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CURRENT DEVELOPMENTS

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∗

I. INTRODUCTION

In 2011 and 2012, the Hungarian parliament enacted laws that excluded arbitration for disputes involving Hungarian national assets. These provisions were fiercely criticized because they arguably ran counter to international treaty law and were, from a business perspective, not sustainable. In 2013, the anti-arbitration provisions passed the test of the Hungarian Constitutional Court ("CC"), which refused to pronounce them unconstitutional and, in a controversial judgment, established that they were not irreconcilable with international treaty law. However, the concerns related to economic sustainability proved to be real: in 2015, Hungary revoked these provisions in order to execute a major international economic transaction.

This article presents and analyzes Hungary's recent legislative efforts and ultimate failure to exclude arbitration in matters involving Hungarian national assets, demonstrating the difficulties a country faces if it attempts to defy the prevailing pattern of dispute settlement in international trade. The lesson of the Hungarian arbitration saga is that, unsurprisingly, arbitration is not only a "take it or *leave it*," but even a "take it or *leave*" rule of the club of international economic relations.

II. THE ANTI-ARBITRATION PACKAGE

The Hungarian rules adopted in 2011 and 2012 prohibited entities in charge of national assets from agreeing to arbitration and declared cases concerning national

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∗ Csongor István Nagy, LL.M., Ph.D., S.J.D, dr. juris is a professor of law in Hungary, the head of the Department of Private International Law at the University of Szeged, Faculty of Law, and research chair and the leader of the Federal Markets "Momentum" ("Lendület") Research Group of the Hungarian Academy of Sciences. He is admitted to the Budapest Bar. Furthermore, he is recurrent visiting professor at the Central European University (Budapest/New York), the Riga Graduate School of Law (Latvia) and the Sapientia University of Transylvania (Romania). This paper is based on research supported by the Hungarian Scientific Research Fund, within the framework of the OTKA PD-101612 research program. When writing this paper, the author was senior research fellow with the International Law Research Program of the Center for International Governance Innovation and gratefully acknowledges its support. The author is indebted to Professor Tibor Várady for his comments on an earlier draft of this article. Of course, all views and any errors remain the author's own.

assets to be non-arbitrable ("anti-arbitration provisions"). Section 17(3) of Act CXCVI of 2011 on National Assets provided that in civil-law contracts concerning national property "being on the territory delimited by the borders of Hungary," the person having the right of disposition over the national property could stipulate only the Hungarian language, Hungarian law and the jurisdiction of Hungarian courts, to the exclusion of arbitration; the person in charge of national assets could not stipulate arbitration for the settlement of these legal disputes. Section 4 of Act LXXI of 1994 on Arbitration, listing non-arbitrable disputes, was extended to legal disputes concerning national assets that came within the scope of the Act on National Assets and that were "on the territory delimited by the borders of Hungary" or any right, claim, or demand related to this.[1]

As provided in Section 17(1) of the Act on National Assets, Section 17(3) had no retrospective effects (the new provision did not concern rights and obligations that were acquired lawfully and in good faith). However, the amendment of Section 4 of the Act on Arbitration did not try to preclude retrospective effects: it provided that the extension of non-arbitrability had to be applied in procedures launched after the amendment's entry into force,[2] irrespective of whether the arbitration agreement had been lawfully and validly concluded before this date. Accordingly, only pending matters were immune from this rule; all other arbitration covenants were supposed to be unilaterally invalidated.

III. THE HUNGARIAN CONSTITUTIONAL COURT'S JUDGMENT ON THE ANTI-ARBITRATION PROVISIONS' CONFORMITY WITH INTERNATIONAL TREATY LAW AND CONSTITUTIONAL REQUIREMENTS

The above provisions were fiercely criticized in the scholarly literature.[3] The Commissioner (Ombudsman) for Fundamental Rights requested the Hungarian Constitutional Court ("CC") to establish that the anti-arbitration provisions ran

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[1] This was inserted by Section 2 of Act LXV of 2012 and entered into force on June 13, 2012.

[2] *I.e.*, Act LXV of 2012, Sec. 4 (June 13, 2012).

[3] See Miklós Boronkay & György Wellmann, *A választottbíráskodás helyzete Magyarországon*, MTA Law Working Papers 2015/12, ISSN 2064-4515, pp. 6-7, *available at* http://jog.tk.mta.hu/uploads/files/mtalwp/2015_12_Boronkay-Wellmann.pdf; László Kecskés & Péter Tilk, *A nemzeti vagyonról szóló 2011. évi CXCVI. törvény 17. §-a (3) bekezdése választottbírósági kikötést tiltó szabályának Alaptörvénybe, illetve nemzetközi jogba ütközése*, *in* VALASZTOTTBIROK KÖNYVE 213-230 (László Kecskés & Józsefné Lukács eds., 2012); András Dániel László, *Választottbíráskodás nemzeti vagyonnal kapcsolatos ügyekben*, 62(3) MAGYAR JOG 152-60 (2015); Csongor István Nagy, *The Hungarian Constitutional Court's Judgment on Hungary's New Anti-Arbitration Rules*, *in* HUNGARIAN YEARBOOK OF INTERNATIONAL LAW AND EUROPEAN LAW 2014 at 629-38 (Marcel Szabó, Petra Lea Láncos, Réka Varga & Tamás Molnár eds., 2015); István Varga, *A választottbírósági eljárás és az állami bírósági polgári per viszonyrendszerének összefüggései*, *in* EGY UJ POLGARI PERRENDTARTAS ALAPJAI at 639-40 (János Németh, & István Varga eds., 2014).

counter to the 1961 Geneva Convention, the 1958 New York Convention, the 1965 Washington Convention and the bilateral investment-protection treaties concluded by Hungary and fell foul of the requirement of legal certainty;[4] thus, they were unconstitutional.

Article II(1) of the 1961 Geneva Convention expressly establishes that public entities shall have the right to enter into arbitration agreements. Although Article II(2) of the Convention permits signatory states to make a reservation limiting the foregoing right to arbitration, Hungary made no such reservation. It is to be noted that although Article II(2) does embed the possibility of making such a reservation, the exercise of this right is time-limited: signatory states can submit such a reservation only when "signing, ratifying or acceding" to the Convention.

According to the Commissioner, the violation of Article II(1) of the 1961 Geneva Convention also gave rise to a violation of Article II(I) of the 1958 New York Convention, which provides that contracting states must recognize written arbitration agreements covering arbitrable matters: since arbitration agreements entered into by public entities should be arbitrable, Article II(I) of the 1958 New York Convention obliges contracting states to recognize these agreements.

The Commissioner also referred to Article 25 of the 1965 Washington Convention: although the jurisdiction of ICSID is not mandatory, that is, ICSID has jurisdiction over a case only if "the parties to the dispute consent in writing to submit it to the Centre," once the parties agree to the jurisdiction of the ICSID, "no party may withdraw its consent unilaterally." However, contracting states may exclude certain classes of disputes from the jurisdiction of ICSID; the exercise of this right of reservation is not time-barred: this may occur "at the time of ratification, acceptance or approval of this Convention or at any time thereafter."

In essence, the CC rejected the Ombudsman's request on the ground that the exclusion of arbitration did not violate treaty law categorically and the frustration of legitimate expectations could be dealt with effectively through the adoption of "constitutional requirements," which were meant to ensure that the exclusions could not be applied to arbitration agreements and treaties retrospectively (that is, the legal status of the agreements and treaties concluded before the entry into force of the anti-arbitration provisions was not impaired).[5]

First, the CC held that it is a "constitutional requirement" that the new rules must not have retrospective effects: they cannot frustrate legitimate expectations and cannot impair validly concluded arbitration agreements. Although this principle did appear explicitly in Section 17(1) of the Act on National Assets, no such rule was established as to Section 4 of the Act on Arbitration; on the contrary, with the exception of pending procedures, the extension of non-arbitrability entered into force with immediate effect.[6] However, the CC extrapolated the rule enshrined in Section 17(1) to new Section 4. It should be

[4] The Commissioner's request is presented in ¶¶ 1-12 of the CC's judgment. Case number: II/03736/2012; number of the Constitutional Court's judgment: 14/2013.

[5] *Id*. ¶¶ 21-92.

[6] *Id.* ¶¶ 40, 51 & 63.

noted that the purpose of "constitutional requirements" is not to amend the legal provision under review (if it had to be amended to bring it in line with the constitutional requirements, the law would have to be set aside). "Constitutional requirements" can be used only if the legal norm has more than one reasonable interpretation and at least one of them is in accord with the constitution. As to Section 4, the constitutional requirements could obviously not be reconciled with the statutory language.

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.[7] 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.[8] 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; 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 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.[9] 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.[10]

It is easy to disagree with the CC's analysis. However, even if it is accepted that the above reasoning is persuasive in doing away with the violation of international treaty law (and disregarding that the fact that a state can make a reservation does not imply that it is free from the obligation in case it does not make the reservation and in particular, if such a reservation is time-barred and can no longer be made), the Court would have been expected, as it usually does in such matters, to call on the legislature to take the necessary steps (either to repeal the anti-arbitration provisions or to submit reservations or to denounce the treaty concerned) and to set a deadline for this purpose. However, surprisingly, even though these options did emerge in the judgment's reasoning, they did not appear in the operative part.

As far as the CC's substantive analysis is concerned, it seems that it either blatantly misinterpreted the relevant rules of arbitration treaty law or it treated rules that blatantly violated the norms of public international law very mildly. Probably the gravest flaw was that it treated unilaterally terminable obligations as

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[7] *Id.* ¶¶ 40-41 & 48-52.
[8] *Id.* ¶¶ 55-57.
[9] *Id.* ¶¶ 64-65.
[10] *Id.* ¶ 75.

non-existent. Although according to Article 25(4) of the 1965 Washington Convention, contracting states do have the right to exclude a class or classes of disputes from the jurisdiction of ICSID and such reservations can be made "at any time," Hungary had made no such reservation. Hence, the obligations emerging from the Convention were unrestricted. It appears to be easily understandable that the possibility to restrict one's involvement in a convention does not imply that one's involvement has actually been restricted. This error is even more salient as to the 1961 Geneva Convention, since here the reservation was time-barred; according to Article II(2), such reservation could have been made only "[o]n signing, ratifying or acceding to this Convention" but no such reservation was made at that time. Justice Dienes-Oehm puts this very succinctly in his dissenting opinion: since no reservation was made, the violation of the treaty had already occurred at the time the new provisions entered into force.[11] Thus, in the context of the 1961 Geneva Convention, it appears to be even clearer that the mere possibility of denouncing a convention does not imply that it is not binding. The efforts of the CC to question that Article II of the 1961 Geneva Convention empowers public entities to stipulate arbitration made the judgment even more strained, when one observes that the title of Article II is the "Right of Legal Persons of Public Law to Resort to Arbitration."

IV. THE REVOCATION OF THE ANTI-ARBITRATION RULES IN 2015: PRIDE AND PREJUDICE?

The anti-arbitration provisions did not stand the test of business reality: they failed very early, suggesting that arbitration is not only a "take it or *leave it*" but even a "take it or *leave*" rule of international economic relations. 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 rules,[12] both Section 17(3) and Section 4 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"[13] and its only purpose is to make clear that international treaties take precedence over the rules

[11] *Id*. ¶ 99.

[12] Act VII of 2015 on the investment related to the maintenance of the capacity of the Nuclear Plant of Paks, as well as on the amendment of certain connected acts (in Hungarian: "2015. évi VII. törvény a Paksi Atomerőmű kapacitásának fenntartásával kapcsolatos beruházásról, valamint az ezzel kapcsolatos egyes törvények módosításáról").

[13] Explanatory memorandum attached to Section 33 of Act VII of 2015 on the investment related to the maintenance of the capacity of the Nuclear Plant of Paks, as well as on the amendment of certain connected acts.

of Section 17(3). 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.

According to new Section 17(3),

> If an international treaty does not provide otherwise, in civil-law contracts concerning national property situated on the territory delimited by the borders of Hungary, the person having the right of disposition over the national property can only stipulate the application of the Hungarian language, Hungarian law and the jurisdiction of the Hungarian court for any legal dispute. The exclusivity of the jurisdiction of the Hungarian courts does not affect the right to stipulate arbitration.

The last sentence of new Section 17(3) clearly seems to suggest that arbitration may be agreed to without any restriction. However, as noted above, a closer look at the explanatory memorandum attached to the legislative proposal may warrant a more cautious approach. And, unfortunately, the poor wording of Section 17(3) might arguably call for the taking into account of the legislative intent embedded in the explanatory memorandum. Namely, the last sentence of new Section 17(3) refers to the "exclusivity of the jurisdiction" (in other words: the exclusive jurisdiction) of Hungarian courts; and not to the rule that exclusively Hungarian courts can be chosen. The term "exclusive jurisdiction" has a clear meaning in Hungarian (and in EU) law:[14] the grounds of exclusive jurisdiction do not operate in parallel with general jurisdiction and the parties may not enter into a choice-of-court agreement in cases coming under exclusive jurisdiction. If, with the purpose of looking behind the statutory language of this sentence, the explanatory memorandum of new Section 17(3) is taken into account, it appears that the legislative intent was not to amend the substance of the provision adopted in 2011 but to make it clear that international treaties take precedence over Section 17(3). According to the explanatory memorandum, new Section 17(3) conveys an important message: it makes clear what, allegedly, has already been the dominant international law interpretation – an international treaty is necessarily considered to be a lex specialis, that is, should take precedence over the prohibition embedded in Section 17(3); the explanatory memorandum asserts that the legal practice in Hungary has already interpreted Section 17(3) in this way, thus "the provision has no new norm-content, and does not qualify as retrospective legislation."[15]

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[14] CSONGOR ISTVÁN NAGY, PRIVATE INTERNATIONAL LAW IN HUNGARY 136-39 (2012).

[15] Explanatory memorandum attached to Section 33 of Act VII of 2015 on the investment related to the maintenance of the capacity of the Nuclear Plant of Paks, as well as on the amendment of certain connected acts.

Accordingly, the explanation attached to the legislative proposal spells out that these amendments cannot be considered to be a backing down; rather they were just meant to make clear what had already been included in these provisions: international treaty obligations had always had precedence. Though this statement may appear to be excessive, it makes clear that the Hungarian legislature aimed at permitting arbitration without fully (or at least formally) abandoning its initial stance. Unfortunately, attempting such a compromise yielded a questionable result.

The construction suggested by the explanatory memorandum, if it were to overshadow the very language of the law, would result in a controversial situation. As noted above, the Hungarian regime on arbitration in matters involving national property was based on two pillars: a ban addressed to entities in charge of national assets not to stipulate arbitration (Section 17(3) of the Law on National Property) and the non-arbitrability of such agreements (Section 4 of the Arbitration Act), which was, presumably, introduced after the realization that an interdiction on Hungarian entities does not necessarily make such agreements illegal. In 2015, the Hungarian parliament swept out the exclusion from arbitrability and amended the ban on Hungarian entities. New Section 17(3) indicates that it does not interfere with international treaties, by introducing this provision with a proviso ("if an international treaty does not provide otherwise"). This phrase was meant to save, in a conceptually flawed manner, the Hungarian-Russian inter-state agreement from the ban of Hungarian law. However, in taking a closer look at the provision it becomes clear that, if the construction suggested by the explanatory memorandum is accepted, the ban embedded in Section 17(3) may be departed from only in case, at the time of the arbitration agreement, there is a preexisting right to arbitration secured by an international treaty. An investment treaty might not be covered by the exception: although it is obviously an international treaty, it cannot create a treaty right to arbitration before it has been concluded, while without that, formally, no arbitration can be stipulated. Accordingly, if the right to arbitrate cannot be deduced from a currently effective international treaty (in force before the conclusion of the proposed investment treaty), it would be difficult to argue that an international treaty provides otherwise.

Article II(1) of the 1961 Geneva Convention establishes the "right of legal persons of public law to resort to arbitration" ("In cases referred to in Article I, paragraph 1, of this Convention, legal persons considered by the law which is applicable to them as 'legal persons of public law' have the right to conclude valid arbitration agreements."). It is noteworthy that although this is exactly the sort of treaty provision that appears to come under the purview of the introductory sentence of new Section 17(3), the CC's judgment on the old version of Section 17(3), unfortunately, complicates the interpretation of the new provision. The CC established, as to the old version of Section 17(3) that fully excluded arbitration, that it did not go counter to Article II(1) of the 1961 Geneva Convention for two reasons: first, it was not clear whether Article II(1) of the 1961 Geneva Convention did authorize public entities to enter into arbitration agreements (that is, the Court, notwithstanding the clear treaty language, did not take the existence of such a right for granted); second, a reservation could be made to this provision

on the basis of Article II(2) ("[o]n signing, ratifying or acceding to this Convention any State shall be entitled to declare that it limits the above faculty to such conditions as may be stated in its declaration"). The CC established that the lack of the right to stipulate arbitration did not infringe Article II of the 1961 Geneva Convention. Be the rationality of this construction as it may, this odd interpretation might arguably suggest that the 1961 Geneva Convention "does not provide otherwise" than Section 17(3).

The situation would be especially dubious as to investment matters. Notably, Article 25 of the ICSID Convention makes the choice of ICSID arbitration optional, without entrenching a specific right to arbitration – it does not provide that signatory states should subject themselves to arbitration; quite the contrary, Article 25(1) of the ICSID Convention provides that the ICSID has jurisdiction only if "the parties to the dispute consent in writing to submit [the dispute] to the Centre."

All in all, 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 the above needless and superfluous argument will be avoided and courts will listen to the words of the law, instead of the alleged intention of the legislature.

V. CONCLUSIONS

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.

Though the Hungarian mutiny failed for economic reasons, it also demonstrates how difficult it is to reconcile a categorical "no arbitration" approach with international treaty law. The CC's (inconsistent) analysis very well reveals this. It is also noteworthy that the anti-arbitration provisions raised a good number of practical problems. For instance, it was doubtful whether, in case of the enforcement of an arbitral award ignoring Hungary's anti-arbitration provisions, the anti-arbitration rules were capable of sheltering Hungary's assets located abroad. Namely, arbitrability for enforcement purposes is governed by the *lex fori* – according to Article V(2) of the 1958 New York Convention: "Recognition 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*" (emphasis added). Accordingly, since contracts concerning national assets are normally arbitrable, Hungary may be able to shield its assets located in Hungary, but may not be able to immunize its assets from enforcement outside Hungary.