbitrable, enshrined in Section 4 of the Act on Arbitration[3] hereafter, by way of shorthand: Section 4). In this paper, the term 'new provisions' or 'anti-arbitration provisions' refers to these provisions.

First, persons (entities) having the right of disposition over national property are prohibited from stipulating arbitration in civil law contracts concerning national property.

Section 17(3) provides that in civil law contracts concerning national property located on the territory of Hungary ('being on the territory delimited by the borders of Hungary'), the person having the right of disposition over the national property can stipulate only Hungarian language, Hungarian law and, for the case of a legal dispute, the jurisdiction of Hungarian courts, with the exclusion of arbitration; the person having the right of disposition over the national property cannot stipulate arbitration for the settlement of these legal disputes.

Accordingly, the person (entity) in charge is enjoined from entering into any obligation that would make legal disputes concerning national property subject to arbitration.

In respect of the temporal scope of the rules, Section 17(1) of the Act on National Property provides that the provisions of the Act do not concern the rights and obligations that were acquired lawfully and in good faith before the Act's entry into force. In other words, the prohibition embedded in Section 17(3) has no retrospective effects.

Second, the scope of non-arbitrable cases, as defined in Section 4, was extended to legal disputes the subject-matter of which concerns national property that comes under the scope of the Act on National Property and is located on the territory of Hungary ('on the territory delimited by the borders of Hungary') or any right, claim, demand related to this.[4]

Accordingly, this provision made legal disputes connected to national property non-arbitrable. While as to Section 17(3) one could have argued that it embeds only a command addressed to the person in charge of disposing of the national property and this rule does not make the stipulation of arbitration invalid (i.e. it contains no general prohibition on arbitration), the subsequent amendment of Section 4 of the Act on Arbitration lifted this uncertainty and made the exclusion of arbitration watertight – at least on the national level (see prologue).

2 Act CXCVI of 2011.
3 Act LXXI of 1994.
4 This was inserted by Section 2 of Act LXV of 2012 and entered into force on 13 June 2012.

Surprisingly, and contrary to Section 17(3), the amendment of Section 4 of the Arbitration Act does not try to obviate retrospective effects: the amending statute provides that the extension of non-arbitrability has to be applied in procedures launched after the amendment's entry into force, that is, 13 June 2012.[5] In other words, the statutory language makes it clear that the rule that legal disputes concerning national property are not arbitrable does apply to covenants lawfully and validly concluded before 13 June 2012. The relevant point of time is the start of the procedure: only pending matters were immune to this rule. Therewith, Section 4 was destined to unilaterally invalidate all arbitration covenants Hungary was party of.

## 38.3 The Request of the Commissioner for Fundamental Rights

The Commissioner for Fundamental Rights request the CC to establish the unconstitutionality of the new anti-arbitration provisions on the basis that these provisions infringe the 1961 Geneva Convention, the 1958 New York Convention, the 1965 Washington Convention and the bilateral investment-protection treaties concluded by Hungary and go counter to the requirement of legal certainty.[6]

Article II(1) of the 1961 Geneva Convention expressly establishes that public entities shall have to right to enter arbitration agreements. Although Article II(2) of the Convention permits signatory states to enter a reservation limiting the foregoing right to arbitration, Hungary made no such reservation. It is to be noted that albeit that Article II(2) does embed the possibility to make a reservation, the exercise of this right is limited in terms of time: signatory states can submit such a reservation only when 'signing, ratifying or acceding' to the Convention.

> Article II – Right of Legal Persons of Public Law to Resort to Arbitration
> 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.

According to the Commissioner, the violation of Article II(1) of the 1961 Geneva Convention gives rise also to the violation of Article II(I) of the 1958 New York Convention, which provides that contracting states have to recognize written arbitration agreements covering

5 Section 4 of Act LXV of Act 2012.

6 The Commissioner's request is presented in Paras. 1-12 of the CC's judgment.

arbitrable matters: since arbitration agreements entered into by public entities are arbitrable, Article II(I) of the 1958 New York Convention obliges contracting states to recognize these agreements.

> Article II
> I. 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.

According to Article 25 of the 1965 Washington Treaty, although the jurisdiction of the International Centre for Settlement of Investment Disputes (ICSID) is not mandatory, that is, the ICSID has jurisdiction only if 'the parties to the dispute consent in writing to submit to the Centre', once the parties agree to the jurisdiction of the ICSID, 'no party may withdraw its consent unilaterally.' However, contracting states may exclude certain classes of disputes from the jurisdiction of the ICSID; the exercise of this right of reservation is not time-barred: this may occur 'at the time of ratification, acceptance or approval of this Convention or at any time thereafter'.

> Article 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 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.
> (…)
> 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).

## 38.4 The Judgment of the Constitutional Court

In essence, the CC rejected the request of the Commissioner for Fundamental Rights on the basis that the exclusion of arbitration does not violate treaty law categorically and the frustration of legitimate expectations can be tackled effectively through the adoption of 'constitutional requirements', which ensure that the new exclusions cannot be applied to currently effective arbitration agreements and treaties.[7]

First, as to substantive concerns, it established that the incriminated provisions either do not infringe treaty law, or the tension can be lifted by Hungary, by way of example, through making a reservation or denouncing the relevant convention; although acknowledging that the parliament needs to take the necessary measures, it failed to adopt any disposition calling the parliament to do this.

As to the domain of investment protection, the CC established that the BITs effective at the time of the new provisions' entry into force are not covered by the new anti-arbitration provisions; it is the government's duty to ensure that the new provisions and future BITs will be in line with each other.[8] This covers investor-state disputes, including cases where the foreign state acts as a private investor. The Constitutional Court stated that the new provisions, *ratione materiae*, do not cover inter-state disputes; hence, the problem non-compliance does not emerge in this regard.[9]

The CC also found that the new provisions do not infringe the 1965 Washington Convention either, since Hungary has various methods to bring Hungarian law in line with the Convention.[10]

For instance, according to Article 25(3) of the 1965 Washington Convention, state entities' assent to the jurisdiction of ICSID can be made dependent on the state's approval.

> Article 25
> 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.'

Furthermore, a contracting state can exclude certain classes of disputes from the jurisdiction of the ICSID and this reservation can be submitted at any time.

7 Paras. 21-92.
8 Paras. 40-41 and 48-52.
9 Para. 47.
10 Paras. 55-57.

> Article 25
> 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).

The new provisions' conformity with the 1961 Geneva Convention was more difficult to demonstrate. The CC held that in case Article II(1) of the 1961 Geneva Convention does authorize public entities to enter into arbitration agreements (that is, the Court, notwithstanding the clear treaty language, did not take the existence of such a right as granted), the Convention ensures the possibility for Hungary to opt-out from this.[11] The mechanism suggested by the Court is rather odd: albeit that such a reservation limiting the right to arbitration is time-barred (Article II(2) provides that such a reservation can be made only '[o]n signing, ratifying or acceding to' the Convention), Hungary could denounce the Convention on the basis of Article X(9) and then re-enter the Convention, this time with the reservation permitted by Article II(2).[12] Such a denunciation would take effect twelve months after the date the Secretary-General receives the notification of denunciation.

As to concerns connected to temporal scope, the CC held that it is a 'constitutional requirement' that the new rules cannot frustrate legitimate expectations and cannot affect arbitration agreements that were validly concluded before the new provisions' entry into force. This principle appeared explicitly in Section 17(1) of the Act on National Property; however, no such rule was established as to Section 4; on the contrary, with the exception of pending procedures, the extension of non-arbitrability entered into force with immediate effect.[13]

Interestingly, the CC extrapolated the rule embedded in Section 17(1) of the Act on National Property (that is, acquired rights cannot be impaired) to new Section 4 of the Arbitration Act, as if Section 17(1) were applicable to the latter as well. This is an odd construction, since the purpose of 'constitutional requirements' is not to amend or override the law (if this is needed, the law has to be set aside); 'constitutional requirements' can be used when the law can be interpreted in more than one way and, hence, the judge or authority can construct it in a constitutional manner without overriding the law itself. This condition was obviously not met here, since the amending act that extended non-arbitrability to cases concerning national property expressly provides that this exclusion

11 Paras. 64-65.
12 Para. 75.
13 Paras. 40, 51 and 63.

does intrude into existing legal relationships and solely pending procedures are immune from the rule of non-arbitrability.

## 38.5 Dissenting Opinion

Justice Egon Dienes-Oehm dissented; his opinion was joined by Justice Péter Paczolay, the CC's president.

He opined that the CC should have quashed the new provisions; or it should have called the legislator to take the necessary measures necessary for lifting the contradiction between arbitration treaty law and the new provisions and set a deadline for this.[14] Albeit that the lack of conformity appears in the CC's decision, it tries to tackle the contradiction with obscure 'constitutional requirements'.

As to the 1961 Geneva Convention, Justice Dienes-Oehm established that the violation of the treaty occurred already at the time the new provisions entered into force.[15] Since Hungary made no reservation under Article II(2) of the Convention, it had the duty to ensure that public entities can stipulate arbitration; this right could not be excluded by means of a statute.[16]

As to BITs, Justice Dienes-Oehm established that with the conclusion of these treaties, Hungary made the choice of arbitration as a future dispute-settlement mechanism possible; this could not be excluded with an internal legal act.[17] Although Article 25(4) of the 1965 Washington Convention does authorize contracting states to exclude certain classes of disputes from the jurisdiction of the ICSID, Hungary made no such reservation in respect of legal disputes connected to national property.

In sum, Justice Dienes-Oehm and Justice Péter Paczolay held that the new provisions violate the 1961 Geneva Convention, several docents of BITs, the 1965 Washington Convention and the 1958 New York Convention.[18]

## 38.6 Assessment

When reading the CC's judgment, it is not difficult to obtain a critical acumen. First, the CC misapplied the rules of Hungarian constitutional law and applied the concept of 'constitutional requirements' in a case this could not have been applied. Second, it seems

14 Para. 95.
15 Para. 99.
16 Para. 100.
17 Para. 106.
18 Para. 114.

that the CC's judgment failed to construct the applicable international treaties properly and blatantly misinterpreted them.

The use of 'constitutional requirements', to the extent the CC used them, clearly appears to be flawed, since the new provisions visibly fall foul of arbitration treaty law. As noted above, 'constitutional requirements' can be used in case a legal norm can be interpreted in more than one way and there is at least one version of interpretation that is constitutional; with this, the provisions' constitutionality can be secured through interpretation. However, 'constitutional requirements' can certainly not be used as a tool to re-write the law and to vision something into the law that is clearly not part of it.

The CC appears to have been exceedingly 'creative' as to the interpretation of the new provisions; this culminated in the extrapolation of Section 17(1) of the Action on National Property, excluding all retrospective effects, to new Section 4 of the Act on Arbitration. While Section 17(1) of the Act on National Property does indeed provide that the provisions of this Act do not concern the rights acquired lawfully and in good faith before the Act's entry into force, the act extending the ambit of non-arbitrability (Act LXV of Act 2012) expressly and crystal-clearly provided that the extension does apply to existing arbitration agreements; the statutory language makes it clear that the rule that legal disputes concerning national property are not arbitrable does apply to covenants lawfully and validly concluded before this rule's entry into force. The CC, arbitrarily and capriciously, ignored this rule on temporal scope and extrapolated Section 17(1) of the Act on National Property to Section 4 of the Arbitration Act. Of course, the CC could have certainly established that the conformity of new Section 4 can be secured only if its temporal scope is shaped in the way Section 17(1) of the Act on National Property does; however, the temporal scope of Section 4 was blatantly not shaped in this way. Through extrapolating Section 17(1) to Section 4, the CC, in fact, quashed the rule on the temporal scope of Section 4.

Accordingly, the use of 'constitutional requirements' was exaggerated, since (as Justice Dienes-Oehm puts it) the violation of the Fundamental law occurred already at the time the new provisions entered into force and the rules of new Section 4 on temporal scope cannot be reconciled with the constitutional law.

Nonetheless, even if disregarding the above and assuming that the CC, albeit that in a conceptually erroneous manner, succeeded in obviating the frustration of legitimate expectations, it cannot be disregarded that it completely failed to address the violations emerging from the *pro futuro* application of the new provisions. As Justice Dienes-Oehm held, the CC had, in fact, two options: it could quash the new provisions or, if it found this appropriate, it could call the legislative to lift the tension between the new provisions and arbitration treaty law (through amending (repealing) the new provisions or denouncing the relevant treaties). None of these were adopted. Although the CC's judgment's reasoning contends that Hungary has to decide whether to amend (or quash) the new provisions or to submit reservations or to denounce the treaty concerned, this does not appear in the

judgment's operative part. The CC failed to call the legislative to take the necessary measures; likewise, albeit that in such cases this has to be done, it failed to set a deadline for the adoption of these measures.

As far as the CC's substantive analysis is concerned, it seems that it either blatantly misinterpreted the relevant rules of arbitration treaty law or it treated rules that blatantly violated the norms of public international law very mildly. Probably, the gravest flaw was that it treated unilaterally terminable obligations as non-existing. Although Article 25(4) of the 1965 Washington Convention does permit contracting states to exclude a class or classes of disputes from the jurisdiction of the ICSID and they can make such a reservation 'at any time', Hungary has made no such reservation; thus, its obligations emerging from the Convention are unrestricted. It appears to be easily understandable that the possibility to restrict one's involvement in a convention does not imply that one's involvement is restricted. This error is *a fortiori* present as to the 1961 Geneva Convention, since here the reservation is time-barred; according to Article II(2), it could have been made only *'[o]n signing, ratifying or acceding to this Convention'*. It appears to be even more easily understandable that the possibility to denounce a convention does not imply that one would not be bound by it. The efforts of the CC to intimate that the right of public entities is likely deducible from Article II of the 1961 Geneva Convention but this construction is not unequivocal make the judgment even more frivolous, taking into account, among others, that this is the title of Article II: the 'Right of Legal Persons of Public Law to Resort to Arbitration'.

All the above remarks explaining that the tension between the new provisions and treaty law could be lifted through making a reservation or denouncing the convention clearly suggest that there is such a tension, which has to be lifted. On the contrary, the CC failed to call the legislative to eliminate these contradictions within a certain deadline. How many debtors would applaud a judgment providing that there no need to enjoin the debtor to pay, since the debtor could easily eliminate his monetary obligation through paying? Whether this would be a reasonable judgment; well, the CC's judgment would suggest: it would.

## 38.7 Epilogue

It is to be noted that the new provisions raise various concerns also outwith the domain of constitutional law.

Although it is a question of feasibility and not of constitutionality, it is noteworthy that the new provisions raise a number of practical problems of enforcement. Although Hungary unquestionably does have the power to enforce the anti-arbitration provisions on its territory, there is, put it mildly, no guaranty that the arbitral awards concerning national

property will not be enforced abroad. Namely, arbitrabilit is governed by the *lex fori*. According to Article V(2) of the 1958 New York Convention:

> [r]ecognition and enforcement of an arbitral award may also be refused if the competent authority in the country where recognition and enforcement is sought finds that: (a) The subject matter of the difference is not capable of settlement by arbitration under the law of that country.

Accordingly, since contracts concerning national property are normally arbitrable, Hungary, with this idiosyncratic rule, erected, on the territory of Hungary, a protecting wall against arbitration but could not immunize its assets outside Hungary from enforcement. Taking into account that currently 150 states are party to the 1958 New York Convention,[19] this facet appears to be rather relevant.

Furthermore, the new provisions have various other aspects that raise legal concerns. By way of example, Section 17(3) makes the choice of Hungarian language, Hungarian law and, for the case of a legal dispute, the jurisdiction of Hungarian courts mandatory in civil law contracts concerning national property located on the territory of Hungary. This appears be excessively ambitious, since under Article 3 of the Rome I Regulation[20] the parties may choose the law of any country (they can even choose the law of a non-EU country) and, likewise, under Article 23 of the Brussels I Regulation[21] they have the right to agree to the jurisdiction of the court of any Member State (this rule is preserved in Article 25 of the Brussels I Recast Regulation[22])[23]; this liberty is also embedded in Article 5 of the 2005 Choice of Court Convention.[24]

19 www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention_status.html.

20 Regulation (EC) No. 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I), OJ L 177, 4 July 2008, pp. 6-16.

21 Regulation (EC) No. 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters. OJ L 12, 16 January 2001, pp. 1-23.

22 Regulation (EU) No. 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, OJ L 351, 20 December 2012, pp. 1-32.

23 The Brussels I Recast Regulation is applicable as from 10 January 2015.

24 Convention of 30 June 2005 on Choice of Court Agreements, concluded on 30 June 2005.