

# Kluwer Arbitration Blog

## Joining the Positive Trend: Lessons from Hungary on Pathological Arbitration Clauses

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A recent international arbitration case administered by the Permanent Arbitration Court attached to the Hungarian Chamber of Commerce and Industry (“*HCCI Arbitration Court*”) demonstrated that Hungary follows the international trend in dealing with the enforceability of pathological arbitration clauses.

Arbitration clauses are pathological if they contain defective elements, thus making their interpretation at best uncertain, but more likely impossible. These defects may make arbitration clauses either difficult and costly to comply with or, in case of irreparable defects, may even make the parties’ agreement to arbitrate invalid or unenforceable.

Arbitration agreements may be pathological if they lack specificity, fail to conclude a valid agreement to arbitrate, inaccurately designate the arbitration institution or even refer the dispute to a non-existent arbitration institution. In the last decade we witnessed the emergence of hybrid arbitration clauses which may also be fertile ground for pathological outcomes: something the Hungarian arbitration community has just been faced with in the case that is the very topic of this post.

### Pathological Arbitration Clauses in Hungary

A recently decided arbitration case paints a very realistic picture of the Hungarian experience with pathological arbitration clauses. The applicable dispute resolution clause provided for the arbitration to be administered by the [HCCI Arbitration Court](#) with an interesting twist: the parties chose to apply the rules of procedure of the International Chamber of Commerce (“*ICC*”). The clause provided as follows:

*The Parties agree that the **Court of Arbitration attached to the Hungarian Chamber of Commerce and Industry** is the most appropriate and convenient court to settle all disputes, controversies or claims arising out of or in connection with his Agreement, including any question regarding their existence, validity, breach or termination and finally settled under the **Rules of arbitration of the International Chamber of Commerce (“Rules”)** in force at the time the proceedings are*

*commenced, which Rules are deemed to be incorporated by reference to this section. The number of **arbitrators shall be three (3), appointed in accordance with the Rules**. The seat of arbitration shall be Budapest, Hungary. The language of the arbitration shall be English.*

During the subsequent arbitration procedure, the respondents raised a jurisdictional objection, arguing that the arbitration clause is contradictory as the parties had effectively stipulated the jurisdiction of two arbitral institutions. The respondents contended that the effect of the clause was that the parties submitted the resolution of their disputes to the HCCI, and by virtue to the ICC at the same time by referencing the applicability of its Rules, which state that parties arbitrating under them accept that their case be administered by the ICC. They argued that the two institutions could not act simultaneously.

The respondents explained that the inoperable nature of the arbitration agreement was also demonstrated by the fact that the HCCI Arbitration Court operating under the ICC Rules could not submit the draft award to the ICC for scrutiny, which would not be consistent with the will of the parties.

They argued that the incorporation of the ICC Rules also contradicted the mandatory rules of the *lex arbitri*, as the Rules state that the presiding arbitrator must be appointed by the ICC. In their view this contradicted the [Hungarian Arbitration Act](#), which prescribes that the arbitral tribunals under the auspices of the HCCI Arbitration Court must be constituted according to its own rules of procedure (“**HCCI Rules**”).

Based on the above, respondents stated that the arbitration agreement could not be applied as intended by the parties, making the arbitration clause completely invalid.

### **The Decision of the Arbitral Tribunal**

The tribunal, in its decision on jurisdiction, ruled that the arbitration agreement, although partially invalid, was operable and enforceable.

The tribunal explained that the intention of the parties was to submit their dispute to arbitration under a hybrid scheme. In this vein it noted that the HCCI Rules allow for derogations: the parties could derogate from its provisions or substitute them with rules from another arbitral institution as long as they do not violate the *lex arbitri*. The tribunal also stated that the intention of the parties was not to submit their dispute to the ICC, but to derogate from the HCCI Rules and to apply the ICC Rules to the fullest extent possible.

With regards to the jurisdiction, the tribunal ruled that the mandatory provisions of the Hungarian Arbitration Act expressly state that the HCCI Arbitration Court may only carry out its function regarding the administration of the arbitration in accordance with the HCCI Rules. In this vein, the provisions of the ICC Rules, stating that only the ICC is allowed to administer arbitrations under the Rules, was found to be inapplicable as the parties deviated from this provision by designating the HCCI Arbitration Court as the administering institution. Thus, the arbitral tribunal ruled that the HCCI Arbitration Court shall administer the arbitration under its own rules, while the ICC Rules, to the extent they are enforceable, shall be applied to the conduct of the procedure.

With regards to the arbitration clause prescribing that the arbitrators shall be appointed in accordance with the ICC Rules, the tribunal came to the conclusion that they are invalid and unenforceable as they are contrary to the mandatory provisions of the *lex arbitri* which provides that in procedures administered by the HCCI, the appointment of arbitrators shall be conducted in accordance with the HCCI Rules.

### **The Decision of the Hungarian Court**

Following the tribunal's decision on jurisdiction, the respondents promptly challenged it before the Metropolitan Court of Budapest<sup>1)</sup>, which, however, confirmed the decision of the tribunal.

It stated that the arbitration agreement is not contradictory given the fact that the parties clearly stipulated the jurisdiction of the HCCI Arbitration Court, unlike that of the ICC. The court ruled that the parties acted lawfully in stipulating the jurisdiction of the HCCI Arbitration Court with the simultaneous application of the ICC Rules and that the parties are free to agree on the rules applicable to their procedure, notwithstanding the fact that the ICC Rules state that only the ICC may deal with cases under the ICC Rules.

The court agreed with the tribunal on the partial invalidity of the arbitration agreement regarding the constitution of the tribunal according to the ICC Rules. However, while assessing whether to consider the complete arbitration agreement invalid as a result, it referred to the invalidity clause of the contract, obliging the parties to replace such clauses with valid terms as close as possible to the original intentions. Given the fact that the arbitration agreement left no doubt that the parties did not wish to submit their disputes to state courts, and that their intention was clearly to have the HCCI Arbitration Court decide on them, the court noted that it would be unreconcilable with the will of the parties to declare their entire arbitration clause invalid based on its invalid terms regarding the constitution of the tribunal.

Based on the above, the court ruled that the will of the parties was best served by allowing the HCCI to decide their dispute.

### **Possible Ways to Salvage Pathological Clauses**

This Hungarian decision follows the international trend of [courts](#), [arbitration institutions](#) and [tribunals](#) around the world trying to salvage pathological clauses whenever possible, while simultaneously trying to preserve the original intention of the parties. Tribunals and courts may rely on the intention of the parties to arbitrate, the drafting history of the arbitration clause or even the declarations of the parties regarding the clause.

When it comes to the options for arbitration lawyers regarding such clauses, they first need to ascertain whether there is a possibility to arbitrate at all or if the client's only real option is to seek remedy from the courts? If they conclude that the pathology of the clause may be overcome in full, or at least to a certain extent, they need to settle on the most appropriate forum for the procedure. This could be either an arbitral institution that was most likely the intended forum of the parties, but they may even try to resort to *ad hoc* arbitration. These options should be carefully examined on a case-by case basis.

## Conclusion

The tale of this hybrid arbitration clause shows that Hungary is a friendly jurisdiction towards arbitration, and is open to taking a progressive approach to preserve the intention of the parties to arbitrate as much as possible. This arbitral decision as well as the court precedent will be able to guide practitioners confronted with pathological arbitration clauses referencing hybrid procedures in Hungary.

More importantly, however, these decisions are going to be yet another addition to the growing number of international cases dealing with pathological arbitration clauses. This is rather important as the dilemma is always the same, irrespective of whether one operates in the domestic or the international arena: can the parties' intention to arbitrate according to their hybrid arbitration clause be respected or are the risks of inoperability too much to bear?

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**The contributors were involved in the case.**

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## References

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