Kluwer Arbitration Blog

The Lesson of a Short-Lived Mutiny: The Rise and Fall of Hungary's Controversial Arbitration Regime in Cases Involving National Assets

Csongor István Nagy (University of Szeged) · Friday, December 2nd, 2016

This post is based on my paper published in the American Review of International Arbitration (Vol. 27, No. 2, pp. 239-246, 2016) and posted on SSRN. The paper presents the saga of Hungary's controversial arbitration regime in cases involving national property. It analyzes Hungary's legislative efforts and ultimate failure to exclude arbitration in matters involving Hungarian national assets, demonstrating the efforts and the difficulties a country faces if it attempts to defy the prevailing pattern of dispute settlement in international trade.

A few years ago, Hungary enacted two laws that ruled out arbitration in disputes involving Hungarian national assets. The provisions enacted in 2011 and 2012 were led by the thinking that (private) arbitration did not secure the protection of the public interest. The regime rested on two pillars. First, public entities were prohibited from stipulating arbitration in civil-law contracts concerning national property. Second, the scope of non-arbitrability was extended to cases concerning national assets located on the territory of Hungary.

The provisions were fiercely criticized because they arguably ran counter to international treaty law and were, from a business perspective, not sustainable. It is noteworthy that the new provisions raised a number of practical problems. For instance, while Hungary may obviously enforce its law on its own territory, the risk that arbitral awards concerning Hungarian national property would be enforced abroad could not be ruled out. According to Article V(2) of the 1958 New York Convention, arbitrability is governed by the *lex fori*:

> "[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".

As a corollary, given that contracts concerning national property are normally arbitrable, Hungary could protect its assets located in Hungary against enforcement based on an arbitral award but could not shield its assets located outside the country. Taking into account that currently more than 150 states are party to the 1958 New York Convention, this risk appears to be certainly real.

In 2013, the above rules were approved by the Hungarian Constitutional Court (hereinafter: "CC"), which refused to declare them unconstitutional and established that they did not violate international treaty law. First, the CC held that it was a "constitutional requirement" that the new rules must not have retrospective effects: they could not frustrate legitimate expectations and could not impair validly concluded arbitration agreements. Second, the CC came to the conclusion that the anti-arbitration provisions either were not counter to treaty law or, if they were, the violation could be abolished through making a reservation or denouncing the relevant convention. The government had to ensure that future bilateral investment treaties would be in accord with the anti-arbitration provisions. According to the CC, the provisions at stake were in line with the 1965 Washington Convention, as Hungary had various methods to do away with the conflicts between the anti-arbitration provisions and the Convention. By way of example, Article 25(3) of the 1965 Washington Convention embeds the possibility to make state entities' assent to ICSID jurisdiction subject to the state's approval and according to Article 25(4) of the ICSID Convention, contracting states, through a reservation, can exclude certain groups of cases from the jurisdiction of ICSID.

Establishing the new provisions' conformity with the 1961 Geneva Convention was more challenging. The CC held that even if the 1961 Geneva Convention, in Article II(1), enabled public entities to agree to arbitration, Hungary could opt-out from this obligation. The suggestion of the CC was rather odd: although such a reservation could be made only "[o]n signing, ratifying or acceding to" the Convention, and Hungary had made no such reservation, the Court advised Hungary to denounce and re-enter the Convention, so the possibility of reservation could be re-opened.

Finally, the concerns related to economic sustainability proved to be real. In 2015, Hungary withdrew these provisions in order to execute a major international economic transaction. Hungary concluded an inter-state agreement with Russia to expand the country's only nuclear power plant. The project was to be carried out and financed by Russia. The agreement stipulated arbitration. When in the parliamentary debate on the legislative package it emerged that this stipulation was irreconcilable with the anti-arbitration provisions, the rules were amended, unfortunately, in a controversial manner. While the statutory language of the adopted provisions is fairly clear in that they abolish the earlier prohibition against arbitration, the explanatory memorandum attached to these provisions, which, as a matter of practice, is regarded as authoritative guidance of interpretation by the courts, alleges that "the provision has no new norm-content" and its only purpose is to make clear that international treaties take precedence over the rules concerned.

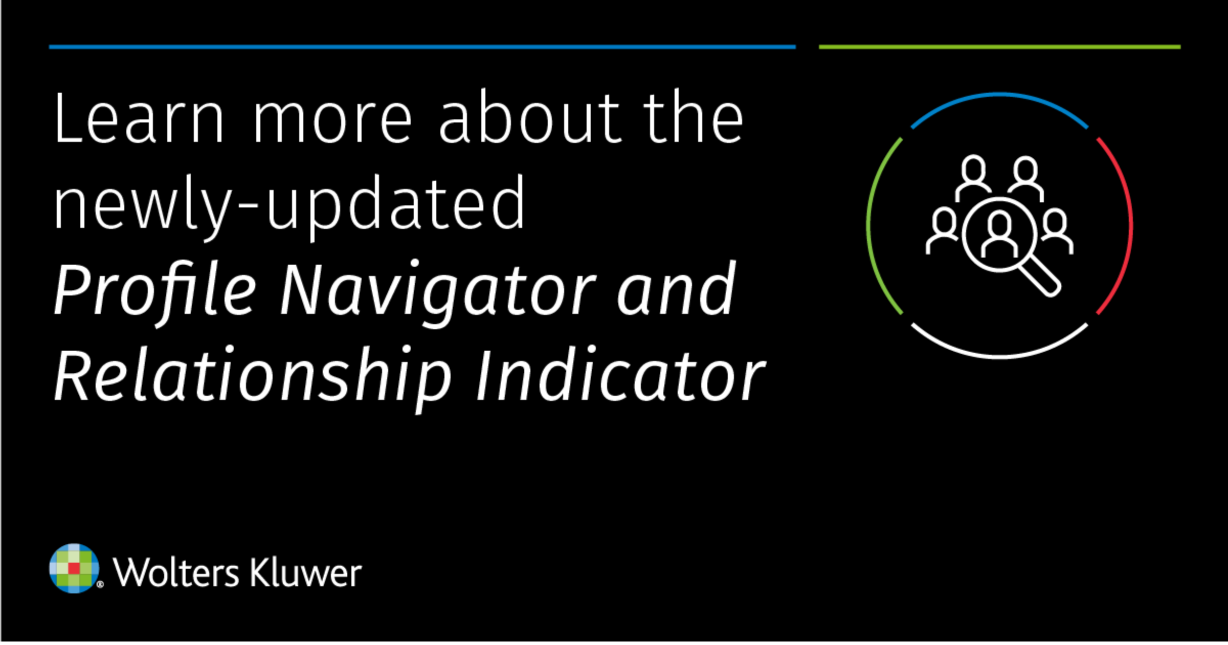
It is easy to see that the explanatory memorandum's construction, fueled by the desire not to back down, at least formally, from the initial anti-arbitration stance, would result in a controversial plight. It is hoped that courts will rely on what the legislature actually said and not on what it claims to have wanted to say. Notably, legislative intent is relevant only when the statutory language is not clear or it can be reconciled with the statutory language, and the statutory language suggests that the age of "no arbitration" is over.

All in all, Hungary's mutiny against the entrenched principle of international dispute settlement proved to be short-lived and appeared very much to be an up-hill battle. Hungary, for economic reasons, had little choice but to back down from its initially harsh approach. The teachings of the Hungarian arbitration saga appear to be clear. Arbitration may be good or bad, but it is the mechanism for settling international (commercial) disputes, which cannot be departed from through unilateral measures.

To make sure you do not miss out on regular updates from the Kluwer Arbitration Blog, please subscribe here. To submit a proposal for a blog post, please consult our Editorial Guidelines.

Profile Navigator and Relationship Indicator
Includes 7,300+ profiles of arbitrators, expert witnesses, counsels & 13,500+ relationships to uncover potential conflicts of interest.

Learn how **Kluwer Arbitration** can support you.



This entry was posted on Friday, December 2nd, 2016 at 10:52 am and is filed under Arbitrability, Arbitration, Hungary
You can follow any responses to this entry through the Comments (RSS) feed. You can leave a response, or trackback from your own site.