



# MASARYK UNIVERSITY FACULTY OF LAW

Klára Drličková, Slavomír Halla (eds.)

## FIRST BRNO ARBITRATION CONFERENCE 2017

Current Issues  
of International Commercial Arbitration

Conference Proceedings



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Klára Drličková, Slavomír Halla (eds.)

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## PREFACE

Even though international commercial arbitration is almost as old as international trade itself, this does not mean that it leaves scholars and legal researchers without interesting topics to analyse and discuss. Quite to the contrary, international commercial arbitration evolves hand in hand with the global trade community and thus it becomes more complex and challenging with each passing year. Therefore, the proverbial well of contemporary issues is far from being drained.

The same can be said about the second topic of the conference – CISG, the uniform law on international sales, now celebrating its 37<sup>th</sup> anniversary. Being one of the most studied international instruments, it comes as no surprise that the volume of commentaries, legal studies, research papers and other scholarly materials is abundant. Yet, CISG is indeed a “living” instrument, closely connected to the evolving needs of international trade, and as such, it consistently keeps generating interesting topics and issues to be solved.

Both worlds are fused and embraced in a truly remarkable educational event – Willem C. Vis International Commercial Arbitration Moot. International competition of law students the goal of which is to foster the study of international commercial law and arbitration for resolution of international business disputes through its application to a concrete problem of a client and to train law leaders of tomorrow in methods of alternative dispute resolution.

Teams from Masaryk University have been participating in the Vis Moot competition for almost a decade now. Seeing the impact of the competition, a decision has been taken to further promote awareness of international commercial arbitration and the CISG. Thus, First Brno Arbitration Conference has been organised for young scholars - especially master and Ph.D. students. The conference was held within the framework of Brno Pre-Moot. In 2017 Masaryk University organised third annual Brno Pre-Moot. Eight student teams from six countries took part. We also welcomed arbitrators from several countries, practitioners as well as academics. Around ninety people finally met in Brno.

Most of them also took part in the conference. Alongside the teams, practitioners, academics and other students (Ph.D. as well as master) participated. The aim of the conference was three-fold. Firstly, to promote understanding of international arbitration and the CISG by presentations of experienced practitioners. Secondly, to help interchange thoughts and ideas relating to these topics among young scholars, as well as between these scholars and participating practitioners. Thirdly, to provide young scholars with a platform for publishing parts of their research which relates either to international commercial arbitration or the CISG. This conference proceeding now presents such platform.

As a way of general introduction, Vít Makarius, one of the expert panellists, provides a thought provoking contemplation about the past, present and potential future of arbitration in the Czech Republic.

Consequently, respective research papers are organised in the three blocks. In the first block, a more overarching perspective is used to analyse topics of the conference.

Ivan Cisár presents cross-sectional view whether CISG is a suitable tool for international commercial transactions, and consequently a good law to apply even in international commercial arbitration.

Judit Glavanits follows the line of argument with a more territorially narrowed look – based on the recent empirical study, she brings deep insights based on CISG application before Hungarian courts, as well as before arbitration tribunals seated in Hungary.

Second block brings some evergreens of international arbitration, as well as some peculiar problems on application of CISG.

Anita Garnuszek analyses a fascinating problem of time-bars and other contractual time-limitations on arbitral procedure; contemplating both international and Polish perspective.

Erika Rigó focuses her paper on interesting interaction between Article 7 CISG and hardship clauses, presenting us with some intriguing challenges judges and arbitrators face in their interpretation attempts.

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Alexandra Živělová provides us with a topic emerging from comparative challenges arbitrators must regularly face – in this case, a possibility to award punitive damages in the arbitration proceedings.

Last block of papers shifts focus on the most practical side of any proceeding – costs and fees.

Pavel Lacko discusses basic concepts of awarding of legal costs in arbitration, and analyses the situation in Slovakia in this regard.

Last paper by Judit Molnár provides a very pragmatic look on the topic of costs – comparing their origination, comparing “classical” court proceedings and commercial arbitration – joining the global discussion whether the arbitration is indeed a more cost-effective tool for international commercial disputes.

This overview clearly shows that the proverbial well is still full of interesting and provoking challenges, some semi-old, while others quite anew; it surely promises many interesting discussions amongst scholars and practitioners in the years to come – hopefully hosted again by the (Second) Brno Arbitration Conference as well.

*Klára Drličková, Slavomír Halla*

## LIST OF ABBREVIATIONS

<b>CISG</b>	United Nations Convention on Contracts for the International Sale of Goods of 11 April 1980
<b>Court of Justice</b>	Court of Justice as a part of the Court of Justice of the European Union
<b>European Convention</b>	European Convention on International Commercial Arbitration of 21 April 1961
<b>European Convention on Human Rights</b>	Convention for the Protection of Human Rights and Fundamental Freedoms of 3 November 1950
<b>EU</b>	European Union
<b>ICC</b>	International Chamber of Commerce
<b>New York Convention</b>	Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958
<b>Rome I Regulation</b>	Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I)
<b>UNCITRAL</b>	United Nations Commission on International Trade Law
<b>UNCITRAL Model Law</b>	UNCITRAL Model Law on International Commercial Arbitration, with amendments as adopted in 2006

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# INTERNATIONAL COMMERCIAL ARBITRATION IN THE CZECH REPUBLIC: THIRTY YEARS ON

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## **Abstract**

The paper outlines the main features of international commercial arbitration in the Czech Republic since the fundamental political and economic changes of 1989. Its first part summarizes the key contemporary trends in the Czech arbitration law and assesses the challenges the law faces. General characteristics of the arbitration industry and arbitration community in the Czech Republic is provided in the following sections of the text. The last chapter of this brief review identifies the prime areas of the Czech arbitration law calling for modernisation. It is complemented by a brief list of possible reforms to accommodate the growing needs of the arbitration community in the Czech Republic.

## **Keywords**

International Commercial Arbitration; Arbitration Agreements; Czech Arbitration Law; Arbitral Procedure; Set-aside Proceedings; Enforcement.

## **1 Introduction**

The beginning of the political and economic changes in Czechoslovakia, sparked by the fall of the Iron Curtain in 1989, will soon mark its thirtieth anniversary. In almost three decades, the Czech Republic, which succeeded Czechoslovakia in 1993, has evolved in one of the most open and market-oriented economies in Central and Eastern Europe. Naturally, foreign investments

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and cross-border business brought about a steep rise in international arbitral disputes, a trend amplified by globalisation, European integration and modern technologies. With the thirtieth anniversary of the political changes looming on the horizon, it may be instructive to look at how the Czech Republic has facilitated those disputes.

## **2 International Arbitration in the Czech Republic**

As in other jurisdictions, international arbitration in the Czech Republic is not defined merely by the national law, but also by the local arbitration industry, its reputation and other social and economic factors, such as the size of the economy, education and akin.

### **2.1 Legal Framework**

Being a party to all international treaties, regional conventions and bilateral agreements relevant to both international commercial arbitration and its geographic location, the Czech Republic is well anchored in the system of international arbitration law.

The New York Convention has a preeminent role amongst the sources of international law applicable in the Czech Republic, while the European Convention is the leading, albeit not frequently used, regional convention applicable in the European context. Bilateral treaties on judicial cooperation and recognition of arbitral awards, concluded between Czechoslovakia and other countries may, in certain cases, govern the execution of arbitral awards and judicial assistance to arbitral tribunals. Furthermore, the European Convention on Human Rights may be instrumental for assessing issues relevant to arbitration, for instance due process, or the execution of arbitral awards. Lastly, the EU law, with its ever-increasing influence on arbitration, has been applicable in the Czech Republic since the country's accession to the EU in 2004.

As a matter of principle, domestic statutory arbitration law of the Czech Republic does not contravene obligations arising under the treaties and complies with them.

Compared to the most developed arbitration jurisdictions, judicial practice of the Czech courts applying international arbitration legal instruments is still rather limited. It is thus difficult to observe, on a larger scale, any settled line

of cases indicating the courts' policies on particular issues under arbitration treaties. Nonetheless, nothing suggests that the Czech courts hinder or restrict application of international arbitration law. Nor does their practice show any lack of deference to the cornerstones of that law, such as the recognition and enforcement of international arbitration agreements and foreign arbitral awards.

In terms of statutory domestic law, the rules governing international commercial arbitration were, in 1989, still centred around the International Arbitration Act<sup>2</sup> adopted in Czechoslovakia in 1963. A strict state monopoly on international trade, carried out through the state ownership and state control of all Czechoslovak entities licensed to deal with counterparts abroad, allowed the communist-ruled Czechoslovakia to introduce in the International Arbitration Act a surprisingly liberal piece of legislation reflecting the then modern trends in international arbitration.

Together with the UNCITRAL Model Law, the International Arbitration Act served as one of the sources of inspiration for drafting the Czech Arbitration Act<sup>3</sup> which replaced, on 1 January 1995, the International Arbitration Act and remains hitherto in force.

Passed in the midst of far-reaching liberal reforms, privatisation and a campaign against the state interventionism in the Czech economy, which *inter alia* opened international trade to the Czech private entities and individuals, the Czech Arbitration Act introduced a relatively large scope of arbitrable disputes.<sup>4</sup> Significantly, consumer matters became thereby arbitrable and quickly proliferated. In few years, consumer arbitration grew to become a driving force in the entire Czech arbitration industry. Many retailers and providers of legal services seized the opportunity. New selling policies, practitioners and arbitral institutions appeared on the market, some of them pursuing their own interests rather than those of consumers.

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<sup>2</sup> CZECH REPUBLIC. Act No. 98/1963 Coll., on Arbitration in International Commercial Relations and the Enforcement of Arbitral Awards.

<sup>3</sup> CZECH REPUBLIC. Act No. 216/1994 Coll., on Arbitration and the Enforcement of Arbitral Awards ("Czech Arbitration Act").

<sup>4</sup> In principle, any property-right dispute that may be litigated in civil courts and settled by the parties, i.e. any such matter of civil, commercial, labour, and family law, fell within the Czech Arbitration Act's substantive scope of application pursuant to its Article 2. The Czech Arbitration Act provided for several exceptions, the matters of insolvency law and enforcement law being among them.

Having regard to that trend and taking into consideration the EU consumer protection law,<sup>5</sup> the Czech judiciary and legislature responded gradually by introducing a series of restrictions on consumer arbitral disputes.<sup>6</sup> Ultimately, they put an end to the consumer arbitration saga in 2016, when the amended Czech Arbitration Act declared consumer disputes non-arbitrable.<sup>7</sup> Permitted by law for more than twenty years, consumer arbitration dominated the public debate, judicial practice and legal theory to such an extent that it overshadowed, if not eliminated, most legal questions that were widely debated within the arbitration communities in developed arbitration jurisdictions. While other countries made attempts to address new challenges brought about by the fast development of international arbitration in the 1990's, the Czech arbitration discourse remained for many years characterised by issues, such as validity of arbitration agreements or legality of permanent arbitral institutions, whose importance for international commercial arbitration was secondary or marginal. Moreover, the Czech Arbitration Act has struggled to get amended so as to reflect new trends in international commercial arbitration. Furthermore, the state policy to protect the interests of consumers became so vehement that its side effects sometimes negatively touched upon other classes of arbitration, including commercial arbitration. Some rulings by state courts intended to tighten the regulation governing consumer disputes failed to distinguish between consumer matters on the one hand and non-consumer differences on the other, thus threatening application of core arbitration maxims, such as flexibility, the parties' autonomy, foreseeability, etc., to the latter.<sup>8</sup>

<sup>5</sup> Council Directive No 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts [online]. In *EUR-Lex* [accessed on 2017-08-08]; Commission Recommendation No 98/257/EC of 30 March 1998 on the principles applicable to the bodies responsible for out-of-court settlement of consumer disputes In: *EUR-Lex* [accessed on 2017-08-08]; decision of the Supreme Court, Czech Republic of 22 January 2013, No. 23 Cdo 2628/2010 [online]. In: *Nejvyšší soud* [accessed on 2017-08-18]; decision of the Supreme Court, Czech Republic of 22 February 2012, No. 33 Cdo 3721/2011 [online]. In: *Nejvyšší soud* [accessed on 2017-08-08]; decision of the Constitutional Court, Czech Republic of 5 October 2011, No. II. ÚS 3057/10 [online]. In *NALUS* [accessed on 2017-08-08].

<sup>6</sup> For instance, CZECH REPUBLIC. Act No. 19/2012 Coll., amending Act No. 216/1994 Coll., on Arbitration and the Enforcement of Arbitral Awards.

<sup>7</sup> CZECH REPUBLIC. Act No. 258/2016 Coll., amending certain laws in connection to adoption of the Act on Consumer Credit.

<sup>8</sup> See *inter alia* decision of the Olomouc High Court, Czech Republic of 19 July 2012, No. 1 Cmo 103/2012-174, subsequently quashed by decision of the Supreme Court, Czech Republic of 4 September 2013, No. 23 Cdo 3896/2012 [online]. In: *Nejvyšší soud* [accessed on 2017-08-08].



Carving out consumer cases from the ambit of arbitrable disputes under the Czech Arbitration Act should be therefore perceived as an opportunity to focus on matters where arbitration has the strongest potential to show its advantages, i. e. on cross-border business disputes. Although the Czech arbitration law represents a solid legal framework capable to address the fundamental needs of commercial arbitration users, efforts should concentrate on bringing the law in its entirety in line with modern trends in international commercial arbitration.

Reforms should primarily target the six following areas of the Czech arbitration law.

Let us begin with the statutory law governing appointments of arbitrators by state courts. In that regard, the Czech Arbitration Act principally follows the UNCITRAL Model Law.<sup>9</sup> With an important exception, however. By contrast to the UNCITRAL Model Law,<sup>10</sup> it does not lay down any restrictions on appeals against decisions of state courts. As it nowadays stands, the envisaged assistance by state courts in appointing arbitrators – however rare in international arbitration practice – may excessively protract arbitration proceedings and substantially impair their efficiency.<sup>11</sup> For appointments by state courts may be appealed and further contested by extraordinary reliefs, especially by an appeal on points of law. Moreover, in certain circumstances, the parties may file an appeal to the Czech Constitutional Court and an application to the European Court of Human Rights in Strasbourg.<sup>12</sup> While such a multitude of remedies pursues a legitimate aim of safeguarding the impartiality and independence of arbitrators, the Czech Arbitration Act should try to strike a fair balance with other competing interests emblematic for arbitration, in particular efficiency, expeditiousness, foreseeability, and legal certainty. Many developed national arbitration laws found a balanced solution in promoting a high-quality decision-making in a single – usually senior – judicial instance of ordinary courts.

<sup>9</sup> Article 11(1)-(4) of the UNCITRAL Model Law.

<sup>10</sup> Article 11(5) of the UNCITRAL Model Law.

<sup>11</sup> Section 9 of the Czech Arbitration Act taken in conjunction with the Article 201 of the Czech Code of Civil Procedure (CZECH REPUBLIC. Act No. 99/1963 Coll., Code of Civil Procedure).

<sup>12</sup> Article 201, Article 228, Article, 229, Article 236 of the Czech Code of Civil Procedure; Section 72(1) of the Constitutional Court Act (CZECH REPUBLIC. Act No. 182/1993 Coll., the Constitutional Court Act); Article 34 of the European Convention on Human Rights.

The aforementioned description and assessment of the law relevant to appointments of arbitrators by state courts apply *mutatis mutandis* to the provisions of the Czech Arbitration Act governing challenges to arbitrators entertained by state courts.<sup>13</sup>

Second, in the times marked in modern arbitration laws by the trends to vest ever greater powers in arbitrators, the Czech Arbitration Act stays aside. Remarkably, it is still based on a prohibitive attitude on issues such as preliminary and conservatory measures. That policy may be reconsidered. Foreign arbitration laws, which provide for various approaches to the arbitrators' powers to grant preliminary and conservatory measures, may serve as a valuable source of inspiration in that regard.<sup>14</sup> In commercial arbitration, and especially in international commercial arbitration practice, applications for interim measures lodged with state courts proved seldom effective. If it should stay competitive, the Czech Arbitration Act cannot ignore the shift to entrusting arbitrators with the power to issue preliminary and conservatory measures for long.

Third, the Czech Arbitration Act enshrines the fundamental procedural principles governing an arbitral procedure in a fairly reasonable manner. Yet, interpretation and application of some provisions of the Czech Arbitration Act governing procedural matters still cause difficulties.

Section 30 of the Czech Arbitration Act, a far-reaching rule, belongs to such provisions. According to it, the Czech Code of Civil Procedure applies, in an appropriate manner, to arbitral proceedings, unless the Czech Arbitration Act provides otherwise. The scope and content of the term "appropriate application" of the Code of Civil Procedure remain – almost a quarter of a century after adoption of the Czech Arbitration Act – blurred. For, at the same time, the parties are under Section 19 of the Czech Arbitration Act entitled to agree on the matters of procedure, failing which the arbitrators are themselves empowered to decide on the questions of procedure and

<sup>13</sup> Section 12(2) of the Czech Arbitration Act *in fine* taken in conjunction with Article 201 of the Czech Code of Civil Procedure.

<sup>14</sup> See *inter alia* Section 183 of Swiss Private International Law Act (SWITZERLAND. Federal Act on Private International Law of 18 December 1987; Article 595 of the Austrian Code of Civil Procedure (AUSTRIA. Code of Civil Procedure of 1 August 1895, RGBl. Nr. 113/1895); Article 1468 taken in conjunction with Article 1506 of French Code of Civil Procedure (FRANCE. New Code of Civil Procedure).

to conduct proceedings as they deem appropriate. Neither the statutory law, nor practice of state courts provides clear guidelines on how to reconcile Section 19 of the Czech Arbitration Act and Section 30 thereof.<sup>15</sup>

Importantly, application of the Czech Code of Civil Procedure to international arbitration by default envisaged in Section 30 of the Czech Arbitration Act goes contrary to the tendency, generally accepted in many developed international arbitration laws, to abandon application of local civil procedural rules in international arbitration.<sup>16</sup> In order to bolster flexibility, efficiency and autonomy of arbitration, local rules of civil procedure are being replaced by autonomous powers of arbitrators in the matters of procedure. These powers are limited merely by fundamental procedural principles and public policy. In the light of the foregoing, Section 30 of the Czech Arbitration Act seems to be not only unclear and conceptually problematic, but also obsolete.

It is true that the Code of Civil Procedure enshrines *inter alia* legal principles whose observance is indispensable for preserving the integrity of arbitral proceedings, such as the equality of arms, the party's opportunity to present its case, the independence and impartiality of arbitrators (judges), foreseeability, etc. Nonetheless, these principles form part of the right to a fair trial (due process) and (procedural) public policy that govern arbitrations pursuant to Section 18, Section 19 and Section 25 of the Czech Arbitration Act and other applicable laws. They are further embodied in the Czech Charter of Fundamental Rights and Freedoms and relevant instruments of international law, e.g. the European Convention on Human Rights, the New York Convention, and the European Convention. The aforementioned reference to the Code of Civil Procedure stipulated in Section 30 of the Czech Arbitration Act is therefore not only ambiguous and outdated but also superfluous.

<sup>15</sup> In the past, the senior Czech courts repeatedly confirmed applicability of the Czech Code of Civil Procedure to (domestic) arbitral proceedings; see *inter alia* decision of the Supreme Court, Czech Republic of 28 March 2012, No. 32 Cdo 4706/2010 [online]. In: *Nejvyšší soud* [accessed on 2017-08-18]; or decision of the Supreme Court, Czech Republic of 24 July 2013, No. 23 Cdo 2251/2011 [online]. In: *Nejvyšší soud* [accessed on 2017-08-18]. However, the Czech judiciary seems to be recently revisiting that practice; see *inter alia* decision of the Prague High Court, Czech Republic of 15 September 2015, No. 1 Cmo 56/2015-196.

<sup>16</sup> See *inter alia* Section 182 of the Swiss Private International Law Act; Article 1509 of the French Code of Civil Procedure.

Fourth, while the state should ease the legal restrictions on the aforementioned powers of arbitrators in procedural matters, it should be, at the same time, explicitly empowered to verify compliance with the agreed procedure, focusing on the fundamental procedural rights. Yet, by contrast to the UNCITRAL Model Law<sup>17</sup> and some national arbitration laws, the Czech Arbitration Act hitherto does not recognize a substantial breach of agreed procedure as grounds for setting aside an arbitral award.<sup>18</sup> Although the Czech courts, for the time being, laudably fill in the gap in the statutory law by means of their judicial practice, the legislature should consider to follow suit and amend the statutory law accordingly.<sup>19</sup>

Fifth, concerning the grounds for setting aside an arbitral award, Section 31(g) of the Czech Arbitration Act provides for setting aside an arbitral award if, after delivery of the award, new decisive evidence appears, provided that such evidence could not be relied upon by a party when the arbitration was still pending. This legal provision directly refers to an extraordinary relief of reopening a case governed by Article 228 of the Czech Code of Civil Procedure. Such extraordinary recourse may be legitimate in civil proceedings before state courts. It is however difficult to justify its existence in international commercial arbitration characterised by the party's autonomy and responsibility to argue and establish its case, and by the need for efficiency, expeditiousness and legal certainty in resolving disputes. That is why neither the UNCITRAL Model Law, nor the European Convention embodies such grounds for setting aside an arbitral award.

Moreover, Section 31 of the Czech Arbitration Act requires state courts to set aside an award where one or more of the grounds listed in that provision are established.<sup>20</sup> Nonetheless, arbitration practice sometimes gives rise to situations where automatic setting aside of an arbitral award is not, given the circumstances of a particular case, appropriate. Therefore, the

<sup>17</sup> Article 34(2)(a)(iv) of the UNCITRAL Model Law.

<sup>18</sup> Section 31 of the Czech Arbitration Act. See *inter alia* decision of the Supreme Court, Czech Republic of 25 June 2013, No. 23 Cdo 3285/2012 [online]. In: *Nejvyšší soud* [accessed on 2017-08-08].

<sup>19</sup> See *inter alia* decision of the Supreme Court, Czech Republic of 25 June 2013, No. 23 Cdo 3285/2012 [online]. In: *Nejvyšší soud* [accessed on 2017-08-08].

<sup>20</sup> Section 31 of the Czech Arbitration Act provides that: “[a] court shall set aside an award, if [...]“:

UNCITRAL Model Law and many other national laws grant state courts a margin of appreciation, whereby judges *may* rather than *must* set aside an arbitral award on the statutory grounds for setting aside arbitral awards.<sup>21</sup>

Sixth, the prevailing trends in developed national arbitration laws suggest revisiting the set-aside procedure before the Czech state courts. Many leading arbitration jurisdictions – for instance Switzerland, Austria, but also Bulgaria<sup>22</sup> – have already transformed set-aside proceedings into an one-instance procedure conducted before and by specialised justices, usually at the nations’ senior courts. The Czech Arbitration Act by contrast still provides for set-aside proceedings conducted by a large variety of state courts of first instance.<sup>23</sup>

Moreover, rulings of the courts of first instance are subject to an appeal just as any other decision of civil courts. Although filing an action to set aside does not suspend the effects of a final arbitral award, the parties are left in uncertainty, at least until an appellate court decides on the action. For only then becomes the judicial decision binding.<sup>24</sup>

Yet, even if the ruling enters into force, it does not necessarily become final. For the judicial architecture laid down by the Czech Arbitration Act and the Czech Code of Civil Procedure provides for extraordinary reliefs, most importantly for an appeal on points of law to be lodged with the Czech Supreme Court. Moreover, this most senior instance of the Czech ordinary courts, too, needs not be an end of the dispute. The Czech Constitutional Court is empowered to review cases of alleged impairments of fundamental procedural safeguards. Notably, a significant number of set-aside challenges asserts just that. A recourse to the Czech Constitutional Court is thus not a stranger to post-arbitration practice. Jurisdiction of the European Court of Human Rights is of similar nature and scope; applications stemming from set-aside proceedings and filed with that court therefore come as surprise neither.<sup>25</sup>

<sup>21</sup> Article 34(2) of the UNCITRAL Model Law; Section 190(2) of the Swiss Private International Law Act; Article 152 of the French Code of Civil Procedure.

<sup>22</sup> Article 615 of the Austrian Code of Civil Procedure; Section 191 of the Swiss Private International Law Act; Section 47 of the Bulgarian Act on International Commercial Arbitration.

<sup>23</sup> Sections 41–44 of the Czech Arbitration Act.

<sup>24</sup> Article 159 of the Czech Code of Civil Procedure.

<sup>25</sup> Article, 229, Article 236 of the Czech Code of Civil Procedure, Article 201, Article 228; Section 72(1) of the Constitutional Court Act; Article 34 of the European Convention on Human Rights.

Although a multi–instance judicial review of awards may increase the quality of judicial scrutiny, it inevitably comes at the expense of expeditiousness and legal certainty of dispute resolution. As mentioned above, the prevailing trend is nonetheless to strike a balance between the public interest to ensure the integrity of the arbitral proceedings on the hand and the principles of legal certainty and finality on the other. Such balance is usually found in expertise and experience of justices hearing cases in a single senior judicial body rather than in multiple checks built in a complex system of courts of several instances. It is difficult to find reasons why that approach should not prove beneficial also to the Czech Arbitration Act.

## 2.2 Reputation

Statutory law and judicial practice, albeit crucial, are not the only factors influencing international arbitration in the Czech Republic. Confidence among users is of the essence for any private dispute resolution, and arbitration is no exception. Parties are unlikely to resolve their differences in arbitration, unless they believe it represents a fair and efficient dispute resolution system. Trust of arbitration users and the wider Czech public in arbitration has been subject to severe tests over the past decades. Three factors influencing the reputation of commercial arbitration in the Czech Republic may be underlined.

The first is the public debate. Although international commercial arbitration users are usually assisted by professionals, they do not remain entirely immune to the public opinion shaped by politicians, civil servants and other opinion makers. In developed jurisdictions with a long tradition of the rule of law, politicians comment on judges and their decision–making with utmost restraint. For critical statements undermine the authority of courts and thus the legitimacy of the judiciary.

There is no reason to approach arbitration differently. Similarly to state courts, arbitration is a dispute resolution sanctioned by the state itself. Yet, the public debate in the Czech Republic has not yet been free of critical comments by politicians and state officials questioning arbitration as such. Such statements, if not made with prudence, are detrimental to the reputation of arbitration in the Czech Republic.

The second of the three factors consists in the liberalisation of arbitration in the 1990's. Following the adoption of the Czech Arbitration Act in 1994, numerous small permanent arbitral institutions were established and scores of new arbitrators entered the market. Most of them without proper experience, expertise and safeguards preserving the integrity of the disputes administered or decided by them. Inevitably, many arbitrations resulted in dubious outcomes, others revealed unethical and sometimes illicit practices. While some of those errors and malpractices were deliberate, many originated in a mere lack of expertise and experience within the arbitration community and limited knowledge among arbitration users.<sup>26</sup>

Although these shortcomings occurred primarily in domestic arbitration, especially in consumer disputes, trust in arbitration as such was undermined. After many years, the boom of the newly founded arbitral institutions was contained, as state courts consolidated their practice requiring that a permanent arbitral institution be established by a statutory law.<sup>27</sup> That left in the Czech Republic a sole permanent arbitral institution with universal jurisdiction, the Arbitration Court affiliated to the Economic Chamber of the Czech Republic and Agricultural Chamber of the Czech Republic, in the hope of bringing the aforementioned shortcomings and malpractices to an end. The dramatic reduction in the number of permanent arbitral institutions undoubtedly reduced the amount of the cases suffering from deficiencies and errors. At the same time, it is not yet clear whether it helped improve the reputation of commercial arbitration.

Regrettably, the sole Czech permanent arbitral court with universal jurisdiction itself does not nowadays enjoy a particularly high reputation among many commercial arbitration users. Reasons for their reserved approach vary. Some are related to a lack of transparency in appointments of arbitrators by the arbitration court. Other stem from purported deficiencies on the part of the selected arbitrators. On that account, arbitration users often speak of the conflicts of interest, doubts about impartiality and independence,

<sup>26</sup> Print No. 371/0 dated 26 May 2011, Amendment of the Arbitration Act, *travaux préparatoires*. The Chamber of Deputies of the Parliament of the Czech Republic, published 2011.

<sup>27</sup> See *inter alia* decision of the Supreme Court (Grand Civil Chamber), Czech Republic dated 11 May 2011, No. 31 Cdo 1945/2010 [online]. *Nejvyšší soud* [accessed 2017-08-08].

low foreseeability in the decision-making process, inflexibility in procedural matters, and inefficient costs- and time-management. To address those concerns, several prominent arbitration users already ceased to conclude arbitration clause in favour of that arbitration court.

Such a trend is alarming. It is true that parties still have the possibility to resolve their disputes abroad or in arbitrations *ad hoc*. However, that may not always be a suitable alternative to an arbitration administered by a permanent arbitration court seated in the Czech Republic. Fully developed arbitration jurisdiction of the size of the Czech Republic cannot afford operating without a proper permanent arbitration facility trusted by key domestic commercial arbitration users.

The last of the three main factors affecting the reputation of commercial arbitration is the quality of legal services.

While the Czech arbitration industry offers some outstanding practitioners, many struggle to advise on international arbitration issues competently. Vague and incomplete advice, a lack of necessary skills, questionable expertise and limited experience often harm arbitration more than an inappropriate legislation or unforeseeable and inefficient judicial practice.

According to one of the golden arbitration rules emphasised by seasoned practitioners, an arbitration is only as good as the arbitrators. In the light of this principle, first-hand experience of arbitration users with arbitration plays a crucial role. Even the most sophisticated legal framework and best designed arbitral institution do not impress arbitration users, unless an arbitration is handled by competent personnel.

### **2.3 Human Resources**

No matter how elaborated its legal and institutional framework, arbitration is unable to become a reasonable alternative to state courts without well trained and experienced professionals, be it arbitrators, counsel, members of staff in permanent arbitral institutions, or judges.

Despite the ongoing “democratisation” of international arbitration and an ever increasing number of lawyers active in that field of law, arbitration users and appointing authorities often struggle to find seasoned arbitrators



trained in the Czech law and possessing appropriate skills and expertise. Similarly, parties encounter difficulties when finding, among Czech practitioners, international arbitration counsel meeting their expectations in terms of experience, expertise, industry knowledge, language and other necessary soft skills. As for the Czech state courts, few are justices who regularly deal with cases related to international arbitration and have broad experience in international arbitration law.

The roots of such a limited pool of distinguished professionals are manifold. Some of them, such as the size and structure of the Czech economy, are complex and difficult to change. Other causes may be addressed more easily and are therefore worth of attention.

First comes education and training. Although all the Czech universities nowadays require students to enrol to dispute resolution classes lasting up to several semesters, the time committed to arbitration, let alone to international arbitration, usually amounts merely to a couple of units. Some universities, driven by the new generation of energetic and innovative scholars, do offer facultative international arbitration classes and facilitate voluntary arbitration-related programmes, such as moot courts, conferences and akin. Yet, those activities are usually either instantaneous, or do not last more than a single semester.

Symptomatically, Czech-written comprehensive textbooks, studies and research papers on international arbitration are scarce. The Czech legal terminology used in the field of international arbitration remains to a certain degree unsettled. It is beneficial, and indeed indispensable, to teach international arbitration courses in English, the *lingua franca* of the field. Nevertheless, with its distinguished tradition of legal studies, theory and research, a country such as the Czech Republic should aspire to have a settled legal terminology in its own language.

As regards the training organised by the bars of legal professionals, lectures on international arbitration are rather rare, selective and therefore unable to build up a comprehensive curriculum aimed at acquiring skills required in international arbitration.

A consolidated national arbitration association, which usually facilitates sharing experience and training among practitioners in developed arbitration jurisdictions, is yet to be founded. An increasing number of Czech practitioners engages in the activities of arbitration associations abroad. That is by all means a positive phenomenon. It, however, cannot entirely fill in the gap the absence of a domestic (or regional) arbitration association creates.

Efficiency of the training provided to justices by the judiciary and the ministry of justice is limited by decentralized jurisdiction of courts empowered to hear arbitration-related cases. The number of judges who may deal with such cases is considerably high, while the probability that all of them will hear those matters on a regular basis remains low. The Czech state courts do have several judges with exquisite expertise in international arbitration law. It is nonetheless unclear to what extent this is a result of a systemic education programme maintained by the judiciary and the ministry of justice, on the one hand, and to what extent it is a consequence of their individual talents and effort, on the other.

### **3 What Could be Done to Enhance International Commercial Arbitration in the Czech Republic**

Some key causes of where international commercial arbitration nowadays stands can be dealt with only indirectly and in a long term. The shape and structure of the Czech economy are among them. International arbitration cannot exist without its *raison d'être*, i. e. its users. In that respect, it should not be ignored that the ranks of those who traditionally benefit most from international arbitration – export-oriented turn-key civil engineering project suppliers – have been for many years shrinking. In construction, machinery, transportation, infrastructure and energy, and other industries with a long tradition in the Czech lands, domestic general contractors struggle to keep their market position, often opting instead for sub-contracts, restructuring their businesses or leaving foreign markets for good.

Other causes can be addressed more directly and expeditiously.

The national legal and institutional framework of international arbitration should be modernised. The reform of the Czech Arbitration Act, declaring

consumer disputes non-arbitrable, paved the way for amending the law so as to strengthen the parties' autonomy, particularly in the area of designing arbitration procedure.

By the same token, the power to decide all procedural matters, failing the parties' agreement, should be unambiguously granted, by virtue of the Czech Arbitration Act, to arbitrators.

Unless the parties decide otherwise, jurisdiction of arbitrators should include the power to issue provisional and conservatory measures, including security; as a check, state courts should be empowered to refuse or suspend enforcement of such measures, albeit on narrow and clearly defined statutory grounds.

The reference in Section 30 of the Czech Arbitration Act to the Czech Code of Civil Procedure, which provides for applicability of the Czech civil procedure to international arbitration, should be abolished in respect of international arbitral proceedings.

The grounds for setting aside arbitral awards should be clarified and redrafted so as to bring them as close to the UNCITRAL Model Law as possible. As a matter of principle, a substantial breach of agreed procedure should constitute statutory grounds upon which an arbitral award may be set aside. The legal basis for setting aside an arbitral award in order to reopen the case similarly to the Czech Code of Civil Procedure, embodied in Section 31 g) of the Czech Arbitration Act, should be repealed.

Judicial proceedings related to arbitration matters should be simplified and centralised. In particular, actions to set aside arbitral awards, challenges to, and motions for appointments of, arbitrators should be heard in a single-instance procedure, preferably by a specialised chamber of the Supreme Court.

State courts dealing with an arbitration-related case load should distinguish, in a clear and concise manner, between cases concerning international arbitration on the one hand and domestic arbitration on the other. Attention should be also paid to the specifics of the disputes where the parties' autonomy to conclude an arbitration agreement is limited, such as in the matters arising in connection with carrying out professional and other activities, for

instance sport and alike. State courts should not apply principles applicable to one class of arbitration to the others without due consideration and justification reflected in the reasoning of their rulings.

As for the institutional framework of arbitration, the debate on permanent arbitral institutions seated in the Czech Republic should be intensified. From the international arbitration perspective, such debate is of complementary nature, since many Czech exporters often lack the leverage to convince their customers to enter into an arbitration clause referring disputes to a Czech permanent arbitral institution. Nonetheless, the matter should be treated with due care. No arbitral institution based in the Czech Republic is likely to become, any time soon, a prime venue in the international context. Yet, it is still desirable, and indeed indispensable, that the country has an independent, impartial and transparent permanent arbitration facility trusted nationwide and possibly beyond.

Whatever institution that may be, it will need to build firm institutional safeguards guaranteeing independence, impartiality, integrity, fairness, foreseeability and efficiency of the proceedings it administers. That will undoubtedly require introducing, *inter alia*, a default mechanism for the selection and appointments of seasoned, impartial and independent arbitrators respected for their authority and integrity. A two-stage process of selecting arbitrators, separating a body making proposals from a board of experts approving appointments, should be introduced. Members of the board, the majority of them composed of foreigner experts with no interests in the Czech Republic, should not be eligible for appointments as arbitrators. The binding list of arbitrators should be abolished, the arbitration rules revised.

Furthermore, to meet contemporary European standards, such arbitral institution will need to recruit its staff on the basis of expertise, experience, independence and personal integrity.

Concerning the quality of arbitration-related services, education and training should be bolstered at all levels – in respect of students, professionals, in-house counsel, judges, and the wider public.

A chief task in that respect will be confined to academia. Knowledge and expertise are the only ways to further advance international arbitration

in both the legal theory and practice. At the same time, promoting knowledge is the best way to cope with prejudices arbitration in the Czech Republic suffers from. Universities should spearhead scholarly and research efforts, support arbitration-related educational activities and strengthen the curriculum of courses devoted to the subject. Arbitration should not be treated as a mere chapter of civil procedure classes. Instead, compulsory courses should help understand arbitration as dispute resolution in its own right.

Education and training, particularly at the university level, should be bilingual. The prominent status of English in the field should be respected, while the use of Czech is indispensable for advancing the theory and practice of international arbitration law in the Czech Republic.

Communication across and outside the arbitration community – between academics, judges, professionals, in-house counsel, bailiffs and public figures – should be intensified. To that end, an arbitration association providing a platform for the entire community, closely linked to the Slovak arbitration matrix, should be established and supported.

## **4 Conclusion**

International arbitration in the Czech Republic has gone a long way. Exposed to an ever-increasing amount of changes brought by the globalised world, it faces a large number of challenges. They can be dealt with in various ways, some of which were outlined in this paper.

Certain reforms, if carried out properly, may yield results in our time. The seminal ones will however take years to implement and even more to show benefits. Yet, even if they make the Czech Republic a fairer and more efficient place to live and work at only for our children or the following generations, they are worth trying.

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# **RESEARCH PAPERS**



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# THE APPLICATION OF CISG IN INTERNATIONAL ARBITRATION

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## **Abstract**

International arbitration allows great flexibility of the parties to structure their whole relationship. One of the key factors is the choice of the law applicable to the substance of the relationship. CISG is intended for the regulation of such relations between international businessmen. This paper builds on the empirical evidence of the International Arbitration Surveys conducted among various groups of practitioners on their reasoning concerning choice of law applicable to the substance of the relationship and argues that although CISG is not chosen by them frequently (or arguably not chosen at all), this “omission” is not warranted.

## **Keywords**

CISG; International Arbitration; Choice of Applicable Law.

## **1 Introduction**

International commercial arbitration is dispute settlement mean sought by international businessmen as preferred way of judicial dispute settlement compared to national court systems. The declared qualities of the arbitration regularly quoted by the international businessmen include fairness, neutrality and flexibility of dispute settlement procedures provided by the

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arbitration. Outcome of such flexible procedures should be efficient solution to their disputes.<sup>2</sup>

The flexibility of the arbitration has manifold aspects. Parties to the dispute are in general free to choose persons who will be in charge of the settlement of their dispute, or at least choose arbitral institution which will administer process of the dispute settlement. Indeed, the possibility to choose persons of own choice as arbitrators is the internationally recognized characteristic of the arbitration.<sup>3</sup> Another example of flexibility of the arbitration relates to the choice of the (legal) seat of arbitration. Consequently, the parties are in the position to choose underlining procedural regulations, the safety-net of procedure law and also ultimate referee of the procedural aspects of the case.<sup>4</sup> However, contrary to the national court proceedings in which the seat of the court is also venue where the parties will meet in person with judges (except of specific circumstances in which national procedural laws allows court to hold hearing in place different from the court room due to specific grounds connected with procedural propriety of specific case), the international arbitration allows the parties to select also venue (or even venues) for individual hearings.<sup>5</sup>

<sup>2</sup> 2012 *International Arbitration Survey: Current and Preferred Practices in the Arbitral Process* [online]. White & Case; Queen Marry, University Of London, London, 2012, p. 2 [accessed on 2017-03-20]; BLACKABY, Nigel, PARTASIDES, Constantine. *Redfern and Hunter on International Arbitration*. 6th ed. Oxford: Oxford University Press, 2015, paras. 1.97, 1.104; BORN, Gary B. *International Commercial Arbitration*. 2nd edition. Alphen aan den Rijn: Kluwer Law International, 2014, pp. 69, 83.

<sup>3</sup> See e.g. Arbitral Procedure: Draft Prepared by the Commission. In: *Yearbook of the United Nations*. 1953, p. 672; Report of the International Law Commission Covering the Work of its Fifth Session, 1 June–14 August 1953: A/2456. In: *Yearbook of the International Law Commission* [online]. 1953, Vol. II., p. 202 [accessed on 2017-03-20]; Advisory Opinion of the Permanent Court of International Justice of 21 November 1925, Interpretation of Article 3, paragraph 2, of the Treaty of Lausanne. *Publications of the Permanent Court of International Justice*, Series B, No. 12, p. 26; Judgment of the International Court of Justice of 16 March 2001 (Merits), Maritime Delimitation and Territorial Questions between Qatar and Bahrain, para. 113 [online]. *International Court of Justice* [accessed 2017-08-08]; BLACKABY, Nigel, PARTASIDES, Constantine. *Redfern and Hunter on International Arbitration*. 6th ed. Oxford: Oxford University Press, 2015, para. 1.71. BORN, Gary B. *International Commercial Arbitration*. 2nd. Alphen aan den Rijn: Kluwer Law International, 2014, p. 1540.

<sup>4</sup> BLACKABY, Nigel, PARTASIDES, Constantine. *Redfern and Hunter on International Arbitration*. 6th ed. Oxford: Oxford University Press, 2015, para. 1.77; BORN, Gary B. *International Commercial Arbitration*. 2nd edition. Alphen aan den Rijn: Kluwer Law International, 2014, pp. 1595–1596.

<sup>5</sup> BLACKABY, Nigel, PARTASIDES, Constantine. *Redfern and Hunter on International Arbitration*. 6th ed. Oxford: Oxford University Press, 2015, para. 4.171; see e.g. Article 17(2) of the 2017 ICC Rules of Arbitration: “The arbitral tribunal may, after consultation with the parties, conduct hearings and meetings at any location it considers appropriate, unless otherwise agreed by the parties.”

This paper will deal with the third aspect of the international arbitration flexibility – the possibility to choose also the law governing the substance of the dispute. Although it is not only the speciality of the arbitration,<sup>6</sup> international arbitration is the prime forum where such flexibility is utilized. Moreover, the choice of the substantive regulation is intertwined with the choice of the seat.<sup>7</sup>

## 2 Requirements on Law Governing Substance of the Dispute

In general, international businessmen are free to choose from minimally 200 different legal systems round the world.<sup>8</sup> The choice of national legal system is broadened by various initiatives proposing unified or harmonized codes of legal regulation more suitable for international transactions.<sup>9</sup> The most formalized attempts to provide unified legal regulation for international transactions are international agreements provided for direct regulation of international business transactions with direct application taking precedence before invocation of national legal system. A prime example of the unification tendencies in the form of direct regulation is the CISG.

The selection of proper law governing the substance of the dispute is based on a range of considerations. International businessmen who participated

<sup>6</sup> See e.g. BLACKABY, Nigel, PARTASIDES, Constantine. *Redfern and Hunter on International Arbitration*. 6th ed. Oxford: Oxford University Press, 2015, para 3.97; Article 3(1) of the Rome I Regulation: “A contract shall be governed by the law chosen by the parties. The choice shall be made expressly or clearly demonstrated by the terms of the contract or the circumstances of the case. By their choice the parties can select the law applicable to the whole or to part only of the contract.”

<sup>7</sup> 2015 *International Arbitration Survey: Improvements and Innovations in International Arbitration* [online]. White & Case; Queen Mary, University of London, London, 2015, p. 13 [accessed on 2017-03-20].

<sup>8</sup> Currently, there are 193 member states to the United Nations. Several entities which could be deemed to achieve characteristics of statehood are not members, e.g. Palestine or the Republic of China (Taiwan). Additionally, there are several entities claiming to be states but not recognized as such (or recognized only by small minority of states, e.g. one or two). Moreover, several states are organized as federal states with separate legal systems for each individual constituent party (e.g. United States of America, Canada, United Kingdom, Australia). See *Status. United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980)* [online]. UNCITRAL [accessed on 2017-03-20].

<sup>9</sup> E.g. UNIDROIT Principles of International Commercial Contracts, INCOTERMS (in various versions), Uniform Customs and Practice for Documentary Credits (either UCP 500 or UCP 600) etc.

in the 2010 International Arbitration Survey<sup>10</sup> listed these influences (listed in relative order of importance as indicated in the Survey):

- Neutrality and impartiality of the legal system
- Appropriateness for type of contract
- Familiarity with and experience of the particular law
- Choice of law imposed by other party
- Corporate policy, standard terms and conditions
- Place of performance of the contract
- Location of company headquarters
- Location of the arbitration institution chosen for the arbitration
- Seat chosen for the arbitration
- Location of legal team
- Recommendation of external counsel
- Location of other party

The most important influences or the top three characteristics relevant for the choice of the law governing the substance of a contract are perceived neutrality and impartiality of the legal system with regard to the parties and their contract, the appropriateness of the law for the type of contract and the party's familiarity with the law.

Several of these influences have some common denominator and could be summarized under one heading. For example, location of company headquarters can be deemed as just specification or reason for greater familiarity and experience with particular law. Similar reasoning can be employed in relation to ground of location of legal team and also reasoning related to corporate policy or standard terms and conditions employed. Selected method of dispute settlement and especially its seat are common to reasons of location of the arbitration institution chosen for the arbitration and seat chosen for the arbitration. These characteristics aim at the familiarity with the selected law by the arbitrators.

<sup>10</sup> 2010 *International Arbitration Survey: Choices in International Arbitration* [online]. White & Case; Queen Mary, University Of London, London, 2015, p. 11 [accessed on 2017-03-20].

The same survey as above quoted also tried to find out which legal systems are selected (and consequently arguably do fulfil the listed characteristics).<sup>11</sup>

It is not much of a surprise that parties mostly chose their own law, law of their home jurisdiction, if they were free to choose, and even imposed their own law in case they were in such position. What is more interesting, however, is that English law was the second most frequently chosen law in case parties were free to choose (and consequently also in cases when such law is imposed by other party).<sup>12</sup> Other national legal systems are selected rather rarely when compared to English law.

### **3 CISG and the Requirements on Law Governing Substance of the Dispute**

Previous section introduced most important characteristics that are sought by the users of international commercial arbitration –international businessmen, when selecting the legal system applicable to the substance of their business relations. As was indicated, the most popularly selected legal system was the national legal system of England. On the other hand, the international agreement with the aim of unification of substantive law – the CISG was selected rather rarely. This section employs the abovementioned criteria on the CISG with the aim do determine whether the position of the CISG as a rather unused (and even unwanted) legal regulation is justified.

#### **3.1 Neutrality and Impartiality**

CISG is an international agreement concluded by the states as primary subjects of public international law. It emerged after many years of negotiations and discussions brokered by the UNCITRAL in which representatives from all Member States of the United Nations had the possibility to participate

<sup>11</sup> Ibid., pp. 13–14.

<sup>12</sup> It has been also argued, that English law serves in some areas purpose of the unified international regulation, especially in case of trade with commodities. See ZELLER, Bruno. *CISG and the Unification of International Trade Law*. New York: Routledge-Cavendish, 2007, pp. 5–6. For further comparison between English law and CISG also discussing overall advantages of English law over CISG see ZHOU, Qi. The CISG and English Sales Law. In: DIMATTEO, Larry A. *International Sales Law: A Global Challenge*. Cambridge: Cambridge University Press, 2014.

and indeed had participated. Therefore, *prima facie* it is not an outcome of particular legal system, legal system of a particular country or even an imposition of the so-called developed countries on the developing ones. The inherently anticipated bias of a national legal order in favour of the domestic businessmen is eliminated in the case of CISG. As an international agreement concluded and adhered to by 85 states<sup>13</sup> it is hard to say that it contains rules specific to one state and thus favouring its nationals.

As was indicated above, national law is strongly favoured. However, its selection as the chosen one is limited either by the willingness of the counterparty to accept it or by the negotiation power of the party to impose its wish on the counterparty. Selection of the CISG eliminates potential risks to the created relationship as it cannot be deemed as advancing only one side of the transaction. Moreover, the exercise of the negotiation power and advantage position could seed at least caution if not distrust between the parties. Such risks are avoided by selection as compromise rules that are not home-coming for either of the parties.<sup>14</sup>

Also, as an internationally negotiated instrument trying to accommodate needs and opinions of countries from various corners of the world with different economic policies and interests, the CISG is a compromise between the interests of export oriented states (naturally advancing rather interests of their exporters, i.e. sellers) and import oriented/depended states (naturally advancing interests of their importers, i.e. buyers). Consequently, CISG is deemed to be a balanced document respecting the interests of both parties to the transaction – seller and buyer.<sup>15</sup>

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<sup>13</sup> *Status. United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980)* [online]. UNCITRAL [accessed on 2017-03-20].

<sup>14</sup> It has been reported that CISG is viewed as such neutral law and compromise among lawyers in German speaking countries. See SCHROETER, Ulrich G. Empirical Evidence of Courts' and Counsels' Approach to the CISG (with Some Remarks on Professional Liability). In: DIMATTEO, Larry A. *International Sales Law: A Global Challenge*. Cambridge: Cambridge University Press, 2014, p. 660.

<sup>15</sup> Note on the UNCITRAL web page provides following characterisation: “*The resulting text provides a careful balance between the interests of the buyer and of the seller.*” See United Nations Convention for Contract on the International Sale of Goods (Vienna, 1980) [online]. UNCITRAL [accessed on 2017-03-20].



Neutrality and impartiality of the CISG could be attractive in international commerce. The visible advantages could indicate that CISG should be selected more compared to national legal systems.

### 3.2 Appropriateness for Type of Contract

The second most important characteristic listed by the international businessmen in connection with their choice of substantive law to govern their business relationship is the appropriateness of the selected law for the type of contract.

CISG is designed to provide substantive law for “*contracts of sale of goods*”.<sup>16</sup> The covered sale of goods is further specified by elimination of certain sales either by type of goods involved (sale of goods for personal, family or household use; sale of stocks, shares, investment securities, negotiable instruments or money; sale of ships, vessels, hovercraft or aircraft; sale of electricity) or by method of conclusion of contract (sale by auction; sale on execution or otherwise by authority of law).<sup>17</sup>

On the one hand, this specification provides high level of legal certainty for the parties of the limits concerning application of the CISG. On the other hand, the specificity of the scope of application limits the potential selections. Although clear cut sales contracts have been cornerstones of international trade, they are often only part of the overall transaction. In that case it would establish more legal conflicts instead of bringing more legal certainty to the transaction if only portion of the transaction (the sales part) is regulated by the CISG and the rest of the contract would be governed by other law. The *dépeçage* is in general allowed but not promoted as there are rather more risks than advantages connected with it.<sup>18</sup> It is also true that parties could decide to adopt CISG also to other parts of the transactions (incorporate CISG into the transaction regulation provided by the

<sup>16</sup> Article 1(1) of the CISG.

<sup>17</sup> Article 2 of the CISG.

<sup>18</sup> E.g. see Article 3(1) of the Rome I Regulation; ROGERSON, Pippa, COLLIER, John G. *Collier's Conflict of Laws*. 4th edition. Cambridge: Cambridge University Press, 2013, p. 306.

contract).<sup>19</sup> However, as CISG is designed for the sales of goods, it does not contain regulation required for other types of transactions, e.g. agency, royalties etc.<sup>20</sup> Contrary to limitations of the CISG, national legal orders offer in general comprehensive regulation for whole business transaction.<sup>21</sup>

### 3.3 Familiarity and Experience with the CISG

On first sight, CISG will lose points on familiarity as it is not a national law of any potential party of the transaction.

The lack of experience is caused by its lack of application and in turn creates vicious cycle. Such consequence could not occur in the case of a national law which is imposed and enforced by the power of the state (formally sole holder of power to compel through monopoly of violence) and the subject of the law cannot avoid its application.

However, at least in cases of the Czech (and also Slovak) businessmen the familiarity and even experience with the CISG is inherent to their familiarity and experience with their national law. The former Czechoslovak Commercial Code (which is still applied in modified, amended, form in Slovakia) was modelled in chapters concerning formation of contract, issues of contract breach (issues of fundamental breach) and specifically regulation of the sales contract on the CISG. The tradition of this regulation has been retained also

<sup>19</sup> HUBER, Peter, MULLIS, Alastair. *The CISG: A New Textbook for Students and Practitioners*. München: Sellier, 2007, p. 66; SCHLECHTRIEM, Peter, BUTLER, Petra. *UN Law on International Sales: The UN Convention on the International Sale of Goods*. New York: Springer, 2008, p. 21. (However, the main point the authors made concerns domestic circumstances and not comparison to other types of international transactions than sales of goods. Although the authors also discuss the application of CISG to framework or preliminary contracts like distribution agreements.)

<sup>20</sup> See e.g. MAURIC, Jan. *Právní jistota použití Úmluvy OSN o smlouvách o mezinárodní koupi zboží na atypické smlouvy, smíšené smlouvy a různé smluvní typy dle českého právního řádu*. In: ROZEHNALOVÁ, Naděžda, DRLIČKOVÁ, Klára et al. *Úmluva OSN o smlouvách a mezinárodní koupi zboží - ano či ne?* Brno: Masarykova univerzita, 2012.

<sup>21</sup> ZHOU, Qi. *The CISG and English Sales Law*. In: DIMATTEO, Larry A. *International Sales Law: A Global Challenge*. Cambridge: Cambridge University Press, 2014, p. 673.

in the recent recodification of the private law in the Czech Republic and the new Civil Code follows same heritage.<sup>22</sup>

Thus, businessmen versed in the Czech (and also Slovak) law have already advantage in familiarity and experience with the CISG. Such advantage could be used in their contract negotiations in cases where they either are not in the position to impose their national law or would rather not to press this issue, and as compromise or concession see as a better negotiating tactic an offer of adoption of international rules in the CISG. By choosing the CISG they would not select an unknown law but rather their home law in disguise.

Similar conclusions are applicable also to Czech (and Slovak) lawyers who would be involved in such international commercial transactions either as counsels or as arbitrators.

### 3.4 Place of Performance of the Contract

It is understandable that the place of performance of the contract has significant place among the criteria for the selection of applicable substantive law. The factual place of the performance of the contract (place where the goods are actually delivered) could be relevant e.g. for availability of evidence. The CISG fulfils this criterion very well.

Although CISG is not the most successful international agreement in the field of international transactions, the list of contracting parties contains 85 state parties which represents nearly one half of the current number of states. When considering landmass, these countries occupy nearly the whole of Europe (except for the United Kingdom and Portugal), most of Asia (with the exception of the portion of the Middle East and south and south-east Asia), both Americas (with few exceptions) and Australia.

Besides, what is more important, the contracting parties represent significant portion of international trade - countries with highest rates of both

<sup>22</sup> ROZEHNALOVÁ, Naděžda. Czech Republic. In: FERRARI, Franco. *The CISG and Its Impact on National Legal Systems*. Munich: Sellier, 2008, pp. 108–111. For more complex analysis of the relations between Czech Civil Code and CISG and other regulations designed for the international transactions see e.g. ROZEHNALOVÁ, Naděžda, DRLIČKOVÁ, Klára, VALDHANS, Jiří et al. *Nový občanský zákoník pohledem mezinárodních obchodních transakcí*. Brno: Masarykova univerzita, 2014.

exports and imports are state parties to the CISG as indicated in the following tables (the state parties to the CISG are highlighted):

World biggest exporters in 2015 <sup>23</sup> (share in world exports by their value)		World biggest importers in 2015 <sup>24</sup> (share in world imports by their value)	
China	14.1 %	United States of America	14 %
United States of America	9.3 %	China	10.2 %
Germany	8.2 %	Germany	6.4 %
Japan	3.8 %	United Kingdom	3.8 %
Republic of Korea	3.2 %	Japan	3.8 %
Hong Kong, China <sup>25</sup>	3.1 %	France	3.4 %
France	3 %	Hong Kong, China <sup>25</sup>	3.4 %
Netherlands	2.9 %	Republic of Korea	2.7 %
United Kingdom	2.9 %	Netherlands	2.5 %
Italy	2.8 %	Canada	2.5 %
Canada	2.5%	Italy	2.5 %
Belgium	2.4 %	Mexico	2.4 %
Mexico	2.3 %	India	2.4 %

It may be noted that also the white gap in the map of contracting parties in Africa is not so to say “CISG-free”. Similarly to the CISG influence on the Czech national contract law, the CISG served similar role in Africa where Organisation for the Harmonisation of Business Law in Africa representing 17 African states adopted common sales law based on the CISG.<sup>26</sup>

<sup>23</sup> *List of Exporters for the All Products in 2015* [online]. International Trade Centre (ITC) [accessed on 2017-03-20].

<sup>24</sup> *List of Importers for the All Products in 2015* [online]. International Trade Centre (ITC) [accessed on 2017-03-20].

<sup>25</sup> The status of Hong Kong (and similarly to Macao) Special Administrative Region of the PRC as (part of) contracting state to the CISG is not entirely clear. For more discussion see e.g. SCHROETER, Ulrich. The Status of Hong Kong and Macao under the United Nations Convention on Contracts for the International Sale of Goods. *Pace International Law Review* [online]. 2004, Vol. XVI, No. II, pp. 307–332 [accessed on 2017-03-21].

<sup>26</sup> ZELLER, Bruno. *CISG and the Unification of International Trade Law*. New York: Routledge-Cavendish, 2007, p. 8; FERRARI, Franco. CISG and OHADA Sales Law. In: MAGNUS, Ulrich. *CISG vs. Regional Sales Law Unification: With a Focus on the New Common European Sales Law*. Munich: Sellier, 2012.

Adding the local perspective, the member states of the CISG are also most important trade partners for the Czech Republic itself (state parties to the CISG are highlighted):

Czech exports in 2015 <sup>27</sup>		Czech imports in 2015 <sup>28</sup>	
Germany	32.2 %	Germany	26 %
Slovakia	9 %	China	13.5 %
Poland	5.9 %	Poland	7.9 %
United Kingdom	5.3 %	Slovakia	5.1 %
France	5.1 %	Italy	4.1 %
Austria	4.1 %	France	3 %
Italy	3.7 %	Russian Federation	3 %
Hungary	3	Netherlands	3 %

The abovementioned statistics indicate that vast majority of the world export is placed (and performed) in the CISG Contracting States. Consequently, CISG is frequently part of the law applicable at the place of contract performance.

The significant share of the state parties to the CISG in world exports is also telling from the point of view of the applicable law. The seat / residence of the seller is usually the sole criterion for the determination of the applicable law for the substantive regulation. And the CISG already anticipates this situation when prescribes its own application in situation when the rules of private international law lead to the application of the law of a contracting state, i.e. the exporter's home state.

## 4 Conclusion

Previous analysis showed that CISG fulfils several important considerations for the selection of substantive law – CISG is inherently neutral and was also drafted taking into consideration both parties of the transaction, it has been specifically designed for the contract of sales of goods, when imposed by other party it should not bring any special discomfort and

<sup>27</sup> *List of exporters for the all products in 2015 for the Czech Republic* [online]. International Trade Centre (ITC). [accessed on 2017-03-20].

<sup>28</sup> *List of importers for the all products in 2015 for the Czech Republic* [online]. International Trade Centre (ITC). [accessed on 2017-03-20].

it is also applicable when taking into consideration the place of the contract performance. For the businessmen from the Czech Republic (and Slovakia as well as other countries round the world) CISG also provides additional advantage of familiarity and experience with it even without special need to study CISG. CISG's negative is its specialization – it is appropriate for the clear-cut contract of sale but is not prepared to provide regulation for more complex international business transactions. Also, from the point of view of businessmen in general, as it is not used widely, there is an element of lack of familiarity and experience with it.

However, CISG is not a dead document. *Mistelis* estimated that by 2007 there could have been 4,250 to 5,000 awards rendered in CISG-governed international business transactions, based on number of cases listed in the public databases of decisions based on CISG (i.e. Pace, UNILEX, CLOUT and ICC collections of abstracted awards) (in total 512 awards published between 1988 and 2007 which should have been multiplied by the ratio of 5 % representing the rate of award publication). It is true that such number is only a small portion of the awards rendered worldwide. However, it is still a considerable number. We may hope that the number will rise further.

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*List of importers for the all products in 2015* [online]. International Trade Centre (ITC). Available from: [http://www.trademap.org/Country\\_SelProduct.aspx?nvp=1||||TOTAL|||2|1|1|1|1||2|1|1](http://www.trademap.org/Country_SelProduct.aspx?nvp=1||||TOTAL|||2|1|1|1|1||2|1|1)



*List of exporters for the all products in 2015 for the Czech Republic* [online]. International Trade Centre (ITC). Available from: [http://www.trademap.org/Country\\_SelProduct.aspx?nvpm=1||||TOTAL|||2|1|1|2|1|2|1|1](http://www.trademap.org/Country_SelProduct.aspx?nvpm=1||||TOTAL|||2|1|1|2|1|2|1|1)

*List of importers for the all products in 2015 for the Czech Republic* [online]. International Trade Centre (ITC). Available from: [http://www.trademap.org/Country\\_SelProduct.aspx?nvpm=1||||TOTAL|||2|1|1|1|1|2|1|1](http://www.trademap.org/Country_SelProduct.aspx?nvpm=1||||TOTAL|||2|1|1|1|1|2|1|1)

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# CISG AND ARBITRATION IN THE HUNGARIAN LEGAL PRACTICE

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## Abstract

During 2015 an extensive empirical research has been made on the Hungarian jurisdiction and legal practice of the CISG. As a result, it became clear that in the contractual routine many of the legal representatives advise the jurisdiction of an arbitration tribunal rather than the traditional court system. As we examine the awards of the most popular Hungarian arbitration court and compare them with the decisions of the national courts the reasons of this tendency become self-understanding. The paper analyses the differences between the arbitration and the traditional court system in working on the field of international sales contracts.

## Keywords

CISG; Jurisdiction; Arbitration; International Sales Contracts.

## 1 Introduction<sup>2</sup>

International sale contracts are the engines of commercial activities. It is obvious, that the regulation and harmonization of these contracts are in the basic interest of countries who are – or want to be – a part of the global market. This is even more evitable for those countries tend to raise their activities on international commercial grounds, like the so-called V4-countries.

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On 15 February 2016, the Visegrad Group (“V4”) celebrated the 25th anniversary of its establishment. In 1991, only two years after the fall of a totalitarian regime, hardly anyone expected this project of a regional cooperation to survive quarter-century as well as Poland, Hungary, the Czech Republic and Slovakia to successfully complete the transformation of society and take an important place in the system of international relations.<sup>3</sup> As international surveys show, even the citizens of these countries believe that this regional formation’s main goal is economic and trade cooperation.<sup>4</sup> Far from exhausting the possibilities, but V4 initiative is a well-working and developing regional cooperation.<sup>5</sup> On the field of trade cooperation, the basic legal instrument is the CISG. The purpose of the CISG is to provide a modern, uniform and fair regime for contracts for the international sale of goods. Thus, the CISG contributes significantly introducing certainty in commercial exchanges and decreasing transaction costs. At the time of writing this study, 85 contracting states are involved in this unification, including the most important trading partners of the world: USA, China, Japan, Russia, Germany, Australia. Although, some important countries are missing: from the EU Great Britain, Portugal and Malta did not join the CISG so far, India and many African countries are also not on the list of contracting states.

During the formation and adoption of the CISG, Hungary was striving to play an active role in the unification of law right from the early sixties. Hungarian legal scholars and academics, based upon a century-old sophisticated legal culture, were never willing to accept the idea and reality of a divided world and their country’s isolation behind what was called the Iron Curtain. They all shared the dream of more unified legal rules for international transactions not only because there was a universal need and aspiration for this, but also because the unification of civil law, at least relating to cross-border contracts, opened a window of opportunity to break out

<sup>3</sup> GYÁRFÁŠOVÁ, Olga, MESEŽNIKOV, Grigorij. *25 Years of the V4 as Seen by the Public* [online]. Bratislava: Institute for Public Affairs, 2016, p. 7 [accessed on 2017-04-26].

<sup>4</sup> *Ibid.*, p. 13.

<sup>5</sup> DANCÁK, Bretislav, GNIAZDOWSKI, Mateusz, HAMBERGER, Judit, HUDEK, Adam (chief eds.). *Two Decades of Visegrad Cooperation: Selected V4 Bibliography* [online]. Bratislava: International Visegrad Fund, 2011, p. 288 [accessed on 2017-04-26].

of the political, economic and legal isolation of Hungary.<sup>6</sup> I believe that this was all the same by the other countries of the V4, and as a proof of this, these countries joined the CISG among the first ones. The CISG entered into force on 1 January 1988 in Hungary, in the Czechoslovakia on 1 April 1991, the Czech Republic and Slovak Republic succeeded to the convention as of 1 January 1993. In Poland, it came into force on 1 June 1996, so at least the Polish legal system has more than 20 years of experience so far.

We can say that the V4-countries commercial regulation is highly influenced by the CISG. As Zell states “*the Vienna Sales Convention has been influential in shaping the path of development taken by contract law in Central and Eastern Europe*”<sup>7</sup> – especially in countries of the V4 group. The Hungarian new Civil Code is literally naming the CISG as a role model on regulating the contractual liability.<sup>8</sup> Jurčová points out that the Slovak commercial law has changed in many ways “*becoming more unified, or is shifting toward the system of the uniform model of breach in the regulation of sales contracts based on the Vienna Convention*”.<sup>9</sup>

If we are looking at the statistical data of commercial activities among the V4 countries, we can find how interconnected these economies are. We should also underline the importance of Germany in this field, which country is the most valuable export partner for all V4 country. However, it should also be mentioned, that with only one except (United Kingdom) the mentioned states are “all” Contracting States of the CISG!

<sup>6</sup> MARTONYI, János. Introduction. In: *Thirty-five Years of Uniform Sales Law: Trends and Perspectives*. Proceedings of the High Level Panel held during the Forty-eighth Session of the United Nations Commission on International Trade Law Vienna, 6 July 2015. New York: United Nations, 2015.

<sup>7</sup> ZELL, Fryderyk. The Impact of the Vienna Convention on the International Sale of Goods on Polish Law, With Some References to Other Central and Eastern European Countries. *Rebels Zeitschrift für Ausländisches und Internationales Privatrecht*, 2007, No. 1, p. 98.

<sup>8</sup> See in details: FUGLINSZKY, Ádám. *Kártérítési jog*. Budapest: HVGORAC, 2015.

<sup>9</sup> JURČOVÁ, Monika. *The Influence of Harmonisation on Civil Law in the Slovak Republic*. *Juridica* [online]. 2008, No. 1, pp. 166–172 [accessed on 2017-04-26].

Figure 1: Top 10 export partners of the V4 counties (in order of importance)<sup>10</sup>

Top 10 export partners of Czech Republic	Top 10 export partners of Hungary	Top 10 export partners of Poland	Top 10 export partners of Slovakia
Germany	Germany	Germany	Germany
Slovakia	Romania	United Kingdom	Czech Republic
Poland	Italy	Czech Republic	Poland
United Kingdom	Austria	France	Hungary
France	France	Italy	France
Austria	Slovakia	Russia	Austria
Italy	United Kingdom	Netherlands	Italy
Russia	Czech Republic	Belgium	United Kingdom
Hungary	Poland	Sweden	Russia
Netherlands	Russia	Hungary	Spain

During the year 2015 a unique survey has been made among the Hungarian legal practice. With a questionnaire sent directly to the most significant international law firms, to the Hungarian National Chamber of Attorneys and to the Győr-Moson-Sopron County Chamber of Attorneys, the process of drafting and entering of international sales contracts has been examined. As in Hungary the participation in the Chamber is mandatory for all the lawyers practicing, the survey reached the complete field of experts. At the same time, a parallel research has started in the judicial field. 150 sheets of printed questionnaires were sent directly to the Courts, and parallel the National Office of the Judiciary sent the questionnaire via email to the heads of the Courts, altogether 49 questionnaires arrived with appraisable content. Parts of this survey has already been published in Hungarian, in this study I only focus on the subject of applying the CISG and the choice of the forum and applicable law for international sales contracts.

<sup>10</sup> The Observatory of Economic Complexity (OEC), MIT, 2014.

## 2 Choice of Jurisdiction and Applicable Law for International Sales Contracts

In the upper mentioned questionnaire, a group of questions highlighted the jurisdiction issues of international sales contracts. All 35 answerers from legal representatives agreed to adopt a clause of jurisdiction in the sales contract, and the results on the chosen forum can be seen on Figure 2. The questionnaire included answer on alternative dispute resolution (“ADR”) as: “*I specify alternative dispute resolution (arbitration, mediation, other ADR).*” At this point we can see a very important difference between the smaller and the bigger law firm’s contractual design: the law firms dealing with more than 10 contracts in a business year are choosing ADR in 65, 21% in comparison with the average 57,14%, and the choice of the Hungarian forum is less (56,52%) than the average (65,7%).

Figure 2: Choice of jurisdiction in the sales contracts

Which jurisdiction do you chose?	Answers	%	Choice of jurisdiction by law firms with more than 10 contracts/year	Answers	%
Hungarian	23	65,70%	Hungarian	13	56,52%
Contracting partner’s country’s	8	22,85%	Contracting partner’s country’s	4	17,39%
Other country’s	2	5,70%	Other country’s	2	4,34%
ADR	20	57,14%	ADR	15	65,21%

For direct exclusion of a certain country’s forum only two participants (both with more than 20 contacts/year) stated that they used to exclude specific jurisdiction. Both participants also excluded the use of CISG in the contractual terms with the argument that the international application of CISG is incoherent, one of the answerers wrote that in his/her practice: “*Almost every contract contains the exclusion of the CISG because in the international practice it is not accepted for many reasons.*”

As for the application of the CISG, it is may be more important how the contracting parties agree on the applicable law for the contract. Figure 2 is showing the result for the question which focus was the choice of applicable law.

Figure 3: Choice of applicable law in sales contracts

Choice of applicable law for the contract	Answers	%	Choice of applicable law for the contract by law firms more than 10 contracts/year	Answers	%
Hungarian	35	100	Hungarian	23	100
Contracting partner's country's	9	25,71	Contracting partner's country's	7	30,43
Other country's law or refer to international convention	10	28,57	Other country's law or refer to international convention	6	26,08
Law of the arbitration body	11	31,42	Law of the arbitration body	9	39,13
Other	0		Other	0	

As a common ground, we can see that the Hungarian law is the mostly used applied law in the contracts. Here we also face a difference between the major law firms and the smaller one: from all the answers, the choice of the law of the arbitration court can be found in almost 40% by major law firms, and only plus 2 of the smaller ones chose also that answer – this can be seen from the answers in comparison. The previously studied question and this one together reflects the same way in the position and part of dispute resolution of arbitrators: the bigger the law firm is the more likely they use the jurisdiction and applicable law of arbitration court.

A problematic issue in the Hungarian legal practice is the exclusion of the CISG. However, this is not a unique phenomenon in the international field. As *Rozebnalová* reports in 2008, among the Czech Republic and Slovakia, the practicing lawyers tend to exclude the application of the CISG tendentiously. The reasoning is the misunderstanding in the national and international jurisdiction of some articles (she names Article 4) and the regulation of lump-sum damages.<sup>11</sup> Homeward trend is an often-cited *terminus technicus* of *Honnold* representing the interpretation difficulties of the CISG.<sup>12</sup>

<sup>11</sup> ROZEHNALOVÁ, Naděžda. Czech Republic. In: FERRARI, Franco (ed.). *CISG and its Impact on National Legal System*. Munich: Sellier, 2008, pp. 107–108.

<sup>12</sup> See in details HONNOLD, John O. *Documentary History of the Uniform Law for International Sales*. Kluwer Law and Taxation Publishers, 1989.

It reflects the fear that national courts will ignore the mandate of autonomous and international interpretation of the CISG in favor of interpretations influenced by national law. It is difficult for the courts to “become a different court that is no longer influenced by the law of its own national state”.<sup>13</sup> Honnold still believed in 1999, that the uniform interpretation is not illusory: “To read the words of the Convention with regard for their »international character« requires that they be projected against an international background. With time, a body of international experience will develop through international case law and scholarly writing.”<sup>14</sup> Although joining Honnold’s optimism I am afraid this time has not yet come, and we should wait for even longer, if the practitioners are excluding the CISG this often.

According to the results of the questionnaire, the Hungarian legal practitioners explained the exclusion with the followings:

Figure 4: Excluding certain legal order and the reasons of such exclusion

<b>Do you tend to exclude the use of certain country’s law or any other legal orders or conventions for the disputes?</b>	<b>Reason or comment on exclusion</b>
I exclude the CISG at the request of the client.	Comment: “Fundamentally I have positive experiences. The Convention is easy to use for a continental lawyer, the Hungarian and foreign language (basically German) commentary literature is useful help. But at the same time during the civil procedure neither the judges nor the clients realize the need for applying the regulations of the CISG, they have to be noticed on this fact during the process.”

<sup>13</sup> DiMATTEO, Larry A., DHOOGHE, Lucien, GREENE, Stephanie, MAURER, Virginia. The Interpretive Turn in International Sales Law. *Northwestern Journal of International Law and Business* [online]. 2004, No. 24, pp. 302–303 [accessed on 2017-04-26].

<sup>14</sup> HONNOLD, John O. *Uniform Law for International Sales under the 1980 United Nations Convention*. 3rd ed. The Hague: Kluwer Law International, 1999, pp. 88–89.



Do you tend to exclude the use of certain country's law or any other legal orders or conventions for the disputes?	Reason or comment on exclusion
I exclude the CISG.	Reasoning: "In case of international sales contract in many concrete cases it is favorable for the seller to use only the Hungarian law. Without direct excluding of the Vienna Convention it must be applied, and as the Convention does not govern all relevant fields, in disputes this doubles the applicable laws, which may lead to confusion in the judgement." Comment: "The main problem of the Convention is the lack of uniform application, which is the result of the phenomenon that the national courts interpret the Convention based on national laws."
I exclude the CISG almost all the time.	Reasoning: "The Convention is not accepted in the international practice for many reasons, almost every time its applicability is excluded."
I exclude the CISG.	Reasoning: "The application of the CISG is internationally rare"
If the client is the seller, I exclude CISG.	Reasoning: "The Hungarian civil law is more in favour of the seller in particular situations."
The clients expressing the will for excluding the CISG.	Comment: "Despite of the fact that the Convention's regulations are clear, the Courts have inconsistent practice of interpretation, or simply do not use the Convention though it is mandatory in the process."

Summarizing the reasons for exclusion, we must say that the commonly known arguments can be found in the Hungarian legal practice as well: lack of uniform interpretation and inconsistent judicial practice. Here I must refer to the work of *Koehler* and *Guo* summarizing the reasons of exclusion.<sup>15</sup> They stated the main problem was lack of knowledge of the CISG. Our results show that both the lack of uniform interpretation and the

<sup>15</sup> KOEHLER, Martin F., GUO, Yujun. The Acceptance of the Unified Sales Law (CISG) in Different Legal Systems. *Pace International Law Review* [online]. 2008, No. 1, pp. 45–60 [accessed on 2017-04-26].

inconsistent judicial practice are more dominant reasons for excluding the CISG; however, the attorneys also stated that the courts do not realize the mandatory use of the CISG.

In comparison within the V4 countries we found proof that the upper criticized lack of uniform interpretation is familiar in the other countries' practice as well. *Jurewicz* stated in 2009, that the Polish Supreme Court made a great step towards fulfilling the criteria named in Article 7 of the CISG, but also refers to the fact, that this is unique in previous the jurisprudence. She summarizes: *“The approach taken by the Court shows tremendous progress in building useful international jurisprudence since its first decision in 2003, where the Court abstained from discussing several issues that were at the heart of the case.”*<sup>16</sup>

### 3 Arbitration in Hungary

According to the UNCITRAL Model Law an arbitration is international, if the following criteria are fulfilled:

1. the parties to an arbitration agreement have, at the time of the conclusion of that agreement, their places of business in different states; or
2. one of the following places is situated outside the state in which the parties have their places of business:
  - a) the place of arbitration if determined in, or pursuant to, the arbitration agreement;
  - b) any place where a substantial part of the obligations of the commercial relationship is to be performed or the place with which the subject matter of the dispute is most closely connected; or
3. the parties have agreed expressly that the subject matter of the arbitration agreement relates to more than one country.<sup>17</sup>

Hungary has regulated the modern arbitration first in 1994, and the regulation is fully harmonized with the UNCITRAL Model Law.<sup>18</sup> This first

<sup>16</sup> JUREWICZ, Aleksandra. A Milestone in Polish CISG Jurisprudence and Its Significance to the World Trade Community. *Journal of Law and Commerce*, 2009, No. 1, p. 74.

<sup>17</sup> Article 1(3) of the UNCITRAL Model Law.

<sup>18</sup> See in details OKÁNYI, Zsolt, BIBÓK, Péter. Arbitration in Hungary. In: LÖRCHER, Torsten, PENDELL, Guy, WILSON, Jeremy (eds.). *CMS Guide to Arbitration* [online]. CMS Legal Series EEIG, Fourth Edition, 2012, pp. 389–416 [accessed on 2017-04-29].

regulation is in force ever since, but the concept of the new Hungarian Civil Procedure Code has already mentioned that the revision of the current regulation is very up-to-date to make the arbitration system even more efficient.<sup>19</sup>

In Hungary, the enforcement of arbitration agreements is basically governed by three legal sources:

- New York Convention (implemented to the Hungarian law by Law Decree 25 of 1962),
- Act III of 1952 on the Civil Procedure Code (changing from 1 January 2018 according to the new Act CXXX of 2016 on Civil Procedure Code) and
- most importantly the Hungarian Arbitration Act LXXI of 1994 on Arbitration (“Arbitration Act”).

During the formation of the new Civil Procedure Code the Drafting Commission of the Code raised the question of implementing new arbitration rules into the Civil Procedure Code in according to show more faith in the institution. The concept of this laid on the presumption that this will ensure the international investors that the Hungarian Government takes arbitration seriously. If we take into consideration the TTIP<sup>20</sup> negotiations, we can easily see that the Commission had the right idea – but with the wrong timing. Not surprisingly the accepted version of the Act did not contain this concept, and the regulation remained the same.

According to the Arbitration Act a matter can be brought to arbitration if: (i) at least one of the parties is a person professionally engaged in economic activity, and the legal dispute is in connection with this activity; (ii) the parties may dispose freely over the subject-matter of the proceedings; and (iii) the arbitration was stipulated in an arbitration agreement.

From 1 January 1997, the most favoured standing arbitration tribunal in Hungary is the Arbitration Tribunal attached to the Hungarian Chamber of Commerce and Industry (“ATHCCI”), it is dealing with most of the

<sup>19</sup> *Concept of the New Hungarian Civil Procedure Code accepted on 14th January 2015* [online]. Hungarian Government, p. 28 [accessed on 2017-04-29].

<sup>20</sup> Transatlantic Trade and Investment Partnership (TTIP) Agreement between the EU and the US; unfortunately frozen this time being.

international cases. In 2017, there are the following specified arbitration forums operating: Arbitration Court of Money and Capital Markets, Permanent Arbitration Court for Sport, Arbitration Court attached to the Hungarian Agricultural Chamber, Arbitration Court of Electronic Communications and Arbitration Court of Energy. There is legal possibility for *ad hoc* arbitral tribunals of course, but it is very rare in the Hungarian legal practice.<sup>21</sup>

As the inspected area of this study is the international sales law and the arbitration, we will focus on the ATHCCI and its case law. As pointed out previously in the research, there is a common trust among legal practitioners in the ATHCCI. Examining the awards there is clear evidence on the cause of this: the awards given by the arbitrators are far more fitting to the international case law, than those coming from the traditional judicial system. There is no legal tradition of case law in Hungary, so the courts are not bound by other sentences. Unfortunately, this means that they are not primarily forced to take into consideration the international case law as well – not speaking about the Court of Justice’s decisions of course. As a result on the CISG, this has serious effects. Article 7 says “*In the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade.*” However, this rule can hardly be detected in the court decisions. But the arbitral awards are very different. As a model-award we can cite the arbitral decision from 1997, which cites Hungarian and German scientific literature, and in the text is referring expressively to “other countries’ case law”<sup>22</sup>. Unfortunately, it is not easy to study the Hungarian arbitration cases, as almost all of them is protected by referring to trade secrets and therefore the Chamber refuses to allow even the scientific research on the texts. However, the Chamber is publishing some anonymized cases, and the upper conclusion can be drawn even from that few awards.

Observing the publicly available case law of Hungarian courts and the arbitration awards, in the case of the most referred articles of the CISG (which

<sup>21</sup> See in details: HORVÁTH, Éva. *Nemzetközi választottbíráskodás*. Budapest: HVGORAC, 2010.

<sup>22</sup> VB/9638, BH1997/10 (available only in Hungarian).

are Articles 1, 38, 74 and 78) we must agree that there is common and proper, uniform interpretation. We also find one common phenomenon in interpretation: the consequent and recurring use of the Hungarian Civil Code, and in general the Hungarian civil law, while applying the CISG. From the examined 38 cases, in 13 (34%) the Hungarian forum cited the CISG, but in the argumentation or in evaluating the court used the terms or the terminology of the Hungarian Civil Code, sometimes parallel with the articles of the CISG.

In the Hungarian legal system, a decision rendered by a lower court can be reversed or overruled by a higher court declaring the lower court's decision (as well as the result or the argumentation) wrong. In some cases, we can still observe that the lower courts did not apply the CISG at all, and only the second (rarely the third) instance gave attention to the CISG. We can see the same in some cases on the jurisdiction and applicable law governed by EU law. In many cases when the parties have domicile in EU Member States when searching for the legal basis of jurisdiction the court applies Act 13 of 1979 (Hungarian Code on International Private Law) to decide the jurisdiction and the applicable law as well, while it is the Brussels Ibis Regulation that should have been applied. Luckily, in case of international sales contract, the regulation and the Hungarian Act both use the same principles.

#### **4 Concluding Remarks**

Although Hungary is among the first contracting states of the CISG, the proper and internationally influenced application of it is still far from satisfactory. This is not a unique phenomenon in the region, the so-called "V4" counties are reporting the same based on empirical evidences: lack of knowledge on the side of legal representatives, regularly used clause on opting out of the CISG in the export contracts. An expansive survey made in 2015 in the Hungarian legal practice and its cross-border simultaneous surveys across Europe show that the CISG is used in the legal practice under its value. Examining the reasoning of excluding the CISG we find out lack of knowledge, uncertainty of case law, and special request of exclusion from the contracting partners.

In my belief, we can name three main reasons of the lack of relevant legal experience on the CISG in Hungary:

1. lack of detailed knowledge on the CISG and its international case law;
2. the courts are not motivated enough to be up-to-date with relevant national and international scientific literature and international decisions;
3. the legal representative's accidental application of the CISG rules and lack of knowledge of foreign languages.

It is crucial for export and import companies settled in a country like Hungary (but we could speak about the whole V4 region) to be aware of the legal framework of international sale contracts, and among this knowing the possible positive and negative effects on business routine of application or opting out of the CISG. As for a Hungarian company, we can summarize, that being on the seller's position the CISG – under specified circumstances – offers better legal position than the national regulation. This is not true however being on the buyer side, while the duty of examination of the goods governed by Article 38 and 39 of the CISG is much stricter than the national law. But if the legal representative – and sometimes the court itself – does not know about the differences, it can be a serious disadvantage for the business transactions.

Analysing the arbitral awards and arbitration system in Hungary we can see, that according to the survey made among law firms, the bigger a Hungarian law firm is the more likely it is choosing arbitration as resolution for international disputes. If we compare the decisions we came to the result that although there is no case law in Hungary, the arbitral tribunals, especially the most favoured ATHCCI, the awards contain references on national and international scientific literature, citations on international case law – which makes this arbitration forum working much more like an international dispute settlement body, than the traditional judicial forums.

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# TIME LIMITS IN ARBITRATION AGREEMENTS – WHAT CAN WE EXPECT, IF WE FAIL TO MEET THEM?

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## **Abstract**

Since parties often include in their arbitration agreements different time limits, the main purpose of the author is to answer the question whether incompliance with a set time limit renders the case inadmissible or is a bar to arbitral tribunal's jurisdiction. The first part of the paper deals with the question of applicable law. Subsequently, the author analyses what the differences between an objection to jurisdiction and to admissibility of claims are, and finally the paper considers how certain example clauses could be interpreted under Polish law. The author's hypothesis is that arbitration clauses containing time limits should be interpreted based on the law applicable to a relevant arbitration agreement. Furthermore, qualification of an incompliance with a particular time limit as a matter of jurisdiction or of admissibility of claims depends on the assessment whether parties expected that in case of a failure to meet the stipulated deadlines they could not pursue the case in arbitration or at all.

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## Keywords

International Commercial Arbitration; Arbitration Agreements; Time Limits in Arbitration Clauses.

## 1 Introduction

Consciously or not, parties often include in their arbitration agreements different time limits. They either set a time limit for commencement of arbitration or for its conclusion. They may also decide that arbitration may commence first upon the lapse of a specified period of time.

The main question which arises relating to inclusion of time limits in arbitration agreements is what legal consequences the parties may expect in case of a failure to meet them.

Consequently, the purpose of the author is to answer the question about the qualification of non-compliance with time limits stipulated in arbitration agreements. Namely, the author will analyse whether it is a bar to arbitral tribunal's jurisdiction or a hindrance to admissibility of claims. It will be also considered whether such time limits may be held unenforceable.

The author's hypothesis is that arbitration clauses containing time limits should be interpreted in accordance with the law applicable to a relevant arbitration agreement. Under Polish law, arbitration clauses containing time limits which are clearly worded are in principle enforceable. Qualification of an issue as a matter of arbitral tribunal's jurisdiction or of admissibility of claims depends on the assessment of parties' intention with respect to the consequences of a failure to meet the stipulated deadlines. The question is whether the parties wanted the case to be discontinued in arbitration proceedings or in general. If it is possible to determine that the parties consented to arbitration on condition that a particular time limit lapses, then such issue is of a jurisdictional nature.

Under Polish law, the most likely scenario is that a requirement to comply with a stipulated time limit would be qualified as a "condition" or a "term". However, it is also possible that an obligation to refrain from arbitration during a particular period of time would be qualified as a particular *pactum de non petendo*, although such qualification may cause certain concerns.

## 2 Applicable Law

Since there is no transnational or supranational rule governing consequences of non-compliance with time limits included in arbitration agreements, it is necessary to look for answers to the aforementioned questions in the applicable law. There are several ways by which arbitral tribunals may determine the applicable law. Unlike in domestic courts which would simply look for the applicable law in their own conflict of laws rules,<sup>2</sup> in arbitration the outcome of a search for the applicable law could be more unpredictable. This is because arbitral tribunals do not have their forum and consequently their conflict of laws rules.<sup>3</sup>

In domestic courts, the determination of the applicable law usually consists of three steps. Firstly, the court has to fit the issue in question into the pertinent legal category, through the process called characterization.<sup>4</sup> Secondly, the court, with the help of a connecting factor, needs to connect (localise) the legal category or issue with the applicable law. Thirdly, the court should ascertain the content of the applicable law and apply it.<sup>5</sup>

In international arbitration, if the parties did not choose the applicable law, arbitrators may determine it either indirectly by using conflict of laws rules or directly by applying the law which they consider appropriate.<sup>6</sup> It is believed that the competence of an arbitral tribunal to determine the applicable law stems from the principle of the parties' autonomy.<sup>7</sup>

<sup>2</sup> LEW, Julian D. M. Relevance of Conflict of Law Rules in the Practice of Arbitration. In: VAN DEN BERG, Albert Jan (ed.). *Planning Efficient Arbitration Proceedings: The Law Applicable in International Arbitration, ICCA Congress Series. Vol. 7.* Alphen aan den Rijn: Kluwer Law International, 1996, p. 447.

<sup>3</sup> BLACKABY, Nigel, PARTASIDES, Constantine et al. *Redfern and Hunter on International Arbitration.* 6th ed. Oxford: Oxford University Press, 2015, paras 3.211–3.213.

<sup>4</sup> FAWCETT, James, CARRUTHERS, Janeen M. *Cheshire, North & Fawcett: Private International Law* (Sir Peter North consultant ed.). 14th ed. Oxford: Oxford University Press, 2008, p. 42.

<sup>5</sup> *Ibid.*, pp. 41–42.

<sup>6</sup> LEW, Julian D.M., MISTELIS, Loukas A., KRÖLL, Stefan Michael. *Comparative International Commercial Arbitration.* Alphen aan den Rijn: Kluwer Law International, 2003, p. 425.

<sup>7</sup> POCZOBUT, Jerzy. Zagadnienia kolizyjnoprawne w międzynarodowym arbitrażu handlowym. In: SZUMANSKI, Andrzej (ed.). *System Prawa Handlowego Tom 8 Arbitraż Handlowy.* 2nd ed. Warsaw: C.H. Beck, 2015, p. 237 and following; LEW, Julian D.M., MISTELIS, Loukas A., KRÖLL, Stefan Michael. *Comparative International Commercial Arbitration.* Alphen aan den Rijn: Kluwer Law International, 2003, p. 425.

If arbitrators opt for indirect determination of applicable law they may choose a particular system of conflict of laws rules, such as the conflict of laws rules of the place of arbitration, conflict of laws rules most closely connected with the subject matter or which they consider most appropriate.<sup>8</sup> They may also decide to apply a particular conflict of laws rule instead of a whole system of conflict of laws.<sup>9</sup> The UNCITRAL Model Law makes a general suggestion that arbitrators may determine applicable law by whichever conflict of laws rules they consider applicable. It has been suggested that it is the easiest for arbitrators to apply a national system of conflict of law rules.<sup>10</sup>

If arbitrators decide to apply a particular system of conflicts of laws they should first determine within the scope of which norm the issue in question falls. Under Polish system of conflict of laws rules envisaged in the Polish Private International Law Act (“PPIL”)<sup>11</sup> interpretation of an arbitration agreement, inclusion of terms and conditions and consequences thereof are governed by the law applicable to the arbitration agreement.<sup>12</sup> These issues have been similarly characterized by *Poudret* and *Besson*. According to them the effects of contractual time limits included in arbitration agreements are governed by the law applicable to the arbitration agreement.<sup>13</sup> Likewise, *Born* found that issues such as interpretation, termination and expiration of an arbitration agreement are governed by the law applicable to an arbitration agreement.<sup>14</sup>

<sup>8</sup> LEW, Julian D.M., MISTELIS, Loukas A., KRÖLL, Stefan Michael. *Comparative International Commercial Arbitration*. Alphen aan den Rijn: Kluwer Law International, 2003, p. 428.

<sup>9</sup> LEW, Julian D. M. Relevance of Conflict of Law Rules in the Practice of Arbitration. In: VAN DEN BERG, Albert Jan (ed.). *Planning Efficient Arbitration Proceedings: The Law Applicable in International Arbitration, ICCA Congress Series. Vol. 7*. Alphen aan den Rijn: Kluwer Law International, 1996, p. 449.

<sup>10</sup> LEW, Julian D. M. Relevance of Conflict of Law Rules in the Practice of Arbitration. In VAN DEN BERG, Albert Jan (ed.). *Planning Efficient Arbitration Proceedings: The Law Applicable in International Arbitration, ICCA Congress Series. vol.7*. Alphen aan den Rijn: Kluwer Law International, 1996, p. 449.

<sup>11</sup> POLAND. Official Journal 2011 No. 80 pos. 432, Private International Law Act (“PPIL”).

<sup>12</sup> POCZOBUT, Jerzy. Zagadnienia kolizyjnoprawne w międzynarodowym arbitrażu handlowym. In: SZUMANSKI, Andrzej (ed.). *System Prawa Handlowego Tom 8 Arbitraż Handlowy*. 2nd ed. Warsaw: C. H. Beck, 2015, pp. 202–203.

<sup>13</sup> POUDRET, Jean-François, BESSON, Sébastien. *Comparative Law of International Arbitration*. 2nd ed. London: Sweet & Maxwell, 2007, p. 257.

<sup>14</sup> BORN, Gary B. *International Commercial Arbitration*. 2nd ed. Alphen aan den Rijn: Kluwer Law International, 2014, p. 489.

According to Article 39 of the PPIL, an arbitration agreement is primarily governed by the law chosen by the parties. In the absence of a choice of law by the parties, the arbitration agreement is subject to the law of the agreed seat of arbitration. Where the latter was not agreed, the arbitration agreement is subject to the law applicable to the legal relationship to which the given dispute relates. However, it is sufficient that the arbitration agreement is effective under the law of the country of the place of arbitration or in which the arbitral tribunal issued the award.<sup>15</sup>

### **3 Arbitration Agreements Containing Time Limits – Different Scenarios**

The parties may include different time limits into their arbitration agreements or more broadly – into dispute resolution clauses. For instance, they may decide that:

1. arbitration should be initiated within 30 days after it was agreed that the difference or dispute could not be resolved by negotiation, or
2. the arbitral tribunal is obligated to resolve the dispute no later than within two weeks as of filing of a statement of claim by any of the parties, or
3. the dispute cannot be referred to arbitration before the lapse of 45 days following an invitation to negotiate.

The above list of example clauses containing time limits is not exhaustive, naturally.

Depending on the wording of a particular clause parties may suggest that the clause does not create any legal obligations and thus is not enforceable. On the other hand, they may claim that the clause is clearly worded and consequently implies obligations on the parties. In the latter case, they may submit that incompliance with the time limit renders the case inadmissible (at least temporarily) or that it is a bar to the tribunal's jurisdiction.

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<sup>15</sup> POCZOBUĆ, Jerzy. Umowa o arbitraż w polskim prawie prywatnym międzynarodowym-z uwagami prawnoporównawczymi. In: PAZDAN, Maksymilian (ed.). *System Prawa Prywatnego Tom 20 B prawo prywatne międzynarodowe*. Warsaw: C. H. Beck, 2015, pp. 678-680; Article 39 of PPIL.

In the following parts of the paper, I will firstly consider what the main differences between the notions of admissibility and jurisdiction are. Since a particular arbitration clause should be interpreted on the basis of applicable law and not in the abstract, subsequently, I will analyse how the above examples clauses could be qualified and interpreted under Polish law, if it was found applicable.

#### 4 A Question of Admissibility or of Jurisdiction?

Differentiation between the matter of jurisdiction and of admissibility is not an easy task. Counsels and tribunals often referred to objections to jurisdiction and admissibility without distinguishing between the two.<sup>16</sup> The issue has been raised particularly in investment arbitration. While in the past tribunals rather avoided the issue, recently this attitude has changed.<sup>17</sup> Over the years also several authors have shed some light on the issue.<sup>18</sup>

Qualification of an issue as a matter of jurisdiction or of admissibility has also practical consequences, since the arbitral tribunal's determination as to the admissibility of claims should be final and conclusions pertaining to tribunal's jurisdiction may be subject to subsequent review by domestic courts.<sup>19</sup>

<sup>16</sup> NEWCOMBE, Andrew. The Question of Admissibility of Claims in International Investment Arbitration [online]. In: *Kluwer Arbitration Blog*. Wolters Kluwer [accessed on 2017-04-30].

<sup>17</sup> GOUIFFÈS, Laurent, ORDONEZ, Melissa. Jurisdiction and admissibility: Are We Any Closer to a Line in the Sand? *Arbitration International*, 2015, Vol. 31, p. 107.

<sup>18</sup> See PAULSSON, Jan. Jurisdiction and Admissibility. In: AKSEN Gerald et al. (eds.). *Global Reflections on International Law, Commerce and Dispute Resolution, Liber Amicorum in Honour of Robert Briner*. Paris: International Chamber of Commerce, 2005; GOUIFFÈS, Laurent, ORDONEZ, Melissa. Jurisdiction and Admissibility: Are We Any Closer to a Line in the Sand? *Arbitration International*, 2015, Vol. 31; HEISKANEN, Veijo. Ménage à trois? Jurisdiction, Admissibility and Competence in Investment Treaty Arbitration. *ICSID Review*, 2014, Vol. 29; ZEILER, Gerold. Jurisdiction, Competence, and Admissibility of Claims in ICSID Arbitration Proceedings. In: BINDER, Christina et al. (eds.). *International Investment Law for the 21st Century: Essays in Honour of Christoph Schreuer*. Oxford: Oxford University Press, 2009.

<sup>19</sup> PAULSSON, Jan. Jurisdiction and Admissibility. In: AKSEN Gerald et al. (eds.). *Global Reflections on International Law, Commerce and Dispute Resolution, Liber Amicorum in Honour of Robert Briner*. Paris: International Chamber of Commerce, 2005, p. 601.

Jurisdiction is defined as the legal power of an arbitral tribunal to adjudicate a case.<sup>20</sup> The question is about existence of the tribunal's authority to hear the case and scope of this authority.<sup>21</sup> The tribunal's authority is derived from the parties' consent expressed in the arbitration agreement.

On the contrary, the notion of admissibility relates to appropriateness of a claim for adjudication.<sup>22</sup> Therefore, the question is whether a claim, as presented at a particular moment in time, can be adjudicated by an arbitral tribunal, which has already established its jurisdiction.<sup>23</sup>

The distinction between admissibility and jurisdiction was explained *inter alia* in the dissenting opinion to *Waste Management, Inc. v. United Mexican States* in which it was stated that: “*Jurisdiction is the power of the tribunal to hear the case; admissibility is whether the case itself is defective—whether it is appropriate for the tribunal to hear it*”.<sup>24</sup>

In my understanding, whenever the parties question existence, validity, operability or scope of an arbitration agreement, namely the issues which relate to their consent to arbitrate or lack thereof, the objection is of a jurisdictional nature. If it is possible to conclude that the parties do not question their consent to arbitrate, but rather the mere possibility to have their case heard by the arbitral tribunal at a given time, the objection relates to admissibility of claims.

For instance, allegations pertaining to lack of capacity of the parties to enter into an arbitration agreement are objections to jurisdiction of the tribunal. If an arbitration agreement has not been concluded by competent parties then it does not exist and consequently there is no consent of the parties to arbitrate.

<sup>20</sup> GOUIFFÈS, Laurent, ORDONEZ, Melissa. Jurisdiction and Admissibility: Are We Any Closer to a Line in the Sand? *Arbitration International*, 2015, Vol. 31, p. 109.

<sup>21</sup> HEISKANEN, Veijo. Ménage à trois? Jurisdiction, Admissibility and Competence in Investment Treaty Arbitration. *ICSID Review*, 2014, Vol. 29, p. 237.

<sup>22</sup> GOUIFFÈS, Laurent, ORDONEZ, Melissa. Jurisdiction and Admissibility: Are We Any Closer to a Line in the Sand? *Arbitration International*, 2015, Vol. 31, p. 109.

<sup>23</sup> HEISKANEN, Veijo. Ménage à trois? Jurisdiction, Admissibility and Competence in Investment Treaty Arbitration. *ICSID Review*, 2014, Vol. 29, p. 237 - 238.

<sup>24</sup> Dissenting Opinion of Keith Hight of 8 May 2000, ICSID Case No. ARB(AF)/98/2. *Waste Management, Inc. v. United Mexican States*, para. 58 [online]. In: *Italiam.com* [accessed on 2017-04-30].

An example of an objection to admissibility of claims is where claimant has failed to exhaust local remedies.<sup>25</sup> In such scenario parties usually do not question their consent to arbitrate but only the mere possibility to recognize the claim before exhaustion of local remedies.

However, the issue might not be that easy to qualify in a situation of different time limits stipulated in arbitration clauses.

In the *Vekoma v. Maran* case,<sup>26</sup> the contract provided that arbitration should be initiated within 30 days after it was agreed that the difference or dispute could not be resolved by negotiation. The Swiss Supreme Court upheld the challenge to the award, stating that the arbitration agreement was subject to a condition subsequent, the 30-day limit, and that claimant had failed to satisfy it. As a consequence, the court held that the arbitration agreement had lost its effects and arbitrators lacked competence to hear the case.<sup>27</sup> In result, the arbitration award was set aside.

This judgment was criticized by some authors, including *Paulsson* who suggested that the Swiss Supreme Court erred in its decision because it misunderstood the nature of the challenged arbitral award in which arbitrators decided about the admissibility of claims rather than their jurisdiction.<sup>28</sup>

However, it seems that the parties to the dispute similarly understood the consequences of non-compliance with the stipulated time limit and that the dispute at hand was actually about the determination of an event triggering the 30-day limit for submission of a statement of claim.<sup>29</sup> Therefore, the main critics of the Swiss Supreme Court's judgment is that it questioned the arbitral tribunal's factual findings concerning the event triggering the stipulated time limit.<sup>30</sup> *Friedland*, who apparently was Claimant's counsel, suggests

<sup>25</sup> HEISKANEN, Veijo. Ménage à trois? Jurisdiction, Admissibility and Competence in Investment Treaty Arbitration. *ICSID Review*, 2014, Vol. 29, p. 238.

<sup>26</sup> Judgment of the Supreme Court, Switzerland of 17 August 1995, No. 4P.284/1994/odi. Transporten Handelsmaatschappij 'Vekoma' BV v. Maran Coal Corporation. In *ASA Bulletin*, 1996, Vol. 14, No. 4.

<sup>27</sup> *Ibid.*

<sup>28</sup> PAULSSON, Jan. Jurisdiction and Admissibility. In: AKSEN Gerald et al. (eds.). *Global Reflections on International Law, Commerce and Dispute Resolution, Liber Amicorum in Honour of Robert Briner*. Paris: International Chamber of Commerce, 2005, p. 602.

<sup>29</sup> FRIEDLAND, Paul D. The Swiss Supreme Court Sets Aside an ICC Award. *Journal of International Arbitration*, 1996, Vol. 13, Issue 1, p. 111.

<sup>30</sup> *Ibid.*, pp. 111–115.



that: “If contracting parties wish to provide a contractual deadline for resort to arbitration following negotiations, they should provide that the time-period runs from the receipt of written notice of the existence of a dispute, without any reference to the date that the parties’ negotiations have ended or failed”.<sup>31</sup>

Nevertheless, it seems that the case inspired *Paulsson* to write his famous paper on jurisdiction and admissibility.<sup>32</sup> As stated above, according to *Paulsson*, the issue analysed in the *Vekoma* case was a matter of admissibility of claims rather than jurisdiction of the arbitral tribunal.<sup>33</sup>

*Paulsson* emphasises that: “The parties had agreed that all disputes under their contract would be decided by this particular tribunal and validity of arbitration clause was not an issue”.<sup>34</sup>

Although indeed validity of an arbitration clause was not an issue, the issue was whether the arbitration agreement lost its effects and thus became inoperative. An arbitration clause might be held inoperative where it has ceased to have legal effects as a result, for example, of a failure by the parties to comply with a stipulated time limit.<sup>35</sup>

Further, *Paulsson* suggests that in order to answer the question whether the time limit was intended to be a bar to the tribunal’s jurisdiction or to the admissibility of claims, it is necessary to ascertain whether it was the parties’ intention that the relevant claim should no longer be arbitrated (but could be pursued in another forum) or that the claim could no longer be raised at all. In the *Paulsson’s* opinion opting for the former would mean that the objection is jurisdictional.<sup>36</sup> If we decided that the consequences of in-compliance with a time limit were a question of admissibility, this would mean that Claimant could not pursue the claim at all either in arbitration or in domestic court. Such outcome seems to be severe.

<sup>31</sup> Ibid., p. 116.

<sup>32</sup> PAULSSON, Jan. Jurisdiction and Admissibility. In: AKSEN Gerald et al. (eds.). *Global Reflections on International Law, Commerce and Dispute Resolution, Liber Amicorum in Honour of Robert Briner*. Paris: International Chamber of Commerce, 2005, *passim*.

<sup>33</sup> Ibid., p. 602.

<sup>34</sup> Ibid.

<sup>35</sup> BLACKABY, Nigel, PARTASIDES, Constantine et al. *Redfern and Hunter on International Arbitration*. 6th ed. Oxford: Oxford University Press, 2015, para 2.202.

<sup>36</sup> PAULSSON, Jan. Jurisdiction and Admissibility. In: AKSEN Gerald et al. (eds.). *Global Reflections on International Law, Commerce and Dispute Resolution, Liber Amicorum in Honour of Robert Briner*. Paris: International Chamber of Commerce, 2005, p. 616.

In my view, it is not possible to make a general conclusion that in all instances in compliance with the set time limits is a bar to tribunal's jurisdiction or a hindrance to admissibility of claims. Such qualification depends on the wording of a particular clause and on the intention of the parties which should be ascertained on the basis of the law applicable to the arbitration agreement.

## 5 Possible Interpretations of Arbitration Clauses Containing Time Limits Under Polish Law

### 5.1 Binding Character of Arbitration Clauses Containing Time Limits

Parties sometimes try to suggest that their commitment to engage in negotiations or mediation followed by a cooling off period does not create any legal obligations and therefore is unenforceable.

However, it is generally believed that time restrictions make multi-step dispute resolution clauses enforceable.<sup>37</sup>

These conclusions also hold under Polish law. A declaration of intent depends on parties' will to cause certain legal effects,<sup>38</sup> such as an obligation to initiate arbitration within a particular time period. Arbitration clauses are subject to interpretation like any other kind of contractual provision, in accordance with the rules set forth in Article 65 of the Polish Civil Code. If it is sufficiently clear that parties intended that arbitration should be initiated within 30 days after negotiations had failed or that the dispute should be resolved no later than within two weeks as of filing of a statement of claim or that the dispute cannot be referred to arbitration before the lapse of 45 days following an invitation to negotiate, then the clause constitutes a declaration of intent imposing legal obligations on the parties and thus should be deemed enforceable.

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<sup>37</sup> Judgment of the Supreme Court, Switzerland of 6 June 2007, No. 4A\_18/2007, para 4.3.2. In: *ASA Bulletin*, 2008, Vol. 26, Issue 1; BOOG, Christopher. How to Deal with Multi-Tiered Dispute Resolution Clauses. Note. 6 June 2007. Swiss Federal Supreme Court. *ASA Bulletin*, 2008, Vol. 26, p. 106.

<sup>38</sup> Judgment of the Supreme Court, Poland of 21 January 2003, No. III RN 6/02 [online]. In: *Legalis No. 94235* [accessed on 2017-04-30].

## 5.2 Qualification of Time Limits Included in Arbitration Clauses under Polish Law

It is commonly accepted in the Polish doctrine that an arbitration agreement can be made conditional.<sup>39</sup> Parties can stipulate either a condition precedent, fulfilment of which activates the legal effects of an arbitration agreement, or a condition subsequent as a result of which the agreement ceases to be in force.<sup>40</sup> The effect of an arbitration agreement may also be dependent on the lapse of a time limit.<sup>41</sup>

Sometimes it might be difficult to conclude whether a particular arbitration clause contains a “condition” or a “term”. The main distinction between the two is that a condition is a future and uncertain event, while a term’s expiry is certain. Some clauses may be of a mixed character.<sup>42</sup> Although the distinction between the two notions is important, in any event, under Polish Civil Code, provisions pertaining to “conditions” apply to “terms” accordingly.<sup>43</sup>

In case No. I Aca 1822/14, the Warsaw Court of Appeal decided that a stipulation according to which “*the arbitral tribunal is obligated to resolve the dispute no later than within two weeks as of filing of a statement of claim by any of the parties*” is a “term” within the meaning of the Polish Civil Code and after its expiry the arbitration clause lost its effects and became inoperative.<sup>44</sup>

<sup>39</sup> ERECIŃSKI, Tadeusz, WEITZ, Karol. *Sąd arbitrażowy*. Warsaw: LexisNexis, 2008, p. 104; TOMASZEWSKI, Maciej. Umowa o arbitraż. In: SZUMAŃSKI, Andrzej (ed.). *System Prawa Handlowego Tom 8 Arbitraż Handlowy*. 2nd ed. Warsaw: C. H. Beck, 2015, pp. 350–351; Judgment of the Supreme Court, Poland of 27 November 2008, No. IV CSK 292/08 [online]. In: *Legalis No. 117886* [accessed on 2017-04-30].

<sup>40</sup> ERECIŃSKI, Tadeusz, WEITZ, Karol. *Sąd arbitrażowy*. Warsaw: LexisNexis, 2008, pp. 104–105.

<sup>41</sup> WIŚNIEWSKI, Andrzej W. *Międzynarodowy arbitraż handlowy w Polsce. Status prawny arbitrażu i arbitrów*. Warsaw: Wolters Kluwer, 2011, p. 428; TOMASZEWSKI, Maciej. Umowa o arbitraż. In: SZUMAŃSKI, Andrzej (ed.). *System Prawa Handlowego Tom 8 Arbitraż Handlowy*. 2nd ed. Warsaw: C. H. Beck, 2015, pp. 380–381; Judgment of the Supreme Court, Poland of 27 November 2008, No. IV CSK 292/08 [online]. In: *Legalis No. 117886* [accessed on 2017-04-30].

<sup>42</sup> GIESEN, Beata. Komentarz do art. 89 k.c. In: KSIĘŻAK, Paweł et al. (eds.). *Kodeks cywilny. Komentarz. Część ogólna*. 2nd ed [online]. Available in *LEX database*, 2014 [accessed on 2017-04-30].

<sup>43</sup> POLAND. Official Journal 1964 No. 16 pos. 93, Civil Code, Article 116.

<sup>44</sup> Judgment of the Warsaw Court of Appeal, Poland of 18 June 2015, No. I Aca 1822/14 [online]. In: *Legalis No. 1349081* [accessed on 2017-04-30].

The case concerned *inter alia* interpretation of an arbitration clause contained in a 1994 Lease Agreement. After the dispute arose, claimant initiated arbitration against respondent. Unsurprisingly, the arbitral tribunal did not manage to resolve the dispute within two weeks and consequently respondent questioned the tribunal's jurisdiction to hear the case claiming that an arbitration agreement had lost its effects.<sup>45</sup>

The arbitral tribunal rejected respondent's jurisdictional objection and rendered an award. Respondent filed an application to set aside the award. The court of first instance partially agreed with respondent's arguments but it did find that the arbitration clause had lost its legal effects.

The court of second instance set aside the remaining part of the award on the basis that the arbitration clause contained in 1994 Lease Agreement had lost its legal effect due to lapse of the time limit for conclusion of the proceedings.

The Warsaw Court of Appeal found that the tribunal was "obliged" to render an award within a two-week time limit. It concluded that both parties understood the consequences of lack of compliance with the set time limit as a hindrance to further pursue a claim in arbitration (but not in general).

In consequence, the issue was qualified as a matter of jurisdiction and thus was successfully challenged in a domestic court.

Commentators suggests that the parties should be careful when they draft arbitration agreements and should avoid creating an issue which could jeopardise arbitration proceedings.<sup>46</sup>

On the other hand, no matter how unrealistic the time limit was, since the parties agreed to such a provision, it should have been given legal effects.

Example clauses No. 1 and 2 could potentially be qualified as clauses containing either a "condition" or a "term". This would mean that lack of initiation of arbitration within 30 days after it was agreed that the difference could

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<sup>45</sup> Ibid.

<sup>46</sup> KOS, Rafal, DURBAS, Maciej. Time Limits in Arbitration Agreements [online]. *International Law Office* [accessed on 2017-04-30].

not be resolved by negotiations, or lack of conclusion of arbitration within two weeks as of filing of a statement of claim, would mean that an arbitration agreement has lost its legal effects and has become inoperative.

Example clause No. 3 according to which the dispute cannot be referred to arbitration before the lapse of 45 days following an invitation to negotiate, could also be considered as a matter of admissibility. However, the admissibility approach under Polish law seems to be understood in quite a different manner than in international literature.<sup>47</sup> It seems that admissibility is regarded as a substantive matter.<sup>48</sup>

*Tomaszewski* states that an arbitration agreement made under the condition that parties attempt to negotiate the dispute for a particular period of time, should be qualified as “*particular type of pactum de non petendo*”,<sup>49</sup> which under Polish law is used mainly in the context of release from debt, which is regulated in Article 508 of the Polish Civil Code.<sup>50</sup>

According to *Tomaszewski* in such scenario the effects of an arbitration clause are neither frozen nor expired but respondent may raise the objection of temporary inadmissibility of claims until the time limit lapses. However, it is necessary to note that even *Tomaszewski* questions the possibility to rely on a *pactum de non petendo* doctrine under Polish law.<sup>51</sup>

<sup>47</sup> GARNUSZEK, Anita, ORZEL, Aleksandra. Enforceability of Multi-tiered Dispute Resolution Clauses under Polish Law. *Arbitration Bulletin-Young Arbitration*, 2016, Vol. 24, pp. 171–174.

<sup>48</sup> See TOMASZEWSKI, Maciej. Umowa o arbitraż. In: SZUMAŃSKI, Andrzej (ed.). *System Prawa Handlowego Tom 8 Arbitraż Handlowy*. 2nd ed. Warsaw: C. H. Beck, 2015, p. 380.

<sup>49</sup> *Ibid.*

<sup>50</sup> GARNUSZEK, Anita, ORZEL, Aleksandra. Enforceability of Multi-tiered Dispute Resolution Clauses under Polish Law. *Arbitration Bulletin-Young Arbitration*, 2016, Vol. 24, pp. 171–174; ZAGROBELNY, Krzysztof. Komentarz do art. 508 k.c. In: GNIEWEK, Edward, MACHNIKOWSKI, Piotr (eds.). *Kodeks cywilny. Komentarz*. 7th ed. [online]. Available in *Legalis database*, 2016 [accessed on 2017-04-30].

<sup>51</sup> TOMASZEWSKI, Maciej. Umowa o arbitraż. In: SZUMAŃSKI, Andrzej (ed.). *System Prawa Handlowego Tom 8 Arbitraż Handlowy*. 2nd ed. Warsaw: C. H. Beck, 2015, pp. 380–381. For further considerations see GARNUSZEK, Anita, ORZEL, Aleksandra. Enforceability of Multi-tiered Dispute Resolution Clauses under Polish Law. *Arbitration Bulletin-Young Arbitration*, 2016, Vol. 24, pp. 171–174.

## 6 Conclusions

The answer to the question posed in the title of this paper need to be looked for in the law applicable to an arbitration agreement which governs its interpretation, expiration etc. This law may be determined by arbitral tribunals either indirectly through application of a particular system of conflict of laws rules or directly by application of the law which arbitrators consider appropriate.

It is not possible to answer the question whether the issue relates to admissibility of claims or to jurisdiction in abstract. Such qualification depends on the wording of a particular clause and on the intention of the parties.

Under Polish law, arbitration clauses containing time limits which are clearly worded are in principle enforceable. Qualification of an issue as a matter of arbitral tribunal's jurisdiction or of admissibility of claims depends on the assessment of parties' intention with respect to the consequences of a failure to meet the stipulated deadlines. The question is whether the parties wanted the case to be discontinued in arbitration or in general. If it is possible to establish that the parties consented to arbitration on condition that a particular time limit lapses or until it lapses, then such issue is of a jurisdictional nature.

Under Polish law, the most likely scenario is that a requirement to comply with a stipulated time limit would be qualified as a "condition" or a "term". However, it is also possible that an obligation to refrain from arbitration during a particular period of time would be qualified as a particular *pactum de non petendo*, although such qualification may cause certain concerns.

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# INTERPRETATION HARDSHIPS REGARDING THE CISG, IN PARTICULAR ARTICLE 7

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## **Abstract**

Even though there are many instruments facilitating the autonomous interpretation of the CISG, it is never an easy task to apply an international treaty in the same way in Contracting States with different legal and cultural traditions. Uniform application of international private law is hard to achieve and there are some crucial question. I intend to observe the role of Article 7 of the CISG in a comprehensive way, which provision is about uniform application, good faith and how to settle matters, which are not expressly settled in the CISG. I also intend to present cases regarding this article demonstrating the concrete problems judges and arbitrators have to deal with. My goal is to summarize briefly the interpretation hardships in the case law regarding Article 7 of the CISG based on international judgements and academic literature. I also analyse some Hungarian cases that has not been published internationally so far. The conclusion is that the importance of Article 7 of the CISG might not be reflected well in Hungarian case law, even though this provision could be of great help – taking into consideration that the CISG is not commonly and widely applied in Hungary.

## **Keywords**

Interpretation; CISG; Article 7; Case Law.

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## 1 Introduction

Nowadays international commerce became beyond question really significant and because of globalization cross-border transportation of goods gives a real chance to be the part of it for almost everyone. Our daily life is unimaginable without the opportunity to take part in this kind of commercial activity – not only for enterprises, but even for consumers.

Nonetheless international commerce is not an unregulated topic: it is well regulated on international level, because the interest of those who take part in it requires the uniformity. The subject of this study is the successful convention, CISG, in particular Article 7, which is a very multi-functional provision and is primarily the source of unification. The achievements of the CISG are incontestable on the field of international trade, however it is also important to take into consideration some problematic questions. The CISG has more than 80 Contracting Parties,<sup>2</sup> so understandably because of this high number the uniform interpretation of the CISG can easily face hardships, since there are many states with different legal system and traditions. These countries may interpret the CISG rules differently – which is a clear obstacle of the main goal of uniform regulation worldwide. As a solution for this Article 7 of the CISG is containing rules for taking into consideration the international character, to promote uniformity, to observe good faith and it also contains a rule how to fill legal gaps.

In my study, I will write shortly about the CISG itself, the institutions that can improve and help the uniform application and interpretation, next the barriers that are present in spite of the previous factors and in the light of the previous questions I write about Article 7 of the CISG and also present some cases which are good examples for the wide possibility of how to apply it.

## 2 CISG

CISG was accepted in Vienna 1980 and was made by the United Nations specialized body - UNCITRAL. The convention's goal is to regulate uniformly

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<sup>2</sup> There are 86 parties of the CISG, information available at: *Status. United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980)* [online]. UNCITRAL [accessed on 2017-07-08].

the problems regarding international trade and to promote wide acceptance. Its success was obvious from the start: in the Vienna Conference almost half of the parties of the United Nations represented themselves and many countries signed the CISG immediately.<sup>3</sup>

It was not accidental that the CISG was elaborated within the work of UNCITRAL: this institutions main task is to coordinate and promote the harmonization and unification the law of international commerce, to contribute to wider participation in the existing conventions, and it also works on preparing new conventions and model laws.<sup>4</sup> It is important to note, that the CISG also had antecedents: in 1935 within the International Institute for the Unification of Private Law (“UNIDROIT”) was created the first draft of a uniform law on the sale of goods. After World War II the work continued with drafts, and in 1964 in a Diplomatic Conference held at The Hague, twenty-eight States approved two Conventions: the Uniform Law on the International Sale of Goods (“ULIS”), and the Uniform Law on the Formation of Contracts for the International Sale of Goods (“ULF”), however these two Hague Conventions failed to accomplish the desired result of unification of sales law.<sup>5</sup> The real improvement was the CISG.

Nonetheless it was only natural that in the centre of unification stood the question of international commercial regulation already early in the 20th century. On this field, the development was really dynamic even in the aspects of different countries so it became clear on this field that the differences in national regulations and the uncertainty regarding the solutions of rules on conflict of laws caused obstructive effects in international relations.<sup>6</sup>

<sup>3</sup> MÁDL, Ferenc, VÉKÁS, Lajos. *A nemzetközi magánjog és nemzetközi gazdasági kapcsolatok joga*. Budapest: Elte Eötvös Kiadó, 2012, p. 287.

<sup>4</sup> Milassin is referring to the United Nations General Assembly Resolution 2205 (XXI) of 17 December 1966: Establishment of the United Nations Commission on International Trade Law in his book, while defining the tasks of UNCITRAL, see: MILASSIN, László. *Az ENSZ Nemzetközi Kereskedelmi Jogi Bizottsága (UNCITRAL)*. Győr: Universitas-Győr Nonprofit Kft., 2016, p. 31.

<sup>5</sup> FELEMEGAS, John. The United Nations Convention on Contracts for the International Sale of Goods: Article 7 and Uniform Interpretation. *Review of the Convention on Contracts for the International Sale of Goods (CISG)* [online], 2000-2001, pp. 115–265 [accessed on 2017-04-26].

<sup>6</sup> BÁNRÉVY, Gábor. *A nemzetközi gazdasági kapcsolatok joga*. Budapest: Szent István Társulat, 2005, p. 25.

Nowadays there are 86 parties of the Convention, which shows the interest of the states and the success of the CISG. However, if we want to get a clear picture of reality we should observe the situation much closer.

## 2.1 Helping and Hindering Instruments Regarding the Uniform Interpretation and Application

The CISG itself contains rules helping uniform interpretation and application: the *Preamble* states: “...*the adoption of uniform rules which govern contracts for the international sale of goods and take into account the different social, economic and legal systems would contribute to the removal of legal barriers in international trade and promote the development of international trade...*”. The other important provision is Article 7 of the CISG which I will introduce hereinafter.

First, we must highlight the importance of the official Secretariat Commentary on CISG,<sup>7</sup> which I will use in my study while observing Article 7 of the CISG. In addition, there is the CISG Advisory Council, which was established in 2001 on private initiative. Its main task is to publish its decisions regarding questions of interpretation and application of the CISG, so, its main goal is to promote uniform interpretation and application. The members of the CISG Advisory Council are more like scientists than representatives of their country and legal system. The Council's operation is based on authorization of Article 7 of the CISG.<sup>8</sup>

There are many databases containing and systematizing case law regarding the CISG. The four most important databases are the followings: first, Case Law on UNCITRAL Texts (CLOUT)<sup>9</sup> which was established in 1988 by the UNCITRAL Secretariat to help the work of UNCITRAL. This collection helps judges, arbitrators, lawyers, parties to be informed on court decisions and arbitration awards related to texts created by UNCITRAL and also to promote the uniform interpretation and application of the CISG

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<sup>7</sup> Commentary on the Draft Convention on Contracts for the International Sale of Goods prepared by the Secretariat [online]. [accessed on 2017-04-25] (“Secretariat Commentary”).

<sup>8</sup> SZABÓ, Sarolta. *A Bécsi Vételi Egyezmény, mint nemzetközi lingua franca: az egységes értelmezés és alkalmazás újabb irányai és eredményei*. Budapest: Pázmány Press, 2014, pp. 59–60.

<sup>9</sup> *Case Law on UNCITRAL Texts* (CLOUT) [online]. UNCITRAL [accessed 2017-04-25].

and other UNCITRAL texts.<sup>10</sup> Secondly, the UNCITRAL Digest of Case Law on the United Nations Convention on Contracts for the International Sale of Goods 2016 Edition presents cases and other information regarding the CISG in a format based on chapters corresponding to its articles. The Digest 2016 makes reference to the full text of the decisions when it is needed, yet the CLOUT reports cases only in the form of abstracts.<sup>11</sup> Thirdly, it is important to mention the work of the Institute of International Commercial Law of the School of Law, Pace University which has elaborated a huge database that is universal and free of charge for anyone interested in researching CISG.<sup>12</sup> Finally, there is the UNILEX system, which is a database of international bibliography and case law not only on the CISG, but also on the UNIDROIT Principles of International Commercial Contracts and like the other databases it contains detailed abstracts of cases.<sup>13</sup> Besides these well-known instruments, we cannot forget that the publication of relevant international case law on as many languages as possible is one crucial step forward the autonomous interpretation. This is why it is as important as the upper mentioned one to have a database in French,<sup>14</sup> or from April 2017 in Hungarian!<sup>15</sup>

After the short summary of instruments helping the uniform interpretation and application of the CISG, I would like to highlight the fact, that the CISG was published in six official languages.<sup>16</sup> In my opinion this fact itself can cause an opportunity for national courts to interpret and apply it in different ways. Questions of interpreting a foreign language is always problematic.

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<sup>10</sup> *Case Law on Uncitral Texts (CLOUT). User Guide* [online]. United Nations General Assembly, 2 June 2010, p. 2 [accessed on 2017-04-25].

<sup>11</sup> *UNCITRAL Digest of Case Law on the United Nations Convention on Contracts for the International Sale of Goods 2016 Edition* [online]. New York, 2016, p. XII [accessed on 2017-04-26] (“Digest 2016”).

<sup>12</sup> *CISG Database* [online]. Institute of International Commercial Law, School of Law, Pace University [accessed on 2017-04-26].

<sup>13</sup> *UNILEX on CISG and UNIDROIT Principles* [online]. UNIDROIT [accessed on 2017-04-26].

<sup>14</sup> *CISG France* [online]. [accessed on 2017-04-26].

<sup>15</sup> *CISG – Nemzetközi adásvételi jog* [online]. Széchenyi István University Egyetem [accessed on 2017-04-26].

<sup>16</sup> Article 101(2) of the CISG states: “... DONE at Vienna, this day of eleventh day of April, one thousand nine hundred and eighty, in a single original, of which the Arabic, Chinese, English, French, Russian and Spanish texts are equally authentic.”

In Hungary, people barely talk any foreign languages<sup>17</sup> so it is only natural that national courts, lawyers and others use much likely the national regulation. It is not only in Hungary, but for example also in China, that there are signs of the fact, that Chinese regulation is more favourable than the CISG by courts and arbitrators.<sup>18</sup> A great issue is that there is no upper judicial forum, which could really help the uniform application and its decisions could be guidelines for national courts to take them into consideration.

In the light of the above-mentioned facts, how can a single article of the CISG help to maintain the goal: uniform interpretation and application?

### 3 The Multifunctional Article 7

First of all, Article 7 of the CISG contains the following:

*“(1) In the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade.*

*(2) Questions concerning matters governed by this Convention which are not expressly settled in it are to be settled in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law.”*

The importance of Article 7 is great: it was the first rule among the general provisions of the CISG that demanded to monitor application and help unification of the convention. Later this rule became a measurement in creating the text of other UNCITRAL documents.<sup>19</sup>

The Secretariat Commentary observed this article in a strict way, as it contains only the basic information, like the necessity to avoid differing constructions of the provisions of CISG by national courts, because there are

<sup>17</sup> Glavanits writes more detailed about this question in her study GLAVANITS, Judit. Obstacles of ODR in Developing Countries. In: *UNCITRAL Furthering the Progressive Harmonization and Modernization of International Trade Law*. Conference working paper, manuscript, 2017, p. 1.

<sup>18</sup> YONGPING, Xiao, WEIDI, Long. Selected Topics on the Application of the CISG in China. *Pace International Law Review* [online], 2008, Vol. 20, No. 1, p. 101 [accessed on 2017-04-26].

<sup>19</sup> MILASSIN, László. *Az ENSZ Nemzetközi Kereskedelmi Jogi Bizottsága (UNCITRAL)*. Győr: UNIVERSITAS-GYŐR Nonprofit Kft., 2016, p. 59.

sharp divergences in approach and concept among national rules. The task of Article 7 of the CISG is to solve this. The Secretariat Commentary also writes about the principle of good faith.<sup>20</sup>

From another approach, Article 7 of the CISG is containing the unification clause, because there is no upper judicial forum that could ensure uniform application. With this the danger is real: it can happen that national courts apply the CISG in their own perception with their own domestic traditions, constraining the goal of the convention.<sup>21</sup> Another approach in Hungarian literature is similar: the greatest danger for an internationally unified law is when in the contracting states national courts work out different case law. The role of Article 7(1) of the CISG is to restrain national courts and arbitrators from turning to domestic law while applying the convention.<sup>22</sup>

As for this short summary, I do not intend to observe every aspect of Article 7 of the CISG, I think showing the above-mentioned assertions in cases is much more useful.<sup>23</sup>

### 3.1 Related Cases

The following case is a good example of applying Article 7 of the CISG in a comprehensive way.

In the first matter, a Serbian seller and an Albanian buyer concluded a “Sales and distribution agreement”, which expired on 31 December 2007. However, the arbitration clause provided it “*shall survive termination or expiration of (the Contract)*”, so it was not time barred. The parties also agreed in the arbitration clause, that they may resort to arbitration within 30 days if the dispute could not be amicably settled. Thus, when the buyer failed to pay its obligation within 45 days of the delivery of the goods, the seller initiated the arbitration proceedings. The contract between the parties also contained a choice of law

<sup>20</sup> Secretariat Commentary, pp. 17-18.

<sup>21</sup> VÖRÖS, Imre. *A nemzetközi gazdasági kapcsolatok joga II*. Budapest: Krim Bt., 2004, p. 102.

<sup>22</sup> MÁDL, Ferenc, VÉKÁS, Lajos. *A nemzetközi magánjog és nemzetközi gazdasági kapcsolatok joga*. Budapest: Elte Eötvös Kiadó, 2012, p. 297.

<sup>23</sup> For further information about Article 7 of the CISG it would be worth to take a look at classic commentaries, like SCHWENZER, Ingeborg (ed.). *Schlechtriem & Schwenzger Commentary on the UN Convention on the International Sale of Goods (CISG)*. 4th ed. Oxford: Oxford University Press, 2016, p. 1602; or HONNOLD, John O. *Uniform Law for International Sales Under the 1980 United Nations Convention*. Edited and updated by Flechtner, Harry M. 4th ed. Kluwer Law International, 2009, p. 748.



clause, providing that the Contract “*shall be governed and construed in accordance with applicable regulations and laws of the Republic of Serbia*”, and since Serbia has ratified the CISG, the arbitrator stated that the CISG should be applied. In the meaning of Article 78 of the CISG, the seller was entitled to interest on the purchase price the buyer did not pay. Since the CISG does not determine the interest rate to be applied, the arbitrator found that the rate had to be determined in accordance with the principles of the CISF, in particular that of full compensation. The arbitrator also noted, that seller cannot get into a better position because of full compensation, than he would be if the contract was performed. The arbitrator considered the purpose of achieving uniform application of the CISG while applying Article 7(1), he also applied Article 7 while filling the gaps regarding the question of interest, and in my opinion, he also used the good faith rule, because he said that applying Serbian law in accordance with interest rate – as the seller requested – would result in overcompensation of the seller.<sup>24</sup>

In my perception in this case it was necessary to apply every aspect of Article 7 to make the right decision, but even so there are many cases where only parts of Article 7 are needed. And yet, even applying Article 7 of the CISG is not always consistent: sometimes we can get the same results from different ways. In the following examples in both cases Dutch tribunals had jurisdiction and the question was whether general provisions could be applied or not. However, in the first case the tribunal took into consideration the fact that the CISG does not contain rules regarding general provisions and so applying Article 7 of the CISG the tribunal got the final judgement from CISG and as a result of gap-filling, German law,<sup>25</sup> while in the second case no tribunal referred to Article 7, they applied only the provisions of the CISG.<sup>26</sup>

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<sup>24</sup> Arbitral award of the Foreign Trade Court of Arbitration attached to the Serbian Chamber of Commerce of 28 January 2009, No. T-8/08 [online]. In: *Pace Database on the CISG and International Commercial Law*. Pace Law School, Institute of International Commercial Law [accessed on 2017-04-26].

<sup>25</sup> Decision of Arrondissementsrechtbank Arnhem, Netherlands of 17 March 2004, No. 107309 /HA ZA 03-2099 [online]. *Pace Database on the CISG and International Commercial Law*. Pace Law School, Institute of International Commercial Law [accessed on 2017-04-26].

<sup>26</sup> Decision of Hof 's-Hertogenbosch, Netherlands of 29 May 2007, No. C051069/HE [online]. *Pace Database on the CISG and International Commercial Law*. Pace Law School, Institute of International Commercial Law [accessed on 2017-04-26].

### 3.2 Hungarian Case Law on Article 7

Even though the application of the CISG is mandatory for the courts in Hungary too, there are out of a few cases referring to the CISG in the text of the decision. Here I present three cases to represent the routine of the Hungarian courts applying or referring to Article 7 of the CISG.

In the first case, the main question was if there was a sales contract or not, because to be able to apply the CISG it is by all means necessary to have a sales contract between the parties. However, in this matter there was no mutual intention between the parties to sell or buy the involved equipment. The situation was that the plaintiff's subsidiary company was part of defendant's Ltd. since 2002, and the plaintiff also negotiated with the defendant to become partners since then. On 3 February 2005 Plaintiff undertook to commit money on building the defendants new production hall. Still in June 2004 the plaintiff delivered an industrial equipment to the defendant's depot, and billed 49.000 €, while defendant kept it among the Ltd's assets, and recorded it in his accounting. However, on 8 November 2006 defendant sent it back saying it is unnecessary because the planned investment failed. The defendant claimed the plaintiff bought the equipment to accomplish the investment, and the invoice would have been paid of capital increase. Yet, plaintiff stated there was a sales contract between the parties and the judgement of the court violated many articles of the CISG, like for example Article 7, that should have been applied. In this case however there was no sales contract, so the CISG was not applicable.<sup>27</sup> As we can see in this case Article 7 of the CISG did not play a great role to solve the dispute, it was just merely referred to.

In the second, so called "egg" case the parties concluded a contract in which the Romanian seller would deliver 6,000,000 pieces of eggs to Hungarian buyer from 14<sup>th</sup> to 50<sup>th</sup> week of 2006. However, on 12 May 2006 defendant, the buyer stated he cannot accept any eggs, while plaintiff, the buyer didn't consent to it. On 13 May 2006 because of bird flu an official movement and sales restriction entered into force in Romania regarding living chicken, yet the production at the defendant's didn't stop completely in the concerned

<sup>27</sup> Decision of Kúria, Hungary of 12 November 2013, No. Gfv.30106/2013/6 [online]. In: *birosag.hu*. National Office of Judiciary [accessed 2017-04-29].

period, in November 2006 he even ordered eggs. The plaintiff referred in his suit on the CISG and he even referred to Article 7, while the defendant referred there was a force majeure in Romania. The CISG was applicable in this case on the basis of Article 1(1)(b) of the CISG and the tribunal determined the defendant could not prove the period of force majeure and the fact that he let the plaintiff know about the situation in Romania within a reasonable time, and it was a fact that the production did not stop completely.<sup>28</sup> In this case Article 7 was also just shortly referred to: the plaintiff referred to Article 7(2) of the CISG, stating that Hungarian law should be applied.

In the third case a Spanish seller, as plaintiff and a Hungarian buyer, as defendant concluded a contract of 27-28 tons fish. Because the seller did not perform even in the fixed additional period of time, the buyer had to purchase fish from other distributors, and the damage he suffered added up to 35 100 €. The plaintiff demanded 35 100 € plus interests, while the defendant asked for the rejection of plaintiff's suit, asked firstly for the compensation of 35 100 €, and secondly submitted counter-claim. In the CISG the compensation is not regulated so applying Article 7(2) of the CISG resulted in applying Hungarian law. Basically, the Spanish law should have been applied, however the parties agreed on the exclusion of foreign law, so Spanish law could not be taken into consideration. In the judgement, the plaintiff got 17 € of interest from the defendant and the jury highlighted the fact that he rejected the defendant's counter-claim, the 35 100 € has been taken into account.<sup>29</sup>

In this case the conflict was between an Austrian seller and a Hungarian buyer, because the defendant, the buyer did not pay for the goods. The plaintiff sued the defendant for 91 104,04 €. The question was whether Austrian or Hungarian law could be applied – in the final judgement the applicable law was the Austrian law regarding the interest rate, however in this case the interesting thing was that *expressis verbis* in the text of the judgement no one

<sup>28</sup> Decision of Budapest Környéki Törvényszék, Hungary of 5 March 2014, No. G.40313/2010/71 6 [online]. In: *birosag.hu*. National Office of Judiciary [accessed 2017-04-29].

<sup>29</sup> Decision of Pécsi Ítéltábla, Hungary of 06 April 2011, No. Gf.30010/2011/7 6 [online]. In: *birosag.hu*. National Office of Judiciary [accessed 2017-04-29].

mentioned the fact, that the CISG does not have provisions regarding the interest rate – even though they referred more than one time to Article 7(2) of the CISG – and this is why it had to be the Austrian law to determine the interest rate.<sup>30</sup>

Even though the number of cases concerning the CISG is not high in Hungary, Article 7 of the CISG can be of great use, like in the third and fourth cases, and in some cases, like the first two they just refer to Article 7 of the CISG, where the importance of this provision is not sensible.

#### 4 Conclusion

It is not a question that the CISG has achieved great results and Article 7 plays a great part in it. However, in the road to achieve real uniform interpretation and application of the CISG, there are still many obstacles.

Article 7 of the CISG is an essential rule, however, it is not enough and is not a perfect solution: even if there is a right direction, it can be interpreted broadly. In my opinion, national courts – understanding with the above-mentioned scholars – apply much likely their own regulation, which they know and trust. In my perception, a higher jurisdictional forum could be a way for solving this issue, so national courts could have a pattern they could use, and there would not be any uncertainty and it could be a great starting point when applying an international Convention. Like that, even if there were a legal gap, national courts would much likely apply the CISG and maybe even judges, lawyers, legal advisors and others would not insist on applying their own national rules.

The possible lack of trust is reflected in Article 6 of the CISG: “*The parties may exclude the application of this Convention or, subject to article 12, derogate from or vary the effect of any of its provisions.*” Glavanits has made an interesting empirical research regarding the CISG in Hungary. She determined that the exclusion of law is not typical in Hungarian practice, however if they take the opportunity they do it regarding the CISG. The most common answer among the respondents was related to the fact, that applying only Hungarian regulation is more favourable for sellers, than the CISG and in cases the

<sup>30</sup> Decision of Győri Ítéltábla, Hungary of 12 January 2010, No. Gf.20087/2009/7 6 [online]. In: *birosag.hu*. National Office of Judiciary [accessed 2017-04-29].

CISG is not excluded but in which the CISG does not regulate an issue, there the applicable law doubles and it makes harder to solve the conflict.<sup>31</sup> Years before, Koehler has made similar conclusion in his empirical study regarding the CISG: the reasons for an exclusion are mainly practical and the lack of familiarity of the Convention means the most relevant cause. Koehler also states: “*If a law is not applied the chance is let slip by the practitioners to make use of, or at least experience, the advantages ‘preached’ about the law in the literature, with the result that any incentive to apply the law fails to arise.*”<sup>32</sup> I agree with Koehler on that and in my opinion, it is also of crucial importance to help increase the trust regarding the CISG, especially in Hungary.

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<sup>32</sup> KOEHLER, Martin F. Survey Regarding the Relevance of the United Nations Convention for the International Sale of Goods (CISG) in Legal Practice and the Exclusion of its Application [online]. In: *Pace Database on the CISG and International Commercial Law*. Pace Law School, Institute of International Commercial Law [accessed on 2017-04-26].

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# AWARDING PUNITIVE DAMAGES IN CZECH ARBITRATION PROCEEDINGS

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## **Abstract**

The goal of this paper is to explore an intriguing issue of punitive damages and a possibility to award them in Czech arbitration proceedings. Being it a hotly debated topic especially in the United States, the paper firstly focused on an analysis of approach to punitive damages there. It was discovered that the original negative stance to punitive damages in arbitration has been changed and that these days, the U.S. jurisprudence accepts the authority of arbitrators to award punitive damages. The paper then focused on the Czech Act on Arbitration Proceedings. A conclusion was made that that even though the Act does not expressly cover an arbitrator's authority to award punitive damages, it contains a provision granting arbitrators wide discretionary powers. In consequence, based on these wide powers and general pro-arbitration approach, an arbitrator might be able to issue a punitive damages arbitration award based on the Czech Act on Arbitration Proceedings.

## **Keywords**

Punitive Damages; Arbitration; Czech Act on Arbitration Proceedings; Powers of Arbitrators.

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## 1 Introduction

Awarding punitive damages in civil proceedings and in arbitration has always been quite a controversial issue, and not only in civil law countries. This is a result of the fact that punitive damages are considered as a special remedy awarded in addition to actual damages if a wrongdoer acted with recklessness, malice, deceit or in other reprehensible manner. The primary function of punitive damages is not to compensate an injured party, but to punish and deter the wrongdoer and other prospective wrongdoers from illegal conduct.<sup>2</sup> Yet, punishment and deterrence have been traditionally seen as falling within the sphere of penal and administrative law and thus opponents of punitive damages advocate against awarding them in any kind of proceedings.<sup>3</sup>

Nevertheless, in the last decade a slight shift in the understanding of punitive damages can be observed in civil law countries. Traditionally, civil law countries quite openly rejected punitive damages and proclaimed compensatory damages as the only form of damages which can be awarded in civil or arbitration proceedings. However, this approach might no longer be valid, as can be demonstrated also in the Czech Republic where several court decisions<sup>4</sup> and commentaries<sup>5</sup> suggest that some form of punitive damages might be available also under Czech law.

<sup>2</sup> GARNER, Bryan A. *Black's Law Dictionary*. 10th ed. St. Paul: Thomson Reuters, 2014, p. 474.

<sup>3</sup> BEDELL, Stephen P. Punitive Damages in Arbitration. *The John Marshall Law Review*, 1987, Vol. 21, No. 1, p. 30.

<sup>4</sup> Decision of the Supreme Court, Czech Republic of 22 August 2014, No. 30 Cdo 3157/2013. In: *ASPI* [legal information system]. Wolters Kluwer [accessed on 2017-04-29]; decision of the Constitutional Court, Czech Republic of 6 March 2012, No. I. ÚS 1586/09. In: *ASPI* [legal information system]. Wolters Kluwer [accessed on 2017-04-29]; decision of the Supreme Court, Czech Republic of 27 July 2012, No. 23 Cdo 3704/2011. In: *ASPI* [legal information system]. Wolters Kluwer [accessed on 2017-04-29].

<sup>5</sup> JANEČEK, Václav. Kdy lze de lege lata poškozenému přiznat preventivně-sankční složku přiměřeného zadostiučinění. *Právní rozhledy*, 2016, No. 22; ŽIVĚLOVÁ, Alexandra. Umožňuje nový občanský zákoník přiznat v řízení o náhradě nemajetkové újmy punitive damages? *Bulletin advokacie*, 2016, No. 4; RYŠKA, Michal. Odškodnění sekundárních obětí dle § 2959 ObčZ. *Právní rozhledy*, 2016, No. 11; HÁNĚLOVÁ, Kristýna. (R)evoluce v odškodňování duševních útrap? *Trestněprávní revue*, 2015, No. 11–12.

Even though there are several Czech courts decisions with respect to punitive damages, there are no available arbitration awards which would deal with this issue. Therefore, a question arises – is it possible to award punitive damages in Czech arbitration proceedings? In order to answer this question, the approach to awarding punitive damages in arbitration in the United States shall be examined [section 2]. It is quite useful to look at the practice of the United States since the debate of the availability of punitive damages awards has already taken place there. After the analysis of the U.S. approach, Czech procedural law, concretely the Act No. 216/1994 Coll., on Arbitration Proceedings and on Enforcement of Arbitration Awards, as amended (“Czech Act on Arbitration Proceedings”)<sup>6</sup> shall be also analysed [section 3]. In the end, this paper will try to answer to question of whether it is indeed possible to award punitive damages in arbitration in the Czech Republic [section 4].

## 2 Awarding Punitive Damages in Arbitration in the U.S.

In the U.S., the possibility to award punitive damages in arbitration has not always been a very straightforward issue and has been subject to many debates and court decisions. These days, however, as a consequence of a strong pro-arbitration policy, there is a tendency to permit arbitrators to award punitive damages.<sup>7</sup>

The debate on punitive damages in arbitration started in 1976 with the landmark decision *Garrity v. Lyle Stuart*<sup>8</sup> which gave rise to so called Garrity Rule.<sup>9</sup> According to the Garrity rule, arbitrators are not authorized to assess puni-

<sup>6</sup> CZECH REPUBLIC. Act No. 216/1994 Coll., on Arbitration Proceedings and on Enforcement of Arbitration Awards, as amended. In: *ASPI* [legal information system]. Wolters Kluwer [accessed on 2017-04-29].

<sup>7</sup> ROTHKEN, Ira P. Punitive Damages in Commercial Arbitration: A Due Process Analysis. *Golden Gate University Law Review*, 1991, Vol. 21, No. 2.

<sup>8</sup> Decision of the New York Court of Appeals, United States of 6 July 1976. *Garrity v. Lyle Stuart, Inc.* [online]. In *Casetext.com* [accessed on 2017-04-29].

<sup>9</sup> The *Garrity v. Lyle Stuart* case involved a dispute between an author Joan Garrity and a publishing company Lyle Stuart Inc. The parties entered into a publishing agreement, but there was no agreement as to the issue of punitive damages. During arbitration proceedings, the company Lyle Stuart Inc. walked out of the hearings. Consequently, the arbitral tribunal awarded USD 45.000 in punitive damages and USD 7.500 in compensatory damages. See WOOD, Darlene S. International Arbitration and Punitive Damages: Delocalization and Mandatory Rules. *Defense Counsel Journal*, 2004, Vol. 71, No. 4, p. 408.

tive damages even if the parties to arbitration agreed that punitive damages can be awarded.<sup>10</sup> According to the Court of Appeals of the State of New York: “*Punitive damages is a sanction reserved to the State, a public policy of such magnitude as to call for judicial intrusion to prevent its contravention. Since enforcement of an award of punitive damages as a purely private remedy would violate strong public policy, an arbitrator’s award which imposes punitive damages should be vacated.*”<sup>11</sup>

In other words, the court stated that there is a strong public policy which gives exclusive authority to state courts with respect to deciding on punitive damages issue. Moreover, the court stated that arbitration awards are generally unpublished which means that the deterrence effect, one of the main goals of punitive damages, cannot be fulfilled in case of a punitive damages award.<sup>12</sup>

Although the rationale of the *Garrity v. Lyle Stuart* decision may be still valid today, it was not followed by all courts. For instance, in *Willoughby Roofing & Supply Co. v. Kajima International*,<sup>13</sup> the court concluded quite an opposite view as to the relation between public policy and a punitive damages award. According to this case, public policy favours arbitration as a method of dispute resolution. Moreover, arbitrators are more likely to be experts with respect to a disputed issue than courts and thus more suitable in choosing the appropriate remedy, including punitive damages. The court also stated that if parties could waive their right to punitive damages, more tortious conduct would likely to occur.<sup>14</sup> All-in-all, the court in the Willoughby case clearly departed from the Garrity rule and opened the door for punitive damages awards.

<sup>10</sup> NORRIS, Alexia A. When Contracting around the Law Will Not Work: The Potential Inability to Expressly Prohibit Punitive Damages in Arbitration. *Journal of Dispute Resolution*, 2005, Vol. 2005, No. 1, p. 150.

<sup>11</sup> Decision of the New York Court of Appeals of 6 July 1976. *Garrity v. Lyle Stuart, Inc.*

<sup>12</sup> NORRIS, Alexia, A. When Contracting around the Law Will Not Work: The Potential Inability to Expressly Prohibit Punitive Damages in Arbitration. *Journal of Dispute Resolution*, 2005, Vol. 2005, No. 1, p. 151.

<sup>13</sup> Decision of the U.S. District Court, N.D. Alabama, Northeastern Division of December 6, 1984. *Willoughby Roofing & Supply Co. v. Kajima International*. 598 F. Supp. 353 (1984) [online]. In: *Casertext.com* [accessed on 2017-04-29].

<sup>14</sup> NORRIS, Alexia, A. When Contracting around the Law Will Not Work: The Potential Inability to Expressly Prohibit Punitive Damages in Arbitration. *Journal of Dispute Resolution*, 2005, Vol. 2005, No. 1, p. 151.

As one of the landmark cases speaking in favour of the possibility to award punitive damages in arbitration is the 1995 decision *Mastrobuono v. Shearson Lehman Hutton Inc.*<sup>15</sup> decided by the U.S. Supreme Court. In this decision, an arbitral award of punitive damages was upheld even though the contract between the parties was governed by New York law which at that time followed the Garrity rule and prohibited punitive damages. It was argued that the arbitration clause incorporated the arbitration rules of the National Association of Securities Dealers (“NASD”) according to which punitive damages may be awarded in arbitration. Consequently, there were two set of rules to consider – New York law prohibiting punitive damages and the rules of NASD permitting them. The U.S. Supreme Court concluded that the choice of New York law applied only to substantive issues whereas the choice of arbitration rules of NASD applied to non-substantive issues, i.e. to the question of awarding punitive damages. Consequently, New York law was not to govern the issue of punitive damages and thus the punitive damages award was permitted.<sup>16</sup>

Another interesting case which gave rise to further debates was the 2004 case *Stark v. Sandberg, Phoenix & VonGontard, P.C.*<sup>17</sup> This case is quite interesting since the court upheld a punitive damages award although parties agreed that any arbitration award shall not include punitive, exemplary or treble damages as they waive their right to such damages to the fullest extent permitted by law. In its reasoning, the court stated that since governing law does not permit waivers of punitive damages and because the waiver was made only to the fullest extent permitted by law, the arbitration clause needs to be interpreted in a way that it permits punitive damages awards.<sup>18</sup>

An important observation should be made with respect to the *Stark case*. In the direct opposition with the *Mastrobuono case*, where the authority

<sup>15</sup> Decision of the U.S. Supreme Court of 6 March 1995. *Mastrobuono v. Shearson Lehman Hutton Inc.* [online]. In: *Casetext.com* [accessed on 2017-04-29].

<sup>16</sup> NOLAN, Michael D., LEBLANC, Andrew M. The Punitive Damages Remedy: Lessons for Drafters of Arbitration Agreements. *Dispute Resolution Journal*, 2005, Vol. 60, No. 4, p. 3.

<sup>17</sup> Decision of the U.S. Court of Appeals, 8<sup>th</sup> Circuit of 26 August 2004. *Stark v. Sandberg, Phoenix & VonGontard, P.C.* [online]. In: *Casetext.com* [accessed on 2017-04-29].

<sup>18</sup> NOLAN, Michael D., LEBLANC, Andrew M. The Punitive Damages Remedy: Lessons for Drafters of Arbitration Agreements. *Dispute Resolution Journal*, 2005, Vol. 60, No. 4, p. 2.

of an arbitrator to issue a punitive damages award has been viewed as an issue of procedural law, the court in the Stark case concluded that such authority to award punitive damages is a matter of substantive law.<sup>19</sup>

The tendency to allow arbitrators to award punitive damages was recently confirmed by the New York Supreme Court in *Flintlock Constr. Servs. v. Weiss*.<sup>20</sup> The core of this decision from 2014 was commencement of arbitration proceedings by an investor against real estate development companies for fraud and breach of contracts, for which the investor requested punitive damages. The real estate development companies brought a petition to stay arbitration arguing that the Garrity rule according to which arbitrators are prohibited from awarding punitive damages should apply. This petition was rejected by the lower court and thus the New York Supreme Court was to decide the issue. The New York Supreme Court concluded that the *Mastrobuono v. Shearson Lehman Hutton Inc.* case is applicable in the case at hand. Unless the parties clearly demonstrate their intent to preclude a punitive damages award, arbitrators do have the authority to award punitive damages.<sup>21</sup>

It can be concluded that in the U.S., there is a tendency to allow arbitrators to award punitive damages, based on the *Mastrobuono case*.<sup>22</sup> Even though one may argue that punitive damages awards in arbitration are an American phenomenon,<sup>23</sup> I believe that the above-mentioned reasoning of the U.S. courts might become helpful in the analysis of whether punitive damages can be awarded also in civil law systems.

<sup>19</sup> NORRIS, Alexia, A. When Contracting around the Law Will Not Work: The Potential Inability to Expressly Prohibit Punitive Damages in Arbitration. *Journal of Dispute Resolution*, 2005, Vol. 2005, No. 1, p. 155.

<sup>20</sup> Decision of the New York Supreme Court of 14 August 2014. *Flintlock Constr. Servs. v. Weiss* [online]. In: *Casetext.com* [accessed on 2017-04-29].

<sup>21</sup> *Arbitrators Have Power to Award Punitive Damages: NY Appellate Division* [online]. Thomson Reuters Practical Law, published on 19 August 2014 [accessed on 25. 04. 2017].

<sup>22</sup> Nevertheless, it should be also noted that in the recent years punitive award rates have declined while an average punitive damages award amounts to USD 447.000 and is strongly associated with the size of a compensatory award. In CHOI, Stephen, EISENBERG, Theodore. Punitive Damages in Securities Arbitration: An Empirical Study. *Cornell Law Faculty Publications*, 2010, paper 391, p. 499.

<sup>23</sup> PETSCHKE, Markus A. Punitive Damages in International Commercial Arbitration: Much Ado about Nothing? *Arbitration International*, 2013, Vol. 29, No. 1.

### 3 Awarding Punitive Damages under Czech Procedural Law

The question of whether arbitrators can award punitive damages under Czech law has two aspects – a substantive one and a procedural one. Although it is not quite clear whether the possibility to award punitive damages is a substantive issue or a procedural one, this paper will examine the procedural aspect only. With respect to substantive part, several Czech authors and decisions of the Czech courts have confirmed that it may be possible under Czech law to award punitive damages in court proceedings.<sup>24</sup>

The position and powers of arbitrators in arbitration proceedings are stipulated in the Czech Act on Arbitration Proceedings. It is true that the Czech Act on Arbitration Proceedings does not expressly cover the authority of an arbitrator to award punitive damages. What is more, the Act does not even enumerate legal remedies which an arbitrator may grant to the winning party.<sup>25</sup> In consequence, general provisions on arbitrators' powers must be examined to conclude whether an arbitrator has a power to award punitive damages or not.

The general basis for arbitrators' powers can be found in the Section 19(2) of the Czech Act on Arbitration Proceedings. According to this provision, if there is no parties' agreement as to how arbitrators are to conduct the arbitration proceedings, arbitrators shall proceed in a way they consider appropriate. Arbitrators also shall conduct the arbitration proceedings without any

<sup>24</sup> JANEČEK, Václav. Kdy lze de lege lata poškozenému přiznat preventivně-sankční složku přiměřeného zadostiučinění. *Právní rozhledy*, 2016, No. 22.; ŽIVĚLOVÁ, Alexandra. Umožňuje nový občanský zákoník přiznat v řízení o náhradě nemajetkové újmy punitive damages? *Bulletin advokacie*, 2016, No. 4; RYŠKA, Michal. Odškodnění sekundárních obětí dle § 2959 ObčZ. *Právní rozhledy*, 2016, No. 11; HÁNĚLOVÁ, Kristýna. (R)evoluce v odškodňování duševních útrap? *Trestněprávní revue*, 2015, No. 11–12; Decision of the Supreme Court, Czech Republic of 22 August 2014, No. 30 Cdo 3157/2013. In: *ASPI* [legal information system]. Wolters Kluwer [accessed on 2017-04-29]; decision of the Constitutional Court, Czech Republic of 6 March 2012, No. I. ÚS 1586/09 [online]. In: *ASPI*. Wolters Kluwer [accessed on 2017-04-29]; decision of the Supreme Court, Czech Republic of 27 July 2012, No. 23 Cdo 3704/2011. In: *ASPI*. Wolters Kluwer [accessed on 2017-04-29].

<sup>25</sup> This is not exceptional with respect to an arbitration law since majority of modern arbitration laws does not address the question of punitive damages or available remedies. PETSCHKE, Markus A. Punitive Damages in International Commercial Arbitration: Much Ado about Nothing? *Arbitration International*, 2013, Vol. 29, No. 1, p. 95.

unnecessary formalities and shall grant to all parties an equal opportunity to assert their rights so that the factual basis necessary for deciding a case is found.

The Section 19(2) of the Czech Act on Arbitration Proceedings, its meaning and purpose needs to be interpreted in line with international practice since its wording is based mainly on the UNCITRAL Model Law.<sup>26</sup>

When the UNCITRAL Model Law was drafted, its creators wished to provide such legal framework which would provide flexibility with respect to various scenarios which might occur in international cases.<sup>27</sup> The intent of the drafters was to provide arbitrators with powers enabling them to tailor arbitration proceedings to the specific circumstances of the case.<sup>28</sup> One can conclude that arbitrators' powers and their discretion with respect to conduct of the arbitration proceedings are construed very widely<sup>29</sup> since arbitrators' discretion is perceived as one of the hallmarks of the international arbitral process.<sup>30</sup>

If the Section 19(2) of the Czech Act on Arbitration Proceedings is compared with arbitration rules and their provisions on arbitrators' powers, a conclusion can be made that also these rules have similar provisions granting the arbitrators wide discretionary powers. For instance, Article 22(2) of the ICC Arbitration Rules sets forth that: "*In order to ensure effective case management, the arbitral tribunal, after consulting the parties, may adopt such procedural measure as it considers appropriate, provided that they are not contrary to any agreement of the parties.*"<sup>31</sup> Article 17(1) of the UNCITRAL Arbitration Rules also stipulates that: "*The arbitral tribunal may conduct the arbitration in such manner*

<sup>26</sup> BĚLOHLÁVEK, Alexander J. *Zákon o rozhodčím řízení a o výkonu rozhodčích nálezů: komentář*. 2nd ed. Prague: C. H. Beck, 2012, p. 658.

<sup>27</sup> *Analytical Commentary of Draft Text of a Model Law on International Commercial Arbitration. Report of the Secretary General* [online]. 1985 [accessed on 2017-04-29].

<sup>28</sup> *Explanatory Note by the UNCITRAL Secretariat on the 1985 Model Law on International Commercial Arbitration as amended in 2006* [online]. Vienna: United Nations, 2008, p. 32 [accessed on 2017-04-29].

<sup>29</sup> ŽIVĚLOVÁ, Alexandra. *Exclusion of Legal Counsels in the International Commercial Arbitration* [online]. Diploma thesis supervised by Klára Drličková. Brno: Masaryk University, Faculty of Law, 2013, p. 17 [accessed on 2017-04-29].

<sup>30</sup> BORN, Gary B. *International Commercial Arbitration. Volume II*. Austin: Wolters Kluwer, 2009, p. 1758.

<sup>31</sup> Rules of Arbitration of the International Chamber of Commerce in force as from 1 Marc 2017 [online]. *International Chamber of Commerce* [accessed on 2017-04-29].



*as it considers appropriate, provided that the parties are treated with equality and that at an appropriate stage of the proceedings each party is given a reasonable opportunity of presenting its case.*"<sup>32</sup>

Based on the above-mentioned ICC Arbitration Rules and UNCITRAL Arbitration Rules, which are one of the most influential arbitration rules, it can be concluded that arbitrators' powers are construed quite widely. This then leads to another conclusion that the power to award punitive damages could fall within the scope of the wide arbitrators' powers. The fact that none of these arbitration rules explicitly mentions punitive damages does not necessarily mean that punitive damages are forbidden by the arbitration rules. It could be the case that the arbitration rules intentionally do not stipulate each individual arbitrators' powers but construe arbitrators' powers just generally in order to cover various situations and remedies which might be appropriate in a certain case. In consequence, if granting a punitive damages award might be appropriate in the case at hand (e.g. because of appalling conduct of the party breaching the contract), arbitrators should have the necessary powers to award punitive damages.

Conclusion that wide arbitrators' powers should include an authority to award punitive damages is further supported by the following arguments.<sup>33</sup> Firstly, arbitration is nowadays considered as a proper, efficient and just method of dispute resolution and is no longer mistrusted, as may have been the case in the past. Secondly, it was not proven that arbitrators in the U.S. abused their power to award punitive damages in cases where they were explicitly authorized to award them. Thus, if we accept that judges in courts

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<sup>32</sup> UNCITRAL Arbitration Rules (with new Article 1, paragraph 4, ad adopted in 2013) [online]. *UNCITRAL* [accessed on 2017-04-29].

<sup>33</sup> To have a full picture of this issue, arguments against the possibility to issue punitive damages should be also stated. These arguments are as follows: firstly, the power to impose sanctions is traditionally the power of the state and cannot be conferred on arbitrators by a private arbitration agreement. Secondly, arbitrators necessarily might not have a legal education and training and thus are not qualified to impose punitive damages. Thirdly, since judicial review of awards is generally limited, the question of whether punitive damages have been awarded lawfully might never be reviewed in courts. Fourthly and maybe most importantly, allowing punitive damages in arbitration can lead to two results - parties may be frightened to use arbitration as a method of dispute resolution and further judicial scrutiny of arbitral award shall be adopted because of this. In FARNSWORTH, Allan E. Punitive Damages in Arbitration. *Stetson Law Review*, 1991, Vol. XX, No. 2, p. 404.

are competent to grant punitive damages to an injured party, so are arbitrators in arbitral proceedings. Thirdly, powers of arbitrators with respect to available remedies are quite wide since it is important to tailor a respective remedy to each individual case. It can happen that a punitive damages remedy is the best one in the case at hand and thus there would be no reason for not allowing an arbitrator to grant such a remedy. Fourthly, it is more time and cost efficient to let an arbitrator decide on all claims and remedies in one proceedings than to split the proceedings in such a way that a claimant would need to seek remedies both in arbitration for compensatory damages and in court for punitive damages.<sup>34</sup>

In conclusion, the Section 19(2) of the Czech Act on Arbitration Proceedings needs to be interpreted in line with international practice. According to this practice, as shown by the UNCITRAL Model Law, UNCITRAL Arbitration Rules and ICC Arbitration Rules, the powers of arbitrators are quite wide. In consequence, it can be concluded that in case this would be an appropriate measure, arbitrators have a power to award punitive damages in arbitration.

#### 4 Conclusion

Even though the issue of punitive damages is still a controversial issue both in common law and civil law countries, there is a tendency, at least in the United States, to award them also in arbitration proceedings. The reasoning in *Garrity v. Lyle Stuart* case which advocated for prohibition of punitive damages in arbitration based on the public policy is no longer followed by the U.S. courts. On the contrary, according to the latest court decisions, it is public policy which favours arbitration as a method of dispute resolution which speaks in favour of awarding punitive damages in arbitration.

Czech Act on Arbitration Proceedings does not expressly cover the issue of punitive damages. Nevertheless, it contains the Section 19(2) which

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<sup>34</sup> Decision of the U.S. District Court, N.D. Alabama, United States of 6 December 1984. *Willoughby Roofing & Supply Co. v. Kajima International* [online]. In *Casext.com* [accessed 2017-04-29]; NORRIS, Alexia, A. When Contracting around the Law Will Not Work: The Potential Inability to Expressly Prohibit Punitive Damages in Arbitration. *Journal of Dispute Resolution*, 2005, Vol. 2005, No. 1, p. 158.

purpose is to grant arbitrators wide discretionary powers in arbitration and to enable them to tailor the proceedings in the most suitable manner for the case at hand.

It can be concluded that based on wide discretionary powers of arbitrators contained in the Section 19(2) of the Czech Act on Arbitration Proceedings and practical arguments speaking in favour of arbitration as a method of dispute resolution, a possibility to award punitive damages in arbitration under Czech procedural law might not entirely impossible. Due to the fact that arbitral awards are usually confidential, we must probably wait a little while to find out whether a punitive damages award will be issued or not. The odds are that sooner or later, such an award will be issued and it will be interesting to analyse further legal issues which shall indeed arise.

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# AWARD OF LEGAL COSTS IN ARBITRATION WITH FOCUS ON REGULATION IN THE SLOVAK REPUBLIC

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## **Abstract**

There are different theoretical concepts regarding the issue of awarding legal costs in an arbitration proceeding. The aim of this article will be to shortly outline the basic aspects of particular concepts with a subsequent referral to the legal regulation in the Slovak Republic. At the conclusion, it will be mentioned which direction the concept of awarding legal fees is heading.

## **Keywords**

Legal Costs; Arbitration.

## **1 Introduction**

*“International arbitral tribunals generally possess, and exercise, the authority to award the prevailing party in an arbitration the costs of arbitration, including its legal costs.”*<sup>2</sup> This article is going to deal with various concepts regulating the award of legal fees with focus on the regulation and practice in the Slovak Republic.

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<sup>2</sup> BORN, Gary B. *International Commercial Arbitration*. 2nd ed. Alphen aan den Rijn: Kluwer Law International, 2014, p. 3086.

## 2 Concepts regarding the Awarding of Legal Fees

Different concepts have evolved in various legal systems dealing with the award of legal fees after the conclusion of disputes. These concepts originate from litigation, whereby they have also been “transferred” into arbitral proceedings.

It should be mentioned at the outset that the best method to avoid any discrepancies regarding the awarding of legal costs is an agreement of the parties. In many cases the parties do not consider this point to be relevant at the time of contracting, also due to the fact that many institutional rules cover this issue in sufficient detail. However, as it will be discussed below, in many cases there is not a clear rule for the award of attorneys’ fees.

### 2.1 “American Rule”

The American rule is based on the principle applied in litigation in the United States and rests on the idea that each party covers its own costs and the winning party cannot recover them from the losing party.<sup>3</sup>

Due to the fact that the Federal Arbitration Act<sup>4</sup> does not regulate the award of attorneys’ fees, there was a tendency in arbitrations conducted in the United States not to award legal fees since the arbitral tribunal did not have jurisdiction in this matter.<sup>5</sup>

However, this tendency is changing and the courts in the United States started to decide that arbitral tribunals have implied authority to award legal fees.<sup>6</sup> Moreover, in international arbitrations with seat in the United States, the American rule should be of little relevance since the institutional rules, many of which have rules dealing with the authority to award legal costs,

<sup>3</sup> Ibid., p. 3090.

<sup>4</sup> UNITED STATES. U.S. Code, Title 9 – Arbitration, Section 1–14, first enacted 12 February 1925.

<sup>5</sup> Decision of the District Court for the Southern District of New York, United States of 20 February 1985, *Sammi Line Co., Ltd. v. Altamar Navegacion SA* [online] In: *JUSTIA US Law* [accessed on 2017-02-01].

<sup>6</sup> Decision of the District Court for the Southern District of New York, United States of 14 July 2015, *NS United Kaiun Kaisha, Ltd. v. Cogent Fibre Inc.* [online]. In: *Casextext.com* [accessed on 2017-02-01].



prevail. Also, in international arbitration the focus on national rules should be limited and the standard that each party bears its own costs does seem to represent United States public policy.<sup>7</sup>

## 2.2 Fees Based on Tariffs (in Slovakia)

In many cases, the amount of recoverable legal fees is objectified to achieve a more equitable result for the parties in dispute. There are many options how to achieve this. One of them (used for a long time in litigation in the Slovak Republic) is a so-called “tariff”. Tariff is a method of determining the extent of legal fees based on the amount of the dispute and the number of acts of legal service. The tariff should represent an objective and predictable concept, how the parties and the court can calculate the recoverable legal fees.<sup>8</sup>

Due to the fact that recently there has been a considerable amendment of the Act No. 244/2002 Coll., on Arbitration (“Slovak Arbitration Act”) and a complete new act was adopted regulating civil procedure in courts,<sup>9</sup> it is better to start with the previous regulation. The Slovak Arbitration Act (effective until 31 December 2014) stated in Section 51(2): “*If this act does not provide otherwise, provisions of the general statute on civil procedure shall be used for the arbitration proceeding.*” At that time it was the Act No. 99/1963 Coll., Civil Procedure Code as amended (“CPC”). There was subsidiarity between the act regulating arbitration and the statute dealing with the court proceeding.

Regarding the award of legal costs, the regulation of the Slovak Arbitration Act was quite short and only mentioned that the arbitral award shall also include the determination of the amount of costs and which party should reimburse them.<sup>10</sup> Therefore, the arbitral tribunals used the subsidiary statute (CPC) which provided for an award of legal costs based on the tariff.

<sup>7</sup> BORN, Gary. *International Commercial Arbitration*. 2nd ed. Alphen aan den Rijn: Kluwer Law International, 2014, p. 3091.

<sup>8</sup> The Act No. 586/2003 Coll., on Advocacy as amended (“Slovak Act on Advocacy”), of course, entitles the parties to agree on a contractual amount of charged legal fees (based on hourly rates, portion of the claim, etc.). However, when the court is deciding on the recovery of legal fees from the losing party, it always uses the tariff to determine the amount which should be recovered.

<sup>9</sup> SLOVAK REPUBLIC. Act No. 160/2015 Coll., Civil Disputes Procedure Act (“CDPA”) which became effective on 1 July 2016.

<sup>10</sup> Section 34(4) of the Slovak Arbitration Act.

For the sake of completeness, it should be mentioned that a recent article has questioned the concept of awarding legal fees (based on the CPC) according to the tariff.<sup>11</sup> The mentioned article definitely had valid arguments. However, more than a 20-year old practice of the Slovak courts saw a consistent application of the “tariff system”.<sup>12</sup> This has been transferred to arbitration proceedings without any alterations.<sup>13</sup>

Moving to the current legal regulation in Slovakia dealing with the award of legal fees, a lot has changed. Firstly, Section 51(3) of the Slovak Arbitration Act has diminished its subsidiarity with the general statute regulating civil procedure (now the CDPA). It now provides: “*If a certain issue cannot be dealt with by this act, the provisions of the general statute on litigation before the courts shall be used if the character of the issue allows it.*” The regulation of the awarding of costs has also changed in the litigation sphere. The costs are now awarded and calculated *ex officio* by the court, without the need of the party to ask for the award of costs and to without the necessity to calculate them. The CDPA is silent regarding the question how the costs should be determined. However, the courts are continuing to use the “old system” based on the tariff without any changes and without any major disagreement among the professional community.

The diminished subsidiarity in arbitration, however, means that the general statute regulating litigation should not be applicable to the award of legal costs in arbitral proceeding anymore. Procedural issues in arbitration shall be dealt with by the CDPA only in matters where the Slovak Arbitration Act is silent. Legal costs are a matter regulated by the Slovak Arbitration Act, and therefore the use of the CDPA is obsolete. This is also the opinion mentioned in the recent commentary to the Slovak Arbitration Act: “*It is not*

<sup>11</sup> MAGÁL, Martin, VÍČEN, Róbert. Je mechanická aplikácia tarifnej odmeny pri priznávaní trov právneho zastúpenia v súlade so zákonom? *Bulletin slovenskej advokácie*, 2014, No. 12, pp. 40–49.

<sup>12</sup> *Ibid.*, pp. 40 and 48.

<sup>13</sup> The arbitral awards are not published. However, from the practise of the author and based on the discussion with other attorneys from Slovakia, this is generally the system applied at the permanent Slovak arbitration courts.

*necessary to calculate legal costs on the basis of a tariff and in international arbitration involving Slovak parties, it is not usual to use a tariff.”<sup>14</sup>*

Due to the latest amendment of the Slovak Arbitration Act, the number of arbitration courts in Slovakia has decreased rapidly. It must be seen whether international arbitration can be attracted to Slovakia and how the remaining arbitration courts will deal with the new regulation with respect to the award of legal cost.

### 2.3 Awarding of Actual Legal Fees

The traditional concept of awarding legal costs in arbitration has been left as the last one. The term “actual fees” has been used mainly to distinguish it from the previous “tariff concept” where actual fees are not relevant.

This is the most common method of awarding attorneys’ fees in current international arbitration practice. Citing Article 40(1) of the UNCITRAL Arbitration Rules:<sup>15</sup> *“The costs of the arbitration shall in principle be borne by the unsuccessful party or parties.”*

Since it is very unpredictable how high the legal costs will be before the disputes in initiated (especially with respect to the costs of the opposing party), there must be some limits on the amount of recoverable attorneys’ fees. Generally, the concept of “reasonable” fees is used. For example, according to UNCITRAL Arbitration Rules: *“The arbitral tribunal may apportion each of such costs between the parties if it determines that apportionment is reasonable, taking into account the circumstances of the case.”<sup>16</sup>* What is reasonable, depends on the circumstances of the case. However, the following factors are usually looked at when dealing with the issue of reasonability of the fees: (i) amount of the dispute; (ii) complexity of the case; (iii) actions of the parties causing delay of the proceeding and (iv) prices of legal services on the market.

It could be argued that this method of determination of legal fees is unpredictable but the reasonability limitation is there to put a cap on extraordinary fees. It is also the most equitable form of fees recovery where the winning

<sup>14</sup> GYARFÁŠ, Juraj, ŠTEVČEK, Marek et al. *Zákon o rozhodcovskom konaní. Komentár*. Praha: C. H. Beck, 2016, pp. 487–488.

<sup>15</sup> UNCITRAL Arbitration Rules (with new Article 1, paragraph 4, adopted in 2013) [online]. UNCITRAL [accessed on 2017-02-01].

<sup>16</sup> Article 40(1).

party can expect to be fully reimbursed for the suffered loss. One way how the arbitrators can avoid the unreasonable fees evaluation by the parties is to ask for a final fee calculation before the award is rendered.

### 3 Conclusion

Award of legal fees in arbitration is still not harmonised but there is a general tendency to award the winning party its actual legal fees to the extent they are reasonable.

Although Slovakia is a young player in the arbitration forum it seems that with respect to the legal fees it follows the general trend used in international arbitration based on the award of actual legal fees.

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# ADVANTAGE OR A DISADVANTAGE? THE COSTS OF ARBITRATION COURT PROCEEDINGS IN HUNGARY

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## **Abstract**

According to the Hungarian regulation of the arbitration can we two types separate: ad hoc and permanent arbitration. Currently operates more permanent arbitration in Hungary, the oldest and most important is the Arbitration under the Hungarian Chamber of Commerce and Industry. The recourse to arbitration is also subject to several conditions, for example the parties, the subject of dispute, but equally important condition is the cost of the arbitration. Between the civil procedure and the arbitration can we more positive and negative characteristics establish. One of these is the cost, that considered a negative marker of the arbitration: the arbitration is expensive. In this lecture, I would like to examine, that in the same case how to develop the costs in the civil procedure and in the arbitration. How much of the costs are the processing fees, the cost of access to the courts (for example the presence of the parties, travel costs), the costs of proceedings. Looking at all these things in the same case can we establish, is the arbitration actually more expensive as the civil procedure.

## **Keywords**

Arbitration; Advantages; Civil Proceeding; Costs of Arbitration.

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## 1 Introductory Thoughts - the Position of Arbitration in the Judicial System of Hungary

“The prevalence of arbitration also depends on the situation of the prevailing national judicial system.”<sup>2</sup> The author attributes this statement to the findings of his historical research demonstrating that arbitration was widely applied in a period when national jurisdiction left much to be desired as far as speed and professionalism were concerned. However, the need of the application of arbitration was reduced when the rules of ordinary court proceedings improved and national courts started their ordinary operation.<sup>3</sup>

Arbitration can be considered as the primary alternative relating to civil court proceedings,<sup>4</sup> which provides that a legal dispute is decided in an organization established by the mutual consent of the parties and according to the rules determined by the parties.<sup>5</sup>

Access to arbitration is based on the right to self-determination declared in the Fundamental Law in such a way that everybody can decide whether they exercise or waive a right. This freedom also applies concerning the right of access to courts. Thus, by concluding a contract of arbitration the parties decide that they do not want to go to a national court and by waiving their right of remedy they submit their legal dispute to arbitration that complies with the relevant judicial system.<sup>6</sup> Based on its name and regulation,

2 KECSKÉS, László. A választottbíráskodással kapcsolatos eljárás jogi gondolatok és intézmények fejlődése Magyarországon 1868-ig. In: GELLÉN, Klára, GÖRÖG, Márta (eds.). *Lege et fide Ünnepi tanulmányok Szabó Imre 65. születésnapjára*. Szeged: Iurisperitus Kiadó, 2016, p. 316.

3 Ibid., pp. 316–317.

4 VARGA, István. Az objektív arbitrabilitás magyar szabályozásának története és csomópontjai. In: MÁTHÉ, Gábor, RÉVÉSZ, T. Mihály, GOSZTONYI, Gergely (eds.). *Jogtörténeti parerga. Ünnepi tanulmányok Mezey Barna 60. születésnapja tiszteletére*. Budapest: ELTE Eötvös Kiadó, 2013, p. 363; BAUMBACH, Adolf, LAUTERBACH, Wolfgang, ALBERS, Jan, HARTMANN, Peter *Zivilprozessordnung*. München: C. H. Beck, 2008, p. 2601; HAUSMANINGER, Christian. Schiedsverfahren. In: FASCHING, Hans W., KONECNY, Andreas. *Kommentar zu den Zivilprozessgesetzen 4. Band/2. Teilband*. Wien: Manz'sche Verlags- und Universitätsbuchhandlung, 2016, p. 1.

5 HUNGARY. Act LXXI of 1994 on Arbitration (“Hungarian Arbitration Act”).

6 Decision of the Constitutional Court, Hungary of 11 January 1992, No. 604/B/1990. VARGA, István. A választottbírói eljárás és az állami bírósági polgári per viszonyrendszerének összefüggései. In: NEMETH, János, VARGA, István (ed.). *Egy új polgári perrendtartás alapjai*. Budapest: HVG Orac, 2014, pp. 639–640.

arbitration is a solution for deciding on legal disputes to be chosen in accordance with the contractual freedom.<sup>7</sup>

The Hungarian Supreme Court emphasizes the alternative manner of choosing arbitration as it declares that the stipulation for arbitration is a choice of court based on a contract: the parties involved agree by expressing their mutual and concordant intent that they choose arbitration for deciding on their legal dispute, thus, they refuse to choose the ordinary court proceedings.<sup>8</sup>

Arbitration court proceedings relating to the enforcement of pecuniary claims can provide great freedom concerning the form of proceedings or detail rules as an optional tool.<sup>9</sup> However, it cannot be considered as a general alternative for ordinary court proceedings as the relevant law - Hungarian Arbitration Act - clearly determines the range of persons entitled for choosing this option: arbitration court proceedings can be applied instead of an ordinary court procedure if a) at least one of the parties is a person involved in a professional economic activity and the legal dispute is connected to his activity and b) the parties can determine the subject of the procedure without limitation and c) arbitration court proceedings has been stipulated in a contract for arbitration.<sup>10</sup> Thus, this procedure can be applied instead of an ordinary court procedure only if cumulative conditions regulated by the law are met. Consequently, such a procedure cannot be applied in the legal dispute of two private persons at all. Also, in case of a pecuniary claim between an entity and a private person it can be chosen in accordance with a contractual stipulation for arbitration only. It is therefore an alternative way of the enforcement of pecuniary claims that first of all can be applied in legal disputes between legal entities.<sup>11</sup> Traditionally, arbitration court proceedings are applicable in the field of economic activities all over the world<sup>12</sup>, they are not a general tool for the enforcement of pecuniary

<sup>7</sup> Decision of the Constitutional Court, Hungary of 22 June 1994, No. 1282/B/1993; Decision of the Constitutional Court, Hungary of 13 March 2001, No. 7/2001.

<sup>8</sup> Decision of the Supreme Court, Hungary of 15 October 2013, No. 3/2013, point IV.

<sup>9</sup> Sections 28–37 of the Hungarian Arbitration Act.

<sup>10</sup> Section 3(1) of the Hungarian Arbitration Act.

<sup>11</sup> OKÁNYI, Zsolt. *Választottbíráskodás Magyarországon belső és nemzetközi ügyekben. Szabályok és elemzések*. Budapest: Alapszín Kiadó, 2009, p. 9.

<sup>12</sup> KECSKES, László, LUKÁCS, Józsefné (ed.). *A választottbírók Könyve*. Budapest: HVG Orac Lapész Könyvkiadó, 2012, p. 154.



claims but they provide a smooth environment specifically for economic operators to solve legal disputes out of an ordinary court procedure.<sup>13</sup>

Both arbitration court proceedings and ordinary civil court procedures can be characterized by describing their advantages and disadvantages and thus, the comparative assessment of both procedures can be compiled.

As far as arbitration court proceedings are concerned, the neutral character of this procedure, providing special expertise, the speed, flexibility and the confidentiality of the procedure as well as the enforceability of the arbitration decisions can be presented as a positive feature.<sup>14</sup>

According to the literature, it is a negative feature that several questions concerning the arbitration court proceedings are not regulated by Hungarian Arbitration Act or they are regulated in a controversial way, e.g. the question of *lis pendens* or *res judicata*. In addition, arbitration has a more restricted room for manoeuvre compared to civil court procedures in the field of ordering provisional measures, distraint-description and coercive measures.<sup>15</sup>

Lack of appeal in the arbitration court procedure can be described as a feature that can be assessed in two different ways. On the one hand, the final nature of arbitration decisions and the lack of appeal contribute to the quick conclusion of legal disputes but on the other hand, it also excludes the remedy of decision faults. Arbitration court decisions can be revised in an annulment procedure before ordinary courts only if certain reasons

<sup>13</sup> VARGA, István. Egyéb fontosabb bírósági nemperes eljárások-A választottbírósági eljáráshoz kapcsolódó polgári nemperes eljárások. In: VARGA, István (ed.). *Polgári nemperes eljárások joga*. Budapest: ELTE Eötvös Kiadó, 2013, p. 1052.

<sup>14</sup> BORONKÁY, Miklós, WELLMANN, György. A választottbíráskodás helyzete Magyarországon [online]. *MTA Law Working Papers (Hungarian Academy of Science)*, 2015, No. 12 [accessed on 2017-04-11]; HORVÁTH, Éva, KÁLMÁN, György. *Nemzetközi eljárások joga- a kereskedelmi választottbíráskodás*. Budapest: Osiris Kiadó, 1999, pp. 7–49, 65–66; SZIGETI, Zsolt. *A nemzetközi kereskedelmi választottbíráskodás néhány karakterisztikus sajátossága a Common Law és a kontinentális jogrendszerben* [online]. p. 3 [accessed on 2017-04-20]; VOIT, Wolfgang. Schiedsgerichtliches Verfahren. In: MUSIELAK, Hans Joachim. *Kommentar zur Zivilprozessordnung*. München: Verlag Franz Vahlen, 2009, p. 2303; HAUSMANINGER, Christian: Schiedsverfahren. In: FASCHING, Hans W., KONECNY, Andreas. *Kommentar zu den Zivilprozessgesetzen 4. Band/2. Teilband*. Wien: Manz'sche Verlags- und Universitätsbuchhandlung, 2016, p. 2.

<sup>15</sup> OKÁNYI, Zsolt. *Választottbíráskodás Magyarországon belföldi és nemzetközi ügyekben. Szabályok és elemzések*. Budapest: Alapszín Kiadó, 2009, p. 45; BAUMBACH, Adolf, LAUTERBACH, Wolfgang, ALBERS, Jan, HARTMANN, Peter. *Zivilprozessordnung*. München: C. H. Beck, 2008, p. 2601.

exist. Hungarian Arbitration Act refers these court proceedings to the jurisdiction of tribunals and the exact terms and conditions of initiating court proceedings are also determined.<sup>16</sup> Annulment procedures cannot be considered as an ordinary remedy relating to arbitration court decisions.

The costs of arbitration court proceedings, in other words, the costs side of such a procedure cannot be considered definitely as a negative or positive feature.<sup>17</sup> In a regulation of fees, the payable fees and costs are determined by permanent arbitration courts. The amount of such fees and costs and their relation to those ones incurred in a civil court procedure influences the fact considerably whether the parties choose an arbitration court procedure or not.

In the following paragraphs, the costs side of arbitration court proceedings will be surveyed on the basis of the regulation of arbitration fees, trying to answer the question whether a clear opinion can be formulated in this issue: Do the costs incurred in arbitration proceedings represent an advantage or a disadvantage?

## 2 Permanent Arbitration Courts in Hungary

Currently, there are six permanent arbitration courts in the Hungarian judicial system.

1. The Permanent Arbitration Court attached to the Hungarian Chamber of Commerce and Industry, which has been the legal successor of the Hungarian Chamber of Economy since 1995, has been working in Hungary since 1949.<sup>18</sup> Unless otherwise provided by law, the Permanent Arbitration Court attached to the Hungarian Chamber of Commerce and Industry acts as a permanent arbitration court in international affairs.<sup>19</sup> The enhanced role of this arbitration court is confirmed by the great number of parties involved, which has promoted its position achieved among the leading arbitration courts in Europe.<sup>20</sup>

<sup>16</sup> Sections 52 and 55 of the Hungarian Arbitration Act.

<sup>17</sup> HAUSMANINGER, Christian: Schiedsverfahren. In: FASCHING, Hans W., KONECNY, Andreas. *Kommentar zu den Zivilprozessgesetzen 4. Band/2. Teilband*. Wien: Manz'sche Verlags- und Universitätsbuchhandlung, 2016, p. 2.

<sup>18</sup> KECSKÉS, László, LUKÁCS, Józsefné (ed.). *A választottbírók Könyve*. Budapest: HVG Orac Lap- és Könyvkiadó, 2012, p.174.

<sup>19</sup> Section 46(3) of the Hungarian Arbitration Act.

<sup>20</sup> OKÁNYI, Zsolt. *Választottbíráskodás Magyarországon belső és nemzetközi ügyekben. Szabályok és elemzések*. Budapest: Alapszín Kiadó, 2009, pp. 34–38; BOÓC, Ádám. *A nemzetközi kereskedelmi választottbíráskodás, a választottbíró megválasztása és kizárása*. Budapest: HVG-ORAC Lapés Könyvkiadó Kft, 2009, pp. 244–254.

2. The Permanent Arbitration Court of Money and Capital Market is the legal successor of the Permanent Arbitration Court of Budapest Stock Exchange (1990) and Budapest Commodity Exchange (1994).<sup>21</sup>
3. The Permanent Arbitration Court attached to the Hungarian Chamber of Agriculture started its activity on 15 October 1997 in order to decide on legal disputes especially in the field of agriculture.<sup>22</sup>
4. The Permanent Sports Arbitration Court was established by Act CXLV of 2000 on Sports and its rules of operation were determined by Section 47 of the Act I of 2004 on Sports.<sup>23</sup>
5. The Permanent Communications Arbitration Court was established on 13 May 2004 in accordance with Sections 72 - 73 of the Act C of 2003 on Communication.<sup>24</sup>
6. The Permanent Energy Arbitration Court is the latest one in Hungary established by the Hungarian Energy Office on 15 December 2008.<sup>25</sup>

Among the above-mentioned arbitration courts, the Permanent Arbitration Court attached to the Hungarian Chamber of Commerce and Industry has a larger number of customers as mentioned before and the other permanent arbitration courts do not have a considerable number of customers. This imbalance can be caused by the range of legal relationships covered by these arbitration courts, in other words, structural problems. The arbitration court presented before as the first one can solve more legal disputes due to the considerable number of customers from several economic sectors, while the other arbitration courts were established focusing on a single economic sector and they can provide help to parties in solving legal disputes of that

<sup>21</sup> OKÁNYI, Zsolt. *Választottbíráskodás Magyarországon belföldi és nemzetközi ügyekben. Szabályok és elemzések*. Budapest: Alapszín Kiadó, 2009, pp. 38–39.

<sup>22</sup> KECSKÉS, László. A választottbíráskodásra vonatkozó jogi szabályozás kialakulása és fejlődése Magyarországon. In: KECSKÉS, László, LUKÁCS Józsefné (ed.). *A választottbírók Könyve*. Budapest: HVG Orac Lapés Könyvkiadó Kft, 2012, p. 179.

<sup>23</sup> OKÁNYI, Zsolt. *Választottbíráskodás Magyarországon belföldi és nemzetközi ügyekben. Szabályok és elemzések*. Budapest: Alapszín Kiadó, 2009, p. 40.

<sup>24</sup> KECSKÉS, László. A választottbíráskodással kapcsolatos eljárási jogi gondolatok és intézmények fejlődése Magyarországon 1868-ig. In: GELLÉN, Klára, GÖRÖG, Márta (eds.). *Legge et fide Ünnepi tanulmányok Szabó Imre 65. születésnapjára*. Szeged: Iurisperitus Kiadó, 2016, p. 181.

<sup>25</sup> OKÁNYI, Zsolt. *Választottbíráskodás Magyarországon belföldi és nemzetközi ügyekben. Szabályok és elemzések*. Budapest: Alapszín Kiadó, 2009, p. 41.

particular sector.<sup>26</sup> Based on this statement, this essay will draw some conclusions by introducing and assessing the regulation of fees of this arbitration court, which is the oldest one and has the largest number of customers in Hungary, concerning the costs of arbitration procedures.

### 3 Regulation of Fees of the Permanent Arbitration Court attached to the Hungarian Chamber of Commerce and Industry

This arbitration court charges the following costs: registration fee and arbitration fee.<sup>27</sup>

In addition, other expenses can arise as arbitration costs, which are adjusted to evidence or use of language in the procedure. There are special rules in this regulation of fees of the arbitration court about the parties' costs that can arise relating to the protection of their interests, namely, about lawyers' fees.<sup>28</sup> These costs will not be examined by this essay as they can arise both in an arbitration or an ordinary court procedure and the comparison of both procedures in terms of costs would not indicate any difference.

The registration fee as the condition of initiating an arbitration court procedure is to be paid at the time of the submission of the application and it cannot be refunded and it is a part of the arbitration fee.<sup>29</sup> This amount is HUF 25,000 that is to be paid by bank transfer to the bank account published by the Secretariat of the arbitration court.

The arbitration fee is an amount determined based on the dispute value and administrative costs, judges' fees and public charges are part of it.<sup>30</sup>

<sup>26</sup> KECSKÉS, László. A választottbíráskodással kapcsolatos eljárási jogi gondolatok és intézmények fejlődése Magyarországon 1868-ig. In: GELLÉN, Klára, GÖRÖG, Márta (eds.). *Legge et fide Ünnepi tanulmányok Szabó Imre 65. születésnapjára*. Szeged: Iurisperitus Kiadó, 2016, p. 182.

<sup>27</sup> HAUSMANINGER, Christian. Schiedsverfahren. In: FASCHING, Hans W., KONECNY, Andreas. *Kommentar zu den Zivilprozessgesetzen 4. Band/2. Teilband*. Wien: Manz'sche Verlags- und Universitätsbuchhandlung, 2016, p. 795.

<sup>28</sup> Rules of Proceedings of the Arbitration Court attached to the Hungarian Chamber of Commerce and Industry, effective as of 1 March [online]. *Hungarian Chamber of Commerce and Industry*, p. 37 [accessed on 2017-04-20] („Rules“).

<sup>29</sup> Ibid.

<sup>30</sup> Milyen összegű a választottbírói díj? [online]. *Magyar Kereskedelmi és iparkamara* [accessed on 2017-04-20].

The fixed scale of fees indicates the same dispute value range both for administrative costs and judges' fees (the main value limits are HUF 5, 10, 25, 50, 125, 250 million as well as HUF 1 billion 250 million and HUF 5 billion.)

Regarding these value ranges, it must be emphasized that for the lowest value range, the administrative costs are determined as 1 % of the dispute value, but at least HUF 25 thousand. Practically, it means that a party must consider paying at least HUF 25 thousand as an administration fee or a maximum amount of HUF 50,000. Cost calculation method changes for higher dispute value ranges as the regulation determines a fix amount and it specifies that a certain percentage above the minimum value of the particular range must be added (e.g. for a dispute value between HUF 5 million and 1 and HUF 10 million, HUF 50,000 + an amount equal to 0.8 % of the part above HUF 5 million).<sup>31</sup>

As far as judges' fees are concerned, the above system can be presented and with the same value ranges, the parties must consider paying 2.4 % of the dispute value in the lowest range (HUF 0-5 million), at least HUF 40, 000. Thus, the judges' fees can be a minimum amount of HUF 40 thousand and a maximum amount of HUF 120, 000 in this range of dispute values. In the following ranges of dispute values, there is a fix amount and a percentage determined according to the actual dispute value is added as shown for administrative costs. The judge's fee refers to a single judge only, so in case of a procedure with a chamber of judges this amount must be multiplied by the numbers of the acting judges. In addition, the chairman of the acting chamber or the acting single judge are entitled to receive a higher fee, so they are entitled to receive an amount of the judge's fee increased by 30 %.<sup>32</sup>

In the fixed scale of arbitration fees, public charges are separated, so duties and health contribution are indicated separately. For duties, the base of calculation is the dispute value and the duty can be 5 % of such a value, but

<sup>31</sup> Rules, pp. 42–43.

<sup>32</sup> Rules, p. 43; VOIT, Wolfgang. Schiedsgerichtliches Verfahren. In: MUSIELAK, Hans-Joachim. *Kommentar zur Zivilprozessordnung*. München: Verlag Franz Vahlen, 2009, pp. 2424–2425; HAUSMANINGER, Christian. Schiedsverfahren. In: FASCHING, Hans W., KONECNY, Andreas. *Kommentar zu den Zivilprozessgesetzen 4. Band/2. Teilband*. Wien: Manz'sche Verlags- und Universitätsbuchhandlung, 2016, p. 789.

at least HUF 5 thousand and a maximum amount of HUF 250 thousand. In consideration of the relation between duties and arbitration fees we can state that the plaintiff must pay the arbitration fee according to the dispute value in advance at the initiation of the procedure and a part of this is the duty amount. The plaintiff does not pay any duties separately but the Financial Directorate of the arbitration court transfers the amount equal to the duty amount from the advance payment to the National Tax and Custom Office.<sup>33</sup>

The amount of the health contribution is calculated on the basis of the judges' fee and it is 27 % of that.<sup>34</sup>

There is a particular scale of fees for accelerated procedures involving a single judge. The value limits and percentages of the calculation of the administrative costs and judge's fees are the same as mentioned above for the general regulation of fees: there is one difference, namely relating to the registration fee, which is HUF 10 thousand compared to the fee of HUF 25 thousand for the general procedure.<sup>35</sup>

As the arbitration fee includes the above-mentioned costs such as the administrative costs, the judges' fees and the public charges, a question arises whether all the costs will be paid by the plaintiff in advance at the beginning of the procedure.

The system regulates it in this way and the plaintiff pays the entire amount in advance but the arbitration court will decide in the decision who will bear it. This fee must be paid in advance and there are no allowances such as notice right, instalment payment or fee exemption, in other words, the plaintiff must pay the calculated entire fee on the basis of the written invitation of the arbitration court within 60 days after such a call for payment was published.<sup>36</sup>

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<sup>33</sup> Milyen összegű a választottbírói díj? [online]. *Magyar Kereskedelmi és iparkamara* [accessed on 2017-04-20].

<sup>34</sup> Milyen összegű a választottbírói díj? [online]. *Magyar Kereskedelmi és iparkamara* [accessed on 2017-04-20].

<sup>35</sup> Rules, pp. 44–45.

<sup>36</sup> Milyen összegű a választottbírói díj? [online]. *Magyar Kereskedelmi és iparkamara* [accessed on 2017-04-20].

On the homepage of the Hungarian Chamber of Commerce and Industry, the arbitration fees of the procedural regulation and the calculation rules as well as a fee calculator can be found providing a quick and efficient help to the users.<sup>37</sup> Simple data for fee calculation are to be entered, then the dispute value, the composition of the acting arbitration court (single judge or chamber of judges) or the fact whether an ordinary or accelerated procedure is applied for shall be indicated there. After entering all these data, the calculator determines the amount of the administrative costs, the judges' fee, the health contribution and the fee amount immediately then these amounts are summarized and the fix registration fee (HUF 25 thousand) is added and the total amount is indicated. Thus, plaintiffs do not have to waste time and energy to interpret the regulation as the automatic system provides exact data about the costs to be paid in advance at the beginning of the procedure immediately.

#### **4 The Costs of Initiation of a Civil Court Procedure v. the Costs of an Arbitration Court Procedure**

In civil court proceedings, the plaintiff must pay a duty in the application. The amount of the duty is determined by Act XCIII of 1990 on Fees ("Act on Fees"). Unless otherwise provided by law, the base of the duty in civil court proceedings and in a non-contentious procedure is the value of the subject-matter of the dispute at the initiation of the procedure, namely the value of the enforced claim.<sup>38</sup> The general extent of the civil court procedures of first instance is 6 % of the subject-matter value but at least HUF 15,000 and a maximum amount of HUF 1,500,000.<sup>39</sup>

The only expenditure to be paid by the plaintiff is therefore the fee of the procedure upon the initiating of the civil court proceedings. Compared to the arbitration fee, this amount is not shared into different items. However,

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<sup>37</sup> See Díjkalkulátor 2017. január 1-től [online]. Magyar Kereskedelmi és iparkamara [accessed on 2017-04-20]; HAUSMANINGER, Christian. Schiedsverfahren. In: FASCHING, Hans W., KONECNY, Andreas. *Kommentar zu den Zivilprozessgesetzen 4. Band/2. Teilband*. Wien: Manz'sche Verlags- und Universitätsbuchhandlung, 2016, pp. 784–785.

<sup>38</sup> Section 39(1) of the Act on Fees.

<sup>39</sup> Section 42(1)(a) of the Act on Fees.

this would be less for a real comparison, so we will demonstrate the costs of these two different types of procedure in case of the same dispute value as follows.

If the value of the subject-matter is determined as HUF 1,500,000, the civil procedure fee is HUF 90,000. In an arbitration court procedure involving a single judge, the plaintiff must pay HUF 128,440 in advance. In case of a chamber of judges, this amount would be HUF 226,040. However, if the plaintiff intends to initiate an accelerated procedure involving a single judge, the costs of procedure is HUF 98,800 only. All this proves that a plaintiff can enforce his claim with a lower dispute subject value in an accelerated procedure involving a single judge by paying approximately the same costs before a civil court or before an arbitration court.

If we examine the costs for a case with a considerably higher dispute subject value, e.g. HUF 450,000,000, we can see as follows: in a civil court procedure, the procedural fee would be HUF 27,000,000, however, there is a rule concerning the determination of a maximum amount, so it would be HUF 1,500,000 only. In case of a chamber of judges, the costs of arbitration procedure are HUF 11,568,260 in a procedure involving a single judge, such a fee is HUF 6,053,680, in a simplified procedure with a single judge it is HUF 5,211,700. It is obvious that the balance tips in favor of the ordinary court procedure for cases with a higher dispute subject value.

The costs of an arbitration court procedure involving a chamber of judges are the highest for both values examined. The judges' fees increase (three-fold calculation and the payment of a health contribution of 27 % in this regard) the cost to be paid by the plaintiff.

In addition to the calculations based on the dispute value only, other aspects are to be considered for the costs of both procedures.

Thus, the fact that an arbitration court procedure is of one instance only can be regarded as a kind of cost reduction as the parties cannot contest the arbitration court decision by applying an ordinary legal remedy. In this procedure, there are no remedy costs contrary to a civil court procedure where the decision of first instance can be contested by submitting an appeal and



in the procedure of second instance the appellant must face an obligation to pay a fee. The extent of the fee is 8 % of the disputed value but at least HUF 15,000 or a maximum amount of HUF 2,500,000.

On the other hand, we can refer to the finding relating to the more reasonable costs of the arbitration court procedure that arbitration courts award legal costs more generously than civil courts. As regards legal assistance, it can be shown definitely that ordinary courts generally award lower legal costs.<sup>40</sup>

When the arbitration court procedure is evaluated in terms of legal costs, the fact that compared to civil court actions, arbitration courts do not allow any legal aid can be considered as a considerable disadvantage. Thus, the plaintiff cannot initiate a court procedure if he cannot pay the procedure fee due to his financial situation in advance. This is a problem that special emphasis should be placed on in case of legal disputes arising from consumer contracts or legal disputes between companies in liquidation.<sup>41</sup>

The costs and the difficulty of initiating the procedure cause the appearance of “third-party funding”. A third party finances the costs incurred in the proceedings and this raises several ethical and procedural problems and issues (for example transparency and conflict of interests). International “best practice standard” has not been developed so far.<sup>42</sup>

## 5 Concluding Thoughts

This essay has attempted to demonstrate the costs incurred in the initiating phase of arbitration court procedure and civil court procedure with the same dispute value accurately after having surveyed the costs incurred in the arbitration court procedure.

However, we could gain a picture about the costs of both procedures and about the extent of the single fees included in the arbitration court procedure

<sup>40</sup> BORONKAY, Miklós, WELLMANN, György. *A választottbíráskodás helyzete Magyarországon* [online]. MTA Law Working Papers (Hungarian Academy of Science). 2015, No. 12, pp. 4–5 [accessed on 2017-04-11].

<sup>41</sup> *Ibid.*, p. 5.

<sup>42</sup> HAUSMANINGER, Christian. Schiedsverfahren. In: FASCHING, Hans W., KONECNY, Andreas. *Kommentar zu den Zivilprozessgesetzen 4. Band/2. Teilband*. Wien: Manz'sche Verlags- und Universitätsbuchhandlung, 2016, pp. 793–795.

by means of the fee calculator operated on the homepage of the Hungarian Chamber of Commerce and Industry in each single case only. If the payable costs linked to the initiation of the procedures are considered only, the fees incurred in a civil court procedure as well as the regulation of the ceiling for larger dispute values are definitely more reasonable for a plaintiff.

In the initiation phase of an arbitration court procedure, higher costs arise, which concerns in particular for a procedure involving a chamber of judges, so while exploring the advantages and disadvantages of arbitration, the author of this essay indicates a clear choice relating to the disadvantages.

Apart from the costs, there are certainly more factors that influence the choice between these two procedures as referred to above. Plaintiffs should take not only the costs incurred in a court procedure but also the positive features of the arbitration court procedure such as the neutral nature of the procedure, the availability of special expertise, the speed, flexibility and confidentiality of the procedure while deciding whether applying for an ordinary court or an arbitration court to solve the legal dispute. The positive features of an arbitration court procedure can outweigh the cost factor and having this necessary information, the plaintiff should consider whether the fee of an ordinary court procedure, which is lower for a given dispute value, provides an advantage, due to which he will not choose an arbitration court procedure.

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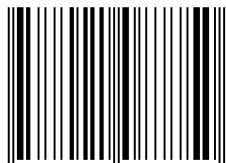
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