

HUNGARY: New bill proposes ban on arbitration with state entities

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The Hungarian parliament is considering a bill that would make domestic arbitration of high-value disputes involving state entities illegal. János Tamás Varga and Zoltán Csernus, partners at VJT & Partners in Budapest, say the proposed change could end up encouraging recourse to international arbitration.



The bill, which is being debated by the parliament and is likely to be adopted, contains an amendment to the Hungarian Arbitration Act. The Act was drafted in accordance with the UNCITRAL Model Law and governs domestic ad hoc and institutional arbitral tribunals as well as some aspects of proceedings before arbitral tribunals seated outside Hungary.

The planned modification

The amendment would only affect arbitration clauses in disputes with a claim exceeding 400 million Hungarian forints (approximately €1.3 million) where either the Hungarian state, a state entity (a municipal government or a state agency) or a state-controlled company is a party to the proceedings. It would apply not only to contracts that are concluded after the amendment comes into force but also to existing contracts and their arbitration clauses.

The official explanation for the need for this change is that arbitration does not currently allow for an appeal to a court of second instance, and therefore does not meet the requirements of high-level protection for public property.

The current wording of the bill may give ground for some interpretive disagreements, as it applies to arbitration proceedings in high-value “litigation”, not in cases of high-value claims. According to Hungarian law, litigation is a process before ordinary courts; therefore if a claimant initiates arbitral proceedings at a Hungarian arbitral tribunal in accordance with the contract, the claimant may argue that there is no litigation and thus the amendment does not apply.

Notwithstanding this vague wording, it is clear that the amendment will apply only to arbitration clauses stipulating domestic (Hungary-based) arbitral tribunals. This is because the bill amends the Act (as it applies to domestic arbitration proceedings) without amending the geographical scope of the Act. Consequently the Act would not exclude the use of arbitration clauses stipulating foreign arbitral tribunals in contracts where the Hungarian state, a state entity or a state-controlled company is a party to the contract.

Possible impacts

If, as a result of the adoption of the amendment, arbitration clauses in investment agreements which stipulate Hungarian arbitral tribunals as the forum for dispute resolution do become invalid and non applicable, then the following rules will apply:

Bilateral investment treaties (BITs)

If there is a BIT between Hungary and the foreign state where the investor is resident, then the BIT's provisions for dispute resolution will apply. Most such BITs stipulate international (ad hoc or institutional) arbitral tribunals as a forum for dispute resolution available to the investor. If the investor seeks legal recourse through an arbitral tribunal, and the award of such tribunal is enforceable under the New York Convention of 10 June 1958 as to the enforcement of arbitral awards, then such award will be enforceable in Hungary.

It is important to mention that some BITs, despite the said arbitral option available to the investor, do not remove the right of the state, state entities and state-controlled companies to launch litigation against the investor through Hungarian state (ordinary) courts, therefore even in case of the existence of BITs, litigation involving an investor in the Hungarian state (ordinary) courts cannot be excluded.

Non-BIT options for EU-resident investors

If there is no BIT between Hungary and the EU state where the investor is resident, then the following rules apply.

In light of EU and Hungarian regulations on jurisdiction in international cases, Hungarian state (ordinary) courts will have jurisdiction over most of the disputes between EU-resident investors and the Hungarian state, state entities and state-controlled companies arising from investments carried out in Hungary. Such court judgments will be enforced in Hungary in accordance with Hungarian and EU rules.

Non-BIT options for non-EU resident investors

If there is no BIT between Hungary and the non-EU state where the investor is resident, then the following rules apply.

A non-EU investor can launch litigation against the Hungarian State, state entity or state-controlled company in the Hungarian state (ordinary) courts. Such court judgments will be enforced in Hungary in accordance with Hungarian rules.

If a non-EU investor launches litigation in its own country against the Hungarian State or a state entity in connection with an investment in Hungary, then according to Hungarian law, the rendered court decision will not be enforceable in Hungary. If such a defendant is a state-controlled company, then the enforceability of such a foreign court decision in Hungary would be at least questionable.

Conclusion

If the present wording of the amendment is adopted by the parliament, it would appear that the amendment's potentially onerous effects would be felt only by investors who have already concluded contracts with the state providing for arbitration in Hungary, as such arbitration clauses will become invalid and unenforceable. Foreign investors would continue to have the option to conclude contracts with arbitration clauses stipulating foreign arbitral tribunals. Therefore, in future, investors will have a clearer picture as to their legal options regarding the dispute resolution clauses of contracts with the state: these options would be reduced in practice to Hungarian ordinary courts or foreign arbitral tribunals.

Although the wording of the amendment may create some uncertainty and a potential legal loophole, the amendment's political purpose is clear. In line with this, we can assume that in future the state will abstain from agreeing contracts with arbitration clauses, regardless of any legal interpretation on the subject of whether the amendment's scope covers foreign arbitral tribunals or not.