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Restrictive Tendencies in Hungarian Arbitration Law – Arbitration Agreements Are Not Enforceable Against Companies under Involuntary Liquidation

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After the fall of communism, Hungary embraced modern arbitration law. Act LXXI of 1994 ("the Arbitration Law") created a comprehensive legal regime for both domestic and international arbitration, based on the UNCITRAL Model Law. State courts generally exercised a liberal approach in connection with arbitral proceedings and awards. However, some recent developments in Hungarian law and court practice reflect less friendly tendencies. One of these is the recent judgment of the Szeged Court of Appeal (Szegedi Ítélőtábla, Gf.I.30.014/2012) published by the Supreme Court of Hungary, as a so-called "decision of theoretical importance", providing guidance to lower courts (EBH 2014.G.4.).

In the case at hand, the Court of Appeal reversed the first instance judgment, which rejected the claim, and found jurisdiction over a contract claim filed by a plaintiff under involuntary liquidation. This decision was made in spite of a clause referring every dispute arising from the contract at issue to arbitration before the Permanent Arbitration Court attached to the Hungarian Chamber of Commerce and Industry. The judgment was based on Article 8 (1) of the Arbitration Law, which implements Article 8 of the UNCITRAL Model Law, stating that the court does not reject the claim otherwise submitted to arbitration "*if it finds that the arbitration agreement (…) is incapable of being performed*".

The final judgment found that arbitration proceedings would hinder the enforcement of the insolvent claimant's rights to such an extent that it has "*become impossible to perform*" the arbitration agreement. The Court of Appeal took into account the following factors: (1) there is no possibility for third party intervention in the arbitration proceedings, thus, creditors of the insolvent claimant cannot intervene to support the claimant; (2) the arbitration procedure is not public; (3) there is no appeal against the arbitral award and the possibility of annulment is limited; (4) arbitration costs are higher than ordinary court fees, they must be paid upfront and there is no possibility to defer them until the final award.

Both the merits and the reasoning of the judgment can and has been criticised. The impossibility of the creditors to intervene or the lack of publicity cannot logically

hinder the enforcement of the insolvent claimant's rights. The one instance procedure and the limited review of the arbitral award can also be regarded as a factor advancing the enforcement of the claimant's rights. Taking into account the tendency of Hungarian courts to curb allegedly "excessive" legal fees, a successful claimant may eventually be better off with an arbitration award ordering full reimbursement of its legal cost.

It is also of interest that the Court of Appeal's decision is based on an unpublished decision (Gfv.XI.30.448/2008/3) of the Hungarian Supreme Court, cited in a well-known analyses of Hungarian arbitration law (Dr Katalin Murányi: *Case law of the state courts relating to the operation of arbitration courts and thoughts on the possibly needed revisions of law* [Az állami bíróságoknak a választottbíróságok működéséhez kapcsolódó gyakorlata és gondolatok az esetleg szükséges jogszabály módosításokról], in Hungarian Law [Magyar Jog] No 2011/4).

In the earlier case before the Supreme Court, it has also been found that the arbitration agreement binding the insolvent plaintiff has become "*incapable of being performed*". However, the factual and procedural background of the earlier Supreme Court decision was rather unique. It concerned a damage claim of an insolvent company against its previous insolvency trustee in connection with the sale of the assets of the insolvent company. According to the available facts, the defendant insolvency trustee issued an invitation of tender, to which only one bidder applied. The trustee then entered into an arbitration agreement with the only bidder for the disputes arising from the tender. The arbitration agreement set forth arbitration by a sole arbitrator and the parties appointed this sole arbitrator in the arbitration agreement. Simultaneously, the insolvency trustee refused to enter into the sale and purchase contract with the bidder. On the same day, the bidder turned to the appointed sole arbitrator and asked for a declaration that the sale and purchase contract has been made. The sole arbitrator rendered its award on the same day, and declared that the contract has been made.

Thus, it appears, first, that the direct subject matter of the relied upon case was not the operability of the arbitration agreement, but rather the liability of the previous insolvency trustee; the qualification of the arbitration agreement was only part of the reasoning. Second, it seems that the Supreme Court was faced with a clear instance of fraud in the process. The Szeged Court of Appeal or the Supreme Court qualifying the judgment of the former as a decision of theoretical importance could have thus easily distinguished the earlier case.

Nevertheless, the Hungarian courts took the position that arbitration agreements can across the board be avoided by the companies under involuntary liquidation, and such companies can file their claims in state courts without any need to actually prove that their financial situation does not permit arbitration. There is no indication that the courts considered if this sweeping rationale applies differently in the setting of domestic and international arbitration. Neither did the court deal with the possible consequences of such an approach within the context of enforcing Hungarian court judgments brought in disregard of an arbitration agreement abroad.

The Hungarian decision, which will likely shape future Hungarian court practice is

even more restrictive than the approach taken by other jurisdictions, which accept that impecuniosity of the plaintiff may lead to the inoperability of the otherwise binding arbitration agreement on the basis of the specific circumstances of the case (See e.g. the so-called Plumber case of the German federal Supreme Court under No III ZR 33/00, CLOUT Case 404). The Supreme Court took a substantial step further, when it decided solely on the formal ground that the plaintiff is under an involuntary liquidation procedure, without investigating the circumstances of the case and the actual merits of the claimant's reliance on its financial situation.

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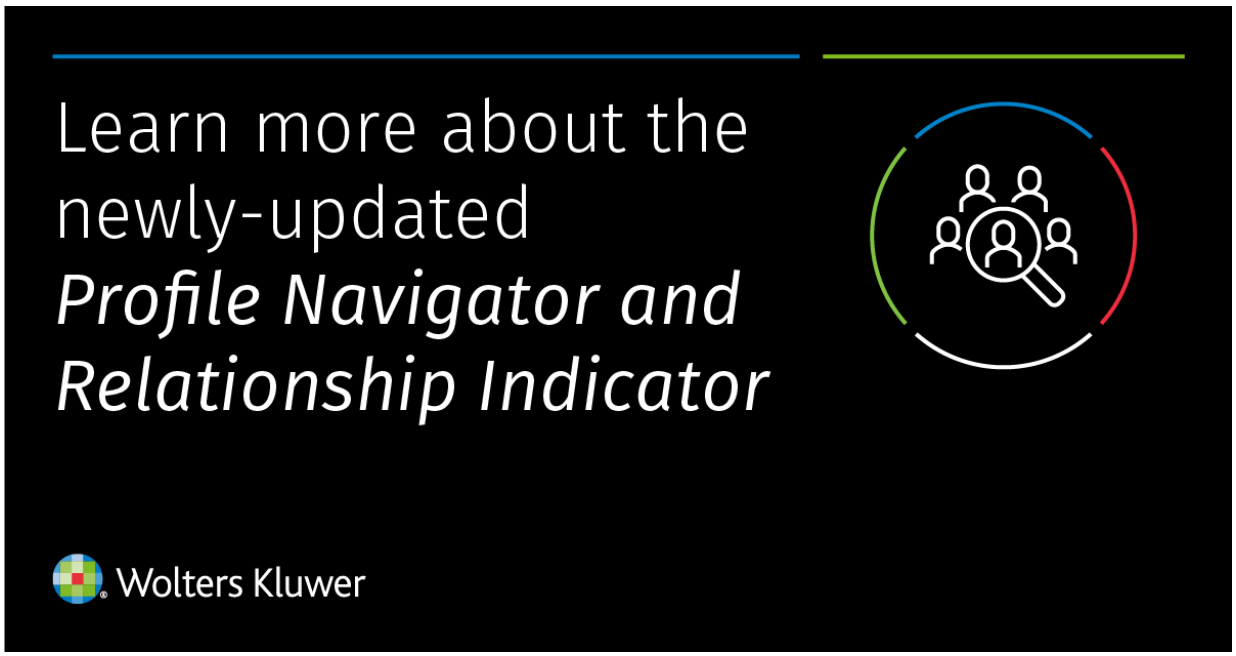

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