Kluwer Arbitration Blog

What Limits Does German Law Impose on Externally Determined Arbitration Agreements in Sports and Commercial Arbitration?

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The analysis of the decision of the Federal Constitutional Court (*Bundesverfassungsgericht* – the "Court") dated 3 June 2022 (1 BvR 2103/16) in the Pechstein case (the "Pechstein Decision", also covered in a previous post) shows constitutional limits to arbitration agreements that are externally determined, *i.e.*, agreements whose content can be *de facto* determined unilaterally by one party.

As described in this post, it follows from the Pechstein Decision that such agreements, including underlying arbitration rules, must comply with the right to a fair trial and otherwise threaten nullity, both in sports arbitration and commercial arbitration.

The Pechstein Saga: Procedural Background

The case arises out of the 2 years doping suspension issued by the International Skating Union ("ISU") against German speed skater and five-time Olympic champion Claudia Pechstein because of an increased blood count. She claimed that this count was due to an inherited blood disease and appealed before the Court of Arbitration for Sport ("CAS"), which was agreed as arbitration due to the pre-formulated competition conditions of the ISU.

The CAS first dismissed the athlete's request for a public hearing and dismissed her claim. Ms Pechstein unsuccessfully challenged the arbitral award before the Swiss courts. The case subsequently came under the review of the European Court of Human Rights ("ECtHR"), which issued its ruling on 4 October 2018 (40575/10 and 67474/10, previously discussed here). In parallel, the award was also challenged before the German courts, so far resulting in the Pechstein Decision reversing a judgment of the German Federal Court of Justice (*Bundesgerichtshof*) dated 7 June 2016 (KZR 6/15, previously discussed here) and remanding the case to the Higher Regional Court of Munich.

Decision of the Court

According to the Pechstein Decision, the constitutional limits of externally determined arbitration

agreements are governed by the right to a fair trial balanced against the freedom of contract and the protection of private autonomy (para. 41). The violation of these constitutional limits can constitute a violation of the general principles of civil law, like Section 134 of the German Civil Code ("BGB") in conjunction with Section 19 of the German Competition Act, regarding prohibited conduct of dominant undertakings, or Section 138 of the BGB, regarding the prohibition of legal transactions offending common decency. These fundamental rights and general clauses do not only apply to sports arbitration, but also to commercial arbitration.

The Right to a Fair Trial

The right to a fair trial guarantees access to state courts. In the case of arbitration agreements, the limitation of the right to access state courts is generally legitimized by freedom of contract. However, this does not apply to externally determined arbitration agreements, because they lack private autonomy. Instead, a balancing of interests is required (para. 40 et seq.).

In sports jurisdiction, the legitimacy lies in the necessity to ensure internationally uniform sports jurisdiction and an effective international anti-doping policy (para. 40). Conversely, in commercial arbitration, it is generally not readily necessary for the functioning of trade and the economy. Nevertheless, the legitimacy of an externally determined arbitration agreement is also possible here, if the arbitration proceedings are in the interests of both parties, depending more on the individual circumstances.

Principle of Publicity of Oral Hearings

The right to a fair trial also includes the principle of public hearings in arbitration and an externally determined arbitration agreement that excludes a public hearing must be judged against this principle (para. 48 et seq.). It requires that one of the recognized exceptions as listed in Article 6 para. 1 of the European Convention on Human Rights applies or that the non-public nature of the proceedings is in the mutual interest of the parties or in the overriding interest of one party.

In the Pechstein Decision, the athlete's interest—being able to publicly defend herself against the already public accusation of doping—is most likely to prevail. By contrast, in commercial disputes the interest in non-publicity might be most likely to prevail, if they involve business secrets or internal affairs of family companies.

Like the ECtHR, the Court found that the 2004 CAS Code of Sports-related Arbitration ("CAS Code") violates the principle of publicity. The amended 2023 CAS Code still violates the principle of publicity. In provision R57 para. 2 sentence 3, it defines the principle of publicity much more narrowly than the right to a fair trial. In particular, it only applies to natural persons, but not to legal persons. The same applies to Section 28 of the 2016 DIS Sport Arbitration Rules.

In commercial arbitration, the 2021 ICC Arbitration Rules and the 2018 DIS Arbitration Rules, for example, do not contain a right to publicity of oral hearings. Therefore, a breach of the principle of publicity can only be avoided by individual contractual provisions.

Principle of Neutrality and Distance of the Judge Towards All Parties

The Court expressly left open a violation of the principle of neutrality and distance of the judge towards all parties (para. 53). However, it made clear that the decision of the ECtHR, rejecting a violation by the majority, does not preclude the assumption of a violation of the right to a fair trial under German constitutional law. Furthermore, the Court refers to its case law and especially its decision dated 22 March 2018 (2 BvR 780/16), where it already allows the "bad appearance" of a lack of objectivity to suffice.

It follows that the violation of the said principles does not require a qualified impairment in the sense of a structural imbalance. Rather, even reasonable doubts about impartiality are sufficient, for example if the rules on the appointment of arbitrators provide an incentive to favor one party.

Accordingly, the 2023 CAS Code also violates the principle of neutrality. This is because, pursuant to provision S14 CAS Code, the International Council of Arbitration for Sport ("ICAS") shall determine who can become and remain an arbitrator despite the fact that it only includes representatives of the international sports federations and Olympic committees, but not of the athletes. In this regard, the number of people on the list of arbitrators is no indication of their independence, quantity is no substitute for quality. Anyone who wants to become and remain an arbitrator at the CAS must ultimately convince the federations, but not the athletes, not only when nominated, but also during the arbitration proceedings. In addition, the chairman of the arbitral tribunal is appointed by the president of the CAS appeals division, who in turn is elected by the ICAS.

This is not without an alternative. For example, the list of arbitrators could be an open list or determined by a neutral body or in part by the athletes' commissions. The chairman could be appointed by agreement between the arbitrators appointed by the parties or by a neutral person.

In commercial arbitration the arbitration organizations are generally neutral. Therefore, their arbitration rules usually do not constitute a violation.

Consequences and Key Takeaways

The guarantees of the right to a fair trial apply at the level of ordinary law, particularly with regard to the validity of the arbitration agreement. A breach leads to nullity under the general principles of civil law.

In the case of domestic awards, partial invalidity is conceivable, in which the statutory or constitutional provision can replace the void provision. In the case of foreign awards, the violation of the right to a fair trial leads to invalidity and violates public policy. The arbitration objection (Section 1032 para. 1 of the German Code of Civil Procedure) does not apply. Recognition must be refused and enforcement of the arbitration award must be rejected without preclusion taking effect.

The 2023 CAS Code violates both the principle of publicity and the principle of neutrality and distance of the judge derived from the right to a fair trial and thus the public policy. They therefore result in the invalidity of the arbitration agreements and the refusal to recognize and enforce the arbitration awards based on them.

The DIS Sport Arbitration Rules are partially invalid with regard to the principle of publicity. With regard to the principle of neutrality and distance of the arbitrator, their application is unclear and creates the risk of an improperly constituted arbitral tribunal.

In commercial arbitration, for externally determined arbitration agreements a right to publicity of the hearing should be provided in case the usual exceptions do not apply nor overriding interests in confidentiality exist. This can be done in individual contracts. However, it would make more sense to include corresponding provisions in the arbitration rules, for example in Article 26 of the ICC Arbitration Rules and Article 29 of the DIS Arbitration Rules. It would be even more consistent to regulate this by law.

Conclusion

Overall, the Pechstein Decision has resulted in clearer limits for domestic and, above all, foreign arbitration agreements and awards, which help to strengthen the central principles of the rule of law, both in sports arbitration and commercial arbitration. In this respect, the arbitration rules of many international arbitration organisations deserve a review.

The above is an abbreviated version of an article published in the SchiedsVZ | German Arbitration Journal, Vol. 22, No. 1 (2024), which is also included on Kluwer Arbitration. See here for more information on and other contributions to the Journal.

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This entry was posted on Monday, May 13th, 2024 at 8:07 am and is filed under Due process, German Federal Constitutional Court, Germany, SchiedsVZ
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