Kluwer Arbitration Blog

Can the Inability to Bear Arbitration Costs Render the Arbitration Clause Unenforceable? According to the Polish Supreme Court, It Can

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The Polish Supreme Court ("PSC") found an arbitration clause unenforceable due to the impecuniosity of one of the parties. This blog post discusses the decision, puts it in the broader context of international and EU law, and considers its relevance to the Court of Justice of the EU ("CJEU") intra-EU commercial arbitration case law.

Polish Supreme Court Findings: Unenforceability of the Arbitration Clause

On 19 January 2024, the Polish Supreme Court annulled a decision (*postanowienie*) of the Warsaw Court of Appeals (decision Warsaw Court of Appeals (II CSKP 897/22) which enforced an arbitration agreement between Polish and Luxembourgish parties. The Warsaw Court of Appeals rejected the plaintiff's argument that the lack of financial resources to conduct arbitral proceedings can cause invalidity or unenforceability of the arbitration clause and found that parties to an arbitration agreement are responsible for their ability to cover arbitration costs. Interestingly, the Court of Appeals noted that the plaintiff failed to, *inter alia*, prove a failed attempt to obtain third party funding.

According to the Supreme Court, which relied on, *inter alia*, European Convention of Human Rights ("ECHR"), art. 6(1) and Charter of Fundamental Rights of the European Union, art. 47, the "objective financial inability" to bear arbitration costs does not make the arbitration clause invalid under Polish Civil Procedure Code ("CPC"), art. 1168(2). It can, however, render the arbitration clause unenforceable within the meaning of CPC, art. 1165(2). Although the need to soften the law in a similar situation had been suggested before, this is a landmark decision.

According to the PSC, removing a dispute from the state court system is an expression of party autonomy. This autonomy, however, is limited by the fundamental right of access to a court. While an arbitration clause allows parties not to refer their dispute to a state court, it does not waive judicial protection. Instead, it is a choice of a different dispute resolution mechanism, ensuring protection equivalent to that provided by state courts.

The PSC acknowledged that arbitration costs, including for legal representation, could present an objective barrier to accessing both courts and arbitration tribunals. The objective inability to bear

the costs at the time of adjudication implies a permanent obstacle in this context, although a hypothetical improvement in the plaintiff's financial situation cannot be excluded. In doing so, the PSC distinguished between assessing the financial situation of a natural person (in this case) and that of a legal person. In this regard, rejecting a claim solely due to the impecunious party's inability to initiate and conduct proceedings before an arbitral tribunal would amount to denial of judicial protection. This, according to the PSC, would be an unacceptable outcome, in view of the importance of the right to justice and the purpose of arbitration clauses. However, the PSC clarified that the unenforceability of an arbitration clause is not simply tied to the claimant's inability to bear the costs of arbitration: "A declaration of unenforceability of the arbitration clause should be the ultima ratio in the event that the financial impediment cannot be removed in the arbitration proceedings under the applicable rules allowing arbitration institution to temporarily assume the costs of arbitration or otherwise mitigating the burden of their payment, if available, or – with the involvement of the opposing party, which seeks to preserve the effect of the arbitration clause and have the case heard by an arbitral tribunal, who may declare the payment of the costs necessary to commence and conduct the arbitration proceedings." The PSC recalled here the Swiss Federal Tribunal decision in *A v Union Cycliste Internationale*, *4A 166/2021*.

International and EU Law Context

The PSC based its decision on, *inter alia*, ECHR, art. 6(1), aligning with the European Court of Human Rights' ("ECtHR") stance that prohibitive costs of legal proceedings may impact the right of access to court. In this context, it is noteworthy that to date the ECtHR has repeatedly found that Poland violated this right due to, *inter alia*, excessive court fees (*e.g.*, *Kreuz v. Poland*). In particular, the Strasbourg court considered that the amount of fees assessed in the light of the circumstances of a given case, the individual's ability to pay them or the stage of the proceedings at which that restriction had been imposed, are all key factors for determining whether the right of access to justice has been breached. The ECtHR has also ruled that a court fee system based on the amount in dispute must take into account individual's financial situation, while it has shown reluctance to adopt the "loser pays principle" or the absolute principle of each party bearing its own costs. Also the CJEU considered the prohibitive costs in light of the Charter of Fundamental Rights of the European Union, art. 47 on multiple occasions.

At the same time, the PSC also seems to embrace ECtHR reservations that the party seeking an exemption from costs must act diligently and in good faith, with the duty of care being even higher for entrepreneurs.

As noticed by Gary Born with respect to arbitration, courts are "generally reluctant [to] invalidate arbitration agreement on unconscionability grounds in commercial settings." Unconscionability challenges related to fees have been predominantly rejected by courts in both common law and civil law jurisdictions. Previous blog posts here and here addressed the issue of non-payment of the advance on costs.

Nevertheless, an arbitration agreement has been deemed invalid or "incapable of being performed" due to the financial burdens that a party cannot bear (*e.g.*, in Germany), the "prohibitive" costs of arbitration (*e.g.*, in the US), or the existence of significant financial disincentives for a party to pursue its legal rights (also in the US). Arbitration agreements have also been declared unenforceable because of a party's inability to pay arbitral costs. Moreover, it has been argued that

arbitration costs may be considered a public policy matter, as exemplified by Singaporean setting-aside decisions. Two authors categorized the approaches regarding the impact of impecuniosity on international arbitration to substantive and jurisdictional that is, respectively, addressing the challenge as a matter of contract enforcement or shifting it to the competence-competence level.

In this respect, the PSC decision is yet another voice embracing unenforceability of an arbitral agreement on financial grounds and the written reasoning attempted to set a standard for balancing the party autonomy and *pacta sunt servanda* in commercial relations on one hand, and access to justice on the other hand.

Similarly to the German Federal Supreme Court's decision (III ZR 33/00), which gave consideration to the other party's capacity to seek effective protection in state courts, PSC noted that it may also be necessary to consider other circumstances. In this context the Court used the example of strong considerations in favor of the arbitration from the point of view of the interests of the other party, which may relate to the neutrality of the arbitral forum and the suitability of the award for recognition and enforcement abroad. The Court went on to hold that, even if the situation were to be viewed as a conflict between the principle of *pacta sunt servanda* and the right of access to a court, priority must be given to the latter because of its primary nature vis-à-vis the secondary choice of forum for dispute resolution (Portuguese Constitutional Court, Ruling No. 311/08). Furthermore, the plaintiff's contribution to his or her bad financial situation – unless he or she acts in bad faith – does not affect the assessment of the objective impecuniosity.

Despite this brief comment, the PSC decision does not shed light on the court's reasoning on the other party's position *ad casu*, which is a missed opportunity given the international context of the matter, where the recourse to arbitration may be an answer to the limitations of the domestic judiciary. Quite astonishingly, it took the parties more than 4 years since the initiation of the proceedings before the Polish courts, to have the preliminary procedural issue decided by PSC – without any decision on merits in sight!

Implications in the EU

The time of the decision is equally important. Preceding the current discussions on the compatibility of investment arbitration with EU law, the CJEU had already showed caution regarding commercial arbitration. Amongst others, in *West Tankers*, the CJEU found that the Brussels I Regulation covered the validity of arbitration agreements but did not confer authority upon courts to issue anti-suit injunctions (see also *London Steamship*). In *Eco Swiss*, the CJEU held that EU competition law was an element of public policy, the violation of which warranted the annulment of an arbitral award. The same principle was applied in examining the compatibility of an arbitral award with EU consumer protection law in *Mostaza Claro*. Most recently, the CJEU annulled the General Court's judgment in *International Skating Union v Commission ("ISU")*, finding that the Court of Arbitration for Sports' exclusive and compulsory jurisdiction reinforced infringement of EU competition law (*see also* previous coverage on the Blog here and here). While the Swiss seat of arbitration seemingly played a key role in the *ISU* case, certain aspects of the judgment appear to align with other CJEU decisions indicating a reluctance towards intra-EU arbitration.

Several noteworthy aspects emerge in this context:

- The decision of the PSC aligns with the recent skepticism of EU institutions to arbitration;
- The decision combines a restrictive approach towards arbitration with the protection of fundamental rights, which may be invoked by the CJEU in marginalizing arbitration in the EU legal space;
- The timing of the decision bears particular relevance for Poland. The bench comprises judges who were actively involved in the fight to protect independence of the judiciary against political pressure of the previous government. It thus sends a clear message of restoring the rule of law. On the other hand, the government responsible for the 2015-2023 rule of law crisis took a confrontational stance against Investor-State Dispute Settlement (see previous Blog coverage here). As a result, the EU and domestic trends converge, strengthening anti-arbitration moods.

Conclusion

Given that the CJEU fight against intra-EU arbitration is taking place under the banner of judicial dialogue and mutual trust, the Polish decision could have resonated much stronger than its *ad casu* character might suggest. Ultimately, this is unlikely. The news of the publication of the operative part of the award (without justification) electrified the arbitration community. Unfortunately, after a tense wait, it turned out that the justification of a potentially significant decision is limited. The time will show if it has any broader ramifications.

This entry was posted on Thursday, March 21st, 2024 at 10:30 am and is filed under Poland
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