



ELTE | LAW

# ANNALES

UNIVERSITATIS SCIENTIARUM  
BUDAPESTINENSIS DE ROLANDO  
EÖTVÖS NOMINATAE  
SECTIO IURIDICA

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Ahrens, Martin\*

# Kollision von Insolvenzrecht und Öffentlichem Recht

## ABSTRACT

Insolvency law organizes in a specific way the equal treatment of creditors. That often collides with the public law or, more specific, several parts of the public law, so as social law, environmental law or tax law. When the state or its parts claimed money from the debtor, they often get a better position than other creditors. If a public actor has preferential rights, private creditors get less money during the insolvency proceedings. But it is not the role of the state, which can legitimize a privilege. The whole assets have to be distributed in equal parts, no matter what origin the outstanding debts are. The better way is to trust in the insolvency law and the equal treatment.

**KEYWORDS:** insolvency law, conflict, public law, social law, environmental law, tax law

## I. STRUKTUREN

### 1. Insolvenzrechtliche Leitgedanken

Die Privatautonomie mit ihrer Ausprägung der Verfügungsbefugnis eröffnet dem Rechtssubjekt die freie rechtliche Vermögensherrschaft. Die einzelnen Gläubiger werden in dieser Situation nach der Entscheidung des Schuldners und ihrer Reihenfolge berechtigt. Diese Ordnungsgrundsätze sind durch die Bevorrechtigung einzelner Gläubiger aus Schuldnerhandlungen in §§ 879 I 1, 1209 BGB und aus Einzelzwangsvollstreckungen durch § 804 III ZPO zum Prioritätsprinzip verfestigt. Danach geht ein früher begründetes Recht einem späteren Recht vor.

Wenn das Vermögen nicht mehr zur Befriedigung sämtlicher Gläubiger ausreicht, also in der Insolvenz, verliert die Bevorrechtigung einzelner Gläubiger ihre legitimierende Wirkung. Eine Befriedigung aufgrund von Schuldnerhandlungen kann unter

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den Voraussetzungen der Insolvenzanfechtung rückgängig gemacht werden. In dieser Situation erscheint es zudem als ungerecht, den zufälligen Zeitpunkt einer Pfändung über eine vorrangige und möglicherweise vollständige Befriedigung des ersten Gläubigers entscheiden zu lassen und einen Ausfall anderer Gläubiger mit ihren Forderungen in Kauf zu nehmen.<sup>1</sup> In der Insolvenz tritt deswegen die gemeinschaftliche Gläubigerbefriedigung für die bei Insolvenzeröffnung begründeten Insolvenzforderungen aus § 38 InsO an die Stelle der individuellen Rechtsdurchsetzung.

Ob eine Verbindlichkeit als Insolvenzforderung i.S.d. § 38 InsO anzusehen ist, hängt aus insolvenzrechtlicher Perspektive davon ab, wann die Forderung entstanden ist.<sup>2</sup> Dazu muss der Rechtsgrund für das Entstehen der Forderung bereits bei Verfahrenseröffnung gelegt, also der anspruchsbegründende Tatbestand vor Verfahrenseröffnung abgeschlossen sein.<sup>3</sup>

Dennoch werden in der Insolvenz nicht sämtliche Gläubiger gleich behandelt. Um eine ordnungsgemäße Durchführung des Insolvenzverfahrens zu ermöglichen, müssen bestimmte Verpflichtungen, die Masseverbindlichkeiten, in vollem Umfang vorweg aus der Masse befriedigt werden, § 53 InsO.<sup>4</sup> Dies gilt für die Kosten des Insolvenzverfahrens, § 54 InsO, sowie die zur Verwaltung und Verwertung der Masse abgeschlossenen Rechtsgeschäfte. Erfasst werden etwa die durch Handlungen des Insolvenzverwalters begründeten oder aus gegenseitigen Verträgen resultierenden Verbindlichkeiten, deren Erfüllung zur Insolvenzmasse verlangt wird, § 55 I InsO.

## 2. Bruchkanten

Als Querschnittsmaterie berührt das Insolvenzrecht zahlreiche Rechtsgebiete. Dabei kollidieren die insolvenzrechtlichen Konzeptionen immer wieder mit den Denkmustern und Regeln anderer Rechtsbereiche. Vor allem die Grenzziehung zwischen den regelmäßig nur mit einer Quote zu berichtigenden Insolvenzforderungen und den vorrangig und grundsätzlich vollständig zu befriedigenden MassEForderungen steht immer wieder zu Diskussion. Dies gilt insbesondere dann, wenn die zu befriedigende Forderung öffentlich-rechtlicher Natur ist und deswegen der Rechtsprechung anderer Fachgerichte und nicht der für das Insolvenzrecht zuständigen Zivilgerichtsbarkeit unterliegen.

Nur scheinbar handelt es sich dabei um Bruchlinien und Verwerfungskanten an den Außenrändern des Insolvenzrechts. Vielmehr werden häufig die

<sup>1</sup> AGR/*Ahrens*, 3. Aufl., § 1 Rn. 28 (dort weitere Belege).

<sup>2</sup> BGH NZI 2011, 953 Rn. 3; FK-InsO/*Bornemann*, 9. Aufl., § 38 Rn. 21; Uhlenbruck/*Sinz*, InsO, 15. Aufl., § 38 Rn. 26.

<sup>3</sup> BGH NZI 2011, 953 Rn. 3; MüKoInsO/*Ebricke/Behme*, 4. Aufl., § 38 Rn. 21; HK-InsO/*Ries*, 9. Aufl., § 38 Rn. 27; Nerlich/Römermann/*Andres*, InsO, 43. EL., § 38 Rn. 13; KK-InsO/*Hess*, 2016, § 38 Rn. 9.

<sup>4</sup> MüKoInsO/*Hefermehl*, 4. Aufl., § 53 Rn. 1.

insolvenzrechtlichen Prinzipien im Spektrum gerade der öffentlich-rechtlichen Diskurse nicht oder nur unzureichend gewürdigt. Beispiele aus den drei auf das Verwaltungshandeln bezogenen Gerichtsbarkeiten der Sozialgerichte, der Verwaltungsgerichte und der Finanzgerichte belegen diesen schwierigen Umgang mit dem Insolvenzrecht.

## II. ZUSAMMENTREFFEN VON INSOLVENZ- UND SOZIALRECHT

### 1. Problemstellung

Das Exempel aus dem Sozialrecht betrifft die Aufrechnung bzw. Verrechnung von Forderungen eines Sozialleistungsträgers mit Ansprüchen des (früheren) Insolvenzschuldners. Im Mittelpunkt steht dabei die Frage, inwieweit durch ein Insolvenzverfahren und eine anschließend erteilte Restschuldbefreiung die Aufrechnungs- bzw. Verrechnungsmöglichkeit eines Sozialleistungsträgers abgeschnitten wird. Hierzu liegen mehrere gegensätzliche Entscheidungen von Landessozialgerichten, aber noch keine höchstrichterliche Entscheidung vor.

Materiell dient die Aufrechnung mit ihrer Vollstreckungsfunktion einer Befriedigung des Gläubigers. Deswegen muss das Insolvenzrecht beantworten, wann eine Privilegierung des Gläubigers durch Befriedigung über die Quote hinaus durch eine Aufrechnung möglich ist.<sup>5</sup> Als Anknüpfungzeitpunkt stellen dafür die §§ 94 ff. InsO auf das Entstehen der Aufrechnungslage ab. Dadurch wird das Vertrauen in eine vor Eröffnung des Insolvenzverfahrens entstandene Aufrechnungslage geschützt.

Sozialrechtlich kann nach § 51 I SGB der zuständige Leistungsträger mit eigenen Ansprüchen gegen pfändbare Ansprüche des Berechtigten auf Geldleistungen aufrechnen, wie dies den zivilrechtlichen Grundsätzen aus §§ 387, 394 BGB entspricht. Als eine sozialrechtliche Besonderheit können bei Ansprüchen auf Erstattung von zu Unrecht erbrachten Sozialleistungen und mit Beitragsansprüchen die Sozialleistungsträger den Pfändungsfreibetrag von derzeit mindestens 1.252,64 € netto mtl. unterschreiten. Leistungsträger dürfen in diesen Fällen Ansprüche auf laufende Geldleistungen bis zur Hälfte aufrechnen, es sei denn für den Leistungsberechtigten tritt dadurch eine Hilfebedürftigkeit ein, § 51 II SGB I. Die Hilfebedürftigkeit ist individuell zu bestimmen und liegt bei einem Betrag zwischen ca. 750,- und 950,- €.

Als weitere sozialrechtliche Besonderheit lässt § 52 I SGB I eine Verrechnung zu. Dabei handelt es sich um eine Aufrechnung, bei der das Gegenseitigkeitserfordernis entfällt. Der für eine Geldleistung zuständige Leistungsträger kann danach mit Ermächtigung eines anderen Leistungsträgers dessen Ansprüche gegen den

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<sup>5</sup> Jaeger/Windel, InsO, 2007, § 94 Rn. 1.

Sozialleistungsberechtigten mit der ihm obliegenden Geldleistung in den Grenzen der Aufrechnung verrechnen. Ausdrücklich ist eine Verrechnung unter dem Insolvenzrechtsregime nicht vorgesehen. Der BGH hat aber in seiner Entscheidung vom 29.5.2008 eine entsprechende Anwendung der Aufrechnungsbestimmungen auf die Verrechnung zugelassen.<sup>6</sup> Damit wird auch für den Verrechnenden eine entsprechende Anwendung der Vertrauensschutzbestimmungen aus §§ 94 ff. InsO ermöglicht.

## **2. LSG Nordrhein-Westfalen vom 15.3.2018<sup>7</sup>**

Das Verfahren betraf die Aufrechnungsbefugnis in den unpfändbaren Teil von Sozialleistungsansprüchen trotz Restschuldbefreiung. Der Kläger bezog Leistungen der Grundsicherung nach dem SGB II. Mit Bescheiden vom 9.9.2009 machte die Beklagte Erstattungsansprüche wegen zu Unrecht gezahlter Leistungen und Beiträgen zur Kranken- und Pflegeversicherung geltend. Am 15.9.2010 wurde das Insolvenzverfahren über das Vermögen des Klägers eröffnet, dem am 14.11.2016 Restschuldbefreiung erteilt wurde. Das Landessozialgericht erklärte die Aufrechnung nach Erteilung der Restschuldbefreiung für unzulässig.

Das LSG Nordrhein-Westfalen lehnt eine Aufrechnung (nach § 43 SGB II) ab, weil bei Eröffnung des Insolvenzverfahrens keine Aufrechnungslage bestanden habe. Einerseits wäre die Hauptforderung des Leistungsempfängers unpfändbar gewesen und deswegen nicht in die Insolvenzmasse gefallen. Da die unpfändbare Forderung nicht Bestandteil der Insolvenzmasse gewesen sei, könne auch keine Aufrechnungslage nach § 94 InsO fortbestehen. Andererseits sei die Gegenforderung der Beklagten aufgrund der eingetretenen aufschiebenden Wirkung des Widerspruchs und der Klage gegen den Erstattungsbescheid nicht fällig gewesen. Schließlich fehle es auch an der Durchsetzbarkeit der Gegenforderung, und damit auch deswegen an einer Aufrechnungslage. Daher könne nicht aufgerechnet werden.

## **3. LSG Bayern vom 21.3.2018<sup>8</sup>**

In einem vergleichbaren Fall gelangte das LSG Bayern nur wenige Tage später zum gegenteiligen Ergebnis. Seit dem 1.2.2007 erhielt der Kläger von der Beklagten eine Altersrente. Wegen Beitragsschulden über ca. 56.000,- € erfolgte bereits am 8.10.2003 ein erstes Verrechnungersuchen gegenüber der Beklagten. Am 23.12.2003 wurde das

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<sup>6</sup> BGH NZI 2008, 479 Rn. 13 f.

<sup>7</sup> LSG Nordrhein-Westfalen ZInsO 2018, 1280.

<sup>8</sup> LSG Bayern NZI 2018, 495.



Insolvenzverfahren über das Vermögen des Klägers eröffnet und ihm am 22.3.2010 die Restschuldbefreiung erteilt. Die mit Bescheid vom 28.5.2014 vorgenommene Verrechnung in den unpfändbaren Teil der Altersrente erklärte das LSG Bayern auch nach einer Restschuldbefreiung für zulässig.

Das Gericht stützte seine Entscheidung auf zwei tragende Argumente. Einerseits bestünde eine bei Eröffnung des Insolvenzverfahrens existierende Aufrechnungslage nach § 94 InsO fort. Wenn sogar während des Insolvenzverfahrens aufgerechnet werden könnte, müsste dies auch nach Erteilung der Restschuldbefreiung möglich sein. Andererseits könnten unvollkommene Verbindlichkeiten in den unpfändbaren Teil von Sozialleistungsansprüchen verrechnet werden, weil unpfändbare Teile der Ansprüche auf laufende Rentenleistungen nicht Bestandteil des Insolvenzverfahrens gewesen seien. Diese letztgenannte Überlegung ist allerdings unzutreffend, weil die laufenden Rentenleistungen nach dem Ende des Insolvenzverfahrens infrage standen. Die Nichtzulassungsbeschwerde gegen diese Entscheidung hat das BSG als unzulässig verworfen.<sup>9</sup>

#### 4. Bewertung

Eine Aufrechnung setzt eine durchsetzbare Gegenforderung voraus. Mit Erteilung der Restschuldbefreiung werden die Insolvenzforderungen in unvollkommene Verbindlichkeiten umgewandelt, § 301 I 1 InsO. Mit diesen können die Insolvenzgläubiger grundsätzlich nicht mehr aufrechnen, weil diese Gegenforderung nach den bürgerlichrechtlichen Regeln gem. § 387 BGB vollwirksam und durchsetzbar sein muss.<sup>10</sup>

Zentral für die Zulässigkeit der Aufrechnung – und entsprechend der Verrechnung – ist der in den §§ 94, 95 InsO angelegte Vertrauensschutz. Hat danach die Aufrechnungslage bei Eröffnung des Insolvenzverfahrens bestanden, berührt das Verfahren gem. § 94 InsO die erworbene Aufrechnungsbefugnis nicht. Die anfänglich bestehende Aufrechnungslage wird insolvenzrechtlich geschützt. Fraglich ist, wie umfassend die Reichweite dieser insolvenzrechtlichen Privilegierung ausgestaltet ist. Zu entscheiden ist, ob sie lediglich während des insolvenzrechtlichen Verfahrens oder auch anschließend wirkt. Wenn § 94 InsO eine übergreifende Rechtsfolge begründet, dann ist der aufrechnende Gläubiger auch gegenüber einer Umwandlung seiner Forderung in eine unvollkommene Verbindlichkeit geschützt.

Die gesetzliche Formulierung des § 94 InsO lässt sich dahingehend auslegen, dass die Aufrechnungslage von den Verfahrenswirkungen unberührt bleibt, also weder durch das Insolvenz- noch durch das Restschuldbefreiungsverfahren einschließlich

<sup>9</sup> BSG vom 13.8.2018, B 13 R 123/18 B.

<sup>10</sup> BGH NJW 1981, 1897; NZI 2011, 538 Rn. 8, zum Insolvenzplan; OLG Frankfurt NJW 1967, 501, 502] HambK-InsO/*Streck*, 7. Aufl., § 301 Rn. 10; *Gernhuber*, Die Erfüllung und ihre Surrogate, 2. Aufl., § 12 IV 1a.

seiner Folgen aufgehoben wird.<sup>11</sup> Bestätigt wird diese Konsequenz durch die Rechtsprechung des BGH, wonach ein bei Eröffnung des Insolvenzverfahrens bestehendes Aufrechnungsrecht auch dann erhalten bleibt, wenn die aufgerechnete Gegenforderung nach einem rechtskräftig bestätigten Insolvenzplan als erlassen gilt.<sup>12</sup>

Endgültig geklärt ist die Aufrechnungsbefugnis durch die Zivilgerichte aber noch nicht. Infolgedessen wirken sich die bestehenden Unsicherheiten auf die Auf- und Verrechnungsmöglichkeiten von Sozialleistungsträgern aus. Sobald eine finale insolvenzrechtliche Klärung erfolgt ist, wird sie von der Sozialgerichtsbarkeit zu rezipieren sein. Entsprechend wird eine der genannten Entscheidungen der Landessozialgerichte nicht weiter zu vertreten sein.

### III. KOLLISION VON INSOLVENZ- UND UMWELTRECHT

#### 1. Ausgangssituation

Nicht selten müssen im Insolvenzverfahren die umweltrechtlichen Konsequenzen aus der früheren Betriebsführung eines Schuldners aufgearbeitet werden. Zu denken ist etwa an zu entsorgende Abfälle, kontaminierte Böden oder zu sanierende oder abzureißende Gebäude.<sup>13</sup> In den beschriebenen Situationen stoßen mit dem Umwelt- und Insolvenzrecht zwei kollidierende rechtliche Ordnungssysteme aufeinander.

Die abstrakt anmutende Auseinandersetzung über eine mögliche Prärogative von Ordnungs- oder Insolvenzrecht besitzt einen sehr konkreten Hintergrund, den Streit ums Geld. Letztlich geht es um die Entscheidung, ob die gerade in der wirtschaftlichen Krise knappen finanziellen Ressourcen einem prioritären ordnungs- bzw. umweltrechtlichen Zugriff unterliegen, also letztlich einem Gläubiger dienen, oder nach insolvenzrechtlichen Maßstäben gleichmäßig auf alle Gläubiger verteilt werden müssen.

Aufgrund der ordnungsrechtlichen Anforderungen müssen die von Altlasten ausgehenden Gefahren und damit die Störungen der öffentlichen Sicherheit beseitigt werden. Es entspricht der verwaltungsrechtlichen Rationalität, die ordnungsrechtliche Verantwortlichkeit dem Störer als der dafür verantwortlichen Person aufzuerlegen. Soweit es sich um die Folgen der (vormaligen) betrieblichen Tätigkeit handelt, erscheint es als folgerichtige Konsequenz, die Kosten der Altlastensanierung gegenüber

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<sup>11</sup> K. Schmidt/*Thole*, 19. Aufl., § 94 Rn. 18; BeckOK InsO/*Liefke*, 24. Ed., § 94 Rn. 58; *Fischinger*, Haftungsbeschränkung, S. 134; a.A. MüKoInsO/*Lohmann/Reichelt*, 4. Aufl., § 94 Rn. 10; MüKoInsO/*Stephan*, 4. Aufl., § 294 Rn. 82; Uhlenbruck/*Sinz*, 15. Aufl., § 94 Rn. 82; HambK/*Streck*, 7. Aufl., § 294 Rn. 16.

<sup>12</sup> BGH NZI 2011, 538 Rn. 9 ff.

<sup>13</sup> MüKoInsO/*Hefermehl*, 4. Aufl., § 55 Rn. 88.

dem Schuldner bzw. dem Insolvenzverwalter geltend zu machen. Eine Antwort darauf, ob mit der ordnungsrechtlichen Verantwortlichkeit auch eine insolvenzrechtliche Vorrangposition einhergeht, ist damit allerdings noch nicht verbunden.

## 2. Reichweite des Ordnungsrechts

Der 7. Senat des BVerwG formuliert zum Verhältnis zwischen Umwelt- und Insolvenzrecht, das Insolvenzrecht beschränke das Ordnungsrecht ebenso wenig, wie umgekehrt das Ordnungsrecht das Insolvenzrecht.<sup>14</sup> Nach der Auffassung des BVerwG<sup>15</sup> und ihm folgend einiger Stimmen in der Literatur<sup>16</sup> regelt das Ordnungsrecht, unter welchen Voraussetzungen eine Störung der öffentlichen Sicherheit (Gefahr) vorliegt, wie dieser Störung zu begegnen ist und wer dafür in Anspruch genommen werden kann. Dies gelte etwa für die Frage, ob bereits die Inbesitznahme einer Anlage eine Ordnungspflicht auslöse oder die Pflichtigkeit erst aus einem in der Vergangenheit liegenden Verhalten resultiere.<sup>17</sup>

Das Insolvenzrecht bestimmt nach dieser Ansicht nur, wie die Ordnungspflichten im Insolvenzverfahren zu bewerten sind. Dies gelte insbesondere für die Frage, ob die aus einer Ordnungspflicht resultierenden Kosten eine Masseverbindlichkeit begründen oder lediglich zu einer Insolvenzforderung führen.<sup>18</sup>

Gerade die Aussage, das Ordnungsrecht gebe vor, wer für die Erfüllung einer Ordnungspflicht in Anspruch genommen werden könne, weist bei näherer Betrachtung gravierende Defizite aus. Die Entscheidung darüber, wer in der Insolvenz des Schuldners für eine Verbindlichkeit einzustehen hat, gehört zu den fundamentalen Konsequenzen eines Insolvenzverfahrens. Insoweit fehlt eine nachvollziehbare Legitimation, warum vom Ordnungsrecht diese Entscheidung getroffen werden darf. Zu klären sind die daraus resultierenden Konsequenzen für die Kennzeichnung als Störer, den Adressaten der Beseitigungsverfügung sowie die Kostenfolgen.

## 3. Störereigenschaft

Störer sind die Personen, gegen die sich eine ordnungsrechtliche Anordnung richten kann. Handlungsstörer verursachen dabei durch aktives Tun bzw. pflichtwidriges Unterlassen eine Gefahr und Zustandsstörer sind für eine Sache verantwortlich, von der

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<sup>14</sup> BVerwG NZI 2005, 51, 52.

<sup>15</sup> BVerwG NZI 2005, 51, 52.

<sup>16</sup> MüKoInsO/*Hefermehl*, 4. Aufl., § 55 Rn. 88; HambK/*Jarchow*, 7. Aufl., § 55 Rn. 72 f.; KK/*Röpke*, 2016, § 55 Rn. 53; s.a. *Depré/Kothe*, in Beck/*Depré*, Praxis der Insolvenz, 3. Aufl., § 36 Rn. 61.

<sup>17</sup> BVerwG NZI 2005, 51, 52; Jaeger/*Henckel*, InsO, 2004, § 38 Rn. 26.

<sup>18</sup> BVerwG NZI 2005, 51, 52; Jaeger/*Henckel*, InsO, 2004, § 38 Rn. 26.

eine Gefahr oder Beeinträchtigung ausgeht.<sup>19</sup> Auf das Insolvenzrecht gewendet, ist zu entscheiden, ob der Insolvenzverwalter als Störer anzusehen ist, weil bereits die Inbesitznahme der Masse durch den Insolvenzverwalter eine Ordnungspflicht des Insolvenzverwalters für die von der Masse ausgehenden Störungen begründet.<sup>20</sup>

Einerseits muss der Insolvenzverwalter nach § 148 InsO das gesamte zur Insolvenzmasse gehörende Vermögen sofort in Besitz und Verwaltung nehmen. Andererseits knüpfen einige umweltrechtliche Sachnormen, wie § 4 III 1 BBodSchG und § 7 II 1 i.V.m. § 3 IX KrWG<sup>21</sup> die Ordnungspflicht bereits an die tatsächliche Sachherrschaft an.

Wird insofern auf die ordnungsrechtlichen Vorschriften abgestellt, wäre die Folge ein vom Insolvenzverwalter nicht zu beeinflussender Verantwortungsautomatismus. Die auf die Sachherrschaft abstellende Ordnungspflicht träfe in jedem Fall den Verwalter. In der Konsequenz müsste der Insolvenzverwalter die aus diesen Ordnungspflichten resultierenden Kosten als Masseverbindlichkeiten erfüllen. Damit besäßen derartige Verbindlichkeiten einen exegetisch über die Zuweisung der Ordnungspflicht begründeten Vorrang, der nach der Systematik der Insolvenzordnung gerade nicht mehr vorgesehen ist.<sup>22</sup>

Zwingend ist dieses verwaltungsrechtlich geprägte Verständnis allerdings nicht.<sup>23</sup> In der Konzeption des BVerwG wird der Insolvenzverwalter wie ein neuer Rechtsträger behandelt, der mit der Inbesitznahme der Masse zu einem neuen Zustandsstörer werde. Demgegenüber ist zu betonen, dass der Insolvenzverwalter nicht als neues Rechtssubjekt agiert, dem eine Zustandsstörung zugeschrieben werden kann. Vielmehr tritt er lediglich als Amtswalter des Schuldners auf, in dessen Person der Störungstatbestand verwirklicht ist. Folgerichtig bleiben danach die vor der Insolvenzeröffnung begründeten Ansprüche mit der gegenüber dem Schuldner geltenden Qualität bestehen.<sup>24</sup> Eine weitergehende Haftung muss dagegen an eine durch eigene Handlungen begründete zusätzliche Verantwortung anknüpfen.

Einer derartigen sowohl systematisch als auch funktional geprägten Auslegung ist zuzustimmen. Es bleibt im Grundsatz bei der vom BVerwG vertretenen ordnungsrechtlichen Anknüpfung für die Voraussetzungen einer Störung der öffentlichen Sicherheit und der insolvenzrechtlichen Qualifikation der Forderungen. Im Unterschied zur bundesverwaltungsgerichtlichen Rechtsprechung<sup>25</sup> muss aber die Stellung des

<sup>19</sup> *Kubitzka*, in Landmann/Rohmer, Umweltrecht, 90. EL., § 100 WHG Rn. 33.

<sup>20</sup> BVerwG NZI 2005, 51, 52.

<sup>21</sup> Nach der früheren Rechtslage §§ 11 I i.V.m. § 3 VI KrW/AbfG, BVerwG NZI 2005, 55, 56.

<sup>22</sup> Kübler/Prütting/*Pape/Schaltke*, InsO, 89. EL., § 55 Rn. 129; Uhlenbruck/*Sinz*, InsO, 15. Aufl., § 55 Rn. 31.

<sup>23</sup> Vgl. auch Jaeger/*Windel*, InsO, 2007, § 80 Rn. 121.

<sup>24</sup> Mohrbutter/Ringstmeier/*Voigt-Salus*, Handbuch Insolvenzverwaltung, 9. Aufl., Kap. 32 Rn. 95; kritisch aus anderer Perspektive Jaeger/*Windel*, InsO, 2007, § 80 Rn. 121.

<sup>25</sup> Kritisch dazu BGHZ 148, 252, 259 f.

Insolvenzverwalters als originär insolvenzrechtlichen Amtsträger insolvenzrechtlich interpretiert werden.

Sachlich führt diese Position zu einer Differenzierung bei der Entscheidung, wer für eine Störung in Anspruch genommen werden kann. Die Störereigenschaft ist nach dem öffentlichen Sachrecht zu bestimmen. Die weitergehende Überlegung, welcher Anspruch daraus resultiert, unterliegt dagegen den insolvenzrechtlichen Kategorien. Dies weicht allerdings von der vom BVerwG vorgenommenen einengenden Gebietszuweisung für das Insolvenzrecht allein zur Bewertung der Ordnungspflichten ab.

#### 4. Adressat der Beseitigungsverfügung

Als Vorfrage der Kostenerstattung ist zu beantworten, gegen wen eine Beseitigungsverfügung zu richten ist. Ganz unproblematisch ist eine vor Eröffnung des Insolvenzverfahrens ergangene, gegen den Schuldner gerichtete Beseitigungsverfügung. Soweit der Schuldner den Ordnungspflichten nicht entsprochen hat und eine Ersatzvornahme seitens der Ordnungsbehörde erfolgt ist, sind die dabei entstandenen Kosten nach den allgemeinen insolvenzrechtlichen Kriterien zu berichtigen, also als Insolvenzforderung.

Schwieriger verhält es sich mit einer Beseitigungsverfügung nach Eröffnung des Insolvenzverfahrens. Einer solchen Beseitigungsverfügung steht nicht schon das Vollstreckungsverbot aus § 89 InsO entgegen.<sup>26</sup> Mit einer solchen Verfügung wird eine öffentlich-rechtliche Ordnungspflicht und kein Vermögensanspruch geltend gemacht. Erst die Vollstreckung von Kosten aus einer Ersatzvornahme könnte dann durch das Vollstreckungsverbot verhindert sein.

Eine nach Eröffnung des Insolvenzverfahrens ergangene Beseitigungsverfügung ist an den Insolvenzverwalter zu richten.<sup>27</sup> Dies gilt auch, wenn der ordnungswidrige Zustand bereits vor Eröffnung des Insolvenzverfahrens eingetreten ist. Der Schuldner kann in diesem Fall nicht der richtige Adressat einer Ordnungsverfügung sein, da ihm gemäß § 80 InsO das Verwaltungs- und Verfügungsrecht über die Massegegenstände entzogen ist. Deswegen könnte er einer Ordnungspflicht nicht mehr nachkommen.<sup>28</sup>

Ganz unproblematisch ist der Insolvenzverwalter der richtige Adressat, wenn der ordnungswidrige Zustand auf einer Handlung des Insolvenzverwalters beruht. Sollte eine Ersatzvornahme erfolgen, ist der Anspruch auf Zahlung der dabei entstandenen

<sup>26</sup> Jaeger/Henckel, InsO, 2004, § 38 Rn. 26; Depré/Kothe, in Beck/Depré, Praxis der Insolvenz, 3. Aufl., § 36 Rn. 55; a.A. Kölner Schrift/Lüke, 3. Aufl., Kap. 22 Rn. 54 f.; s.a. Jaeger/Windel, InsO, 2007, § 87 Rn. 7.

<sup>27</sup> HK-InsO/Kayser, 9. Aufl., § 80 Rn. 58; FK-InsO/Wimmer-Amend, 9. Aufl., § 80 Rn. 41; Nerlich/Römermann/Andres, InsO, 43. EL., § 55 Rn. 66.

<sup>28</sup> MüKoInsO/Hefermehl, 3. Aufl., § 55 Rn. 94.

Kosten unabhängig von der Qualifizierung der Ordnungspflicht zu behandeln.<sup>29</sup> Vielmehr sind diese Kosten nach den insolvenzrechtlichen Maßstäben zu befriedigen.

## 5. Qualifikation der Kostenerstattung

Die Werthaltigkeit eines Kostenerstattungsanspruchs für die Ersatzvornahme zur Beseitigung einer Störung wird entscheidend von der Qualifikation der Forderung als Masseverbindlichkeit geprägt. Als Verhaltensstörer ist der Insolvenzverwalter für die nach Eröffnung des Insolvenzverfahrens durch eine Betriebsfortführung eingetretenen Störungen verantwortlich. Dies gilt auch, wenn er ein Grundstück nach Insolvenzeröffnung nicht hinreichend dagegen gesichert hat, dass Dritte Abfall darauf ablagern. Unstreitig werden in diesen Fällen Masseverbindlichkeiten gemäß § 55 I Nr. 1 InsO begründet.<sup>30</sup> Persönlich haftet der Insolvenzverwalter, wenn er die ihm obliegenden Pflichten schuldhaft verletzt, § 60 I 1 InsO.

Ist umgekehrt bereits vor Insolvenzeröffnung die Störung eingetreten und aufgrund einer gegen den Schuldner ergangenen Ordnungsverfügung die Ersatzvornahme erfolgt, sind die daraus resultierenden Kosten lediglich als Insolvenzforderung geltend zu machen.<sup>31</sup> Auch dies wird nicht in Zweifel gezogen.

Kontrovers behandelt werden dagegen die Fälle, in denen die Gefahr vor Insolvenzeröffnung bestand, die Beseitigungsverfügung aber erst nach der Insolvenzeröffnung gegen den Verwalter ergangen ist. Das BVerwG und die ihm folgende Literatur stellen darauf ab, ob eine ordnungsrechtliche Verantwortlichkeit des Insolvenzverwalters bestehe. Nach der Rechtsprechung des BVerwG bestimmt das einschlägige Ordnungsrecht, wann eine Ordnungspflicht für die von der Masse ausgehenden Störungen der öffentlichen Sicherheit begründet wird. Hierfür knüpft das Gericht an die Tatbestandsmerkmale des jeweiligen Ordnungsrechts an.

Die §§ 5, 22 BImSchG verweisen auf die Stellung als Betreiber der Anlage, weswegen eine Inbesitznahme wohl nicht genügen soll.<sup>32</sup> Der Insolvenzverwalter müsse insoweit als Verhaltensstörer die Emissionen zumindest mit verursacht haben. Dies könne durch positives Tun oder durch Unterlassen einer gebotenen Gefahr abweh-

<sup>29</sup> Jaeger/Henckel, InsO, 2004, § 38 Rn. 26.

<sup>30</sup> BGHZ 148, 252, 257 f.; 150, 305, 316 f.; FK-InsO/Bornemann, 9. Aufl., § 55 Rn. 28; HK-InsO/Kayser, 9. Aufl., § 80 Rn. 59; K. Schmidt/Sternal, 19. Aufl., § 80 Rn. 70; Kübler/Prütting/Pape/Schaltke, InsO, 42 EL., § 55 Rn. 116; KK/Röpke, § 55 Rn. 45; Depré/Kothe, in Beck/Depré, Praxis der Insolvenz, 3. Aufl., § 36 Rn. 48; Häsemeyer, Insolvenzrecht, 4. Aufl., Rn. 13.

<sup>31</sup> Jaeger/Windel, InsO, § 80 Rn. 123; FK-InsO/Wimmer-Amend, 9. Aufl., § 80 Rn. 42; Ahrens/Gehrlein/Ringstmeier/Piekenbrock, InsO, 3. Aufl., § 80 Rn. 34; HK-InsO/Kayser, 9. Aufl., § 80 Rn. 59; K. Schmidt/Sternal, 19. Aufl., § 80 Rn. 70; Kübler/Prütting/Pape/Schaltke, InsO, 89. EL., § 55 Rn. 116; Depré/Kothe, in Beck/Depré, Praxis der Insolvenz, 3. Aufl., § 36 Rn. 52.

<sup>32</sup> BVerwG NZI 1999, 37, 39.



renden Handlung geschehen.<sup>33</sup> Bei dieser ordnungsrechtlichen Verantwortlichkeit des Insolvenzverwalters für eigenes Handeln oder Unterlassen bestehen keine substantziellen Kollisionspunkte des Ordnungsrechts mit dem Insolvenzrecht. Die Ordnungspflichten fügen sich in die insolvenzrechtliche Systematik ein.

Wie erwähnt, stellen etwa § 4 III 1 BBodSchG und § 7 II 1 i.V.m. § 3 IX KrWG<sup>34</sup> auf die tatsächliche Sachherrschaft ab. Danach wird der Insolvenzverwalter bereits mit der Inbesitznahme der Masse ordnungspflichtig. Nach Ansicht des BVerwG hängt die Stellung als Störer von den tatbestandlichen Voraussetzungen des jeweiligen Ordnungsrechts ab und kann bereits durch die tatsächliche Sachherrschaft begründet sein.<sup>35</sup> In der Konsequenz sei die Pflicht als Masseverbindlichkeit zu erfüllen.<sup>36</sup>

Die aus der Inbesitznahme der Masse resultierende umfassende Zustandsverantwortlichkeit des Insolvenzverwalters in diesen Konstellationen führt zu dem zentralen Konfliktfeld zwischen dem Verwaltungs- und dem Insolvenzrecht. Nach der hier entwickelten Position ist die Kategorie des Störers abhängig von den fortgeltenden ordnungsrechtlichen Pflichten zu bestimmen. Damit ist freilich noch keine Aussage über die daraus resultierende Qualität der insbesondere für eine Ersatzvornahme entstandenen Kosten verbunden. Dies folgt insolvenzrechtlichen Überlegungen.

Selbst wenn der Insolvenzverwalter ordnungsrechtlich als Störer anzusehen sein mag, überzeugt die daraus abgeleitete Rechtsfolge für die Qualifikation der Forderung insolvenzrechtlich nicht. Nach der Rechtsprechung des BGH dient die Besitzergreifung an dem Massegegenstand lediglich seiner Sicherstellung. Diese alleine begründet noch keine Masseverbindlichkeit.<sup>37</sup> Erst wenn der Verwalter die Sache zugunsten der Masse nutzt oder verwertet, womit er noch nicht zum Handlungsstörer werden muss, werden Masseverbindlichkeiten begründet.<sup>38</sup>

Dieses überzeugende Resultat folgt aus den zwingenden Vorschriften<sup>39</sup> über die Masseverbindlichkeiten. Masseverbindlichkeiten werden nach § 55 I Nr. 1 Alt. 1 InsO entweder durch Handlungen des Insolvenzverwalters oder durch die Verwaltung der Insolvenzmasse begründet. Handlungen bezeichnen sowohl ein positives Tun als auch ein pflichtwidriges Unterlassen. Die reine Inbesitznahme der Insolvenzmasse nach § 148 InsO kann damit nicht gleichgestellt werden. Sonst träte eine schrankenlose Begründung von Masseverbindlichkeiten ein und die weiteren Kriterien aus § 55 Abs. 1 Nr. 1 und 2 InsO wären überflüssig.

<sup>33</sup> MüKoInsO/*Hefermehl*, 4. Aufl., § 55 Rn. 90a.

<sup>34</sup> Nach der früheren Rechtslage §§ 11 I i.V.m. § 3 VI KrW/AbfG, BVerwG NZI 2005, 55, 56.

<sup>35</sup> BVerwG NZI 2005, 51, 52.

<sup>36</sup> BVerwG NZI 2005, 51, 52; MüKoInsO/*Hefermehl*, 4. Aufl., § 55 Rn. 90a.

<sup>37</sup> BGHZ 150, 305, 311; Uhlenbruck/*Mock*, InsO, 15. Aufl., § 80 Rn. 250; K. Schmidt/*Sternal*, 19. Aufl., § 80 Rn. 70; Nerlich/Römermann/*Witkowski/Kruth*, InsO, 43. EL., § 80 Rn. 131.

<sup>38</sup> BGHZ 150, 305, 311; s.a. K. Schmidt/*Thole*, 19. Aufl., § 55 Rn. 29.

<sup>39</sup> K. Schmidt/*Thole*, 19. Aufl., § 53 Rn. 1.

Damit besteht ein substanzieller Konflikt einerseits zwischen der verwaltungsrechtlichen und andererseits der zivilrechtlichen Judikatur sowie der hier vertretenen Ansicht. Diese Kontroverse ist bislang nicht endgültig ausgetragen. Dies mag allerdings auch daran liegen, dass dem Insolvenzverwalter eine Option eröffnet ist, durch die er die Masse von den Verbindlichkeiten entlasten kann.

## 6. Auflösung durch Freigabe

Der Insolvenzverwalter ist prinzipiell berechtigt, Gegenstände aus der Insolvenzmasse freizugeben.<sup>40</sup> Diese Freigabe wird in § 32 III 1 InsO vorausgesetzt. Auch § 35 III 2 InsO spricht jetzt von einer Freigabe. Bei der sog. echten Freigabe wird ein Gegenstand durch die Erklärung des Verwalters aus dem Insolvenzbeschluss gelöst. Zugleich erhält der Schuldner seine Verwaltungs- und Verfügungsbefugnis über diesen Gegenstand zurück.<sup>41</sup> Eine Freigabe ist insbesondere bei wertlosen Massegegenständen zu erwägen oder, wenn diese Kosten verursachen, die den zu erwartenden Veräußerungserlös möglicherweise übersteigen.<sup>42</sup>

Durch eine Freigabe der belasteten Gegenstände, also insbesondere von Grundstücken, kann sich der Insolvenzverwalter auch von den öffentlich-rechtlichen Pflichten befreien.<sup>43</sup> Dies wird bei einer Verantwortlichkeit des Insolvenzverwalters als Zustandsstörer zugelassen und bei einem als Verhaltensstörer Ordnungspflichtigen abgelehnt.<sup>44</sup> Im Einzelfall können dem allerdings umweltrechtliche Sondervorschriften entgegenstehen, wie landesrechtliche Abfallgesetze.<sup>45</sup> In der Konsequenz kann der Insolvenzverwalter, jedenfalls bei den kritischen Fällen einer an die Sachherrschaft anknüpfenden Störerstellung, die Masse vor etwaigen Masseverbindlichkeiten schützen.

Letztlich handelt es sich dabei um eine insolvenzrechtliche Ausweichstrategie gegenüber der nicht systemkonformen verwaltungsgerichtlichen Judikatur. Sie schützt die Masse, erleichtert aber nicht die Durchführung der ordnungsrechtlichen Maßnahmen. Sachgerechter wäre es, hier eine konsequente Anknüpfung bei der Qualifikation als Masseverbindlichkeit zu erreichen.

<sup>40</sup> BGHZ 163, 32, 34; Ahrens/Gehrlein/Ringstmeier/*Abrens*, InsO, 4. Aufl., § 35 Rn. 28.

<sup>41</sup> BGHZ 163, 32, 35; 166, 74, 82 f.; Ahrens/Gehrlein/Ringstmeier/*Abrens*, InsO, 4. Aufl., § 35 Rn. 28.

<sup>42</sup> MüKoInsO/*Peters*, 4. Aufl., § 35 Rn. 112.

<sup>43</sup> BVerwG NZI 2005, 51, 53.

<sup>44</sup> Ahrens/Gehrlein/Ringstmeier/*Piekenbrock*, InsO, 4. Aufl., § 80 Rn. 35; K. Schmidt/Thole, 19. Aufl., § 55 Rn. 32; Kübler/Prütting/*Pape/Schaltke*, InsO, 89. EL., § 55 Rn. 124; HambK/*Jarchow*, 7. Aufl., § 55 Rn. 80.

<sup>45</sup> HK-InsO/*Kayser*, 9. Aufl., § 80 Rn. 62; K. Schmidt/*Sternal*, 19. Aufl., § 80 Rn. 71; Kölner Schrift/*Lüke*, 3. Aufl., Kap. 22 Rn. 82.



## IV. KONKURRENZ ZWISCHEN INSOLVENZ- UND STEUERRECHT

### 1. Grundlagen

Die Einordnung einer Steuerverbindlichkeit als Insolvenz- oder Masseforderung führt zu gravierenden Konsequenzen. Als Insolvenzforderungen können auch Steuerverbindlichkeiten von den Wirkungen eines Insolvenz- und Restschuldbefreiungsverfahrens erfasst sein. Nach Erteilung der Restschuldbefreiung können sie nicht mehr durchgesetzt werden. Als Masseforderungen sind sie vorrangig zu berichtigen und sie werden nicht von einer Restschuldbefreiung betroffen.

Soweit Masseverbindlichkeiten allgemein durch Rechtshandlungen des Insolvenzverwalters begründet sind, nehmen der BGH<sup>46</sup> und die ganz überwiegende Literatur<sup>47</sup> eine wesentliche Einschränkung vor. Verpflichteter der durch Rechtshandlungen des Insolvenzverwalters nach Verfahrenseröffnung begründeten Masseverbindlichkeiten i.S.d. § 55 I Nr. 1 Alt. 1 InsO ist der Insolvenzschuldner. Seine Haftung ist jedoch während des Verfahrens auf die Gegenstände der Insolvenzmasse beschränkt, die der Insolvenzverwalter freigegeben oder nach Beendigung des Insolvenzverfahrens zurückgegeben hat. Weil die Verwaltungs- und Verfügungsmacht des Insolvenzverwalters auf die Insolvenzmasse beschränkt ist, kann der Verwalter den Schuldner nicht persönlich mit dem insolvenzfremden Vermögen verpflichten.<sup>48</sup>

Steuerrechtlich bestehen bei der Qualifikation deutliche Eigenheiten bzw. Abweichungen. Für die Einordnung steuerrechtlicher Verbindlichkeiten als Masseverbindlichkeit ist nach der Rechtsprechung des BFH entscheidend, wann der Rechtsgrund für den Anspruch gelegt wurde. Der Rechtsgrund für einen (abstrakten) Steueranspruch ist danach gelegt, wenn der gesetzliche Besteuerungstatbestand verwirklicht wird. Ob und wann ein Besteuerungstatbestand nach seiner Art und Höhe tatbestandlich verwirklicht und damit insolvenzrechtlich begründet ist, richtet sich laut BFH auch nach Eröffnung des Insolvenzverfahrens ausschließlich nach steuerrechtlichen Grundsätzen.<sup>49</sup> Im Detail führt die steuerrechtliche Anknüpfung des Entstehenszeitpunkts zu zahlreichen Grenzverschiebungen gegenüber dem insolvenzrechtlichen Verständnis.<sup>50</sup>

<sup>46</sup> BGH NJW 1955, 339; NZI 2009, 841 Rn. 12.

<sup>47</sup> Jaeger/Henckel, § 53 Rn. 10 ff.; MüKoInsO/Hefermehl, 4. Aufl., § 53 Rn. 30; HambK/Jarchow, § 53 Rn. 27; Sämisch, ZInso 2018, 1946.

<sup>48</sup> BGH NZI 2009, 841 Rn. 12.

<sup>49</sup> BFH NZI 2013, 709 Rn. 18.

<sup>50</sup> Kahlert, DSrR 2019, 719, 721.

## 2. Entstehung des Besteuerungstatbestands am Beispiel der Einkommensteuer

Bezogen auf die Einkommensteuer kommt es für die insolvenzrechtliche Begründung der Steuerforderung darauf an, ob der einzelne (unselbständige) Besteuerungstatbestand vor oder nach Insolvenzeröffnung verwirklicht wurde.<sup>51</sup> Entscheidend ist nach der finanzgerichtlichen Rechtsprechung bei der Einkommensteuer (auch) die Art der Gewinnermittlung. Wird der Gewinn durch eine Einnahme-Überschussrechnung nach § 4 III EStG ermittelt, gilt das Zuflussprinzip des § 11 I 1 EStG. Danach ist der Tatbestand für die Einkommensbesteuerung erst vollständig verwirklicht, wenn die Einnahmen bezogen sind, also dem Steuerpflichtigen zufließen.

Bei einer den Maßstäben des Zuflussprinzips unterliegenden Einnahme-Überschussrechnung entscheidet der Abschluss eines Rechtsgeschäfts vor Eröffnung des Insolvenzverfahrens noch nicht über die insolvenzrechtliche Qualifikation einer Steuerforderung als Insolvenzforderung oder als Masseverbindlichkeit. Bei Vereinnahmung der Gegenleistung nach Eröffnung des Insolvenzverfahrens ist der Besteuerungstatbestand grundsätzlich erst nach Eröffnung des Insolvenzverfahrens vollständig verwirklicht und damit eine Masseverbindlichkeit begründet.<sup>52</sup>

Wird nach Insolvenzeröffnung auf der Ebene der Gesellschaft eine Rückstellung aufgelöst und deswegen ein Gewinn erzielt, sind bei der Besteuerung aufgrund einer Einnahme-Überschussrechnung die daraus resultierenden Einkommensteuerschulden Masseverbindlichkeiten.<sup>53</sup> Gleiches gilt bei einer Insolvenzanfechtung. Die aufgrund dessen an die Masse zurück geflossenen Beträge sind ebenfalls als Masseverbindlichkeiten anzusehen.<sup>54</sup>

Wird der Gewinn hingegen durch Betriebsvermögensvergleich nach § 4 I EStG ermittelt, gilt das Zuflussprinzip nach § 11 I 5 EStG nicht. Stattdessen ist das Realisationsprinzip nach § 252 I Nr. 4 HS 2 HGB zu beachten.<sup>55</sup>

## 3. Kritik

Als Masseverbindlichkeiten entstandene Steuerschulden können aufgrund der Rechtsprechung des BFH nach Abschluss des Insolvenzverfahrens mit Erstattungsansprüchen des ehemaligen Insolvenzschuldners verrechnet werden. Reicht die Masse nicht zur Befriedigung der Steuerforderungen als Masseverbindlichkeiten aus oder berichtigt der Insolvenzverwalter (pflichtwidrig) diese Forderung nicht, muss der Schuldner

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<sup>51</sup> BFH NZI 2013, 709 Rn. 19.

<sup>52</sup> BFH ZIP 2015, 1035 Rn. 29; *Kahlert*, DStR 2019, 719, 721.

<sup>53</sup> BFH ZIP 2010, 1612 Rn. 37; NZI 2019, 239 Rn. 15.

<sup>54</sup> BFH NZI 2019, 930 Rn. 13 ff.

<sup>55</sup> BFH ZIP 2013, 790 Rn. 29 f.; NZI 2019, 87 Rn. 27; 2019, 300 Rn. 15.

haften, obwohl er persönlich keinen Einfluss auf die Entstehung des Besteuerungstatbestands genommen hat.

Nach Ansicht des BFH könne die einschränkende Rechtsprechung des BGH zur Haftung des Schuldners für Masseverbindlichkeiten bei Einkommensteuerschulden nicht gelten, weil deren Entstehung nur mittelbar durch Handlungen des Insolvenzverwalters beeinflusst werde. Insofern fehle es an einem zurechenbaren Handlungsbeitrag des Insolvenzverwalters.<sup>56</sup> In der Konsequenz dieser Judikatur sind die im Insolvenzverfahren aufgrund einer Einnahme-Überschussrechnung entstehenden Steuerforderungen häufig als Masseverbindlichkeiten zu qualifizieren.

Jedenfalls diesen Konsequenzen der Rechtsprechung des BFH zur Nachhaftung des Schuldners für Masseverbindlichkeiten kann nicht gefolgt werden. Selbst wenn die Steuerforderung aus gesetzlichen Tatbeständen folgt, beruht der maßgebende Sachverhalt typischerweise auf Handlungen des Insolvenzverwalters. Dies gilt etwa für die Auflösung von Rückstellungen, die Verwertung eines Massegegenstands oder die Geltendmachung von Insolvenzanfechtungsansprüchen. Folgerichtig muss der Steueranspruch den Handlungen des Verwalters zugerechnet werden.

Überhaupt kann der Schuldner die Handlungen des Insolvenzverwalters nicht beeinflussen. Es ist nicht berechtigt, den Schuldner für solche von ihm nicht zu steuernden Effekte nach Erteilung der Restschuldbefreiung haften zu lassen.

## V. MEHR INSOLVENZRECHT WAGEN

Der Befund zum Konkurrenzverhältnis zwischen Insolvenzrecht und öffentlichem Recht fällt über die verschiedenen Rechtsgebiete hinweg durchaus ernüchternd aus. Noch am einfachsten liegt die Situation bei der Aufrechnungsbefugnis nach Erteilung der Restschuldbefreiung. Hier sind die Schwankungen der fachgerichtlichen Judikatur erklärbar, weil die insolvenzrechtliche Klärung noch abzuwarten ist.

Als belastender erweisen sich die bewussten Abweichungen von den insolvenzrechtlichen Prinzipien im Ordnungs- und Steuerrecht. Diese Divergenzen dienen letztlich dazu, Forderungen der öffentlichen Hand zu Masseverbindlichkeiten aufzuwerten. Damit werden außergesetzlich neue Fiskalvorrechte geschaffen. Diese Konsequenzen sind schon deswegen bedenklich, weil die Insolvenzordnung mit der Zielsetzung erlassen worden ist, Vorrechte abzubauen.

Damit wird auch nicht ein Vorrang des Insolvenzrechts proklamiert, dem das öffentliche Recht mit seinem eigenen Geltungsanspruch entgentreten kann. Vielmehr wird die Konsequenz aus der im Insolvenzverfahren nicht mehr zur Befriedigung sämtlicher Verbindlichkeiten reichenden Masse gezogen. Eine Begünstigung der

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<sup>56</sup> BFH NZI 2018, 461 Rn. 31 ff.

Fiskalforderungen muss automatisch mit einer Zurücksetzung anderer Verbindlichkeiten einhergehen. Dies ist indessen nicht berechtigt, weil die Forderungen der öffentlichen Hand keinen allgemeinen Vorrang genießen.

Grosu, Manuela Renáta\*

## Waiver of Right in the Context of same-neutral Hybrid Procedures

### ABSTRACT

The idea of combining arbitration and mediation in resolving commercial disputes as parallel, sequential and integrated processes is a highly debated issue both in legal theory and in practice.

The present contribution focuses on the execution of a waiver of rights in the context of hybrid procedures in which, among the same parties to the dispute, the same individual will serve as mediator and arbitrator. The purpose of this contribution is to discuss how to apply a waiver of right in the arena of international commercial arbitration in the context of same-neutral hybrid procedures. It is a critical aspect since same-neutral hybrid procedures are presumed to result in a higher level of efficiency in terms of saving cost and time during the dispute resolution. How different variations of the institution of waive of right to object can help the disputants and the neutral to reach this goal and preserve the integrity of combined procedures? My purpose with this study is to find answers to these questions.

**KEYWORDS:** international commercial arbitration, mediation, combining procedures, waiver of right to object, commercial dispute resolution, impartiality

### I. INTRODUCTION

The idea of combining arbitration and mediation in resolving commercial disputes as parallel, sequential and integrated processes (hereinafter “hybrid procedures”) is unknown to legal theory nor in practice.

Articles available on this subject matter primarily focus on the advantages and disadvantages attributed to hybrid procedures compared to mediation or arbitration. Among the range of problems associated with hybrid procedures, scholarly as well as professional writing mostly focus on issues related to keeping the requirement of

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confidentiality throughout the procedure, the impact of culture and legal traditions on the application of hybrid procedures and preserving the impartiality of the arbitrator<sup>1</sup> serving both as a mediator and arbitrator, as well as introducing mediation techniques which might be advantageous for arbitrators.

In this contribution, I chose to focus on the execution of a waiver of rights in the context of hybrid procedures in which, among the same parties to the dispute, the same individual will serve as mediator and arbitrator (hereinafter “same-neutral hybrid procedure”).<sup>2</sup>

It is a critical aspect, both at a theoretical and a practical level, since same-neutral hybrid procedures are presumed to result in a higher level of efficiency in terms of saving cost and time during the dispute resolution. There are certain well-established as well as recently discussed solutions and recommendations for ensuring the efficiency and fairness of same-neutral hybrid procedures.

Taking everything into consideration, the purpose of this contribution is to discuss only one possible measure, namely how to apply a waiver of right in the arena of international commercial arbitration in the context of same-neutral hybrid procedures.

This contribution is divided into four main sections. Section II briefly explains what the otherwise well-established institution of the waiver of right to object in international commercial arbitration has to do with same-neutral hybrid procedures, what the special condition of this waiver of right situation is, and why there is a need to execute an “appropriate” waiver. Section III provides a brief overview of different variations of waiver of right and how it may function in the context of same-neutral hybrid procedures. Section IV, from the variations referred to above, explores in detail the significance of a waiver agreement with the collection of some best practices. Section IV is followed by a discussion of certain limitations on the effectiveness of waiver provisions. Finally, the contribution is completed with a separate conclusion.

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<sup>1</sup> As a main rule, the terms arbitrator and arbitral tribunal are used interchangeably, where no further comment will be added.

<sup>2</sup> For the purpose of the current contribution, same-neutral hybrid procedures would cover same-neutral *Med-Arb*, *Arb-Med-Arb*. In *Med-Arb* the neutral functions first as a mediator, assisting the parties in reaching a settlement agreement. If mediation fails (or the parties only partially reach a settlement), the same neutral can then serve as an arbitrator. *Arb-Med-Arb* is the process where mediation is integrated into ongoing arbitration. The arbitrator conducts the mediation and consults with all of the parties to the arbitration together (only joint session mediation). A variation of this arbitrator-conducted mediation is when the arbitrator consults with each of the parties separately (mediation with private session).

## II. WAIVER OF RIGHT AND THE SAME-NEUTRAL HYBRID PROCEDURE

Taking into consideration the advantages and the overall benefit of the same-neutral hybrid procedure: bringing together party self-determination and safety ensured by arbitration (because the mediation phase provides the parties with the opportunity to control the process and its outcome, knowing that if they do not reach a settlement in the mediation then the mediator turned arbitrator will render an arbitral award as a final and binding), saving time and cost due to having a knowledgeable neutral capable of shifting from one role to the other – same-neutral hybrid procedures may cause many problems.

The main concern for a mediator-arbitrator is that the parties might later claim that, due to their participation in the mediation and settlement discussion with the parties, they have lost their impartiality as decision-maker, which is claimed to be reflected in not treating the parties equally and committing procedural irregularities that trigger their removal or a challenge of the arbitral award. Closely related to this issue but a slightly different scenario is when the parties might claim that, even if the mediator-arbitrator preserved their impartiality throughout the arbitration procedure, their conduct is not in accordance with the agreement of the parties and/or applicable law. As a practical matter, the latter scenario is quite unusual and unrealistic. Thus, except for a few remarks to be added below, I will focus on claims based on lack of impartiality.

### 1. Lack of impartiality

Discussing the same-neutral hybrid procedures, we cannot avoid a brief overview of the substance of impartiality, emphasising that the issue of impartiality and independence is a separate and extensive field in domestic and international commercial arbitration. Concerning the dual role, the lack of impartiality or the loss of impartiality is a justified worry. It seems that, while trying to understand the function of a hybrid procedure, we start to worry intensively about the arbitrator's impartiality. Where does this worry come from? Some possible answers: gaining confidential information in the private session<sup>3</sup>

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<sup>3</sup> Electing for a *private session* (sometimes called caucus) is a well-recognised tool of mediators, especially in commercial disputes. The objective of the mediator regarding the private session is to allow the parties and their legal representatives to talk candidly and reveal the possible weaknesses in their position. It also gives the opportunity for the mediator to perform a reality check and ask questions that help the parties to see their position more critically and reasonably. The private session can be an efficient tool, since the mediator may serve as a communication channel without sharing confidential information without the consent of the party. The mere fact that they go from one room to the other and tries to shape the parties' and their legal representatives' dialogue towards a productive direction can be enough to reach a settlement. A private session is also an opportunity for the mediator to ask for each party's bottom line and conduct.

or developing sympathy toward one party/position while the parties know that this can happen in both a private and joint session. We should add that it is not necessarily true that any arbitral award rendered by the mediator-arbitrator will be influenced by information gained in the private session, but such a result is certainly possible.

The meaning of impartiality, independence and neutrality of the arbitrator in general and the relation of these requirements to each other occupies an important place in the overall discussion regarding the duties of the arbitrator. Since there are many approaches<sup>4</sup> to differentiate these concepts from each other, I need to clarify the approach I consider exemplary for the purpose of further discussion and reference.<sup>5</sup> The concept of impartiality invites an abstract level of thinking and requires that the arbitrator neither favours one of the parties, nor is predisposed as to the issues and questions involved in the dispute,<sup>6</sup> adding that impartiality sometimes needs to be assessed in a given cultural and social environment. Hence, the arbitrator is expected to have an objective attitude in general. The following observation demonstrates the connection as well as different purposes of these principles: “[...] impartiality is needed to ensure that justice is done, independence is needed to ensure that justice is seen to be done.”<sup>7</sup> In order to ensure compliance with the duty of independence and impartiality, some guidelines or institutional arbitration rules might serve as orientation points. The IBA Rules of Ethics and Guidelines on Conflict of Interest in International Arbitration (2014) (hereinafter “IBA Guidelines”)<sup>8</sup> are not laws but a set of rules that are frequently recognised and used

<sup>4</sup> As an example, these concepts might be interpreted as follows, in T. Várady, J. J. Barceló III and A. T. von Mehren, *International Commercial Arbitration: A Transnational Perspective*, (Thomson Reuters, 4th ed., 2009) 282–283. Neutrality, in fact, is “an exterior sign or an indication of likely impartiality; it is easier to recognise and easier to translate into standards”. Neutrality has two dimensions, a personal-direct and a general-indirect one. On the personal level, neutrality means that the arbitrator is connected neither through family nor through business ties to any of the parties (and their legal representatives). The general level, on the other hand, covers a broader range of affiliations, such as nationality, religion, and ethnic background. In arbitration, neutrality and impartiality are prerequisites to independence and should be tested in each individual case, since independence is the correct consequence if neutrality and impartiality are kept. On recent attitudes towards the neutrality and impartiality of the arbitrator, see Várady T., *Választottbírói semlegesség és pártatlanság a XXI. században*, in Nochta T., Fabó T. and Márton M. (eds), *Ünnepi Tanulmányok Keckés László Professor 60. születésnapja Tiszteletére*, (Pécsi Tudományegyetem Állam- és Jogtudományi Kara, Pécs, 2013).

<sup>5</sup> Neutrality as a concept is mostly applicable in the case of party-appointed arbitrators and neutrality in relation to the nationality of arbitrators. The concept of independence requires that there should be no relationship between an arbitrator and one of the parties, neither through financial connections or otherwise, since such relationships would affect or at least would appear to affect the arbitrator’s freedom of judgement.

<sup>6</sup> J. D. M. Lew, L. A. Mistelis and S. M. Kröll, *Comparative International Commercial Arbitration*, (Kluwer Law International, 2003) 258–261.; A. Redfern and M. Hunter, *Law and Practice of International Commercial Arbitration* (Sweet&Maxwell, 3rd ed., 1999) 210–214.

<sup>7</sup> Lew, Mistelis and Kröll, *Comparative International Commercial Arbitration*, 261.

<sup>8</sup> *Guidelines on Conflict of Interest in International Arbitration adopted by resolution of the IBA Council on Thursday 23 October 2014*, <https://www.ibanet.org/MediaHandler?id=e2fe5c72-eb14-4bba-b10d-d33dafce8918> (Last accessed: 31 December 2020).



in the arbitration community. The IBA Guidelines provide a framework and determine general standards for evaluating and assessing situations raising the issue of impartiality, including when an arbitrator should disclose potential conflicts, as well as when they should simply not accept an appointment. Taking into consideration that the parties may also have their own views on what constitutes mistrust for them, it is important to require the arbitrators, based on arbitration laws and rules, to disclose any circumstances which may give rise to justifiable doubts as to their impartiality.<sup>9</sup>

## 2. Claiming lack of impartiality – Waiver of right

The lack of impartiality and misconduct of the arbitrator can be claimed at three different points in time.

First, during the arbitration procedure, challenging the arbitrator and initiating their (in accordance with the applicable institutional arbitration rules and/or interlocutory judicial removal at the seat of arbitration) removal promptly after the arbitrator's nomination or after learning of the basis for challenge. Due to Art. 12(2) of UNCITRAL Model Law on International Commercial Arbitration (with amendments as adopted in 2006)<sup>10</sup> (hereinafter "Model Law"), which has served as a model and guideline for most of the national legislations on arbitration law, an arbitrator can be challenged if there are justifiable doubts as to their impartiality. In a same-neutral hybrid procedure, the mediator-arbitrator may learn information that they would not have obtained in an arbitration. As has been pointed out above, the mediator-arbitrator can learn confidential and prejudicial information during the private session which might compromise their impartiality.

It is important to emphasise that directly challenging the arbitrator is the primary recourse against the lack of impartiality of the arbitrator. This also means that, as a main rule, if a party does not object to a particular non-compliance or procedural irregularity committed by the arbitrator during the arbitration, it will waive their right to object for the purpose of annulment or resisting recognition and enforcement of the arbitral award. As explained by Gary B. Born, this principle is incorporated in some institutional arbitration rules, and is applied by national courts even in the absence of express agreements to this effect.<sup>11</sup>

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<sup>9</sup> Várady, Barceló III and von Mehren, *International Commercial Arbitration: A Transnational Perspective*, 283.

<sup>10</sup> UNCITRAL Model Law on International Commercial Arbitration 1985 with amendments as adopted in 2006, [https://uncitral.un.org/en/texts/arbitration/modellaw/commercial\\_arbitration](https://uncitral.un.org/en/texts/arbitration/modellaw/commercial_arbitration) (Last accessed: 31 December 2020).

<sup>11</sup> G. B. Born, *International Commercial Arbitration*, (Kluwer Law International, 2nd ed., 2014) 390., 470., 476. As one court put it, "A party with an objection to an arbitration panel has an affirmative

Second, lack of impartiality can be claimed in annulment of the arbitral award procedures. Here three possible legal bases can be distinguished.<sup>12</sup> As an explanation, I will again refer to the respective provisions of the Model Law. First, claims of a lack of impartiality can be based on Art. 34(2)(a)(ii) of the Model Law, arguing that a partial arbitrator denies a party an opportunity to present its case. Besides the regular lack of impartiality allegation to be referred in relation to this ground for annulment, in the case of a same-neutral hybrid procedure a further argument can be made; namely, the conduct of the mediator-arbitrator caused procedural unfairness and violated the principle of equal treatment of the parties, especially if holding a private session during the mediation and the party only discovers this after the arbitral award was made. As an example, from the reasoning of the arbitral award, the party concludes that the arbitrator has favoured one party over the other without any legal justification.

A discussion on the relationship between impartiality and the equal treatment of the parties is needed, since understanding this correlation will help us understand subsequently the sensitivity and difficulty of preserving impartiality in a same-neutral hybrid procedure, especially in the case of having private sessions with the parties. Equal treatment of the parties to the arbitration procedure is not only one of the guiding principles of arbitration but vital in order to preserve the arbitrator's impartiality and independence. On a more practical level, a biased arbitrator will not be able to treat the parties fairly and equally, since impartiality is a precondition for equal treatment. An arbitrator is a judge by virtue of contract. Under this contract, they have promised the parties (and possibly the arbitration institution) that they will carry out a clearly defined task, which is usually remunerated. They are obliged to behave impartially and equitably and is obliged to treat the parties equally during the process.

The arbitrator's contract and its terms are critical for the purpose of the current discussion, because, besides the applicable laws (law of the seat of arbitration) and respective institutional arbitration rules, it governs the scope and limitations of the arbitrator's power and duties, which are critical considering their involvement in hybrid procedures.

There is no discussion or publication on the duties of an arbitrator without warning the arbitrator that *ex parte* communication with any of the parties is prohibited, although only a few of them give a detailed explanation of the reasons

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obligation to raise that objection with the arbitrators or else that objection shall be waived." *Avraham v. Shigur Express Ltd*, 1991 U.S. Dist. LEXIS 12267 (S.D.N.Y. 1991). For further discussion on waiver and preclusion in the context of Art. V(1)(b) and Art. V(1)(d) of the New York Convention, see Born, *International Commercial Arbitration*, 470 and 474.

<sup>12</sup> Born, *International Commercial Arbitration*, 393. Besides pointing to these three possible correlations between lack of impartiality of the arbitrator and grounds for annulment, Born also points out that "Even absent express statutory authorization, almost all national courts regard an arbitrator's lack of independence or impartiality as a potential basis for annulling an award. The impartiality of the tribunal is central to the arbitral process, and it is unacceptable in most jurisdictions that awards by biased arbitrators be enforced."

for such a limitation. With the involvement in an *ex parte* communication, the arbitrator may compromise their position as an arbitrator and what is going to happen with impartiality if they are seen to be talking with the parties? The *ex parte* communication, including a discussion on the particular case, is problematic from many viewpoints. First, as a result of such an interaction, the arbitrator's impartiality might be compromised. Second, participating in an *ex parte* communication may violate the principle of due process.<sup>13</sup> The arbitrator, despite the flexibility of the procedure, is still obliged to follow the mandatory rules of the seat of arbitration. However, due process also includes that the arbitrator conducts the hearing in a way that enables the parties to be treated equally and ensures their right to be heard. The right to be heard includes the parties' right to deliver their evidence and to have the opportunity to comment on what the other party submits and argues. Then where is the correlation? – the duty of the arbitrator not to become engaged in communication with one party in the absence of the other party is directly related to the right to be heard.<sup>14</sup>

In other words, both the opportunity to present one's case and the principle of impartiality require that every communication between a party and the arbitrator is made in the presence of all the parties, allowing an immediate answer and comment. It is important that this is applicable to any and all communication, thus it is not a question of relevance or substance.<sup>15</sup> Therefore, on the level of the parties, all arguments and evidence invoked by a party must be communicated to the other party, who must be given an opportunity to answer them and, when applicable, react to the possible accusations.<sup>16</sup>

Second, parties might argue, with reference to Art. 34(2)(a)(iv) of the Model Law, that the composition of the arbitral tribunal or the arbitral procedure with the involvement of a mediator-arbitrator was not in accordance with the agreement of the parties, unless that agreement was in conflict with a provision of this applicable law from which the parties cannot derogate, or, failing such agreement, was not in accordance with the applicable law.

Finally, a claim of lack of impartiality can be based on Art. 34(2)(b)(ii), arguing that the involvement of a partial arbitrator – more precisely the arbitral award as the

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<sup>13</sup> A. Philip, The Duties of an Arbitrator, in L. W. Newman and R. D. Hill (eds), *The Leading Arbitrator's Guide to International Arbitration*, (Juris Publishing, 2004) 67–70. It is important to see that the prohibition of *ex parte* communication exists throughout the arbitration procedure. It is certainly applicable from the arbitrator's appointment and on a certain level it is applicable before the appointment of the arbitrator. However, this prohibition does not stand for those discussions which aim to contact the arbitrator in relation to the appointment and to inform them of the nature of the dispute or to discuss with them the selection of the third arbitrator, but the substance of the case should not be discussed with the arbitrator and the arbitrator should not ask in detail about the case and give a preliminary evaluation, since such a revelation and assessment would directly compromise their impartiality.

<sup>14</sup> Philip, *The Duties of an Arbitrator*, 75.

<sup>15</sup> M. S. Kurkela and H. Snellman, *Due Process in International Commercial Arbitration*, (Ocean Publications, 2005) 165. Adding that a significant exception may be the election of the chairman.

<sup>16</sup> Lew, Mistelis and Kröll, *Comparative International Commercial Arbitration*, 527.

outcome of the same-neutral hybrid procedure – violates the concept of procedural public policy of the annulment forum.<sup>17</sup>

The third point in time when lack of impartiality can be claimed is the stage of recognition and enforcement of the arbitral award. Similar to the annulment of international commercial awards, claims for lack of impartiality can be based on denial of the opportunity to present the party's case under Art. V(1)(b) of the 1958 New York Convention on the Recognition of Foreign Arbitral Awards (hereinafter "New York Convention")<sup>18</sup> and Art. V(1)(d) of the New York Convention governing irregular procedural conduct. Adding that the violation of procedural public policy of the country where the recognition and enforcement of the arbitral award is sought is also a ground for refusing to recognition and enforcement based on Art. V(2)(b) of the New York Convention.<sup>19</sup>

It can be concluded that there are certain well-established grounds for challenging the arbitrator's impartiality in practice. The grounds are the same, although some authorities have pointed out that a higher standard must be applied to have the arbitral award annulled or preclude its recognition and enforcement than that in the case of removal of the arbitrator.<sup>20</sup>

An efficient measure to avoid the risks associated with challenges to the arbitrator and arbitral award<sup>21</sup> are to obtain the appropriate waivers from the parties to the arbitration.

Losing impartiality is a justified concern in connection with the same-neutral hybrid procedures. The inconvenience inherent in such a procedure is so great that many arbitrators decline to engage in it and view the risk of claiming lack of impartiality by an unsatisfied or disappointed party arising from their dual participation as a problem that is difficult to overcome. As a result, a forward-looking arbitrator-mediator encourages the parties to waive their rights in this regard.<sup>22</sup>

<sup>17</sup> Art. 34(2)(b)(ii) of the Model Law states that: "[...] An arbitral award may be set aside by the court specified in article [...] only if [...] (b) the court finds that [...] (ii) the award is in conflict with the public policy of this State. This wording (this State) indicates that this should be the public policy of the forum dealing with the annulment action. Nevertheless, as it is explained by Born as well, there are authorities stipulating that public policy exceptions in the context of annulment procedures rather cover international public policy or the public policy of another foreign state."

<sup>18</sup> *Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, New York, 10 June 1958, United Nations Treaty Series, Vol. 330, No. 4739, 3., [https://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtdsg\\_no=XXII-1&chapter=22&clang=\\_en](https://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtdsg_no=XXII-1&chapter=22&clang=_en) (Last accessed: 31 December 2020). To be enforceable internationally an award should also comply with the requirements of the New York Convention.

<sup>19</sup> The cited provisions of the New York Convention are equally explicit in Arts 36(1)(a)(ii), 36(1)(a)(iv) and 36(1)(b)(ii) of the Model Law.

<sup>20</sup> Born, *International Commercial Arbitration*, 475.

<sup>21</sup> Challenging the award for the purpose of the present discussion would cover two categories, such as annulment of the arbitral award and resisting the recognition or enforcement of the arbitral award.

<sup>22</sup> J. Rosoff, Hybrid Efficiency in Arbitration: Waiving Potential Conflicts for Dual Role Arbitrators in Med-Arb and Arb-Med Proceedings, (2009) 26 (1) *Journal of International Arbitration*, 89., 90–91. <https://doi.org/10.54648/JOIA2009004>

### III. VARIATIONS OF WAIVER OF RIGHT TO OBJECT

The idea of waiver of right in common law is rooted in the concept of estoppel and is connected to the principle of *venire contra factum proprium*. With respect to civil law, we may connect it to the principle of good faith.<sup>23</sup> In the context of arbitration, especially international commercial arbitration, the institution of waiver is particularly important, since the conduct of the proceedings and the expectations of the parties might vary from arbitration to arbitration.<sup>24</sup>

To understand how waivers operate in the framework of commercial arbitration, three variations of waiver should be distinguished.

First, as well as the primary meaning of waiver of right, is the omission of objecting to breaches of the arbitration agreement (including applicable institutional arbitration rules, if any) and any rules applicable to the proceedings (such as the law of the seat of arbitration and any relevant procedural agreements reached by the parties).<sup>25</sup> The implicit waiver is the most well-known and mirrored in most national arbitration laws and institutional arbitration rules.

In order to understand this variation of waiver in international commercial arbitration, and more closely with respect to the same-neutral hybrid procedures, the Model Law and the UNCITRAL Arbitration Rules (as revised in 2010) (hereinafter “UNCITRAL Arbitration Rules”) must be viewed. According to the UNCITRAL Model Law

A party who knows that any provision of this Law from which the parties may derogate or any requirement under the arbitration agreement has not been complied with and yet proceeds with the arbitration without stating their objection to such non-compliance without undue delay or, if a time-limit is provided therefore, within such period of time, shall be deemed to have waived his right to object.<sup>26</sup>

Meanwhile, the waiver of right provision of the UNCITRAL Arbitration Rules prescribes that “A failure by any party to object promptly to any non-compliance with these Rules or with any requirement of the arbitration agreement shall be deemed to be a waiver of the right of such party to make such an objection, unless such party can show that, under the circumstances, its failure to object was justified.” Similar provisions to those of Art. 32 of the UNCITRAL Arbitration Rules may be found

<sup>23</sup> T. H. Webster and M. W. Bühler, *Handbook of ICC Arbitration: Commentary, Precedents, Materials*, (Sweet & Maxwell, 3rd ed., 2014) 599.

<sup>24</sup> Webster and Bühler, *Handbook of ICC Arbitration: Commentary, Precedents, Materials*, 600.

<sup>25</sup> The scope of the waiver depends on applicable national laws and institutional rules. As an example, LCIA Arbitration Rules (2020) covers only the arbitration agreement, while under ICC Arbitration Rules (2017) any rules applicable to the arbitration procedure are covered.

<sup>26</sup> Art. 4 Model Law.

in other institutional arbitration rules. Likewise, domestic legislation also sometimes contains provisions to the same effect.<sup>27</sup>

The purpose of these provisions is to ensure that the arbitration procedure will not be disrupted or delayed by unjustifiable late complaints submitted by a disappointed or merely tardy party. In other words, the institution of waiver is critical both for maintaining the efficiency and the fairness of the procedure. Is the objection to be deemed as waived if the time-limit is not met or may the objection be raised in a challenge to the arbitral award or on enforcement proceedings? This question has not been resolved definitively. The better view is that non-compliance with the time-limits on policy grounds should bar any attack of the arbitral award, meaning a party may not “lie in ambush” with an objection to await the decision of the arbitral tribunal.<sup>28</sup>

Therefore, the application of waiver of right provisions aims to protect the integrity of the arbitration procedure from late objections.<sup>29</sup> An example of that is a typical situation when a dissatisfied and disappointed party challenges the award, arguing that their due process rights have been violated. An additional accusation is that the arbitrator exceeded their authority by deviating from the initially agreed procedural rules.

However, the wording of Art. 32 of the UNCITRAL Arbitration Rules gives the impression that, under particular circumstances, the waiver of right provision is automatically applicable; in reality, it is more complicated. Whether a real waiver of right situation occurs will depend on the circumstances and the importance of the procedural right at stake. As will be explained in Section V, in the case of fundamental procedural rights, it tends to be rare and difficult to block the claims based on waiver

<sup>27</sup> Art. 32 UNCITRAL Arbitration Rules. For waiver provisions see also: ICC Arbitration Rules (2017), Art. 40, HKIAC Administered Arbitration Rules (2013) Art. 31, Swiss Rules of International Arbitration Art. 30; CIETAC Arbitration Rules (2015) Art. 10; AAA Commercial Arbitration Rules and Mediation Procedure R-41. The corresponding Art. 30 of the 1976 UNCITRAL Arbitration Rules provides “A party who knows that any provision of, or requirement under, these Rules has not been complied with and yet proceeds with the arbitration without promptly stating his objection to such non-compliance, shall be deemed to have waived his right to object.”

Even though both versions of the UNCITRAL Arbitration Rules serve the same purpose, there are significant differences in their approach. First, Art. 32 abolishes the requirement of the original Art. 30, saying that the waiving party has actual knowledge of the incident of procedural non-compliance at issue while Art. 32 places the burden on the waiving party to prove its failure to object in reasonable time was justified under given circumstances. In addition to that, Art. 32 eliminates the requirement that the waiving party “proceeds with the arbitration” after failing to object promptly. In contrary to that, under the 1976 Arbitration Rules, in addition to having knowledge of the non-compliance, the waiving party is obliged to have moved to the next stage of the arbitration procedure. Continuing the arbitration is, for example: appearing at the hearing, and submitting documents. However this does not mean that the party is allowed to avoid the effect of a waiver by deliberate and calculated efforts not to go ahead with the arbitration. D. D. Caron and M. L. Caplan, *The UNCITRAL Arbitration Rules: A Commentary*, (Oxford University Press, 2013) 695.

<sup>28</sup> Redfern and Hunter, *Law and Practice of International Commercial Arbitration*, 211.

<sup>29</sup> Várady, Barceló III and von Mehren, *International Commercial Arbitration: A Transnational Perspective*, 578.



of right because of late objection. However, if there is supporting evidence, preferably in the record, that the parties' intention was to modify the procedural rules, we then have a stronger and more justified case to prove that the waiver of right has occurred. An arbitrator should pay particular attention to have all deviation from the procedural rules and the parties' corresponding reaction recorded. In practice, the arbitrator would rather document their findings, orders, and determination in waiver of right situations and they may also document the absence of any objections by the disputing party. The Caron and Caplan Commentary suggests that there should be a description in the record of the nature of the procedural objection and the reaction and resolution to that objection and the reason behind a particular reaction or resolution.<sup>30</sup>

Applying this first variation of waiver of right in the context of same-neutral hybrid procedures, reasonably assuming that a party would participate in such a procedure with their explicit agreement, it would be difficult to object to the intervention of the arbitrator as mediator by claiming that the arbitrator failed to comply with parties' agreed procedure. As Born explains: "[...] a party's failure to object to departure from agreed procedure will virtually always waive any objection".<sup>31</sup>

From the other perspective, a same-neutral hybrid procedure (with or in extreme cases, without the express consent of the parties) requires a special and unusual conduct of the procedure, which would be apparent even to non-professional parties without a legal representative (which is rarely the case in arbitration). Consequently, should they wish to object to the arbitrator, they could and should have done it promptly after observing that the neutral wears both hats without the consent of the parties (provided that such an agreement of the parties would not violate mandatory provisions of law of the seat of arbitration) or which has led to their loss of impartiality, otherwise they will be deemed to have waived their right to challenge. In fact, if the parties agree to a same-neutral hybrid procedure, they have implicitly agreed to waive their rights to challenge the arbitrator-mediator for their participation as a mediator. While this interpretation of the implicit waiver is justified and has a rationale, as will be demonstrated below, it is still advisable to ensure, as an arbitrator, that there is an explicit waiver.

Under the second scenario of waiver situations, the waiver of right results from the applicable arbitration rules (and laws). This variation has two types: enforceability of the arbitral award provisions and express provisions on same-neutral hybrid procedures including stipulations on waiver of right in this context.

Regarding the first category, the forms of possible recourse against the award<sup>32</sup> and the extent to which a waiver thereof is permitted varies from jurisdiction to jurisdiction.

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<sup>30</sup> Caron and Caplan, *The UNCITRAL Arbitration Rules: A Commentary*, 692.

<sup>31</sup> Born, *International Commercial Arbitration*, 391.

<sup>32</sup> As an example of express waivers in institutional arbitration rules, see Art. 35(6) of ICC Arbitration Rules (2017): "Every award shall be binding on the parties. By submitting the dispute to

As a standing-point, the UNCITRAL Arbitration Rules makes the following suggestion with regard to possible waiver statements: “If the parties wish to exclude recourse against the arbitral award that may be available under the applicable law, they may consider adding a provision to that effect, as suggested below, considering, however, that the effectiveness and conditions of such an exclusion depend on the applicable law.” The suggested wording is “The parties hereby waive their right to any form of recourse against an award to any court or other competent authority, insofar as such waiver can validly be made under the applicable law.”<sup>33</sup>

Three categories, namely appeal against the arbitral award, annulment of, and resisting recognition or enforcement of the arbitral award, can be distinguished. Explained by Park, the theory behind this rule is that parties to arbitration seek a reasonable measure of finality.<sup>34</sup>

The question is whether institutional arbitration rules, providing that the arbitral award is final and binding and waiving their right to any form of recourse, would cover waiving the right to seek annulment and non-recognition of the award. Scholars generally provide a negative answer to this question, arguing that a waiver of right to seek annulment of the arbitral award must be specific and express. Therefore, “enforceability” provisions of institutional arbitration rules would not suffice to waive the right to seek the annulment or non-recognition of the arbitral award.<sup>35</sup>

Turning to the second category, there are limited number of jurisdictions with specific provisions on same-neutral hybrid procedures. There are both national laws and institutional arbitration rules that suggest a combination of mediation followed by arbitration, or mediation to be integrated during the arbitration procedure. These institutional frameworks cannot and should not force parties into a hybrid procedure but let parties know that it is an available process for them and the institution is willing to help in administering such procedures.

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arbitration under the Rules, the parties undertake to carry out any award without delay and shall be deemed to have waived their right to any form of recourse insofar as such waiver can validly be made.” An almost identical provision is to be found under Art. 26.8. of the LCIA Arbitration Rules (2020).

<sup>33</sup> UNCITRAL Arbitration Rules, Annex.

<sup>34</sup> W.W. Park, *Arbitration of International Business Disputes: Studies in Law and Practice*, (Oxford University Press, 2006) 282.

<sup>35</sup> Gary Born, for example, when discussing the interpretation of agreement to exclude or limit annulment, observes that “Most jurisdictions have required that such waivers be relatively unequivocal and specific. In Switzerland, it is clear that a waiver of rights to seek annulment of an award must be express: Swiss courts have held that an agreement to arbitrate under institutional rules providing that the award is »final and binding« or »without appeal« does not suffice to waive judicial review in an annulment proceeding. Australian and Canadian courts have reached similar results. Those U.S. courts which permit waiver of rights to seek vacatur of an award have also required clear language effecting such a result.” Born, *International Commercial Arbitration*, 405. See also M. Scherer, L. M. Richman and R. Gerbay, *Arbitrating under the 2014 LCIA Rules: A User’s Guide*, (Kluwer Law International, 2015) 348–349 on forms of possible recourse against the award and the interpretation of concerned provision of LCIA Arbitration Rules.



The Hong Kong Arbitration Ordinance of 2011 (hereinafter “Hong Kong Ordinance”) and the Singapore International Arbitration Law as well as Arbitration Act for domestic disputes (hereinafter jointly “Singapore Arbitration Law”)<sup>36</sup> are good examples of legislative frameworks with specific rules on same-neutral hybrid procedures. Both the Hong Kong Ordinance and Singapore Arbitration Law<sup>37</sup> provide that, if an arbitration agreement provides the appointment of a mediator and further provides that the person so appointed is to act as an arbitrator in the event that no settlement is acceptable to the parties or can be reached in the mediation proceedings, no objection may be made against the person acting as an arbitrator or against the person’s conduct of the arbitral proceedings, solely on the grounds that the person had acted previously as a mediator. Both the Hong Kong Ordinance and Singapore Arbitration Law include a provision on mandatory waiver, stating that no objection may be made against the conduct of the arbitral proceedings by an arbitrator solely on the grounds that the arbitrator had acted previously as a mediator in accordance with the provisions governing the situation when an arbitrator acts as a mediator.

Japan’s Arbitration Law of No. 138 of 2003 and the Commercial Arbitration Rules of the Japan Commercial Arbitration Association effective as of 1 January 2019 (hereinafter “JCAA Arbitration Rules”) also provide for the opportunity for the arbitrator to act as the mediator. The JCAA Arbitration Rules state that parties shall not challenge the arbitrator based on the fact that they served as a mediator.<sup>38</sup>

Reflecting on legislative example from the Western tradition as well, based on the Commercial Arbitration Act of Australia, an arbitrator may act as a mediator in proceedings relating to a dispute between the parties to an arbitration agreement in two cases.<sup>39</sup> First, if the arbitration agreement provides for the arbitrator to act as mediator in mediation proceedings (whether before or after proceeding to arbitration, and whether or not continuing with the arbitration). Second, if each party has consented in writing to

<sup>36</sup> Hong Kong Arbitration Ordinance, Cap. 609 (H.K.) (amended 2011), Part 4, Division 2., Secs. 32 and 33 on the appointment of the mediator and power of arbitrator to act as a mediator, [https://www.elegislation.gov.hk/hk/cap609?xpid=ID\\_1438403521102\\_00](https://www.elegislation.gov.hk/hk/cap609?xpid=ID_1438403521102_00) (Last accessed: 31 December 2020). Singapore Arbitration Act Cap. 10 (2002 Revised Edition), §§. 62 and Art. 63 provision on the appointment of the mediator and power of arbitrator to act as a mediator, <https://sso.agc.gov.sg/Act/AA2001> (Last accessed: 31 December 2020); Singapore International Arbitration Act, Chapter 143/A, §§ 16 and 17 on provision on the appointment of the conciliator and power of arbitrator to act as a conciliator, <https://sso.agc.gov.sg/Act/LAA1994#pr16-> (Last accessed: 31 December 2020).

<sup>37</sup> Ordinance Sec. 32(3), (a); Singapore Arbitration Law [Singapore Arbitration Act § 62(3)(a)], Singapore International Arbitration Act § 16(3)(a).

<sup>38</sup> JCAA Arbitration Rules Art. 59(1), [https://www.jcaa.or.jp/en/common/pdf/arbitration/Interactive\\_Arbitration\\_Rules2019\\_en.pdf?211223](https://www.jcaa.or.jp/en/common/pdf/arbitration/Interactive_Arbitration_Rules2019_en.pdf?211223) (Last accessed: 31 December 2020).

<sup>39</sup> Commercial Arbitration Act 2012 (No. 23 of 2012) regulates domestic arbitration. Sec. 27D on the power of arbitrator to act as mediator, conciliator or other non-arbitral intermediary, [https://www.legislation.wa.gov.au/legislation/statutes.nsf/law\\_a146897\\_currencies.html](https://www.legislation.wa.gov.au/legislation/statutes.nsf/law_a146897_currencies.html) (Last accessed: 31 December 2020). For further discussion on practice in Australia, see A. Limbury, *Making Med-Arb Works in Australia*, (2009) 2 (1) *NYSBA New York Dispute Resolution Lawyer*, 84.

the arbitrator so acting. The parties, after giving their consent to this process sequence, waive their right to object to the conduct of the arbitrator in the subsequent arbitration procedure solely on the grounds that they have acted previously as a mediator, although if the parties do not consent to this then the arbitrator's mandate is terminated, and a substitute arbitrator shall be appointed.<sup>40</sup>

According to Art. 30 of the International Commercial Arbitration Act of British Columbia, it is not incompatible with an arbitration agreement for an arbitral tribunal to encourage settlement of the dispute and, with the agreement of the parties, the arbitral tribunal may use mediation, conciliation or other procedures at any time during the arbitral proceedings to encourage settlement. Moreover, according to the Arbitration Act of Alberta, the members of an arbitral tribunal may, if the parties consent to it, use mediation, conciliation or similar techniques during the arbitration to encourage settlement of the matters in dispute. Added to that, after the members of an arbitral tribunal use any of the referred techniques, they may resume their roles as arbitrators without disqualification. Therefore, similar to the previously-mentioned legislation, the parties shall not challenge the arbitrator based on the fact that they served as a mediator.

This legislation on same-neutral hybrid procedures<sup>41</sup> and rules is critical since there is no equivalent in the Model Law and UNCITRAL Arbitration Rules.

Finally, the third variation is the execution of an express and written waiver agreement. In the case of a waiver agreement, the parties acknowledge and approve the same-neutral hybrid procedure and with this the parties waive their right to object to the conduct of the arbitrator based on the fact that they also served as a mediator.

Below I will discuss in detail the possible content and role of a waiver agreement.<sup>42</sup> General waiver provisions (not those particularly addressing same-neutral hybrid procedures) provided for in institutional arbitration rules will not suffice if the parties wish to waive their right to seek annulment and non-recognition of the arbitral award.

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<sup>40</sup> CAA, Sec. 27D(5)–(6).

<sup>41</sup> These pieces of legislation cover the most detailed rules and regulate many critical and problematic issues associated with (same-neutral) hybrid procedures (such as dealing with confidential information, gained in mediation, in subsequent arbitration, renewal of consent to the dual role of the neutral following the failure of mediation to produce settlement). For the purpose of the current contribution, I mentioned only those provisions which govern waiver of right-related issues in the context of hybrid procedures.

<sup>42</sup> A Waiver agreement can either be part of an arbitration agreement as a waiver provision or in a subsequent separate agreement.

## IV. WAIVER AGREEMENT

### 1. Content of the waiver agreement

When neutrals have to decide whether to participate in a same-neutral hybrid procedure, even with the consent of the parties, it is important as a matter of best practice to ensure that the dual roles are pursued with further protection.

The purpose of the waiver agreement is to ensure that the neutral's participation in settlement discussions and their involvement as mediator will not be asserted by any party as grounds for challenging the appointment of the arbitrator or any arbitral award rendered by the arbitrator. A waiver agreement is especially recommended if the parties agree to have the arbitrator engage in mediation with private sessions with individual parties.

In terms of the content of the waiver agreement, the parties should acknowledge, understand, agree and stipulate certain issues in relation to participation in a same-neutral hybrid procedure.

In such a procedure, the arbitrator wants the parties to agree explicitly that they, as the arbitrator, according to the rules of a particular arbitration institution (lacking corresponding rules, due to the contractual arrangement directly regulating the procedure) shall endeavour to assist the parties in settling the controversy and act as a mediator.

Even though the parties to a same-neutral hybrid procedure would certainly know what a mediator does in general and what is the role and aim of their intervention, it is still essential to clarify it in the waiver agreement. A wording like this would be sufficient: "The mediator is an impartial, neutral intermediary, whose role is to assist the parties in reaching a settlement of their controversy or claim by negotiation between or among themselves. The mediator cannot impose a settlement but will assist the parties towards achieving their own settlement. The mediator has no liability for any act or omission in connection with the mediation." In addition, similar to any mediator's agreement, it is beneficial to clarify that the mediator, as neutral third party, will not act as an advocate of any of the parties and will not give legal advice to any party and, as a mediator, they are not entitled to render any legal or other professional advice or decision. Such a wording in a waiver agreement would ensure that the parties and the neutral share the same understanding and expectations towards the procedure.

The critical situation is when the mediation process fails to produce a settlement. A further aim of the arbitrator-mediator is to ensure that if the controversy is not settled during the mediation phase, the parties agree that the mediator-arbitrator shall proceed as the arbitrator and then render an arbitral award, since the main duty of an arbitrator is to render an enforceable arbitral award, having stepped back into the arbitrator's position. Moreover, it is essential to have provisions that cover the worst-case scenario

and the method that the parties as well as the arbitrator can use to opt out of the procedure and ensure the informed consent of the parties.

The principle of party autonomy requires that the arbitrator makes sure that the express consent is not only the express consent of the legal representatives but that of the parties as well. The most critical question here is “to be informed about what”? About the process itself, including its advantages and disadvantages? Some argue that written consent of the parties is essential not only when the arbitrator acts as a mediator but also prior to any promotion of settlement negotiation.

As the conclusion of a waiver agreement, the arbitrator may want to have a provision that demonstrates that they advised them and their legal representatives and that they could choose someone other than him to act as the mediator or that, if they decide that they should act as the mediator, someone else might then be appointed as the arbitrator if the mediation fails. The arbitrator is responsible for introducing and discussing the different options available to the parties, as well as precisely informing them about specific procedural issues associated with a same-neutral hybrid procedure.

It is important to ensure that the parties have a firm understanding of the procedural rules: that they understand the structure, stages, possible outcomes and not only the advantages but the disadvantages of the process as well. By drafting an explicit agreement, we do not need to rely on the assumption that competent businessmen would anyway understand the drawbacks of the process.

Unfortunately, it often happens that parties to a same-neutral hybrid procedure are informed of the transformation, the dual role with two processes conducted by one individual, but on a substantive level they are not briefed on the ground rules of the procedure. In my opinion, in any dispute resolution method, it is critical, especially for the parties, to have a predictable process. Neither party, nor their legal representatives want to participate in a process that they do not adequately understand. In addition to that, the arbitrator should explain the rules governing the procedure and the impact of a possible settlement on costs, including the situation that the mediation fails to produce settlement, and then the remainder of the arbitration must take place. In fact, we need to see the qualitative difference between consent and informed consent to the process.

Furthermore, another critical aspect of informed consent is the use of the information learnt in the mediation process. The mediator needs to advise the parties that, in the course of the mediation process, they and their legal representative may and most likely will disclose to him, while they act as the mediator, their respective settlement position, their opinions on the strengths and weaknesses of their position and other issues that may not be admissible during the arbitration. In order to ensure that the consent was not only informed but had really taken place as part of the waiver agreement, the parties should acknowledge that. In the long term, this is important since, if the mediation is not successful then, as I have stated earlier, the arbitrator is required to render a decision in the case.

Concerning confidential information,<sup>43</sup> Gerald F. Phillips, a distinguished ADR professional with extensive knowledge and practical experience in the field of hybrid procedures, submitted that the mediator should explain that, during the mediation process, all statements made by the parties of the counsel are confidential unless the parties give permission to disclose them to the other side. They add that there are some general exceptions, according to law, to confidentiality on which the mediator should suggest that the parties ask their legal representative to counsel them. Interestingly, Mr. Phillips also suggests that the legal representative would need to advise the parties that, should the case not be settled during the mediation and the dispute proceeds to arbitration, some of the confidential information the mediator heard in the private session may influence the arbitrator in the course of rendering an award.

As a conclusion, before the execution of a waiver agreement, the parties must acknowledge, and understand certain issues and aspects of the same neutral-hybrid procedure in order to ensure a productive and smoothly conducted process rather than a confusing and easily objectionable procedure. As it turned out from the discussion on the second variation of waiver of right to object situation, the key provisions of the waiver agreements are those that stipulate waiving the right to challenge the mediator-arbitrator or the arbitral award.

## 2. Best practices

I have collected some best practices below in order to provide practitioners with some guidelines in relation to formulating a waiver agreement in the case of a same-neutral hybrid procedure.

As discussed above, numerous arbitration institutions turn to the IBA Guidelines in order to decide if a particular situation gives rise to justifiable doubt as to the arbitrator's impartiality. In accordance with the IBA Guidelines, an arbitrator's involvement as a mediator for the parties is a "waivable conflict". The waivable red list of the IBA Guidelines includes the scenario when the arbitrator was previously involved in the case; the arbitrator as a mediator is definitely an example of that. The waivable red list covers the situations in which, by definition, the arbitrator should not serve as an arbitrator. Albeit under given circumstances, they can still serve as an arbitrator

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<sup>43</sup> Please note that different variations of dealing with confidential information (full disclosure, disclosing only material information, non-disclosure, authorisation of the arbitrator to base their arbitral award on information obtained in the mediation) to be obtained in the mediation part of the same-neutral hybrid procedure in subsequent arbitration procedure is a separate subject matter, not to be covered in the present contribution. Like the present subject matter, it is also an important aspect of ensuring the efficient and fair operation of same-neutral hybrid procedures. Here only those aspects which are relevant to the waiver agreement are indicated.

or continue their work as an arbitrator. According to the IBA Guidelines, first of all, all parties, arbitrators, and the arbitration institution or other appointing authority must have full knowledge of the conflict of interest. Second, all parties must expressly agree that such a person may serve as an arbitrator despite the conflict of interest. The explanation to the general standard of the IBA Guidelines highlights a critical and important aspect of informed consent: “Informed consent by the parties to such a process prior to its beginning should be regarded as effective waiver of a potential conflict of interest. Express consent is generally sufficient, as opposed to a consent made in writing which in certain jurisdictions requires a signature.” From the explanation, it also turns out that the express waiver can be manifested in minutes or transcripts. The wording of the explanation is crystal clear when directly referring to a possible situation where the parties would use such a hybrid procedure to disqualify the arbitrator who had previously served as mediator. In order to avoid this tactic, according to the general standard, the waiver should remain effective if the mediation is unsuccessful. As a result, the parties assume and bear the risk of what the arbitrator may learn in the settlement process.

Having a further example directly from a practitioner: mediator-arbitrator practicing in the U.S., an acceptable waiver provision would be thus framed:

The parties agree that Mr. XY may undertake the role both of mediator and arbitrator, and the parties, by and through their lawyers forever, waive and relinquish any claim or objection to their serving in both capacities, and the parties, by and through their lawyers, waive any claim they may have of prejudice resulting from the arbitrator undertaking to act in both capacities as a mediator and as the arbitrator and waive any conflict or impropriety in this regard.

In terms of annulment actions: “The parties, by and through their attorneys, agree that they will not challenge the determination, outcome and decision of the arbitrator on the basis that they have requested the arbitrator to act as both the mediator and arbitrator in this matter.”

An informed consent and waiver together ensure that the issue of violation of natural justice will not come up as long as the arbitrator *de facto* remains impartial. As a consequence, the rule is still the same; the arbitrator must be and remain independent and impartial during the process and this is not a matter of negotiation or execution of a waiver agreement, neither in regular arbitration, nor in a hybrid procedure.

Turning to waiver language explicitly proposed by institutions, the CPR Commission on the Future of Arbitration in its report proposed:

The parties and their counsel must expressly agree in writing or on the record that the arbitrator’s participation in settlement discussions will not be asserted by any party

as grounds for disqualifying the arbitrator or for challenging any award rendered by the arbitrator (unless, for example, on the face of it, it is apparent that the award is based prima facie in material part on information outside the record and learned by the arbitrator during settlement discussions).<sup>44</sup>

According to the Final Report of the CEDR Commission on Settlement in International Arbitration (November 2009) (hereinafter “CEDR Guidelines”): “The Parties agree that the Arbitral Tribunal’s facilitation of settlement in accordance with these Rules will not be asserted by any Party as grounds for disqualifying the Arbitral Tribunal (or any member of it) or for challenging any award rendered by the Arbitral Tribunal.”<sup>45</sup> The consent should include a statement that the parties will not at any later time use the fact that the arbitrator has acted as a mediator/conciliator as a basis for challenging the arbitrator or any award which the arbitrator may make (either alone or as part of a tribunal).<sup>46</sup>

With reference to the above, it is important to keep in mind that each variation of a waiver of right to object scenario functions differently depending on the country in which an arbitration is conducted, or the enforcement and recognition of the arbitral award is sought. As I will discuss below, the effectiveness of waiver of right provisions in institutional arbitration rules and waiver agreements have some limits, and parties and arbitrators are also expected to be aware of the relevant provisions – of the seat of arbitration and those jurisdictions where seeking the enforcement and recognition of the arbitral award can reasonably be expected – that may result in the waiver of right provisions being superseded.

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<sup>44</sup> CPR Commission on the Future of Arbitration, Protocol 8. The first effort to set forth practice guidance regarding med-arb and the role of arbitrators in settlement was made as a part of the 2001 Final Report of the CPR Institute for Dispute Resolution Commission on the Future of Arbitration, a group composed of more than fifty leading commercial advocates and arbitrators. T. J. Stipanowich, Arbitration, Mediation and Mixed Modes: Seeking Workable Solutions and Common Ground on Med-Arb, Arb-Med and Settlement-Oriented Activities by Arbitrators, *Pepperdine University Legal Studies Research Paper*, No. 2020/25, 74–75. See also H. I. Abramson, Protocols for International Arbitrators Who Dare to Settle Cases, (1999) 10 (1) *Am. Rev. Int’l Arb.*, 1–17.

<sup>45</sup> CEDR Guidelines, Appendix 1 Art. 3.3., <https://www.cedr.com/wp-content/uploads/2021/04/Arbitration-Commission-Document-April-2021.pdf> (Last accessed: 31 December 2020).

<sup>46</sup> CEDR Guidelines, Appendix 2, Art. 7.7.5.



## V. LIMITS OF CONCEPT OF WAIVER: BALANCING PARTY AUTONOMY AND PUBLIC INTEREST

### 1. Waiver of annulment action

Is it rational and possible to waive the right to challenge the award, and if so, why? The waiver of annulment action in front of the national courts and challenging the arbitral award on the recognition and enforcement stage – with derogation from otherwise applicable national law and the New York Convention – certainly demonstrate a high level of party autonomy.

With the annulment action, the party leaves the area of private judging in order to gain a limited amount of control of the national judiciary over the justice rendered by the arbitrator. In fact, the annulment action is a “last” opportunity for the parties, who voluntarily gave up having their dispute resolved through the state court system, to receive final control over the fairness of the arbitration procedure by the national judiciary. Therefore, while arguing the inconsistency between party autonomy and public interest, we must recognise that this kind of protection, even if it is counter-productive, in certain cases also serves the interests of the disputants.

This is why generally and specifically waiving the right of annulment action is an extreme and still disputable question in both domestic and international commercial arbitration.<sup>47</sup>

I will discuss the non-waivable nature of only those grounds of annulment and non-recognition which could be applicable in the given same-neutral hybrid procedure scenario.

As has been discussed above, the claim of lack of impartiality can be based on three annulment grounds of the Model Law. In a few jurisdictions, courts have found that parties are not entitled to waive their right to initiate the annulment of an arbitral award by claiming the arbitrator’s lack of impartiality.<sup>48</sup>

Regarding the procedural guarantees (discussed in detail above)<sup>49</sup> stipulated under Art. 34(2)(a)(ii) of the Model Law and reflecting fundamental procedural requirements<sup>50</sup> imposed by national law on locally-seated arbitration, the prevailing

<sup>47</sup> L. Guglya, Waiver of Annulment Action in Arbitration: Progressive Development Globally, Realities in and Perspectives for the Russian Federation (Different Beds–Similar Dreams?), in A. J. Belohlávek and N. Rozehnalová (eds), *Party Autonomy versus Autonomy of Arbitrators 2012, Czech & Central European Yearbook of Arbitration*, Vol. 2. (JurisNet, 2012) 81–82.

<sup>48</sup> Born, *International Commercial Arbitration*, 394.

<sup>49</sup> As a reminder: right to equal treatment, right to present one’s case, right to non-arbitrary procedure.

<sup>50</sup> Born, *International Commercial Arbitration*, 389. As also explained by Born, with reference to related court practice, application of local law does not mean that all procedural rules applicable in local litigation must be complied with in international commercial arbitration, but only those fundamental



opinion among international commercial arbitration practitioners and scholars is that equal treatment is mandatory and cannot be waived or excluded by the parties.<sup>51</sup> Therefore, in a same-neutral hybrid procedure, should an unambiguous violation of principle of equal treatment occur, then claiming lack of impartiality would be possible even if the parties have executed a waiver agreement.

Notwithstanding a comparative study<sup>52</sup> elaborately discussing annulment actions in international commercial arbitration, a growing number of jurisdictions enable the parties to exercise the right of waiver of the grounds of annulment of arbitral award.

Some states provide for such an opportunity in full, some only in part. In Mauritania, Peru, Sweden,<sup>53</sup> Switzerland, Belgium,<sup>54</sup> Tunisia,<sup>55</sup> and Turkey, it is possible to waive the right of annulment with some limitations and under given circumstances, while, for example in Panama, the parties are permitted to do that in full.

The waiver of annulment currently used in international commercial settings is the Swiss model, to which the Belgium legislation is similar. Its main purpose

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requirements of fairness which would be included in respective national constitutions. In relation to fundamental rights (equal treatment, opportunity to present one's case – of administration of justice) see commentary on Act LX of 2017 on Arbitration (hereinafter “Hungarian Arbitration Act”) regarding 29. § A feleket a választottbírószági eljárás során egyenlő elbánásban kell részesíteni, és mindegyik félnek meg kell adni a lehetőséget arra, hogy az ügyét előadhassa. Harmadik rész, A polgári per alternatívája: A magánjogi választottbírószági eljárás-XIII. fejezet: A magánjogi választottbíráskodás belső jogi szabályozója: a 2017. évi LX. törvény a választottbíráskodásról, in Varga I. (ed.), *A polgári perrendtartás és a kapcsolódó jogszabályok kommentárja III/III.* (HVG Orac, Budapest, 2018) 2921.

<sup>51</sup> S. Luttrell, *Bias Challenges in International Arbitration: The need for a ‘real danger’ test*, (Kluwer Law International, 2009) 261.

<sup>52</sup> See Guglya, *Waiver of Annulment Action in Arbitration...*

<sup>53</sup> Sweden also decided to follow the Swiss approach. since Art. 51 of the Swedish Arbitration Act 1999 reads as follows, “Where none of the parties is domiciled or has its place of business in Sweden, such parties may in a commercial relationship through an express written agreement exclude or limit the application of the grounds for setting aside an award [...]”

<sup>54</sup> Art. 1718 of the Belgian Judicial Code Provisions, Chapter 6: Arbitration, “By an explicit declaration in the arbitration agreement or by a later agreement, the parties may exclude any application for the setting aside of an arbitral award, where none of them is a natural person of Belgian nationality or a natural person having their domicile or normal residence in Belgium or a legal person having its registered office, its main place of business or a branch office in Belgium.” Therefore, the limitation is in connection with the parties concerned, for non-Belgian parties, regardless of the grounds on which annulment might be sought, the waiver agreement is presumably valid and enforceable, <https://www.cepani.be/wp-content/uploads/2019/12/Schedule-IV.pdf> (Last accessed: 31 December 2020). The Belgian legislation is a good example of demonstrating the difficulty of this aspect of waiver of right. First, the 1985 Belgian Arbitration Act took a radical position, as it stated under Art. 1717: “Courts of Belgium may hear a request for annulment only if at least one of the parties to the dispute decided by the award is either a physical person having Belgian nationality or residence, or a legal entity created in Belgium or having a Belgian branch or other seat of operation.” Várady, Barceló III and von Mehren, *International Commercial Arbitration: A Transnational Perspective*, 743–744.

<sup>55</sup> In accordance with Art. 78(6) of the Tunisian Arbitration Code, “The parties who have neither domicile, principal residence nor a business establishment in Tunisia, may expressly exclude totally or partially all recourse against an arbitral award.”

is to foster expediency and efficiency. According to Art. 192 of the Swiss Private International Law Act<sup>56</sup>

If none of the parties have their domicile, their habitual residence, or a business establishment in Switzerland, they may, by an express statement in the arbitration agreement or by a subsequent written agreement, waive fully the action for annulment or they may limit it to one or several of the grounds listed under chapter 12 of the Swiss Private International Law Act.<sup>57</sup> If the parties have waived fully the action for annulment against the awards and if the awards are to be enforced in Switzerland, the New York Convention of June 10, 1958 on the Recognition and Enforcement of Foreign Arbitral Awards applies by analogy.

In other words, in some situations Swiss law does allow waiver of the right to challenge an arbitral award that extends to matters of procedural irregularity and public policy. Although, for this to be valid, neither party may be resident or have a branch in Switzerland.

Finally, particular states do not allow their annulment competences to be ousted. As examples, according to the Egyptian Arbitration law and the Romanian and the Greek Civil Codes of Civil Procedure, the parties are not allowed to exercise the waiver *ex-ante* and to give up their right in advance to vacate award by initiating a setting aside procedure. Meanwhile, there are certain states where this is prohibited entirely. This means that a waiver agreement either limiting or excluding the parties' right to seek annulment of the award is unenforceable and would invalidate such a waiver agreement. For instance, in Italy, Hungary, Estonia, Spain, and Canada, the waiver of annulment is completely forbidden.<sup>58</sup>

Interestingly, all the states that allow the parties to waive the right of annulment on an international arbitration level, with the exception of Turkey, expressly provide in relevant laws that, in the case of a full waiver, the award will be treated as a foreign award subject to the respective rules and procedures of recognition and enforcement. The opportunity of partial waivers of annulment, which means that only certain grounds can be eliminated but not all of them, should be expected to produce the

<sup>56</sup> <https://www.swissarbitration.org/Arbitration/Arbitration-Rules-and-Laws> (Last accessed: 23 November 2020).

<sup>57</sup> Art. 190(2) of Swiss Private International Law Act, Chapter 12: The award may only be annulled:  
 a) if the sole arbitrator was not properly appointed or if the arbitral tribunal was not properly constituted;  
 b) if the arbitral tribunal wrongly accepted or declined jurisdiction;  
 c) if the arbitral tribunal's decision went beyond the claims submitted to it, or failed to decide one of the items of the claim;  
 d) if the principle of equal treatment of the parties or the right of the parties to be heard was violated;  
 e) if the award is incompatible with public policy.

<sup>58</sup> Guglya, Waiver of Annulment Action in Arbitration..., 84–87.

same effect as far as the renounced grounds are concerned. The importance of the non-domestic nature of the award is that it should be subject to the application of the New York Convention, assuming that the states are Contracting States and the reciprocity reservation is not made. Concerning the issue of waiver, it is important to keep in mind that three states from those that allow the waiver have made a reciprocity reservation, namely Belgium, France and Turkey. But what is the aim of these types of waivers? I aim to find an answer for this question, first in general, then I will apply it to our particular hybrid procedure setting. On a general level, it is certainly true that it reduces the workload of the arbitration-related courts and chambers. In addition, among many advantages of arbitration, this leads to eliminating the influence of the local court even more. On the other hand, the annulment actions, among many other advantages, have an *erga omnes* effect.

According to the *erga omnes* effect, the award annulled at the seat of arbitration due to Art. V(1)(e) of the New York Convention may not be granted enforcement in another state. Nevertheless, even if the award was annulled in the seat of arbitration, in some of the Contracting States it is still possible to execute the recognition of the award and permit enforcement of the award.<sup>59</sup> On the other hand, recognition and enforcement have a limited effect, only for the state where enforcement is granted.

## 2. Challenging the award in the recognition and enforcement procedures

Besides the place of arbitration, the place of enforcement is the other jurisdiction which is usually relevant and needs to be taken into account when analysing the limits and requirements of an effective waiver.

I will introduce a few aspects of due process under the New York Convention.

In fact, due process appears twice on the list of defences; first in Art. V(1)(b) of the New York Convention with the purpose of guaranteeing a minimum requirement for a fair arbitral procedure. Under this provision, a court may refuse to recognise or enforce an arbitral award if the party against whom the award is invoked was not given proper notice of the appointment of the arbitrator or of the arbitration proceedings or was otherwise unable to present its case. The whole idea of procedural fairness with the

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<sup>59</sup> P. Nacimiento, Article V(1)(d), in H. Kronke, P. Nacimiento, D. Otto and N. Christine Port (eds), *Recognition and Enforcement of Foreign Arbitral Awards: A Global Commentary on the New York Convention* (Kluwer Law International, 2010) 285. See N. Darwazeh, Article V(1)(e), in H. Kronke, P. Nacimiento, D. Otto and N. Christine Port (eds), *Recognition and Enforcement of Foreign Arbitral Awards: A Global Commentary on the New York Convention*, (Kluwer Law International, 2010) 326–344. in connection with discussion on territorial (once the award has been set aside, no more award to be enforced) and delocalised (enforcing court is free to enforce annulled award) approach. For further discussion see also Born, *International Commercial Arbitration*, 406–409.

right to be heard and present their case form the fundamental basis of dispute resolution and, as a result, it is not surprising that when it comes to challenging the arbitral award it is one of the most frequently invoked grounds for non-recognition or non-enforcement. It is not easy to prove it, and the courts seldom accept due process violations as defence.<sup>60</sup> Second, violation of due process may overlap with the international public policy defence. This is because fairness and observance of due process are often seen as the international public policy of many states. However, according to Art. V(2)(b) of the New York Convention, for the purpose of denying execution and enforcement, the only relevant public policy is that of the enforcing state.

In order to understand the correlation between the due process and the public policy defence, it must be noted that the aim of this provision was to establish a uniform international standard deriving from an autonomous interpretation.<sup>61</sup> As a result, the courts, in the course of applying the New York Convention, are expected to follow more of a comparative view and analyse how the due process defence has been developed under the New York Convention rather than turn to the application of *lex fori* and merely focus on their domestic procedural fairness.

In the context of a hybrid procedure, it is especially relevant if we think about conducting private sessions in the mediation phase. Besides the already discussed problems associated with a private session (that enables the mediator to have unilateral communication regarding the case with each party), here it is important to emphasise that the fundamental principles of the right to be heard, to present one's case and the equal treatment of the parties presume that the parties are provided with the opportunity to defend themselves in the event of being accused by the counterparty.<sup>62</sup> On a more general level, a party to an arbitration is entitled to respond to the submission of the counterparty and, in the case of a private session (provided that it is considered as a communication with the parties in the arbitration), these principles might be infringed.

As stated earlier, it is possible to waive the right to challenge the arbitrator based on the fact that they served both as a mediator and arbitrator. On a more concrete level, how can we stipulate explicitly the waiver of grounds for refusal before commencing the arbitral procedure, especially in the arbitration agreement? It is possible to waive this right under given circumstances with particular consequences.<sup>63</sup>

According to Art. V(1)(d) of the New York Convention, the recognition and enforcement of the award may only be refused at the request of the party against whom

<sup>60</sup> Nacimiento, Article V(1)(d), 279–280.

<sup>61</sup> Nacimiento, Article V(1)(d), 286.

<sup>62</sup> Further examples of violation of due process: party has not been able to participate in the taking of evidence, (ii) or discovery procedure, where applicable (iii) or comment on expert report submitted to the tribunal (Lew, Mistelis and Kröll, *Comparative International Commercial Arbitration*, 711.).

<sup>63</sup> Lew, Mistelis and Kröll, *Comparative International Commercial Arbitration*, 254.

it is invoked if that party furnishes, to the competent authority where the recognition and enforcement is sought, proof that the composition of the arbitral authority or the arbitral procedure was not in accordance with the agreement of the parties, or, failing such agreement, was not in accordance with the law of the country where the arbitration took place. As such, the New York Convention does not define the level of “irregularity”; it merely stipulates that the award can be set aside provided that the arbitral procedure was not in accordance with the agreement of the parties. Kurkela and Snellman explain that the materiality or serious irregularity may be supplied by the contract law governing the arbitration agreement. They also suggest that sanction of nullity and denying enforcement, setting aside, are often subject to the test of materiality. Consequently, the *de minimis* rule is applicable in the case; the award will not be set aside but it would entitle the party to claim damages or even specific performance from the arbitrator or institution depending on with whom the parties concluded the “arbitrator’s contract”. Provided that the institution concludes the arbitrator’s contract, the parties will be able to recover damages from the arbitration institution for breaching the terms of the contract between the parties and the institution.<sup>64</sup>

Turning to same-neutral hybrid procedures, we assume that if the arbitrator turning into/having been mediator deviated from the arbitration agreement, this procedural irregularity would be clarified as material and serious instead of the application of the *de minimis* rule and the arbitral award would be set aside. Therefore, waiver of right is especially critical in this context. The parties may waive – expressly or by implication – their right to any and all sanctions in relation to a procedural act that is a serious deviation from or breach of the arbitration agreement, provided that the given right is waivable. Otherwise, the award could be set aside.<sup>65</sup>

As a result, due to Art. V(1)(d) of the New York Convention, first of all, the court concerned is required to interpret and consider the parties’ agreement and should turn to the analysis of the law of the seat of arbitration if the parties fail to reach an agreement on the relevant issue. Hence, this provision of the New York Convention promotes the priority of party autonomy over the law of seat of arbitration.<sup>66</sup> In the context of Art. V(1)(d) of the New York Convention, it means that it is applicable only in the absence of the parties’ agreement, or where the parties’ agreement has a gap. In the case of hybrid procedures, it can be challenging to identify what the agreement was regarding the conduct of the arbitration procedure. Certainly, thorough interpretation of the agreement and the individual circumstances of the case can help us determine the content of the agreement. Applying this to an agreement to a same-neutral hybrid

<sup>64</sup> E. Onyema, *The Use of Med-Arb in International Commercial Dispute Resolution*, (2001) (12) *American Review of International Arbitration*, 156.

<sup>65</sup> Kurkela and H. Snellman, *Due Process in International Commercial Arbitration*, 192–193.

<sup>66</sup> Nacimiento, Article V(1)(d), 282.

procedure, the interpretation can be even harder.<sup>67</sup> Although this provision does not express this directly, in order to challenge the arbitral award successfully based on these grounds, the causality between the procedural defect made by the tribunal and the award must be demonstrated. This means that the procedural defects achieved such a level that without them the decision would have been substantially different.<sup>68</sup> In this way we can observe a direct correlation between the procedural defect and the outcome of the arbitration.

One aspect of improper composition of the arbitral tribunal is also telling for us. Namely, the fact that one of the arbitrators was not impartial can lead to the refusal of the recognition and enforcement of the arbitral award under Art. V(1)(d) of the New York Convention.

However, as I have discussed earlier, the challenges as to the impartiality of the arbitrator have to be discussed and claimed during the arbitration procedure. As a conclusion, the partiality allegation must be so grave that it can be proved that it has affected the arbitral award and it was rendered contrary to public policy.

This way of thinking leads to Art. V(2)(b) of the New York Convention.<sup>69</sup> In fact, while discussing these issues, the courts apply high standards while it tries to figure out whether partiality was real or only assumed.<sup>70</sup>

While it seems confusing and difficult to argue that the constitution of the arbitral tribunal or the arbitration procedure and impartiality of the arbitral tribunal has a connection with public policy, we need to take into consideration that the national legal systems take diverse views on these questions.

There is no consensus on whether or not the parties' right to influence the arbitral tribunal's constitution equally forms part of the procedural public policy.<sup>71</sup> In terms of impartiality of the tribunals, it seems more obvious that it falls under the public policy exemption. There is also an undisputed procedural public policy in favour of procedural fairness and equal treatment of parties in legal proceedings.<sup>72</sup>

As we have discussed earlier, timing is critical when it comes to challenging an arbitrator. For these reasons, it is understandable that a party cannot raise the public policy concern in the course of the recognition and enforcement procedure; they

<sup>67</sup> Nacimiento, Article V(1)(d), 344.

<sup>68</sup> Nacimiento, Article V(1)(d), 345.

<sup>69</sup> New York Convention Art. V(2)(b), "2. Recognition and enforcement of an arbitral award may also be refused if the competent authority in the country where recognition and enforcement is sought finds that: [...] (b) The recognition or enforcement of the award would be contrary to the public policy of that country."

<sup>70</sup> R. Wolff (ed.), *New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards: Commentary*, (C.H Beck, Hart and Nomos, München, 2012) 339.

<sup>71</sup> Wolff, *New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards: Commentary*, 419.

<sup>72</sup> Luttrell, *Bias Challenges in International Arbitration...*, 274.



should have done it earlier. As a result, the key point here is that they lose this right only if they could have raised it as a challenge in the course of the arbitration procedure. Furthermore, in some jurisdictions, the expectations are higher, and there is no general standard regarding impartiality. There are jurisdictions where the standard of partiality for violation of public policy is higher than the standard of partiality for arbitrator challenge or the demand that the award has been affected by their partiality.

As an example, the *ex parte* communication between the arbitrator and a party can recall the public policy defence.<sup>73</sup>

Finally, the defences according to Art. V(2)(b) of the New York Convention, which are examined ex officio by the exequatur court, cannot be waived insofar as they deal with issues covering public interest. As they have been accepted in general, public interest issues are not placed at the parties' disposition.<sup>74</sup> As a consequence, they cannot be waived by mutual agreement concluded between the particular parties to an arbitration agreement. Concerning ex-post waivers, it is not surprising that the parties are permitted to waive defences under Art. V of the New York Convention, given that the parties are aware of the defect that has already occurred. However, the exception (where introduced), namely the waiver of a defence that has a public interest aspect, is not allowed. While arbitration as a dispute resolution method is a creation of contract and the parties are free to form the arbitration procedure, party autonomy has its own limitations in this field as well.

In relation to the relevant provisions of the Model Law, leading scholars of the international commercial arbitration community express the opinion that only those parts of the Model Law that concern non-arbitrability or are expressive of public policy cannot be waived by the parties.<sup>75</sup>

In accordance with the above, there are certain categories of lack of impartiality and arbitrator's misconduct, such as outright corruption or similar onerously abusive procedural arrangements, which are not waivable irrespective of the provisions of the applicable institutional arbitration rules or waiver agreement. In other words, such a waiver is not valid even when a party does not object to them at the time.<sup>76</sup> According to Luttrell, many states recognise that, in the public policy clash between finality and fairness at the enforcement stage, finality should win unless the breach of procedural

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<sup>73</sup> Wolff, *New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards: Commentary*, 421–422.

<sup>74</sup> According to commentary on waiver of right provision of the Hungarian Arbitration Act, the violation of mandatory provisions of law can be objected anytime and they are not waivable. 5. § Lemondás a kifogás jogáról, in Varga I. (ed.), *A polgári perrendtartás és a kapcsolódó jogszabályok kommentárja III/III.* (HVG Orac, Budapest, 2018) 2861–2863.; H. Kronke, P. Nachimiento, D. Otto and N. Christine Port (eds), *Recognition and Enforcement of Foreign Arbitral Awards: A Global Commentary on the New York Convention* (Kluwer Law International, 2010).

<sup>75</sup> Luttrell, *Bias Challenges in International Arbitration...*, 262.

<sup>76</sup> Born, *International Commercial Arbitration*, 476.



justice is found to have been egregious.<sup>77</sup> According to Petrochilos,<sup>78</sup> procedural public policy will only be offended and the arbitral award exposed when the breach is manifest. As framed by Luttrell the breach is manifest when the court does not need the assistance of counsel to see it.

## VI. CONCLUSION

This article has aimed to contribute to the discussion of how waiver of the right to challenge the arbitrator and arbitral award based on their dual role can serve as a legal and practical measure ensuring efficiency in a same-neutral hybrid procedure.

With reference to the discussion above on variations of waiver and their possible implication in the context of same-neutral hybrid procedure it can be concluded:

First, each variation and level of waiver of right (failure to object, institutional arbitration rules-national laws, waiver agreement) is relevant and can be applicable in the context of same-neutral hybrid procedure. In the case of such a procedure, the execution of a waiver agreement would be preferable, unless there is an express provision of law on waivers in this context.

Second, lack of impartiality should primarily be claimed in the course of the arbitration in the form of challenging the arbitrator. After rendering an arbitral award – in the form of an annulment action and seeking non-recognition and enforcement – lack of impartiality can be claimed on the basis of denial of the opportunity to present the party's case, procedural irregularity (failure to comply with the parties' agreed procedure or procedure prescribed by law of the seat of arbitration) and violation of public policy, arguing that the party discovered the circumstances concerned after the award was made. In the context of a same-neutral hybrid procedure, violation of procedural guarantees, especially the violation of the right to equal treatment, is relevant.

Third, the parties should expressly agree in writing and give their informed consent to participate in a same-neutral hybrid procedure, and such an agreement should cover the advantages and disadvantages of such a procedure and the parties' understanding of the role of the mediator.

Fourth, the parties should expressly agree in writing that the arbitrator's participation in the settlement discussion and mediation will not be asserted by any party as grounds for challenging the arbitrator or for challenging the arbitral award (unless the award is based *prima facie* in material part on information gained outside the record of the arbitration procedure and obtained in the course of the mediation).

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<sup>77</sup> Luttrell, *Bias Challenges in International Arbitration...*, 273.

<sup>78</sup> G. Petrochilos, *Procedural law in international arbitration*, (Oxford University Press, Oxford, 2004) 99.

Finally, taking into consideration all the above, it is still critical for both the parties concerned (and their counsel) and the arbitrator to keep in mind that, whether it be a waiver clause, agreement or provision of the applicable arbitration rules, their effect in the domestic courts will vary from case to case and from jurisdiction to jurisdiction, since it depends on the applicable national law. Some legal systems may take the view that certain serious procedural irregularities (serious breaches of principle of equal treatment of the parties) are not capable of being waived by a party. Ultimately, what can or cannot be waived is a matter for the domestic legislator and judge to decide but very few grounds for annulment or non-recognition appear to be non-waivable.



Pap, Dániel

# When Justice Delayed is Justice Denied: Advantages and Disadvantages of Emergency Arbitration in Comparison with Interim Relief

## **ABSTRACT**

Interim protection measures are essential for the proper functioning of dispute resolution processes. Without the existence of such measures, parties to a dispute resolution process – be it ordinary court proceedings or international arbitration – may suffer irreparable harm while waiting for the adoption of a final and binding decision settling their dispute. While international arbitration has many advantages over litigation in domestic courts, interim relief has been considered the Achilles' heel of the system because arbitral tribunals cannot order interim measures of protection before they are constituted. To fill this gap, arbitral institutions have adopted the emergency arbitration procedure. It allows parties who are unable to wait for the constitution of the arbitral tribunal to seek interim measures in proceedings that are independent of the merits. Even so, there are disadvantages to the emergency arbitration procedure in comparison to ordinary court-ordered interim relief. These stem from the peculiarity of international dispute resolution and the arbitral process. This paper sets out to examine the advantages and disadvantages of emergency arbitration as opposed to interim relief and offer potential solutions to the shortcomings of the former.

**KEYWORDS:** international arbitration, interim relief, provisional relief, interim protection measures, emergency arbitrator, expedited procedures, arbitration rules

## **I. INTRODUCTION**

Interim protection measures are essential for the proper functioning of dispute resolution processes. Without the existence of such measures, parties to a dispute resolution process – be it ordinary court proceedings or international arbitration – may suffer irreparable harm while waiting for the adoption of a final and binding decision settling their

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dispute. Delay in the dispute resolution process may result in, *inter alia*, loss of material evidence, continuous intellectual property infringement, dissipation of assets or loss of proprietary market value. Moreover, without interim measures, hostile respondents may engage more freely in guerrilla tactics to further delay and disrupt the dispute resolution process, thereby improving their tactical or commercial position. These concerns are especially present in international disputes, where parties may move their assets to jurisdictions where the possibility of enforcement against those assets is little to none. In some cases where time is of the essence, bereft of interim measures of protection, the dispute resolution process itself could be rendered moot.

Historically, ordinary courts had exclusive competence to order interim measures. This, however, gradually changed, and nowadays most jurisdictions afford the arbitrators the power to order interim measures of protection. At first glance, one would think that this places arbitral tribunals next to ordinary courts when it comes to the efficacy of interim measures of protection. In fact, arbitral tribunals cannot order interim measures of protection before they are constituted. This is a severe handicap for parties opting for arbitration as opposed to ordinary courts, because in most cases the parties seek interim measures at the outset of the proceedings. Moreover, the constitution of the tribunal may be severely delayed by the arbitrator selection and challenge process, thereby exacerbating the issue. To fill this gap, arbitral institutions have adopted the emergency arbitration procedure. It allows parties who are unable to wait for the constitution of the arbitral tribunal to seek interim measures in proceedings that are independent of the merits. Even so, there are disadvantages to the emergency arbitration procedure in comparison to ordinary court-ordered interim relief. These stem from the peculiarity of international dispute resolution and the arbitral process. This essay sets out to examine these and, at the end, to offer potential solutions to these conundrums.

To set the stage for the analysis, I will begin by introducing the domestic and international legislation surrounding interim measures of protection in the arbitral context. I will discuss why, despite its gradual development, it still falls short of expected results. In the second part, I will focus on emergency arbitration as opposed to ordinary court-ordered interim relief. I will present the advantages and disadvantages of these provisional measures. Finally, I will conclude by offering potential solutions to the deficiencies presented by promoting the adoption of the amendment of an existing international treaty and/or the amendment of national legislation.

## II. DOMESTIC AND INTERNATIONAL STANDARDS ON INTERIM MEASURES OF PROTECTION IN ARBITRATION

### 1. International conventions

International conventions, in general, do not contain specific rules on the power of arbitrators to order measures of interim protection. Even so, a trend moving towards the explicit recognition of provisional measures in international arbitration can be traced. Before the 1960s, no international convention dealt with the issue of interim measures: neither the 1927 Geneva Convention on the Execution of Foreign Arbitral Awards<sup>1</sup> nor the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards<sup>2</sup> (“New York Convention”) contains any reference to interim measures. Despite the New York Convention’s silence on this matter, some commentators consider that the New York Convention should be read as precluding the Contracting States from restricting, via legislation, the power of the arbitrators to order interim measures of protection.<sup>3</sup>

The first convention to touch upon the issue was the 1961 European Convention on International Commercial Arbitration, which expressly permits parties to an arbitration to seek interim relief from ordinary courts and stipulates that such conduct will not waive the parties’ right to arbitrate.<sup>4</sup> The European Convention, however, still did not contain any explicit reference to the power of the arbitral tribunal to order interim measures. In actuality, the ICSID Convention (1966) was the first to refer explicitly to the arbitrator’s power to order interim measures.<sup>5</sup>

### 2. Domestic legislation

Contrary to the paucity of international regulation, one would be hard-pressed to find any domestic legal system that does not regulate interim measures in the arbitral context. States naturally wish to regulate and safeguard this subject-matter, as the power to order interim measures goes to the core of a state’s sovereign power. It is therefore

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<sup>1</sup> Convention on the Execution of Foreign Arbitral Awards, Geneva, 26 September 1927.

<sup>2</sup> Convention on the Recognition and Enforcement of Foreign Arbitral Awards of June 10, 1958 (the New York Convention), 330 U.N.T.S. 38 (1959).

<sup>3</sup> C. Boog, The Laws Governing Interim Measures in International Arbitration, in F. Ferrari and S. Kröll (eds), *Conflict of Laws in International Arbitration*, (Jurisnet, 2010) 409., 419.

<sup>4</sup> The European Convention on International Commercial Arbitration of 1961 done at Geneva, April 21, 1961, Article VI, para 49.

<sup>5</sup> Convention on the Settlement of Investment Disputes between States and Nationals of Other States; see also Gary Born, *International Commercial Arbitration*, (Wolters Kluwer, 3th ed., 2021) 2608.

not surprising that, in the early stages of development, domestic legislation took interim measures out of the arbitral tribunals' toolbox.<sup>6</sup>

Some authors claim that this restriction was embedded in the idea that interim measures were akin to coercive measures, which traditionally fell within the exclusive jurisdiction of national courts.<sup>7</sup> This viewpoint was, however, unsustainable because there is no reason to differentiate between the power of the arbitral tribunal to grant final relief by way of a binding award and that of provisional relief, both of which would, in any event, be enforced with the aid of domestic courts.<sup>8</sup> In turn, this practice has been relinquished and now there is almost universal acceptance of interim relief in arbitration, which mimics the general trend towards acceptance and recognition of international arbitration as a viable solution of international dispute resolution.

It is also important to note the impact of the UNCITRAL model law.<sup>9</sup> Article 17 of its 1985 version provided that “[u]nless otherwise agreed by the parties, the arbitral tribunal may, at the request of a party, order any party to take such interim measure of protection as the arbitral tribunal may consider necessary in respect of the subject-matter of the dispute”.<sup>10</sup> This was further extended in the 2006 revision, which omitted the phrase “necessary in respect of the subject-matter of the dispute”, thereby curtailing any limitation on arbitral tribunals that was imposed by the previous wording.<sup>11</sup> Furthermore, the wording “unless otherwise agreed”, which appears in both the 1985 and the 2006 revised version, confirms the drafter's approach to require an express agreement only to restrict the arbitral tribunal's power to order interim measures but not for granting them.<sup>12</sup>

Nowadays, most developed jurisdictions – except for a few outliers<sup>13</sup> – have adopted the approach heralded by the UNCITRAL Model Law. As such, the initial legislative hurdle of the non-acceptance of arbitral interim relief seems to be resolved;

<sup>6</sup> Born, *International Commercial Arbitration*, 2610. For specific examples see German ZPO, §1036 (in force prior to 1998 adoption of UNCITRAL Model Law); Austrian ZPO, §593 (in force prior to adoption of the UNCITRAL Model Law) (“[the arbitrators] may not use enforcement measures or set fines against the parties or other persons”); Greek Code of Civil Procedure, Art. 685 (in force prior to 1999).

<sup>7</sup> Born, *International Commercial Arbitration*, 2610.; J. Lew, Commentary on Interim and Conservatory Measures in ICC Arbitration Cases, (2000) 11 (1) *ICC Ct. Bull.*, 23., 24.

<sup>8</sup> Born, *International Commercial Arbitration*, 2611.

<sup>9</sup> United Nations Commission on International Trade Law, UNCITRAL Model Law on International Commercial Arbitration 1985: with amendments as adopted in 2006 (Vienna: United Nations, 2008) [hereinafter: UNCITRAL Model Law], [https://uncitral.un.org/en/texts/arbitration/modellaw/commercial\\_arbitration](https://uncitral.un.org/en/texts/arbitration/modellaw/commercial_arbitration) (Last accessed: 31 December 2020).

<sup>10</sup> UNCITRAL Model Law, Art. 17. See also H. Holtzmann and J. Neuhaus, *A Guide to the UNCITRAL Model Law on International Commercial Arbitration: Legislative History and Commentary*, (Kluwer and TMC Asser, Deventer and The Hague, 1989) 530–533.

<sup>11</sup> Born, *International Commercial Arbitration*, 2612.

<sup>12</sup> UNCITRAL Model Law on International Commercial Arbitration: A Commentary 314, 321 (2020).

<sup>13</sup> See Chinese Arbitration Law, Art. 68; Italian Code of Civil Procedure, Art. 818; Thai Arbitration Act, §16.



however, the effectiveness of such implementation is still questionable. In the next section, I will look at the deficiencies of interim relief in the arbitral context and how emergency arbitration attempts to resolve those issues.

### III. ISSUES WITH ARBITRAL INTERIM RELIEF

Despite the widespread acceptance of interim relief in arbitration, there are glaring limitations of the system in comparison with ordinary court-ordered measures. The first issue is that arbitral tribunals cannot order interim measures of relief with a binding effect on third parties.<sup>14</sup> This is because arbitration is a creature of consent created by a binding agreement between the parties to refer their case to arbitration; however, the scope of an arbitration agreement does not extend to third parties. In turn, it is generally accepted that, for example, arbitral tribunals cannot order attachment of property held by third parties.<sup>15</sup>

The second issue goes to the principle of equality of arms in international arbitration, which is of utmost importance to safeguard due process.<sup>16</sup> This principle, however, limits the power of arbitral tribunals to order interim measures on an *ex parte* basis, i.e. without hearing the party against which the interim measure is requested. One does not need to look further than Continental Europe. There, the right to a fair trial encompassing equality of arms – as enshrined in Article 6 of the European Convention on Human Rights (“ECHR”) – forms part of European public policy at a normative level.<sup>17</sup> Therefore, even if the direct applicability of Article 6 of the ECHR on arbitration is debatable, arbitral tribunals must nevertheless be cognizant of the possibility of an annulment based on a violation of public policy. It is not surprising therefore that some arbitral rules explicitly exclude the possibility of *ex parte* interim measures.<sup>18</sup>

Third, there is a lack of uniformity concerning the standards for granting interim measures in international arbitration. The issue here boils down to the question of which law governs the standards for the tribunals’ decision to accept or reject a request for an interim measure. Contemporary literature proposes three solutions: (1) the *lex arbitri*; (2) the

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<sup>14</sup> M. Savola, Interim Measures and Emergency Arbitrator Proceedings, (2016) 23 *Croat. Arbit. Yearb.*, 74.

<sup>15</sup> J-F. Poudret and S. Besson, *Comparative Law of International Arbitration*, (Thomson Reuters, 2nd ed., 2007) 522–523.

<sup>16</sup> H. van Houtte, Ten Reasons Against a Proposal for Ex Parte Interim Measures of Protection in Arbitration, (2004) 20 (1) *Arbitration International*, 90–91. <https://doi.org/10.1093/arbitration/20.1.85>

<sup>17</sup> K. P. Papanikolaou, Arbitration Under the Fair Trial Safeguards of Art. 6 §1 ECHR (February 5, 2020), in *Essays in Honour of Prof. C. Calavros*, (forthcoming), <https://ssrn.com/abstract=3567706> (Last accessed: 31 December 2020) 7–8.

<sup>18</sup> See 2006 ICSID Rules, Rule 39(4) (“The Tribunal shall only recommend provisional measures, or modify or revoke its recommendations, after giving each party an opportunity of presenting its observations”).

law governing the parties' underlying contract (*lex causae*); or (3) so-called international standards.<sup>19</sup> As there is no consensus on these issues, there is a high level of uncertainty for the parties when gauging the outcome of their request for an interim measure.<sup>20</sup>

The examples of deficiencies of interim measures in the arbitral context show the limitations of the current system. Still, when complemented with the ordinary courts' aid, interim measures are valuable and effective tools for parties to an arbitration. There is one limitation, however, which is absolute: an arbitral tribunal cannot order an interim measure prior to it being constituted. In such an instance, should a party refrain from seeking an interim measure directly from ordinary courts or should the ordinary courts be prohibited from ordering interim measures, there seems to be no further recourse. Emergency arbitration was created to resolve this specific issue.

#### IV. EMERGENCY ARBITRATION

Emergency arbitration is a procedure to obtain urgent interim relief and is available to the parties between filing an arbitration request and the constitution of the tribunal. It was developed to minimise the parties' reliance on ordinary court proceedings.

The first institution to adopt the emergency arbitration mechanism was the International Centre of Dispute Resolution (ICDR) of the American Arbitration Association (AAA). In 2006, it introduced the procedure under Article 37 of the ICDR Rules as default, so parties may only opt out of it. After 2006, emergency arbitration was quickly picked up by almost all institutions.<sup>21</sup> Since its inauguration, the procedure is gaining increasing traction: as of June 2016, the ICDR registered 67 emergency arbitrator requests, SIAC 50, ICC 34, SCC 23, and HKIAC 6 requests.<sup>22</sup> According to the more recent 2019 ICC survey, a total of 95 requests for emergency arbitration have been filed since its 2012 introduction to the ICC rules.<sup>23</sup>

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<sup>19</sup> Born, *International Commercial Arbitration*, 2458–2459., 2463.

<sup>20</sup> Born, *International Commercial Arbitration*, 2464–2465.

<sup>21</sup> R. Alnaber, Emergency Arbitration: Mere Innovation or Vast Improvement, (2019) 35 (4) *Arbitration International*, 445. <https://doi.org/10.1093/arbint/aiz021>

<sup>22</sup> P. Shaughnessy, Emergency Arbitration: Justice on the Run, in P. Wahlgren (ed.), *Arbitration, published under the auspices of the Stockholm University Law Faculty*, (Stockholm Institute for Scandinavian Law, Stockholm, 2017) 324.

<sup>23</sup> ICC, *ICC Task Force on Emergency Arbitrator Proceedings Releases Findings* (ICC, 15 April 2019), <https://www.whitecase.com/publications/alert/icc-task-force-emergency-arbitrator-proceedings-releases-findings> (Last accessed: 31 December 2020).

## 1. Advantages of emergency arbitration

When comparing emergency arbitration to its main competitor, ordinary court-ordered interim relief, there are clear advantages in favour of the former and disadvantages to the latter. First, by turning to ordinary courts for interim measures, one of the main selling points of international arbitration, i.e. to circumvent “hostile” local fora, could be diminished. Second, the party requesting the interim measure could be hindered before national courts by language barriers. Moreover, national judges could lack the necessary legal and technical expertise required for the full comprehension of the dispute, thereby running the risk of misinterpretation at the interim measure stage. And finally, confidentiality could also be an issue before ordinary courts. On the other hand, with emergency arbitration, the parties gain speed, privacy, flexibility, and neutrality. And more often than not, the parties comply with the emergency arbitrator’s decision without the intervention of ordinary courts.<sup>24</sup>

## 2. Disadvantages of emergency arbitration

Just by looking at this list of the drawbacks of ordinary courts, one would believe that emergency arbitration is a fault-free procedural solution that combines all the advantages of international arbitration without any hindrance present in ordinary court proceedings. In reality, despite its relative popularity, emergency arbitration is not flawless. Due to its relative novelty as a procedure, questions of interpretation linger around emergency arbitration.

First, similarly to the issue raised concerning interim measures in the arbitral context in general (see section III above), the standard for granting the requested interim measure via emergency arbitration is not clear. Therefore, both the parties and the emergency arbitrators are faced with a level of uncertainty akin to that of interim measures. Moreover, the restrictions on ordering interim measures against third parties or on an *ex parte* basis in the arbitral context apply to emergency arbitration as well (see section II above). Emergency arbitration offers no solution to those issues.

Secondly, there is a paucity of domestic legislation that covers emergency arbitration; therefore, its status, as to whether it forms an organic part of the underlying arbitration and in turn whether the same rules of domestic legislation covering arbitration apply to it, remains unclear.

Finally, there is the question of enforceability of the measures ordered by the emergency arbitration – a problem that ties into the previous two issues raised. Since there is no conclusive answer in most jurisdictions as to whether emergency arbitration

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<sup>24</sup> Shaughnessy, *Emergency Arbitration: Justice on the Run*, 324.

is a standalone procedure or part of the arbitration, there is significant uncertainty regarding both the nature of the emergency arbitrator and of the procedure itself, which inevitably affects enforcement. Except for some jurisdictions such as Hong Kong and Singapore, where national legislation explicitly allows for the enforcement of orders rendered by emergency arbitrators, most national laws are completely silent on the matter.<sup>25</sup> The uncertainty caused by this *lacuna* in domestic legislation is a major concern for parties: 79% of respondents to the 2015 Queen Mary survey identified the uncertainty of the enforceability of emergency arbitration decisions as an influencing factor when choosing between options for requesting interim measures.<sup>26</sup>

In sum, the uncertainties mentioned above can be categorised as questions on (i) the nature of the decision; (ii) the nature of the emergency arbitrator; and (iii) the finality of the decision.

(i) The nature of the emergency arbitrators' decisions.

As to the nature of the decision, under some arbitration rules, the emergency arbitrator may render its decision in the form of an order or an award.<sup>27</sup> The term "award" generally refers to a decision on a substantive issue that carries finality with it, while an order is procedural in nature.<sup>28</sup> Therefore, arbitral institutions themselves seemingly could not come to a conclusion as to the legal nature of a decision rendered by an emergency arbitrator. Some institutions even side-stepped the issue by simply referring to the arbitrator's "emergency decision on interim measures".<sup>29</sup> The importance of this distinction can be viewed from the perspective of the New York Convention, which sheds further light on it. Article 1 of the New York Convention, in its pertinent part, reads that "[the New York Convention] shall apply to the recognition and enforcement of arbitral awards [...]". Textual interpretation of this passage can easily lead to the conclusion that an order rendered by an emergency arbitrator falls outside the scope of the New York Convention. In turn, a decision in the form of an order would not be enforceable under it.

(ii) The nature of the emergency arbitrator.

As to the nature of the emergency arbitrator, in essence, the question is whether an emergency arbitrator is an "arbitrator" within the same sense as members of the arbitral

<sup>25</sup> Sections 22A and 22B of Part 3A of Hong Kong's Arbitration Ordinance; Section 12(6) of the Singapore International Arbitration Act.

<sup>26</sup> Queen Mary University of London and White & Case, *2015 International Arbitration Survey: Improvements and Innovations in International Arbitration* (2015) [https://arbitration.qmul.ac.uk/media/arbitration/docs/2015\\_International\\_Arbitration\\_Survey.pdf](https://arbitration.qmul.ac.uk/media/arbitration/docs/2015_International_Arbitration_Survey.pdf) (Last accessed: 31 December 2020) 29.

<sup>27</sup> ICDR International Arbitration Rules (2014) art 6.4; CPR Rules for Administered Arbitration of International Disputes (2014) art 14.10; LCIA Arbitration Rules (2014) art 9B.8; SIAC Arbitration Rules (2016) sch 1, art 8; Swiss Rules of International Arbitration (2012) art 43(8), art 26(2).

<sup>28</sup> V. Clark, Decisions, decisions: order or award?, *Arbitration Blog*, 07.11.2019., <http://arbitrationblog.practicallaw.com/decisions-decisions-order-or-award/> (Last accessed: 31 December 2020).

<sup>29</sup> See as an example: SCC Rules for Expedited Arbitrations 2017, Article 8.

tribunal. It can be argued that while the latter decides issues of substance with finality, the former does not decide upon the merits of the case and renders temporary decisions and is therefore fundamentally different. In jurisdictions with a strict interpretation of the term “arbitrator,” challenges can be made to the decision of the emergency arbitrator based on this distinction.<sup>30</sup>

(iii) Finality of the decision.

Finally, the enforceability of a decision rendered by the emergency arbitrator may also be challenged, based on the argument that it lacks finality. This is because such decisions are temporary by their very nature, therefore they lack the finality required for enforcement under some domestic legislation. This situation is also not resolved by institutional rules classifying the decision of the emergency arbitrator as an award, since the normative content of what constitutes an award will ultimately be decided by national legislation and not by the institutional rules. For example, the Swiss Federal Tribunal has held inadmissible a request to set aside an award for interim measure rendered by an arbitral tribunal for lack of finality.<sup>31</sup> This reasoning naturally extends even more to emergency arbitrators’ decisions, since those are not binding on the arbitral tribunal and will quickly be reviewed once the tribunal is constituted. Some argue that enforcement is a non-issue in practice because parties generally comply with the decisions of emergency arbitrators.<sup>32</sup> Even so, in cases where there are reluctant parties whose non-compliance with the interim measure may jeopardise the arbitration, the initiating parties are left with no other choice but to require assistance from ordinary state courts. In those cases, the challenge to the enforceability of the interim measure may prove to be detrimental to a party’s case.

To sum up, emergency arbitration – similarly to interim measures of the arbitral tribunal – has its advantages and disadvantages when compared to interim relief by ordinary courts. The emergency arbitration procedure, when used properly, may indeed prove to be an adequate replacement for ordinary court proceedings. Even so, one must be mindful of the possibility that hostile parties may challenge the decision of the emergency arbitrator and thereby derail the arbitration. The question remains, therefore, how to remedy these deficiencies.

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<sup>30</sup> R. Brown, Challenging the Enforcement of Emergency Arbitrator Decisions, (2020) 8 (3) *Kuwait International Law School Journal*, 67. <https://doi.org/10.54032/2203-008-031-017>

<sup>31</sup> Judgment of 13 April 2010, DFT 136 III 200.

<sup>32</sup> Savola, Interim Measures and Emergency Arbitrator Proceedings, 95.

## V. CONCLUSIONS AND THE WAY FORWARD

Although the overall scenario is quite promising for emergency arbitration, the following solutions could alleviate the deficiencies explained above and could settle any doubts as to the efficacy of the procedure. The first possibility is the amendment of the New York Convention so that it explicitly includes a reference to the recognition and enforcement of interim measures and, especially, to emergency arbitration. Hypothetically this could be the fastest way to resolve the issues surrounding enforcement of interim measures; in practice this seems unlikely, since amending the New York Convention would require all contracting parties to agree without reservations. In this day and age, this is well-nigh impossible, therefore we may rule out this option.

The more likely solution would be that pro-arbitration states amend their national laws to be similar to those of Hong Kong or Singapore, which recognise emergency arbitration decisions as enforceable. To serve as a final solution to the problems highlighted above, any such amendment to domestic legislation should include a definition of “arbitrator” or “arbitral tribunal” that also covers emergency arbitrators, similarly to the wording adopted by New Zealand in its Arbitration Act<sup>33</sup> to quash any challenge linked to the interpretation on the competences of an arbitrator. Moreover, national laws should recognise the enforceability of emergency arbitration, irrespective of whether it was handed down as an order or an award and irrespective of the seat of arbitration. As emergency arbitration is coming of age, we will see more crystallised case law on these issues, which could potentially gear up a wave of domestic legislation in pro-arbitration states.

Be it as it may, the emergency arbitration procedure is most certainly here to stay. One hopes that, with more and more national jurisdictions accepting the procedure as equivalent to court-ordered interim measures, the remaining hurdles to its efficacy will be removed and international arbitration can become even more of a self-contained regime.

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<sup>33</sup> New Zealand Arbitration Act (1999) s 2(1).

Vittay, Melinda\*

# Hungarian Credit Institutions before the European Court of Human Rights: Overcoming the FX Loan Crisis from a Human Rights Law Perspective\*\*

## ABSTRACT

In the 2000s, retail financing products – including loan agreements registered in a foreign currency – became immensely popular in Hungary. Under these loan agreements, the loan was disbursed in Hungarian Forint at the offer foreign exchange rate of the financial institution and had to be repaid in Hungarian Forint at the then current bid foreign exchange rate applied by the financial institution. The growing demand for these financing products created a housing bubble that eventually burst in 2008, leading to a major social crisis. The crisis management of the Hungarian state was intensely discussed from numerous perspectives, yet the human rights aspect of the legal issues remained in the background. This article explains the history of the Hungarian foreign exchange loans by focusing on the fundamental rights of those involved. The article begins by presenting the economic causes leading to the crisis and the loan products in question, then it explores the legal difficulties surrounding the crisis management and the domestic lawsuits. This section is followed by analysing how the European Court of Human Rights dealt with this issue. The article ends with examining the deficiencies detected in the relevant decisions of the Strasbourg court, and how this decision fits in the general approach that is applied by the court when it comes to economic crises.

**KEYWORDS:** human rights in economic crises, foreign currency loan agreements, fundamental rights of legal persons, ECHR, protection of property, direct effect of directives, inadmissibility

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\*\* The opinions expressed in this publication are those of the author. They do not purport to reflect the opinions or views of the Ministry of Foreign Affairs and Trade or its officials.



## I. INTRODUCTION

The era of the Hungarian foreign currency (*FX*) loan crisis has been discussed multiple times and in multiple forms in the Hungarian legal, economics and political science literature. Parallel to the slow recovery and the decrease in litigation, more comprehensive books of studies,<sup>1</sup> personal memoirs<sup>2</sup> and critical analyses of the management of the crisis have been published. The lawsuits precipitated by the crisis passed every instance of the Hungarian regular court system, ultimately reaching the Curia.<sup>3</sup> Moreover, at the international level, both the European Court of Justice and the European Court of Human Rights (the *ECtHR* or the *Court*) had the opportunity to examine various legal aspects of the *FX* loan crisis. This article reviews an aspect of this storm of litigation that is less discussed both in the legal literature and in the press: the fundamental rights of the creditors, including credit institutions.

The wider context of the topic is the management of economic crises, more specifically the human rights safeguards under crisis management. It goes without saying that extraordinary situations require extraordinary legislative measures. The concept of public emergency is well embedded in the human rights law regime and is contained by the European Convention on Human Rights (the *ECHR* or the *Convention*), too. However, the Convention does not include any derogation clause for economic crises or, more generally, situations where the existence of a nation that is not at stake, therefore, the general rules for derogation apply. Consequently, if the legislator introduces measures that potentially violate human rights, the wording of the relevant provisions – and the inherent limitations – apply along with the jurisprudence of the Court. How does the fact of an economic crisis appear in the argumentation of the Court? In what stage of the evaluation does the *ECtHR* consider the demand for the state to ease the social tension caused by recession, and how can this demand justify any restrictive measures adopted as part of a recovery package?

To illustrate the responses of the *ECtHR* to the above questions, this article takes the Hungarian *FX* loan crisis as an example that revolves around the collapse of the residential *FX* mortgage portfolio. First, the article presents the events that contributed to the appearance of loans denominated in foreign currencies on the Hungarian retail market, and the impact of the global financial crisis. The article then explains the legal construction of the affected loan products, the measures by the Hungarian state aiming to mitigate the crisis, and the related domestic litigation initiated by the banks. Following the exhaustion of domestic remedies, the banks turned to the European

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<sup>1</sup> See Bodzási B. (ed.), *Devizabitelezés Magyarországon. A devizabitelezés jogi és közgazdasági elemzése*, (Budapesti Corvinus Egyetem, Budapest, 2019).

<sup>2</sup> Király J., *A tornádó oldalszele*, (Park, Budapest, 2018). The author, Júlia Király, was the vice president of the Hungarian National Bank between 2007 and 2013.

<sup>3</sup> The high court in Hungary.

Court of Human Rights, that declared their complaints inadmissible. The article reviews this inadmissibility decision and argues that the ECtHR based this decision on an incomplete reading of the underlying facts and the law for two main reasons. First, the decision did not take crucial factual elements into consideration, such as the passivity of the state and the competent public institutions to prevent the escalation of the crisis, and second, the decision misinterpreted the effect of EU law on individuals. The article concludes that the ECtHR did not deviate from its general approach to interference with fundamental rights in times of economic crises. Unfortunately, this time, the basis of this legal assessment was at best deficient.

## II. THE ERA OF CONSUMER FX LOANS IN HUNGARY

### 1. Housing schemes after the regime change

The development of residential mortgage products was the result of collision of two chains of events.

The first chain of events was the transformation of the Hungarian market for the construction of residential premises. Following the political, social and economic change in 1989, the market for the construction of houses showed a strong decline. The number of newly built premises dropped by almost 50% between 1989 and 1994 (from 51 thousand per year to approx. 21 thousand apartments per year), and it lagged behind the ideal 40 thousand new apartments per year for more than ten years (until 2004).<sup>4</sup> In addition to the shrinking supply side of the market, the low level of the Hungarian salaries compared to the European average, paired with a high rate of inflation made it very difficult for a person in Hungary to buy their own apartment. The solution to such cases would be retail financing; however, this was underdeveloped due to the characteristics of the previous regime. The strong depreciation of the Hungarian Forint (HUF) and high central bank rates kept the interest rates of the HUF loan products high and so these loans did not become popular.

The second chain of events revolved around the general market liberalisation following the regime change. Hungary submitted its application for EU membership in 1994, and joined the OECD in 1996, which resulted in the gradual abolition of all barriers concerning credit operations denominated in a foreign currency (i.e. currency

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<sup>4</sup> Kovács L., A devizahitelek háttere, (2013) 12 (3) *Hitelintézetési Szemle*, 183–193., [http://epa.oszk.hu/02700/02722/00066/pdf/EPA02722\\_hitelintezeti\\_szemle\\_2013\\_3\\_183-193.pdf](http://epa.oszk.hu/02700/02722/00066/pdf/EPA02722_hitelintezeti_szemle_2013_3_183-193.pdf) (Last accessed: 31 December 2020); Hungarian Central Statistical Office: *Housebuilding and camping house building (1960–)*, [https://www.ksh.hu/docs/hun/xstadat/xstadat\\_hosszu/h\\_zrs001.html](https://www.ksh.hu/docs/hun/xstadat/xstadat_hosszu/h_zrs001.html) (Last accessed: 31 December 2020).

other than HUF). As a long-term consequence of future EU accession, the introduction of the euro became an increasingly clear vision for the country.

These two processes crossed shortly after 2000. In 2001, the Hungarian government announced a housing scheme that encompassed a retail housing loan (denominated in HUF) that was favourable to both the banks and consumers.<sup>5</sup> Under this scheme, the state provided a 3% interest subsidy for mortgage products, and it covered 80–100% of non-performing loans under certain circumstances. This scheme made credit institutions, which previously concentrated on corporate financing, diversify their portfolio and focus more on the retail market.

The scheme shook up the Hungarian construction market and considerably raised creditor demand. While the 90s could have been described as an era of a weak loan market and low competition, the 2000s saw a boom in retail financing products. Demand grew even more sharply after the government raised the interest subsidy from 3% to 10% in 2002, which put more pressure on the banks to expand their retail portfolio. However, retail financing entails higher costs than corporate business, in terms of maintaining the infrastructure (setting up branches, recruiting personnel etc.), therefore the banks needed extra volume to achieve a fair return, which in turn generated fierce competition on the supply side.<sup>6</sup> The volume targets were incorporated in the compensation plans of the banks' executive officers, too.

In 2002, the new government withdrew the housing scheme for budget reasons (although it has to be noted that the scheme could not have been maintained after Hungary's accession to the European Union anyway, as it raised state aid concerns).<sup>7</sup> This measure made HUF loan products even more unpopular: around the time of the millennium, the central bank rate of the HUF was above 10%, which resulted in high interest rates on the financial market. The banks therefore offered a new option for consumers wishing to buy their own apartment: loan products denominated and registered in a foreign currency (most frequently in CHF). Under these loan agreements, the loan was disbursed in HUF at the offer FX rate of the financial institution and had to be repaid in HUF at the then current bid FX rate applied by the financial institution (the *FX Loan Agreements*). This loan product became popular in an instant. By 2010, FX Loan Agreements accounted for two-thirds of the total Hungarian household debt, i.e. HUF 7300 billion (approx. EUR 24,5 billion), equalling 28% of the GDP.

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<sup>5</sup> Government Decree 12/2001. (I. 31.) on state subsidies for residential purposes.

<sup>6</sup> Bethlendi A., Egy rossz termékfejlesztésből rendszerszintű piaci kudarc, (2015) 14 (1) *Hitelintézési Szemle*, (5–29) 7–8.

<sup>7</sup> See Judgment of 19 March 2015, *OTP Bank Nyrt.*, C-672/13, ECLI:EU:C:2015:185.

## 2. The impact of the global financial crisis on the housing bubble

The effects of the global financial crisis reached Hungary a few years after the crisis broke out in the United States. The reason for this delay was that the structured financial instruments – which contributed to the bubble on the American real estate market bursting – rarely appeared in the portfolio of the Hungarian financial institutions. Hungarian banks, even under difficult circumstances, were able to obtain the necessary amount of foreign currency on the interbank market.

The turning point came with the bankruptcy of Lehman Brothers Holdings, Inc., the fourth-largest investment bank of the United States, which filed for bankruptcy protection in 2008 and prompted panic among investors. The general fear induced investors to withdraw their accounts and hoard their cash and, as a result, the credit markets became frozen. In their credit agreements, the banks had trouble providing appropriate collateral, which caused a general liquidity crisis. This crisis had its impacts primarily on the bank system and the interbank credit market. Investors preferred investments that were traditionally considered to be safe (such as the Swiss government bonds), which was conducive to the gradual increase in the foreign exchange rate of the Swiss Franc.

The crisis found Hungary in a particularly sensitive state. The high sovereign debt (with the net external debt reaching approx. 50% of GDP at the end of 2007), the high interest rate of the central bank and the widespread FX Loan Agreements all added up to a high foreign debt. A significant portion of this debt (almost two third of the total net external debt) was attributed to the private sector.<sup>8</sup> Although the level of the foreign exchange reserves of the Hungarian Central Bank met the requirements at that time, it proved to be clearly insufficient when the banks attempted to obtain foreign currency from sources other than the interbank market. The foreign parent companies of the local subsidiaries initiated significant capital injections to facilitate the smooth operation of their Hungarian branches. However, expensive credit on the interbank market and the constant rise of the foreign exchange rates ultimately resulted in drastically increased repayment instalments under the relevant FX Loan Agreements. By July 2010, Hungarian household debt amounted to approx. HUF 10,600 billion (approx. EUR 40 billion) equalling 40% of the GDP. The collapse of household lending raised the threat of a social catastrophe. To escape the catastrophic consequences of this collapse, the debtors looked for legal ways to challenge the FX Loan Agreements. In order to explain the most frequently occurring legal issues in these litigations, the article continues by presenting the legal construction of FX Loan Agreements.

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<sup>8</sup> For a comprehensive summary of the history of the financial crisis in Hungary please see Király, *A tornádó oldalszele*.

### III. THE RESIDENTIAL FX LOAN AS A LEGAL CONSTRUCTION

The innovative nature of residential FX loans may be illustrated by the fact that, when these products became widespread, they did not even have a comprehensive legal definition. There was no act providing for a unified and comprehensive definition of FX loans and FX based loans; only the general APR Decree contained a method for calculating the annual percentage rate of loans associated with foreign currency.<sup>9</sup> When the crisis broke, the measures aiming at mitigating the recession were focused only on certain aspects of the crisis and, accordingly, the different laws and regulations came up with different definitions for FX loan agreements. The overlap between these definitions was not complete. Therefore, it was left for the Curia to face this regulatory hiatus.

#### 1. The general structure of FX loan agreements as established by the Curia

In its civil law uniformity decision 6/2013.<sup>10</sup> (the *6/2013. Uniformity Decision*), the Curia made the following main assumptions: (i) under the foreign-currency loan agreements, the debtors were entitled to use a certain amount of money, and (ii) there was no restriction in the Hungarian Civil Code<sup>11</sup> preventing the parties from freely agreeing upon the currency of the disbursement and the currency of the repayment. On this basis, the Curia held that an FX loan agreement was an agreement where the loan was disbursed in a currency other than HUF. A subcategory of FX loan agreements is the category of FX *based* agreements, under which the amount of the loan is registered in a foreign currency, but the creditor disburses the loan in HUF, and the debtor repays it in HUF, too. For the sake of simplicity, this article will use the term ‘FX loan agreement’ in a sense that it includes both FX loan agreements and FX based loan and financial lease agreements.

The most frequent choice of currency for registering the loan was the Swiss franc, followed by the Euro and the Japanese Yen. By September 2008, 95% of the total amount of FX loan agreements were denominated in CHF. The interest rate presented to consumers mainly depended on the interest rate that the banks faced on the interbank market when they acquired the necessary capital in the given currency (contrary to the common belief, financial institutions were required to provide the corresponding amount of foreign currency for each loan). After 2000, the average interest rate on the interbank market was between 1 and 5%, which allowed the banks

<sup>9</sup> See Art. 11/B and 13 of Government Decree 41/1997. (III. 5.) on the calculation and publishing of the interest rate, the income of securities and the annual percentage rate.

<sup>10</sup> Available at: <https://kuria-birosag.hu/hu/joghat/62013-szamu-pje-hatarozat> (Last accessed: 31 December 2020).

<sup>11</sup> Act IV of 1959 on the Civil Code (the *Old Civil Code*).

to offer favourable interest rates to the consumer, too. In comparison, the interest rate of the HUF on the interbank market was between 8 and 10% (due to the high central bank rate), that necessarily resulted in a higher interest rate offered to the consumer. In addition, the Hungarian branches of several international banks (such as Erste, and Intesa Sanpaolo) were eager to acquire higher market share, and they were able to get cheap FX loans from their parent company. The retail financing gained momentum, and the FX bubble grew bigger and bigger.

In most cases, the loan was actually disbursed in HUF. To calculate the amount of the disbursement, the banks generally applied their then applicable offer FX rate (instead of the exchange rate of the central bank). Then again, the amount of the repayment instalments was calculated on the basis of the then applicable bid FX rate of the credit institution (the *FX Gap Provision*). The constant fluctuation of foreign exchange rates entailed a higher risk, entirely placed on the consumer side.

However, the unstable nature of the exchange rates was not the only uncertain element of the FX loan agreements. In the majority of loan agreements in general (even in those denominated in HUF), the credit institutions set out the right to increase interest, costs and fees unilaterally (the *Unilateral Increase Provisions*). The conditions for such increase were rather vague: the agreements merely contained a list of factors that could have an impact on the level of costs or interest. These factors included the yield-rate of Hungarian government bonds, the creditor's cost of funds and any change in the creditworthiness of the consumer, but also the operational costs of the relevant bank; their office lease fees as well as marketing costs. As illustrated by this list, some of these factors were only indirectly connected to the underlying loan, and some of them were hardly comprehensible in themselves.<sup>12</sup> Moreover, none of these factors was directly linked to the interest rate, therefore, it was not possible to predict that a certain increase of the operational cost of the bank would result in an equal increase in the interest rate of the loan agreement. To address this uncertainty and to achieve a transparent system of cost elements, the banks adopted a Code of Conduct in 2009, however, that code was not mandatory and did not apply to the FX loan agreements concluded earlier.

The 6/2013. Uniformity Decision also stated that the vast majority of the debtors in FX loan agreements were consumers. To comprehend the significance of this conclusion, the article will briefly present the general level of financial consumer protection in Hungary after 2000.

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<sup>12</sup> Berlinger E., A változtatható és a változó kamatok veszélyei, in Bodzási B. (ed.), *Devizabitelezés Magyarországon. A devizabitelezés jogi és közgazdasági elemzése*, (Budapesti Corvinus Egyetem, Budapest, 2019) 38.



## 2. Financial consumer protection and the sectoral regulation of the credit market

As the cliché goes, the financial literacy and culture of Hungarian consumers have generally been at a low level. Nevertheless, neither the legislator, nor other public institutions or financial institutions made any particular effort to protect the growing number of consumers entering into loan agreements. Against this lack of interest in financial consumer protection, it is not surprising that the relevant legal acts did not even apply a uniform definition of ‘consumer’.

At the time when FX loan agreements were heavily promoted and taken up, between 2004 and 2010, the Old Civil Code set out that a consumer is a person who concludes an agreement for a purpose outside the scope of his economic or professional activity. The specific sectoral act, the Old Banking Act<sup>13</sup> applied a narrower definition: a consumer was any natural person acting for a purpose outside the scope of his economic or professional activity. These concise definitions coupled with the conceptual slippage were unable to answer a number of questions that emerged in day-to-day life, such as should a person qualify as a consumer if they are providing security in order to enable their company to enter into a credit agreement?<sup>14</sup> And even if a person qualified as a consumer, judiciary practice set a certain standard of care. According to the recommendation of the president of the Hungarian Financial Supervisory Authority (the *PSZÁF*), the consumer ‘acts in a reasonably informed manner, with due diligence and care that is expected in the particular situation’.<sup>15</sup> Further, the 6/2013. Uniformity Decision stipulated that ‘it is at least expected from a borrower to study the contract thoroughly and, if necessary, to ask for clarifications about the provisions he does not comprehend. Failing to do so shall be interpreted to the detriment of the borrower pursuant to Art. 4(4) of the Hungarian Civil Code’.<sup>16</sup> As apparent, the then applicable Hungarian legal acts did not provide strong prerogatives for consumers. Moreover, no act resolved payment services provided to natural persons before 2009.<sup>17</sup>

This article argues that the legislator and the regulator expected an attitude from the consumer that matched the scope of the loan agreement, in the sense that consumers should have behaved in an extremely cautious manner. When a debtor offers his home as collateral, one would expect the debtor to learn about the agreement with the utmost accuracy. However, this idea behind the regulation did not take into account

<sup>13</sup> Act CXII of 1996 on credit institutions (the *Old Banking Act*).

<sup>14</sup> Court decision EBH 2005, 1321.

<sup>15</sup> 14/2012. (XII. 13.) Recommendation of the President of the PSZÁF, 2.

<sup>16</sup> 6/2013. Uniformity Decision, III.3.

<sup>17</sup> As most consumer protection laws, the acts on payment services provided to natural persons were adopted under the pressure of the European Union to harmonise legislation. For more details see Németh Cs., *A pénzügyi fogyasztóvédelmi jog fejlődése Magyarországon 2008–2014 között (I. rész)*, (2015) (1) *Gazdaság és Jog*, (3–11.) 4.



the financial literacy of an average consumer, not to mention the fact that the FX loan agreement was a new and innovative product on the market.

To summarise the above, the agile business strategy of the banks to raise their market share, the shifted focus on retail financing and the oversupply of loan products hit both consumers and consumer protection regulation hard and found them unprepared. To illustrate the situation with a colloquial analogy, it was as if consumers were getting into a car for a long journey but did not check the brakes and did not care about the lack of airbags either.

## IV. CRISIS MANAGEMENT AND DOMESTIC LITIGATION

### 1. Measures by the National Assembly and the government to mitigate the crisis

Given that the crisis affected horizontal relations (in the sense that the state was not part of the underlying FX loan agreements), the National Assembly referred to the basic principles of contract law, most notably to the respect for the contractual autonomy of the parties, and refrained from interfering with the existing relations. Therefore, the debtors started to challenge the FX loan agreements before the court. The civil lawsuits – mainly due to Hungarian procedural characteristics – showed little progress over time, and the number of cases was increasing. By 2010, it became clear that the growing number of non-performing loans might have long-term consequences, such as the negative influence on Hungary's sovereign Credit Default Swaps (CDS).<sup>18</sup>

In response to growing public indignation, the Hungarian legislator adopted several amendments to the Hungarian financial laws, most importantly to the Old Banking Act.<sup>19</sup> In 2010, the legislator introduced additional conditions for raising interest rates, fees and costs.<sup>20</sup> Credit institutions had to put their pricing principles in writing, based on which they could make any unilateral increase. The PSZÁF, the financial watchdog of Hungary, continuously assessed the validity of, and monitored compliance with, such pricing principles, but rarely found any failure. In addition, the so-called Early Repayment Act<sup>21</sup> provided for the early repayment of FX loans secured by mortgages on residential real estate, resulting in a 23.3% decrease in such loans.

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<sup>18</sup> The sovereign CDS indicates how much risk it entails for a bank to invest in a certain country. For a comprehensive summary see Király, *A tornádó oldalszele*, 309–312.

<sup>19</sup> Notably, the amendment applicable as of 27 November 2010 required the credit institutions to apply either a median FX rate set by the credit institution or the official FX rate of the Hungarian Central Bank.

<sup>20</sup> Government Decree 275/2010. (XII. 15.) on the conditions of the unilateral amendments to the interest rate set out in contracts.

<sup>21</sup> Act CXXI of 2011.

Nevertheless, as the HUF/FX exchange rates continued to increase, the remaining debtors still faced grave difficulties. As the economic crisis deepened, a tidal wave of borrowers challenged the validity of the FX Loan Agreements on several grounds.

## 2. Civil lawsuits in Hungary

The invalidity of FX loan agreements was claimed on two levels: (i) the debtors put forward that the structure of the FX loan agreements as such was in violation of Hungarian law, but even so, (ii) the debtors were insufficiently informed before concluding the individual contracts.

Concerning the specific structure of FX loan agreements, a great number of applicants claimed that they were in fact HUF-based agreements, since there was no foreign currency transaction behind the agreements.<sup>22</sup> The loan was disbursed in HUF, and similarly, the loan had to be repaid in HUF, too. Further, the applicants pointed out that all the risk associated with the depreciation of the foreign exchange rate was put solely on the debtor. This mechanism in itself raised concerns as to the validity of FX loan agreements. The legal reasoning behind this claim varied: the applicants claimed that the FX loan agreements were contrary to the principle of good faith; they were usurious; they were based on grave misrepresentations and were impossible to fulfil. In addition to the general risk posed by the FX rate, the FX Gap Provision was also challenged in many lawsuits. Finally, during the lawsuits, many references had been made to the allegation that the FX loan agreements did not come into existence as the parties had not been in agreement upon essential conditions. The biggest concern was that the actual amount to be repaid could not be specified in the FX loan agreements, as it was subject to constant change (following the fluctuation of FX rates).

Beyond the specific structure of the FX Loan Agreements, the debtors challenged the Unilateral Increase Provisions, too. According to the applicants, these provisions were not sufficiently clear and precise, since the contracts clearly circumscribed the specific mechanism through which any cost, fee or interest to be borne by the consumer was calculated.

The judgments delivered by the first and second instance courts were contradictory to each other in all of the above-mentioned features of the FX Loan Agreements,

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<sup>22</sup> Vezekényi U., A fogyasztói deviza alapú hitelezéssel összefüggő perekben felmerült jogkérdésekről és az ezekből levonható tanulságokról, in Bodzási B. (ed.), *Devizahitelezés Magyarországon. A devizahitelezés jogi és közgazdasági elemzése*, (Budapesti Corvinus Egyetem, Budapest, 2019) 378–379.

and the number of lawsuits was steadily rising: from 600 proceedings initiated in November–December 2013 to 36,000 by the end of 2016.<sup>23</sup>

#### **a) Proceedings before the Curia: establishing the Fairness Test**

Although not every lawsuit reached the Curia, the political pressure on the judicial body was increasing. To facilitate the work of the lower instance courts, the Curia first issued a number of general guidance.

The first of these was the 2/2012. (XII. 10.) PK Opinion (the 2/2012. *Opinion*)<sup>24</sup> about the Unilateral Increase Provisions. The Curia introduced a test consisting of seven principles that the Unilateral Increase Provisions had to meet. This test comprised: (i) the principle of unambiguous and intelligible language, (ii) the principle of itemised determination, (iii) the principle of objectivity, (iv) the principle of actuality and proportionality, (v) the principle of transparency, (vi) the principle of the freedom to terminate and (vii) the principle of symmetry (together the *Fairness Test* or the *Seven Principles*). When elaborating on the Seven Principles, the Curia primarily referred to the requirement of ‘plain intelligible language’ as contained in section 209(5) of the Old Civil Code. This provision was included in the Old Civil Code by way of implementing the Unfair Terms Directive of the European Union,<sup>25</sup> and it was applicable from 22 May 2009. In addition, the Curia referred to the provisions of the Old Banking Act, applicable from 1 January 2010. Of course, all these provisions came into force years after the first FX loan agreements were concluded.

However, this general guidance was not sufficient to give unambiguous responses to the many other questions surrounding the FX loan agreements. As reiterated above, the lower instance courts judged crucial aspects of these contracts in different ways. For example, placing the entire risk for the depreciation of the foreign exchange rates on the consumer was considered by one tribunal as rendering the agreement null and void, while another affirmed its validity. In order to prevent the Curia from assessing the question case by case, the head of the Civil College of the Curia requested the lower instance tribunals to submit information on the number of the lawsuits concerning the FX loan agreements, as well as the main recurring legal questions.

The information received was processed within three weeks, and the Curia put its conclusions in the 6/2013. Uniformity Decision. This Uniformity Decision underlined,

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<sup>23</sup> From November 2013, the court marked these lawsuits by writing ‘DH’ on the file, hence the exact statistical data. The statistical data of the National Office for the Judiciary is available at <https://birosag.hu/nyomtatvanyok/deviza-es-forinhiteles-peres-eljarasok/devizahiteles-peres-ugyek-2013-november-1> (Last accessed: 31 December 2020).

<sup>24</sup> 2/2012. (XII. 10.) PK Opinion on the unfairness of the standard terms of contract allowing for unilateral modification of a consumer-loan contract employed by a financial institution.

<sup>25</sup> Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts, OJ L 95, 21.4.1993, p. 29–34. (the *Unfair Terms Directive*).

as a matter of principle, that the FX Loan Agreements do not violate national legislation, are not contrary to the principle of good faith, are not usurious, are not based on grave misrepresentation, nor are impossible to perform solely for the reason that it is the debtor that bears the risk of the fluctuation of the FX rate in exchange for a favourable interest rate.<sup>26</sup> The drastic depreciation of the HUF against other currencies following the conclusions of the FX Loan Agreements could not be assessed within the scope of validity, because any reason for invalidity must be present at the very moment of the conclusion of the underlying contract. Therefore, the concept of the FX loan agreements was affirmed by the court: the *possibility* of an event occurring that would result in a great disproportionality to the detriment of the consumer, and thus violating the principle of good faith, was not considered as a provision already contrary to good faith.

The debtors were greatly disappointed by the 6/2013. Uniformity Decision but they did not lose hope. There was an ongoing preliminary procedure before the European Court of Justice (the *ECJ*), in which the ECJ had to answer, *inter alia*, whether the FX Loan Agreements met the requirement of being written in a 'plain intelligible language', as interpreted according to the Unfair Terms Directive.<sup>27</sup>

**b) The responses given by the *Kásler* case to the questions concerning the FX Gap Provisions and whether the provisions were written in plain intelligible language**

Árpád Kásler and his wife Hajnalka Káslerné Rábai concluded their FX Loan Agreements just months before the economic crisis broke out, on 29 May 2008. Due to the rapid depreciation of the HUF, their repayment instalments increased steadily. Like many of the debtors at that time, the couple turned to the court and initiated proceedings against OTP Bank, the largest retail bank in Hungary. The applicants argued that their FX loan agreement did not meet the criteria of Art. 4(2) of the Unfair Terms Directive. Pursuant to that provision, the potential unfair nature of a term cannot be assessed if that term relates either to the definition of the main subject matter of the contract or to the adequacy of the price and remuneration, on the one hand, as against the services or goods supplied in exchange, on the other, *insofar* as these terms are written in plain intelligible language.

The applicants specifically referred to the FX gap provision. It was argued that the different exchange rates confer an unjustified benefit on the bank. To assess this claim on the merits, the applicants had to substantiate two alternative lines of argumentation: (i) either the FX gap provision was a regular contractual provision, in the sense that it did not relate to the main subject matter of the contract; or (ii) the

<sup>26</sup> 6/2013. Uniformity Decision, point II.

<sup>27</sup> Judgment of 20 April 2014, *Kásler Árpád and Káslerné Rábai Hajnalka v OTP Jelzálogbank Zrt.*, C-26/13, ECLI:EU:C:2014:282 (the *Kásler*-judgment).

FX gap provision did relate to the main subject matter of the contract; however, it was not in plain intelligible language.

The case of the Káslers ultimately reached the Curia, that in turn initiated a preliminary procedure about the FX gap provision. In its judgment, the ECJ held that it was for the national court to determine whether the FX Gap Provision constituted part of the subject matter of the FX loan agreements. In any case, this provision could not be regarded as a remuneration that was exempt from an assessment of its fairness, provided that the provision was drafted in a clear and intelligible manner.<sup>28</sup> This requirement should go beyond grammatically correct and plain language. The ECJ requested an assessment of whether the consumer, when reviewing the information material before signing the FX Loan Agreement, was able to recognise the difference that is generally present between the offer and the bid rate of a foreign currency, and was able to assess the impact of the change of the FX rate on the instalments and on the entire amount of the loan.<sup>29</sup> Finally, even if such a contractual term was invalid, the national court may remedy the situation by replacing the invalid term with an applicable, dispositive provision of the national law.<sup>30</sup>

By its very nature, the judgment of the ECJ could not decide the outcome of the underlying case. However, the Curia relied heavily on the sections of the judgment that explained the requirement of ‘clear and intelligible language’. On this basis, the Curia delivered its judgment 2/2014. Civil Law Uniformity Decision (the 2/2014. *Uniformity Decision*) on 16 June 2014. This decision was a major turning point in the legal assessment of FX loan agreements.

### *c) Final decision on the FX Gap Provision and the Unilateral Increase Provisions*

The 2/2014. Uniformity Decision held that the contractual term that conferred the entire risk of a change in the FX rate on the consumer – in exchange for a favourable interest rate – indeed constituted the subject matter of the FX loan agreements. That said, the invalidity of these terms cannot be assessed unless they are not drafted in a clear and intelligible manner. However, the 2/2014. Uniformity Decision claimed that the FX rate gap itself was unfair because there was no actual underlying service behind the application of a different FX rate when providing the loan and when receiving the instalments, respectively. Instead of applying different FX rates, the Curia held that the instalments must be calculated on the basis of the applicable rate of the Hungarian Central Bank.

Concerning the Unilateral Increase Provisions, the 2/2014. Uniformity Decision confirmed the Fairness Test as set out in the 2/2012. Opinion and held that these were

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<sup>28</sup> *Kásler*-judgment, para. 59.

<sup>29</sup> *Kásler*-judgment, paras 74–75.

<sup>30</sup> *Kásler*-judgment, para. 85.

unfair unless they would completely satisfy the seven principles of the Fairness Test. The 2/2014. Uniformity Decision did not expect consumers to inquire about any provision they find unclear. The Curia held that it fell within the responsibility of the credit institution to present the surrounding circumstances of the FX Loan Agreement so that the consumer was able to evaluate the obligations they were about to undertake.<sup>31</sup> According to the Curia, meeting the Fairness Test was a necessary requirement for such a presentation.

Pursuant to the Fundamental Law, uniformity decisions have a binding legal effect on lower courts.<sup>32</sup> Consequently, the credit institutions expected that this reasoning would appear in the upcoming judgments. However, there was little time left for the legal representatives of the banks to change their litigation strategy. The legislator, based on the findings of the Curia, re-regulated the FX loan agreements.

### 3. From judicial decision to the legislation – the FX Loan Act

Weeks after the delivery of 2/2014. Uniformity Decision, on 4 July 2014, the Parliament adopted Act XXXVIII of 2014 on the resolution of questions relating to the Uniformity Decision concerning the settlement of certain issues relating to loan agreements between consumers and financial institutions (the *FX Loan Act*).

In essence, the FX Loan Act repeated the main conclusions of the 2/2014. Uniformity Decision. The FX Loan Act provided that the FX Gap Provision is considered to be null and void, thus preventing what would have been a massive wave of litigation. Instead of the application of different FX rates, the FX Loan Act rendered the rate of the Hungarian Central Bank as the mandatory FX rate to be applicable during the performance of the FX loan agreements.

Concerning the Unilateral Increase Provisions, the legislator took the Fairness Test and reformulated it as a rebuttable presumption. The FX Loan Act set out that the Unilateral Increase Provisions, as applied from 1 May 2004 – on which date Hungary joined the EU – in the FX loan agreements, are null and void because they do not meet the Fairness Test.<sup>33</sup> To rebut this presumption, the credit institutions could have initiated proceedings in which they could only claim that their standard FX Loan Agreements complied with all of the principles of the Fairness Test.<sup>34</sup> This meant that, in practice, that the credit institutions could not challenge the legitimacy of these principles. The credit institutions had 30 days from the date of effect of the FX Loan Act to lodge this claim before the domestic court. The rules of this court procedure

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<sup>31</sup> 2/2014. Uniformity Decision, III. 2.

<sup>32</sup> Fundamental Law, Art. 25(3).

<sup>33</sup> FX Loan Act, Section 4.

<sup>34</sup> FX Loan Act, Section 8(4).



significantly deviated from that of the ordinary civil proceedings. The rebuttal of the unfairness presumption was considered in an expedited procedure. After the court received an application, it must set the date of a public hearing within 8 days from the receipt.<sup>35</sup> No intervention, counterclaims, modifications of the statement of claims or requests for missing information were allowed.<sup>36</sup> In sum, the credit institutions entered into a procedure with tight rules that gave the judge any hardly possibility to delve into the individual agreements. At the same time, all the other ongoing suits – 13,268 civil proceedings – relating to the validity of the FX Loan Agreements were suspended by virtue of the FX Loan Act.

#### 4. The litigation attempting to rebut the unfairness presumption

Altogether 73 credit institutions challenged the unfairness presumption as provided by the FX Loan Act. The general terms and conditions (the *GTCs*) submitted by each credit institution, were more than ten thousand pages long and, in addition to these, robust legal arguments concerning the legality of the FX Loan Act were presented in each application.

Part of these arguments addressed Hungary's failure to fully transpose the Unfair Terms Directive. Hungary should have implemented this directive by 1 May 2004; however, the transposition remained incomplete: the requirement of the 'plain intelligible language' as provided by Art. 4(2) of the Unfair Terms Directive<sup>37</sup> was not incorporated in the Hungarian law. Due to this failure, an infringement procedure was initiated by the European Commission. As a result, Hungary transposed this requirement by amending the Civil Code in 2009, and the infringement procedure was closed the same year. Nevertheless, this amendment of the Civil Code, incorporating Art. 4(2) of the Unfair Terms Directive, did not have retroactive effect. Therefore, the credit institutions argued that the FX Loan Agreements concluded between 2004 and 2009 were in full compliance with the law.

The other main line of argumentation was that the FX Loan Act violated the provisions of the Fundamental Law of Hungary on prescribing the protection of property and the requirement of a fair trial. Moreover, the FX Loan Act allegedly violated the equivalent provisions of the European Convention of Human Rights. The rationale behind invoking the ECHR was that the ECtHR, when assessing the

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<sup>35</sup> FX Loan Act, Section 10(2).

<sup>36</sup> FX Loan Act, Section 7(7)a–d), h).

<sup>37</sup> Art. 4(2) of the Unfair Terms Directive: 'Assessment of the unfair nature of the terms shall relate neither to the definition of the main subject matter of the contract nor to the adequacy of the price and remuneration, on the one hand, as against the services or goods supplies in exchange, on the other, *in so far as these terms are in plain intelligible language.*' (Highlighted by the author.)



fulfilment of the admissibility criteria, pays special attention to whether the applicant referred to a violation of the ECHR when exhausting the domestic legal remedies, and the national courts could assess such allegations. In the majority of Hungarian cases, the courts did not share the view of the credit institutions on the potential violation of the ECHR.

## 5. The resolution of the Constitutional Court

During the litigation challenging the FX Loan Act, numerous applicants submitted a motion in which they requested the court to turn to the Constitutional Court and initiate a procedure to assess whether the FX Loan Act complies with the Fundamental Law. As a result, the Constitutional Court delivered several resolutions in which it assessed certain provisions of the FX Loan Act.<sup>38</sup> In addition, three concerned credit institutions, as well as one debtor (a natural person) submitted individual complaints pursuant to Section 26(2) of the Constitutional Court Act.<sup>39</sup>

The credit institutions referred to the violation of Article B(1) of the Fundamental Law. According to their motion, the FX Loan Act ignored the statutory limitation period and allowed for the enforcement of obligations stemming from long-term contracts that had expired and, hence, were unenforceable. This is contrary to the respect of acquired rights that are, as per the motions, ‘intangible assets that were acquired in exchange for material investment, while trusting in the applicable legal environment’.<sup>40</sup>

The credit institutions also claimed that declaring the FX loan gap provisions *ipso iure* null and void violated the general restriction on retroactive legislation, and not even the ECJ set out any such requirement. Moreover, there is an actual FX operation underlying FX-based loans, which inevitably results in a difference between the FX rates, and this cost must be borne by one party or the other.

The credit institutions also maintained that the settlement mechanism behind the FX loan agreements was well known at the time of the conclusion of the agreements in question and therefore each party was aware of the inherent risks in this mechanism.<sup>41</sup> Further down the line of this argumentation, their motion referred to the violation of their property rights. As claimed by the credit institutions, the income stemming from

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<sup>38</sup> See Resolution 34/2014. (XI. 14.), Resolution 2/2015. (II. 2.), Resolution 7/2015. (III. 19.), Resolution 3121/2015. (VII. 9.).

<sup>39</sup> Act CLI of 2011 on the Constitutional Court.

<sup>40</sup> Cited by Resolution 7/2015. (III. 19.), para. 6.

<sup>41</sup> This is further supported by Gárdos I., Gondolatok a devizahiteles törvények kapcsán, (2015) (3) *MTA Law Working Papers*, <https://jog.tk.hu/mtalwp/jog-jogertelmezes-gondolatok-a-devizahiteles-torvenyek-kapcsan> (Last accessed: 31 December 2020).

the FX Gap Provisions constituted a material asset that was withdrawn by the FX Loan Act without any kind of compensation and redistributed to the debtors.

The complainants in their motion also challenged the FX Gap Provisions, more precisely the mandatory application of the Central Bank FX rates. According to the motion, should the FX Gap Provisions be null and void, the debt must be registered as a loan denominated in HUF, and the settlement should be adjusted accordingly.

The Constitutional Court held that all the above motions were unfounded. Concerning the unfairness of the FX Gap Provisions, the Constitutional Court referred to the 6/2013. Uniformity Decision, stating that the performance of the FX loan agreements did not require any conversion. Instead, there was a recalculation of the debt. This recalculation resulted in an additional payment obligation that lacked any underlying service; therefore, the FX Gap Provision qualified as *ipso jure* unfair. In this respect, the Constitutional Court deemed the arguments relating to the retroactive legislation irrelevant because such a referral cannot result in a situation in which numerous unfair – thus, void – provisions remain untouchable and the debtor continues to have a payment obligation.<sup>42</sup>

In relation to the arguments on the general restriction on retroactive legislation, the Constitutional Court again referred to the 6/2013. Uniformity Decision that deemed the Unilateral Increase Provisions to be unfair. The Constitutional Court took the view that the FX Loan Act merely elevated the interpretation of the Curia on the impugned provisions to the level of a statute.<sup>43</sup> Since the legal interpretative activity of the law enforcement bodies and the legislation are not directly related to the prohibition on retroactive legislation, the Constitutional Court rejected the related arguments without delivering any decision on the merits.<sup>44</sup>

As regards the potential violation of the right to property, the Constitutional Court highlighted that the payment obligation of the credit institutions was a direct consequence of the null and void nature of the impugned provisions. The unfair provisions – that were not analysed by the Constitutional Court on the merits – did not create any legitimate expectations, therefore they could not be subject to the protection of property rights.<sup>45</sup>

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<sup>42</sup> Resolution 7/2015. (III. 19.), para. 36.

<sup>43</sup> Resolution 7/2015. (III. 19.), paras 38–41.

<sup>44</sup> Resolution 7/2015. (III. 19.), para. 43.

<sup>45</sup> Resolution 7/2015. (III. 19.), para. 48.

## V. THE CREDIT INSTITUTIONS IN STRASBOURG: THE DECISION DELIVERED IN THE CASE OF *MERKANTIL ZRT.* *AND OTHERS*

The lawsuits initiated by the credit institutions before the Hungarian courts were dismissed without exception. Some of the former plaintiffs – including the members of the biggest Hungarian retail bank, the OTP Group – lodged an application to the ECtHR in the spring of 2015. This step appeared to be reasonable, yet unusual. The Hungarian applicants before the ECtHR are mostly natural persons for a number of reasons.

First, the Hungarian courts deliver significantly fewer decisions concerning the fundamental rights of legal entities. Since the Fundamental Law took effect in 2012, the Constitutional Court had delivered altogether 22 decisions regarding the fundamental rights of a legal person until 31 May 2020. As the exhaustion of domestic legal remedies is one of the main admissibility criteria of the ECHR, the small number of decisions inevitably resulted in fewer applications to the ECtHR. In 2015, nearly half of the cases before the Court concerned the excessive length of court proceedings,<sup>46</sup> while the Hungarian press mostly dealt with cases about the poor detention conditions in Hungarian prisons. Therefore, there was limited awareness among companies of this potential way of litigation. Moreover, in the case of major companies, any lawsuit to be initiated against the state is subject to careful consideration. To give some flavour to this conversation, the memory of the sectorial taxes imposed on the banks in Hungary was still vivid, and numerous other examples of the Hungarian government adopting legislation in fast-track proceedings, without any prior civil consultation, were widely known. Finally, the business planning of the banks also experienced some challenges. The reason for the confusion was that, in the event of a judgment finding a violation, the ECtHR may grant the applicant just satisfaction (instead of an indemnity). The Court had not yet published any clear formula or tool to calculate the amount of such satisfaction. The first comprehensive study on the issue was published in 2015.<sup>47</sup> As such, there was no guarantee that the credit institutions would receive a fair value of their lost property even with a favourable judgment.

Against this background, the application of the banks meant an exciting development for domestic legal human rights practice; besides, it was of great economic

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<sup>46</sup> [https://www.echr.coe.int/Documents/Facts\\_Figures\\_2015\\_ENG.pdf](https://www.echr.coe.int/Documents/Facts_Figures_2015_ENG.pdf) (Last accessed: 31 December 2020) 11.

<sup>47</sup> S. Altwicker-Hamori, T. Altwicker and A. Peters, Measuring Violations of Human Rights: An Empirical Analysis of Awards in Respect of Non-Pecuniary Damage Under the European Convention on Human Rights, (2016) 76 *Zeitschrift für ausländisches öffentliches Recht und Völkerrecht (ZaöRV)/Heidelberg Journal of International Law (HJIL)*, 1–51. <https://doi.org/10.2139/ssrn.2631404>

significance. In their application, the credit institutions referred to damage amounting to more than one hundred million EUR that was claimed to be the result of the FX Loan Act. Even though there was no assurance that the applicants would be compensated with the same amount, even a fraction of this sum could have meant a heavy burden on the state budget of Hungary.

### **1. The main elements of the complaints of the credit institutions**

The credit institutions mainly referred to the breach of two articles of the ECHR, Article 6 on the right to fair trial, and Article 1 of Protocol 1 on the entitlement to the peaceful enjoyment of property. Since neither of the invoked rights is absolute, the applications focused on the alleged lack of legal basis and the disproportionate nature of the interference, namely the FX Loan Act and the Settlement Act.

Concerning the lawsuits initiated by the banks to rebut the unfairness presumption, and hence the alleged violation of Art. 6, the applications claimed that the Hungarian courts were restricted in terms of their power of decision. The courts could only assess whether the GTCs of the banks passed the Fairness Test, and they were not allowed to take into account other circumstances surrounding the conclusion of the FX loan agreements. As a consequence, the FX Loan Act considerably restricted the banks' right to submit evidence and their right to have a reasonable opportunity to present their case, which in turn violated the principle of equality of arms.<sup>48</sup> Moreover, the applications referred to the extreme deadlines that significantly undermined the chance to carry out a thorough collection and presentation of evidence.

Concerning the alleged violation of the right to property, the applicants claimed that the amounts collected from the consumers, as well as the future contractual claims under the Unilateral Increase Provisions were deemed to be a 'possession' for the purposes of Art. 1 of Protocol no. 1. This allegation itself raised numerous concerns, as it could not be assessed independently from the assessment of the lawfulness of the interference of this possession. The reason for that is this allegation required the applicants to prove that, despite the presumption introduced by the FX Loan Act, the GTCs were lawful and valid provisions. Should the GTCs have failed the Fairness Test, no possession could have been established, as invalid provisions may not give rise to contractual claims, and hence future possession. Since the ECtHR does not have the competence to assess the validity of contractual claims, the credit institutions focused on the argument that the FX Loan Act as a legal instrument is an unlawful interference, and that, before the enactment of this legislation, they had a valid contractual claim. Consequently, both the claim for having a possession and the

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<sup>48</sup> *Merkantil Zrt. v Hungary*, ECtHR 20 December 2018, 22853/15, para. 64. (the *Merkantil Decision*).

claim addressing the violation of the right to property depended on the lawfulness of the FX Loan Act.

Having that in mind, the credit institutions pointed out that, before 1 January 2010, the applicable Hungarian legislation did not include any provision that rendered the unilateral raise of interest rates unfair or set out conditions for raising them. On the contrary, some measures of the government, and the first judgments of the Hungarian courts delivered in FX loan cases, appeared to be tacit confirmation of the validity of the Unilateral Increase Provisions. The Old Banking Act and the relevant government decrees set out conditions that were fulfilled by the banks, and up until the 2/2012. Opinion (that introduced the Seven Principles) being issued, no legal instrument was in effect that made the interest rate-raising practice of the banks dubious. Moreover, the 2/2012. Opinion precluded the unfairness of those contractual terms that complied with the Government Decree.<sup>49</sup>

In addition to the above, the banks claimed that the state violated the restriction on retroactive legislation, because the FX Loan Act was applicable to GTCs in force from 1 May 2004 while, under Hungarian law, the general statute of limitation is five years. Therefore, the scope of the FX Loan Act (adopted in 2014) extended for more than ten years, reopening claims concerning instalments that were already paid by the debtors.<sup>50</sup> Finally, the banks reiterated that the FX Loan Act violated their procedural rights and thus infringed Art. 6 of the ECHR.<sup>51</sup>

To present the big picture behind the legislation, the credit institutions also submitted that the actual reason behind the financial crisis in Hungary at that time was that, since 2008, the HUF had drastically depreciated against other currencies (in particular against the CHF and the EUR) and this could not have been foreseen. Moreover, before the financial crisis, the debtors of the FX loan agreements were in a more favourable position than those of HUF-based loan agreements, and some measures adopted during the crisis also provided significant assistance to the consumers (such as the early repayment scheme). In sum, the existence of Unilateral Increase Provisions was not the root cause of the crisis. Nevertheless, it was the applicants that were obliged to pay back more than a hundred billion forint to consumers.<sup>52</sup>

## 2. The *Bárdi and Vidovics* case as a precedent

Shortly before receiving the applications of the credit institutions, the ECtHR had already faced the problem of the Hungarian FX Loan Agreements – and the special features of

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<sup>49</sup> Merkantil Decision, para. 87.

<sup>50</sup> Merkantil Decision, para. 88.

<sup>51</sup> Merkantil Decision, para. 89.

<sup>52</sup> Merkantil Decision, para. 90.

the FX Loan Act – from the debtors’ perspective. The applicants in the *Bárdi and Vidovics* case<sup>53</sup> were two natural persons who concluded their FX Loan Agreements in 2006. When the crisis broke out, the applicants turned to the Hungarian courts and requested them to establish the invalidity of their FX Loan Agreements. While the litigation before the domestic court was in progress, the National Assembly adopted the FX Loan Act, the provisions of which were applicable to the litigation by the applicants, too.

The applicants found that this procedure violated their right to a fair trial as protected by Art. 6 of the ECHR, because it was the National Assembly that enacted legislation determining how their disputes were to be resolved. It, by definition, lacks several guarantees of a civil procedure, i.e. it is not independent of the legislative and executive authorities, several procedural safeguards are not guaranteed in its proceedings, and legislative actions are not amenable to appeal. Therefore, the National Assembly could not qualify as a tribunal, so it was in no position to decide on the dispute.<sup>54</sup>

In its decision, the ECtHR confirmed that the FX Loan Act was able to influence the outcome of the disputes before the Hungarian courts. However, the Court pointed out that the state was not party to these disputes. The sole purpose behind the FX Loan Act was to ensure that all claims relating to the same subject matter could be resolved in a prompt and comprehensive manner, avoiding any inconsistency in case-law and also overburdening the judicial system.<sup>55</sup> Moreover, the FX Loan Act did not apply to one specific legal procedure; instead, its scope was of a general nature, including all relevant FX loan agreements (whether challenged before a court or not). The Court found that the FX Loan Act merely implemented the Uniformity Decision of the Curia that gave guidance on resolving the issues of the FX loan agreements. For this reason, the applicants could have foreseen a reaction by the National Assembly. There was no reason for the ECtHR to assume that such guidance would not have had to be followed by the domestic courts in any case, even without the enactment of the FX Loan Act. Consequently, the decision concluded that the interference with the right to fair trial was of a much less drastic nature and held the applications manifestly ill-founded.<sup>56</sup>

This decision contained numerous bad signals for the credit institutions. First, the strict procedural rules set out by the FX Loan Act seemed to be in conformity with Art. 6 of the ECHR. Second, it appeared that, when it came to the assessment of the interference (and the potential arbitrary nature of the FX Loan Act), the Court would attach great significance to the fact that the state did not seem to benefit from the FX Loan Act; it was not a party to the FX loan litigation.

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<sup>53</sup> *Bárdi and Vidovics v Hungary*, ECtHR 19 December 2017, 27514/15 and 13876/16 (the *Bárdi-Vidovics* Decision).

<sup>54</sup> *Bárdi-Vidovics* Decision, para. 23.

<sup>55</sup> *Bárdi-Vidovics* Decision, paras 28 and 31.

<sup>56</sup> *Bárdi-Vidovics* Decision, paras 31–32.



### 3. The main elements of the decision in the *Merkantil* case

Although the ECtHR had already assessed the details of the FX Loan Act in the *Bárdi and Vidovics* case, it did not decide on the applications of the banks until one year later. The Court did not unify the proceedings initiated by the different banks, so the decisions were published on separate dates at the end of 2018 and in the beginning of 2019. The first decision was delivered in the case of *Merkantil Zrt and others v Hungary* on 20 December 2018 (the *Merkantil* Decision).

The panel consisted of seven judges who held, unanimously, that the complaint was inadmissible. Even so, the panel analysed in great length the articles in question, namely the right to fair trial (Art. 6) and the right to the peaceful enjoyment of property (Art. 1 of Protocol No. 1), concluding as follows.

Concerning the principle of equality of arms, the ECtHR highlighted that the tight time limits and the strict procedural rules were applicable to all parties to the litigation, and did not result in any imbalance.<sup>57</sup> Having said that, the Court concluded that these arguments related to access to court (instead of the equality of arms) and continued its assessment in this context.

As regards this specific remedy, the FX loan litigation, the ECtHR held that these procedures were of a *sui generis* nature, designed to address a pressing social problem. As numerous FX loan proceedings were suspended at that time, and many others were anticipated, the Court became convinced that the FX Loan Act aimed at preventing a backlog of cases and pursued the legitimate aims of consumer protection and efficient administration of justice. Although the time limits were indeed tight and required extensive efforts from the banks, they were not impossible to meet. And since it was the banks that launched the proceedings, they must have had prepared themselves for the strict rules and arranged their resources accordingly.

Concerning the interference by the legislature in the administration of justice and the presumption of unfairness, the Court pointed out that there was no general prohibition on retroactive legislation. The 2/2014. Uniformity Decision of the Curia contained an unambiguous guidance for the courts on the FX loan litigation, and the ECtHR saw no reason to assume that such guidance would not have had to be followed by the domestic courts in any case, even without the enactment of new legislation. The purpose of the FX Loan Act was not to determine the outcome of the proceedings in favour of the state, but to ensure consumer protection and public interest in general.<sup>58</sup> Moreover, the credit institutions must have been aware of the potentially unfair nature of the GTCs in question, because the relevant piece of EU legislation, the Unfair Terms Directive, became applicable to Hungary on 1 May 2004.<sup>59</sup>

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<sup>57</sup> *Merkantil* Decision, para. 70.

<sup>58</sup> *Merkantil* Decision, paras 77–78.

<sup>59</sup> On this day Hungary joined the European Union.



Concerning the presumption of the unfairness of the GTCs, the ECtHR reiterated that presumptions of fact or of law operated in every legal system. Since the credit institutions had the opportunity to attempt to rebut the presumption, it was eventually for the domestic courts to determine whether the GTCs complied with the Fairness Test. The applicants had the opportunity to submit evidence and arguments, and the standard of proof was not set excessively high. As the ECtHR put it, nothing in the file suggested that the Hungarian courts had assessed the arguments submitted to them arbitrarily.

As a conclusion, the Court found that the FX Loan Act and its effects did not appear to violate Art. 6 of the Convention. In this regard, the ECtHR deemed the applications manifestly ill-founded and rejected the complaints.<sup>60</sup>

Concerning the complaints relating to Art. 1 of Protocol No. 1 of the Convention, the ECtHR put forward two assumptions. First, the instalments and the future instalments paid by the consumers in line with the GTCs qualified as the 'property' of the banks, therefore they fell within the scope of Art. 1 of Protocol No. 1 of the Convention. Second, the application of the FX Loan Act resulted in an interference with the applicants' right to property.<sup>61</sup>

On the above basis, the ECtHR applied its ordinary framework of assessment, and it carried out the so-called three rules analysis.<sup>62</sup> In this framework, the Court considered whether the interference was lawful, whether it served a legitimate aim and whether it was proportionate. The ECtHR responded to the first two questions with ease. The decision found the interference lawful because it was realised through a legal act, the FX Loan Act. Furthermore, the FX Loan Act appeared to have a legitimate aim. With reference to the explanatory memorandum to the FX Loan Act and the Constitutional Court's decision, the ECtHR concluded that the impugned measures were aimed at preventing a backlog in the domestic courts and at protecting customers. The decision also highlighted that states enjoy a wide margin of appreciation when legislating on the implementation of social and economic policies. The ECtHR found that the FX Loan Act had a reasonable foundation; therefore, it would respect the Hungarian legislature's judgment as to what was 'in the public interest'.

The remaining question was whether Hungary struck a fair balance between the general interest of the community and the need to protect the individual's fundamental rights.

After presenting the general economic background, the Court addressed the arguments of the complainants. As to the validity of the GTCs, the ECtHR accepted

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<sup>60</sup> Based on Art. 35(4) read in conjunction with Art. 35(3)a) of the Convention.

<sup>61</sup> *Merkantil Decision*, paras 96–97.

<sup>62</sup> M. Carss-Frisk, *The right to property – A guide to the implementation of Article 1 of Protocol No. 1 to the European Convention on Human Rights*, (Human Rights Handbooks 4) (Council of Europe, 2001), <https://rm.coe.int/168007ff4a> (last accessed: 31.12.2020.) 21–26.

the state's submission that the FX Loan Act did not create new grounds of invalidity but merely codified the uniform judicial practice concerning section 209(1) of the old Civil Code. Although the decision confirmed that the Seven Principles appeared for the first time in the 2/2012. Opinion, delivered in 2012, the Court noted that these principles concerned those GTCs that would have qualified as invalid pursuant to the Unfair Terms Directive. Therefore, the complainants could not have any reasonable expectation on their part that the GTCs in the FX Loan Agreements concluded since 1 May 2004 and not complying with the Seven Principles would be considered fair. The decision noted the arguments that referred to the fact that the GTCs qualified as fair pursuant to both the old Banking Act and the Government Decree, and the 2/2012. Opinion itself precluded the invalidity of those terms that complied with the applicable legislation. The ECtHR pointed back to the domestic courts, highlighting that it is in the first place for the domestic authorities, notably for the courts, to interpret and apply the domestic law. Moreover, the ECtHR held that the old Banking Act did not provide for an unconditional right to unilateral amendments, and the banks should have taken into account the principles of good faith and fairness.

The Court also repeated that the FX Loan Act allowed for the potential rebuttal of the unfairness presumption. Furthermore, at the time of the adoption of the FX Loan Act, numerous cases of litigation were suspended that were likely to have led to the same result as contained in the FX Loan Act, i.e. the domestic courts would have found the GTCs unfair. The credit institutions merely had to reimburse or set off excess consumer payments arising from the unfair unilateral amendments. Therefore, the ECtHR concluded that the FX Loan Act did not upset the balance which must be struck between the protection of the applicant companies' rights and the public interest. As a consequence, the Court found this part of the application manifestly ill-founded, too, and rejected the complaints.

## **VI. CRITICAL ANALYSIS OF THE DECISION OF THE ECtHR**

Needless to say, the founding fathers of the ECHR hardly dreamed of drafting a text that would provide a last resort for financial institutions suffering an extra burden during an economic crisis. Even so, the scope of certain rights, notably the right to property, has always included legal persons, too; see in this regard Art. 1 of Protocol No. 1 and Art. 34 of the Convention. This notion is in harmony with the preamble of the ECHR, stating that fundamental freedoms strengthen the foundation of justice and peace in the world, and they are best maintained by, among others, an effective political democracy. This formulation suggests that the preamble puts a great emphasis

on the rule of law in comparison to the ideals of humanity and the value of human beings and humankind.<sup>63</sup>

However, the decision of the ECtHR contains several elements that appear to undermine the objectives of the notion of the rule of law. This article argues that, notwithstanding the fact that the FX loan agreements contributed to the escalation of a grave financial crisis in Hungary, the measures aiming at economic recovery must comply with the standards of fundamental rights.<sup>64</sup> On this basis, the article continues to consider that certain allegations or lines of arguments in the decision of the ECtHR do not reflect a proper understanding of the underlying Hungarian legislation, or may be questioned from a European Union law perspective.

## 1. The missed opportunities of the Merkantil Decision

Decisions of the ECtHR that find an application manifestly ill-founded have often been criticized for lacking a proper reasoning (or a reasoning at all).<sup>65</sup> This practice is not only at odds with the ECtHR's own standards, but also makes it very difficult to grasp what standards of the 'manifestly ill-founded nature' had been missed in a specific case.

By contrast, the Merkantil Decision stands out due to the excessive length of the reasoning. The ECtHR, by way of a panel consisting of seven judges,<sup>66</sup> after considering the observations of both the government and the applicants and after three and a half years from the submission of the complaints,<sup>67</sup> delivered a 37-page decision that held the application manifestly ill-founded. The lengthy legal analysis makes it already questionable whether the case could have been *manifestly* ill-founded. Further, it what additional assessment criteria should have been included to make a judgment is also uncertain (the decision does not refer to any other factor that should have been considered). Consequently, the Merkantil Decision hardly gives any response to why the ECtHR decided in favour of inadmissibility instead of delivering a judgment.

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<sup>63</sup> P.H. van Kempen, The Recognition of Legal Persons in International Human Rights Instruments: Protection Against and Through Criminal Justice?, in M. Pieth and R. Ivory (eds), *Corporate Criminal Liability*, (Springer, The Netherlands, 2011) 360. [https://doi.org/10.1007/978-94-007-0674-3\\_14](https://doi.org/10.1007/978-94-007-0674-3_14)

<sup>64</sup> This principle is frequently echoed on various international fora that discuss the recovery from the COVID-19 crisis: see for example the report of the UN Secretary General (2020): [https://www.un.org/sites/un2.un.org/files/un\\_comprehensive\\_response\\_to\\_covid-19\\_june\\_2020.pdf](https://www.un.org/sites/un2.un.org/files/un_comprehensive_response_to_covid-19_june_2020.pdf) (Last accessed: 31 December 2020).

<sup>65</sup> J. Gerards, Inadmissibility Decisions of the European Court of Human Rights, (2014) 14 (1) *Human Rights Law Review*, 148–158. <https://doi.org/10.1093/hrlr/ngt044>

<sup>66</sup> Inadmissibility decisions are most frequently decided by a single judge or a three-judge panel.

<sup>67</sup> The application of Merkantil Zrt. is dated 4 May 2015, and the decision was published on 20 December 2018.

The Merkantil Decision also leaves some other pertinent legal questions unanswered. First, the ECtHR took as a starting point that the sums paid back by the credit institutions to the consumers were the ‘property’ of the credit institutions and did not evaluate the arguments of the parties in detail. The lack of analysis may cause some dismay.

The ECtHR has a solid practice under which property claims that have a sufficient basis in national law qualify as ‘asset’ falling within the scope of Art. 1 of Protocol No. 1.<sup>68</sup> The concept of ‘legitimate expectation’ applies with regard to these claims, as this notion also relates to the way in which the claim qualifying as an ‘asset’ would be treated under domestic law and in particular to reliance on the likelihood that the established case-law of the national courts would continue to be applied in the same way. When it comes to property claims that are based on contract, the Court appears to take a more cautious approach. Although in its decision on *S. v. the United Kingdom*, the ECtHR recognised that property may include rights having an exclusively contractual origin, it remained unclear whether the contract itself could be a sufficient basis for the claim. In the case of the claims of certain building societies concerning the interest paid to their investors, the ECtHR could not express any conclusive view on the existence of ‘possessions’, because the applicants had not secured a final and enforceable judgment in their favour.<sup>69</sup> It also remained unclear whether such a precondition would prevent the enforcement of future claims or not. The Court held in many cases that not only the person’s existing possessions should be viewed as property, but it also includes claims which the petitioner lawfully expects to be fulfilled in the future.<sup>70</sup> The justification behind the protection of legitimate expectations is that ‘the law should protect the trust that has been reposed in a statutory undertaking made by legislation’. Nevertheless, the cases concerning future claims related to those that had a legislative basis (instead of a contractual one).

In the present case, the Court had to assess claims that had an exclusively contractual origin; however, the exact amount of these claims could not have been quantified at the time of the conclusion of the FX Loan Agreements and the credit institutions did not have any final and enforceable judgment in their favour either. To add one more layer to the problem, these claims were based on contractual provisions that were deemed invalid under the FX Loan Act. To challenge this presumption, the credit institutions could not carry out comprehensive litigation that took account of every relevant circumstance; the national courts could only apply the Fairness Test. If the ECtHR concluded that the claims of the credit institutions qualified as property,

<sup>68</sup> See for example *Kopecký v. Slovakia*, ECtHR 28 September 2004, 44912/98, *Plechanow V. Poland*, ECtHR 7 July 2009, 22279/04, *N.K.M. v. Hungary*, ECtHR 14 May 2013, 66529/11.

<sup>69</sup> *National & Provincial Building Society, Leeds Permanent Building Society and Yorkshire Building Society v The United Kingdom*, ECtHR 23 October 1997, 21319/93, 21449/93 and 21675/93.

<sup>70</sup> *S v United Kingdom*, ECtHR 13 December 1984, 10741/84.

would that have meant that the Unilateral Increase Provisions were indeed valid provisions, and thus the FX Loan Act would have qualified as unlawful? Could the ECtHR set out any extra requirements for future claims having contractual origins in order to qualify as possessions? Replying to these questions could have significantly contributed to the improvement of the practice of the Court.

## 2. Assessment of the requirement of fair trial

Regarding the reference to the requirement of fair trial, the ECtHR reiterated that Art. 6 was not an absolute right, since adopting a procedural nature, *ab ovo*, called for regulation by the state, which enjoys a certain margin of appreciation in this regard.<sup>71</sup> However, neither the impugned provisions nor their application should prevent litigants from making use of an available remedy.<sup>72</sup>

Nevertheless, after sketching this background, the Court appears to have refused to consider whether a procedure with a specifically limited scope could be suitable for the applicants to make use of an available remedy. In an ordinary civil procedure on the validity of a contractual provision, the court takes into account all relevant circumstances surrounding the conclusion of the contract. In this case, however, the national courts could assess only whether the GTCs of the credit institutions met the Fairness Test. In defence of this procedure, one could argue that a failure to fulfil even one criterion of the Fairness Test would result in such a grave defect that the contract could no longer qualify as valid, and thus the assessment of any other circumstance is unnecessary. However, this argument is contradicted by the fact that the FX Loan Act applies only to FX Loan Agreements; therefore, no other type of loan agreements is subject to the Fairness Test (although Unilateral Increase Provisions frequently appeared in other civil contracts).

Based on the above, it could have been worth having a longer analysis of how the FX Loan Act did not prevent the applicants from asserting their civil rights<sup>73</sup> and to have a clear, practical and effective opportunity to challenge the FX Loan Act.<sup>74</sup>

With reference to the judgment in the *Bárdi and Vidovics* case, the Court highlighted that the purpose of the FX Loan Act was clearly not to determine the outcome of the proceedings in favour of the state,<sup>75</sup> but to ensure consumer protection and public interest in general. The Merkantil Decision did not consider the potential issue that the outcome, in itself, is determined, and the FX Loan Act restricts the

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<sup>71</sup> Merkantil Decision, para. 70.

<sup>72</sup> *Tence v. Slovenia*, ECtHR 31 May 2016, 37242/14 and the case law referred to therein.

<sup>73</sup> See in this regard *Beles and others v. the Czech Republic*, ECtHR 12 November 2002, 47273/99, para. 49.

<sup>74</sup> *Geouffre de la Pradelle v. France*, ECtHR 16 December 1992, 12964/87, para. 34.

<sup>75</sup> See by contrast *Maggio and Others v. Italy*, ECtHR 31 May 2011, 46286/09.

discretion of the Hungarian courts. The predetermined nature of the proceedings is illustrated by the fact that all 73 procedures aiming at rebutting the Unfairness Presumption were dismissed by the courts.

The Court also highlighted that, given the interconnections with EU law, the applicants were aware of the potentially unfair nature of the impugned provisions, because the GTCs were already to be regarded as unfair under the Unfair Terms Directive. The relevant part of the decision appears to suggest a certain duty of care, but the ECtHR did not elaborate upon such a duty, but merely underlined the role of EU law. This approach raises significant concerns, as detailed below.

### 3. Reference to EU law in the decision of the ECtHR

The *Merkantil* Decision makes an interesting statement, claiming that the Unfair Terms Directive became applicable to Hungary as of 1 May 2004. To say the least, this statement is not in harmony with the concept of directives under EU law.

Directives of the European Union are not directly applicable in the Member States, and their direct effect is restricted, too. Directives are addressed to the Member States, and it is up to the Member State to choose the most appropriate form and method of implementation.<sup>76</sup> It was precisely this discretion, left to the Member States, that was why the enforceability of unimplemented directives was surrounded by many questions.

As the documents of the infringement procedure 20 072 499 suggest, the Hungarian legislator failed to implement the Unfair Terms Directive in its entirety up until 22 May 2009. It does not mean that this directive lacked any effect in the Hungarian legal order. The European Court of Justice, in its practice, developed a number of reasons that would underpin the vertical direct effect of the directives.<sup>77</sup> The first argument is that, as set out by the TFEU, a directive shall be binding as to the result to be achieved (which does not mean that natural persons may refer to them during ordinary litigation). However, under Art. 267 of the TFEU, the Court of Justice of the European Union shall have jurisdiction to give preliminary rulings concerning the validity and interpretation of acts of the institutions, bodies, offices or agencies of the Union, which includes the directives, too. This argument is further corroborated by the conclusion of the ECJ that goes as follows: where the EU authorities have, by directive, imposed on Member States the obligation to pursue a particular course of conduct, the useful effect of such an act would be weakened if individuals were prevented from relying on it before their national courts and if the latter were

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<sup>76</sup> Treaty on the Functioning of the European Union (the TFEU), Art. 288.

<sup>77</sup> P. Craig and G. de Búrca, *EU Law: Text, Cases and Materials*, (7th ed., OUP, Oxford, 2020) 237–238. <https://doi.org/10.1093/he/9780198856641.001.0001>



prevented from taking it into consideration as an element of EU law. Consequently, the ECJ deemed it necessary to examine, in every case, whether the nature, general scheme and wording of the provision in question can have direct effects on the relations between Member States and individuals.<sup>78</sup> The third reason for establishing the direct effect of directives highlights the omission of the Member State for failing to implement a certain directive. On this basis, a Member State which has not adopted the implementing measures required by the directive in the prescribed periods may not rely, as against individuals, on its own failure to perform the obligations which the directive entails.<sup>79</sup>

By contrast, the concept of the horizontal direct effect was explicitly rejected by the ECJ. As set out in the judgment in the *Marshall* case,<sup>80</sup> the founding treaties make it clear that the binding force of directives shall exist only in relation to each Member State to which it is addressed. Further arguments can also be made on the basis of legal certainty. As Advocate General Jacobs puts it in his opinion in the *Unilever* case, it would be disproportionately severe if a national court was obliged to find a breach of contract on the basis of disregarding a directive (in that case, a directive prescribing to notify a technical regulation).<sup>81</sup> As per the opinion, the horizontal direct effect of the directive would bring numerous uncertainties including the appropriate remedies for the breach of contract or the applicable legal regime that replaces the disapplied national measures.<sup>82</sup>

Against this backdrop, to strengthen the horizontal effect of directives, the ECJ developed the requirement of harmonious interpretation.<sup>83</sup> According to this concept, in domestic litigation involving an EU directive, national courts should interpret national law in the light of the wording and the purpose of that directive. However, this requirement applies to the interpretation of the existing national law, hence it does not replace the proper implementation of a directive.

Therefore, this article concludes that the expectation of the Court, which required economic operators to take into account an unimplemented directive, is based on a gross misinterpretation of the underlying EU law. The omission by the state may under no circumstances be imputed to the credit institutions.

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<sup>78</sup> Judgment of 4 December 1974, *Van Duyn v. Home Office*, 41-74, ECLI:EU:C:1974:133, para. 12.

<sup>79</sup> Judgment of 5 April 1979, *Pubblico Ministero v. Tullio Ratti*, 148/78, ECLI:EU:C:1979:110, para. 22.

<sup>80</sup> Judgment of 26 February 1986, *Marshall v. Southampton and South-West Hampshire Area Health Authority (Teaching)*, 152/84, ECLI:EU:C:1986:84, para. 48.

<sup>81</sup> AG Opinion of 27 January 2000, *Unilever*, C-443/98, ECLI:EU:C:2000:57, para. 112.

<sup>82</sup> P. Craig, *The Legal Effect of Directives: Policy, Rules and Exceptions*, (2009) 34 (3) *European Law Review*, 349–369.

<sup>83</sup> Judgment of 10 April 1984, *Von Colson and Kamann*, C-14/83, ECLI:EU:C:1984:153, para. 26.; Judgment of 13 November 1990, *Marleasing SA*, C-106/89, ECLI:EU:C:1990:395, paras 7–8.



#### 4. Violation of the right to property

As outlined above, the ECtHR did not assess in detail whether the payments already made and to be made under the Unilateral Increase Provisions and the FX gap provisions constitute 'property'. Instead, it presumed that the credit institutions were deprived of their property and carried on with the following steps of the legal analysis.

##### *a) The lawfulness of the interference*

Concerning the lawfulness of the interference, the ECtHR correctly recognised that the assessment of the retroactive application of the FX Loan Act was strongly linked to the validity of the impugned provisions (i.e. the Unilateral Increase Provisions and the FX Gap Provision). When carrying out the analysis, the Court applied a dual approach.

First, the ECtHR refers to the decision of the Hungarian Constitutional Court, according to which the FX Loan Act had merely codified the interpretation of fairness, developed and made mandatorily applicable in the practice of the European and domestic courts.<sup>84</sup> Second, after this conclusion, the ECtHR carried out its own assessment, and correctly confirmed that the Fairness Test first appeared in the 2/2012. Opinion. This – relatively late – appearance did not prove to be decisive for the Court: the ECtHR again reiterated that those GTCs which, contrary to the requirement of good faith, caused a significant imbalance in the parties' rights and obligations to the detriment of the consumer were already to be regarded as unfair under the Unfair Terms Directive. The precise content of the principle of good faith was to be interpreted by the domestic authorities and could go beyond the Unfair Terms Directive; it could thus naturally involve a consideration of circumstances that later became the Seven Principles.<sup>85</sup> The applicants failed to prove that the GTCs in the FX Loan Agreements concluded since 1 May 2004 and not complying with the Fairness Test would be considered fair by the domestic courts. In this respect, the ECtHR specifically referred to the requirement of plain and intelligible language that is explicitly contained in the Unfair Terms Directive.

The Merkantil Decision again applied a somewhat unique approach to EU law as it expected the credit institutions to comply with a directive to which they are not addressees. Moreover, the Merkantil Decision appears to be based on a selective reading of the Unfair Terms Directive, as it did not take into consideration the other relevant provisions of that directive. In this regard, the Court overlooked the fact that, when it comes to the assessment of the validity (and fairness) of a contractual

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<sup>84</sup> Merkantil Decision, para. 102.

<sup>85</sup> Merkantil Decision, para. 103.

provision, the Unfair Terms Directive prescribes that every relevant circumstance shall be considered.<sup>86</sup> The FX Loan Act clearly disregarded this provision.

It is not disputed here that the concept of contractual invalidity and unfairness cannot be regulated extensively in a legal act, and the courts must be prepared to apply the principles indicating unfairness in light of the changing circumstances of economic life. Even so, it is telling that in the six-eight years preceding the FX loan crisis, neither the regulatory authorities nor the domestic courts held the impugned provisions unfair.<sup>87</sup> As the retail lending sector was already heavily regulated segment, the credit institutions could have reasonably expected the financial watchdogs to speak up in the event of any contractual provisions that would allow severe financial abuse. In sum, the Merkantil Decision expected the credit institutions to prove a negative claim (i.e. that the Unilateral Increase Provisions and the FX Gap Provisions were not unfair), it however disregarded the absence of any corresponding court judgments or resolutions by the financial regulatory authorities.

#### **b) The legitimate aim of the FX Loan Act**

Concerning the legitimate aim of the FX Loan Act, the Merkantil Decision did not result in any novelties. The applicants argued that the FX Loan Act in fact aimed at favouring the debtors of the FX loan agreements without taking into account the fact that the increase in repayment instalments had mostly been attributable to the changes in FX rates resulting from the crisis, rather than to unilateral increases in interest rates and fees applied by the banks.<sup>88</sup>

It goes without saying that the FX Loan Act helped consumers to receive a substantial amount from the banks without the need to go to the courts. Furthermore, even in the absence of the FX Loan Act, the Curia's guidance (i.e. the 2/2012. Opinion and the 2/2014. Uniformity Decision) would have resulted in judgments favourable to consumers. It is disappointing however that, unlike in other cases,<sup>89</sup> the ECtHR did not take into account the role of the state in the escalation of the crisis. If the general interest is at stake, it is incumbent on the public authorities to act in good time and in an appropriate and consistent manner. However, as it is apparent from the growing popularity of the FX loan products during the 2000s, the Hungarian state even facilitated the spread of these products instead of introducing more specific regulation. In addition, the ECtHR failed to assess whether it was legitimate to deprive the banks of amounts that were paid on a basis of a fair interest rate. It is self-evident that the

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<sup>86</sup> Unfair Terms Directive, Art. 4(1).

<sup>87</sup> Although the fact that all litigation claiming the rebuttal of the unfairness presumption was dismissed suggests that the matter is relatively simple.

<sup>88</sup> Merkantil Decision, para. 90.

<sup>89</sup> *Fener Rum Erkek Lisesi Vakfi v. Turkey*, ECtHR 9 January 2007, 34478/97.

global financial crisis affected financial institutions, too, and induced the banks to raise their interest rates.

The above submissions proved to be in vain. When a state measure appears to serve multiple purposes, the ECtHR tends to focus on the aim that it finds legitimate and disregards any additional results.<sup>90</sup> As summarised in the *Merabishvili* case: 'Even when it excludes some of the cited aims, if it accepts that an interference pursues at least one, it does not delve further into the question and goes on to assess whether it was necessary in a democratic society to attain that aim.'<sup>91</sup>

Traditionally, the ECtHR leaves the states with a wide margin of appreciation when it comes to balancing the interest of the national economy and that of private persons.<sup>92</sup> On this basis, the Court set out that it respected the legislature's judgment as to what constituted 'public interest' unless that judgement was manifestly without reasonable foundation.<sup>93</sup> This test means a lower standard for the state.<sup>94</sup> Applying this test to the actual circumstances, the Court decided that it could not substitute its own assessment for that of the domestic courts, and it would only assess the case further if the aim pursued by the FX Loan Act had proved to be manifestly unreasonable. Therefore, only the assessment of the proportionality remained from the three-rule analysis.

### **c) The assessment of the proportionality of the FX Loan Act**

Based on the jurisprudence of the Court, the wide margin of appreciation left to the state entailed that the ECtHR would apply a lower standard when assessing the proportionality of a state measure.<sup>95</sup> This lower standard means that the ECtHR aims at striking a 'fair balance' between the general interest of the community and the need to protect the individual's fundamental rights, and the requisite balance will not be found if the person concerned has had to bear an 'individual and excessive burden'.<sup>96</sup> In the case of claims relating to the deprivation of property, the assessment often boils down to looking at the compensation that the victim received.<sup>97</sup>

The ECtHR delivered numerous judgments that established a violation of Article 1 of Protocol 1 because the interference with that right caused an individual and excessive burden, even if the state measure in question was introduced amidst a

<sup>90</sup> J. Gerards, *General Principles of the European Convention on Human Rights*, (CUP, Cambridge, 2013) 226.

<sup>91</sup> *Merabishvili v. Georgia*, ECtHR 28 November 2017, 72508/13.

<sup>92</sup> *James and Others v. United Kingdom*, ECtHR 21 February 1986, 8793/79; *Animal Defenders International v. United Kingdom*, ECtHR 22 April 2013, 48876/08.

<sup>93</sup> Merkantil Decision, para. 99.

<sup>94</sup> See for example *Pressos Compania Naviera S.A. and Others v. Belgium*, ECtHR 20 November 1995, 17849/91. or *James and Others v. United Kingdom*, ECtHR 21 February 1986, 8793/79.

<sup>95</sup> Gerards, *General Principles of the European Convention on Human Rights*, 243.

<sup>96</sup> Merkantil Decision, para. 98.

<sup>97</sup> W. A. Schabas, *The European Convention on Human Rights – A commentary*, (OUP, Oxford, 2015) 976.

severe economic situation.<sup>98</sup> The Merkantil Decision however did not include a lengthy analysis assessing the proportionality, either. The ECtHR referred to three main circumstances: the high number of the FX loan cases in the courts, the fact that the banks did have the opportunity to challenge the Unfairness Presumption and the fact that the banks only had to repay the amounts incurred under the invalid contractual provisions.<sup>99</sup> The ECtHR failed to address the fact that, with regard to a substantial part of the repaid amounts, the statutory limitation period had already expired. Furthermore, the decision did not mention the compensation of those consumers that had already repaid the entire amount of their debt. In sum, the ECtHR broadly measured the burden on the banks and the interference against the social pressure and did not consider several circumstances that had led to this pressure.

## VII. CONCLUSIONS

The factual background behind the Merkantil Decision is composed of economic, social and legal measures and processes. It is a rather complex process to trace the origins of the Hungarian FX loan crisis.

Following the change in 1989, and during the preparation for joining the European Union, Hungary had gradually removed the barriers relating to financial operations in foreign currencies. The Hungarian credit institutions decided to increase their retail portfolio and launched more and more new products in order to compete effectively for the consumers. Loan products denominated in a foreign currency (most notably in CHF) were by far the most popular offers, since their interest rates were significantly lower than those of HUF-denominated loans. In parallel, the construction of new apartments increased, and consumers' apartments often served as a collateral to these FX loan agreements.

In comparison to this rapid development of innovative financial products, the level of financial consumer protection remained low. Neither the financial watchdog, nor the legislature seemed to expect a bubble to grow, and consumers concluded their FX loan agreements without any specific guarantees nor under dedicated regulation. The global financial crisis and the drastic depreciation of the HUF against foreign currencies resulted in the bankruptcy of a great number of people.

From a legal perspective, retail financing is a regulated area and, in addition to compliance with the sectoral regulations, loan agreements must comply with the general Hungarian contractual provisions, including those regulating fairness and

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<sup>98</sup> *Scollo v. Italy*, ECtHR 28 September 1995, 19133/91.; *Hutten-Czapska v. Poland*, ECtHR 19 June 2006, 35014/97; *Bélané Nagy v. Hungary*, ECtHR 13 December 2016, 53080/13.

<sup>99</sup> Merkantil Decision, paras 109–110.

validity. These general contractual provisions partly serve the implementation of the corresponding EU law: the Hungarian Civil Code has fully contained the provisions of the Unfair Terms Directive since 22 May 2009.

However, the 2/2012. Opinion, the Uniformity Decision and the FX Loan Act set out specific principles that became the Farness Test and were applicable retroactively, from 1 May 2004. In addition to this, while the banks were allowed to attempt to rebut the Unfairness Presumption introduced by the FX Loan Act, none of the litigation brought by them proved to be successful. As a result, credit institutions repaid more than one hundred billion forint to consumers. The FX Loan Act thus resulted in a great financial loss to the banks, and the cost of litigation to rebut the Unfairness Presumption was added to that.

This article concludes that the FX Loan Act attempted to address an actual social crisis and, while doing so, it applied a highly technocratic perspective, and focused on the contractual voidness of certain provisions. The state kept the legal dispute in a horizontal relation (i.e. between the banks and the consumers) and, instead of providing aid to consumers, it made the credit institutions compensate the debtors. After the exhaustion of domestic remedies, the banks turned to the ECtHR to assess the lawfulness of a state measure that did not expropriate any property; instead, the measure put a significant payment obligation on the banks *vis-à-vis* consumers.

This type of measure is part of a subcategory within the main category of crisis management measures in general. The relevant jurisprudence of the ECtHR<sup>100</sup> is consistent when setting up the framework of the analysis: states enjoy a wide margin of appreciation in cases concerning the national economy, and the domestic authorities are better placed to assess such measures, assuming the measures in question are not manifestly unreasonable.

In the present case, the FX Loan Act set out how the banks should have behaved in their long-term contractual relationships since 1 May 2004. Given the retroactive effect of this law, the ECtHR was expected to pay close attention to the lawfulness of the measure, and to the foreseeability of this legislation. A measure interfering with a fundamental right must meet quality requirements, such as complying with the rule of law and preventing arbitrariness.

This article finds that the Merkantil Decision failed to include this meticulous assessment. In most parts of the decision, the ECtHR referred back to the national authorities, and where not, it made statements that are not accurate from an EU law perspective (see the parts on the direct horizontal effect of the Unfair Terms Directive). Moreover, the ‘fair balance test’ applied by the ECtHR when assessing the

<sup>100</sup> *James and Others v. United Kingdom*, ECtHR 21 February 1986, 8793/79, or specifically concerning the financial crisis in 2008: *Da Conceição Mateus and Santos Januário v. Portugal*, ECtHR 8 October 2013 62235/12 and 57725/12.

proportionality of the FX Loan Act lacked crucial factual elements and circumstances. Although the 'fair balance test' does not entail reweighing the interests in cases where the state enjoys a wide margin of appreciation,<sup>101</sup> the Court usually pays attention to any deficiencies of a state measure in question, including the potentially arbitrary nature thereof. In this case, the inaction of the financial authorities and the legislator during the climax of the conclusion of the FX Loan Agreements, as well as the repayment of instalments that were based on fair interest rates are factual elements that question the foreseeability of the FX Loan Act and must have been taken into account when assessing the proportionality of the FX Loan Act.

The history of the Hungarian FX loan crisis has not come to an end yet. There are several cases pending both before the Hungarian courts and the European Court of Justice even today. Given the significance of the crisis, one could have expected the ECtHR to deliver a judgment in which it responded to the fundamental right aspects of the management of this crisis. However, while the ECtHR did deliver a lengthy decision, it did not carry out an in-depth review. This article aimed at outlining both the missing opportunities for the ECtHR, as well as the flaws of the decision. Since none of the applicants turned to the Great Chamber, this line of litigation ended at the admissibility phase. In any case, one could hope that this fiasco does not discourage economic players from turning to Strasbourg in the event of any potential violation of fundamental rights. The doors of the European Court of Human Rights are open to every legal subject, including corporations, too.

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<sup>101</sup> Gerards, *General Principles of the European Convention on Human Rights*, 244.





Börzsönyi, Blanka\*

# Intellectual Property-Related Risk Allocation Provisions in Share Sale and Purchase Agreements

## ABSTRACT

In acquisitions, the irregularities and risks identified by the transactional due diligence will finally be either treated in the transaction documents or will be taken into consideration when establishing the purchase price. On the legal side, contractual provisions that will allocate risk include covenants, warranties and indemnities or alternatively (or additionally), provisions that prescribe that the irregularity is remedied until closing, as a pre-condition. While transactional counsels will have to come up with clear-cut answers as to which vehicle would serve its client's interest the best, the actual contractual provision by which a specific irregularity is remedied, or a risk is mitigated ultimately will be picked and worded in accordance with the bargaining position of the parties.

**KEYWORDS:** M&A, intellectual property, risk mitigation, SPA, warranty, indemnity

## I. INTRODUCTION

Most contract provisions may be viewed as risk-allocating vehicles. Designed more specifically and consciously than other clauses to shift risk from one party to the other, (among others) covenants, representations and warranties, as well as indemnification provisions,<sup>1</sup> alter property rights by allocating risk contractually. Certain risks will be resolved pre-signing, while others will be addressed either pre- or post-closing.<sup>2</sup>

In the context of mergers and acquisitions ("M&A"), provisions allocating misvaluation risks are based on the issues identified by the due diligence reports. Our

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<sup>1</sup> Thomson Reuters Practical Law Commercial, *Using contractual risk allocation provisions to minimize risk and maximize reward*, <https://1.next.westlaw.com/> (Last accessed: 31 December 2020).

<sup>2</sup> J. C. Coates IV., *Allocating risk through contract, evidence from M&A and policy implications*, (Harvard Law School, Cambridge, 2012). <https://doi.org/10.2139/ssrn.2133343>, [http://www.law.harvard.edu/programs/olin\\_center/papers/pdf/Coates\\_729.pdf](http://www.law.harvard.edu/programs/olin_center/papers/pdf/Coates_729.pdf) (Last accessed: 31 December 2020).

previous paper<sup>3</sup> provided an overview – from an intellectual property (“IP”) point of view – of the stages of M&A transactions and the purpose, disciplines and process of due diligence exercises (“DD”), as well as the most common IP considerations and risks identified during DDs.

This paper takes up the task of introducing risk allocation provisions (“RAP”) implemented in share sale and purchase agreements (“SPA”) that address IP-related<sup>4</sup> misvaluation risks, as well as IP-related risks associated with the change of the value of the target between signing the transaction documents and completing the deal (so-called “value-shift risks”).<sup>5</sup>

The structure of this paper is as follows. Part I reviews a model SPA definition for intellectual property. Part II analyses IP-specific covenants. Part III and IV elaborate on IP warranties and indemnities, respectively. Each part describes the essence of the RAP addressed and provides a model clause that may be adjusted in light of the select drafting notes included herein. Part V summarises the findings of Parts I to V.

## II. DEFINITION OF “INTELLECTUAL PROPERTY”

In order to facilitate drafting, negotiation and interpretation, it is usual to include in the SPA a set of defined terms that cover major notions referred to multiple times.<sup>6</sup> The definition of “Intellectual Property” is used throughout SPAs, mostly in the warranty, and occasionally in the indemnification, as well as covenant sections.

A model definition proposed in M&A literature for “Intellectual Property” is, as follows:

all copyright and related rights, moral rights, design rights, registered design, database rights, [semiconductor topography rights,] patents, rights to inventions, [utility models,] business names, trademarks, [service marks,] trade names, domain names, [rights in get-up,] know-how, trade secrets, and rights in confidential information, rights to goodwill or to sue for passing off or unfair competition, and any other intellectual property rights or rights of a similar nature (in each case whether or not registered) and all applications for any of them which may subsist anywhere in the world.<sup>7</sup>

<sup>3</sup> Titled “Intellectual property-related considerations in M&A due diligence”.

<sup>4</sup> Although related to IP matters, in general, information technology, data protection and privacy matters are treated as a separate area of the DD processes. Therefore, this analysis does not encompass IT-, data protection-, or privacy-specific considerations.

<sup>5</sup> Thomson Reuters Practical Law Commercial, *Using contractual risk allocation provisions to minimize risk and maximize reward*.

<sup>6</sup> R. Thompson (ed.), *Sinclair on warranties and indemnities on share and asset sales*, (Sweet & Maxwell, 8th ed., London, 2011).

<sup>7</sup> *Ibid.*

Vendors should consider closely the scope of the definition and make sure that it is not unduly broad and no undue reference is made (e.g., reference to “semiconductor topography rights” might be futile). References that are too wide and general (e.g., to “[...] any other intellectual property rights or rights of similar nature [...] which may subsist anywhere in the world”) may also be unacceptable for the seller, especially if the target conducts business in multiple jurisdictions.<sup>8</sup>

Likewise, acquirers will generally push for an expansive definition to ensure, primarily, that all IP necessary for the operation of the target is within the perimeter, and, secondarily, that the IP-related representations and warranties are comprehensive. Therefore, buyers will want to confirm that IP is defined broadly and the definition is not unintentionally narrowed (which could cause, for example, an unintended limitation on the seller’s non-infringement warranties).<sup>9</sup> This approach is correct, even if the target itself does not own or make use of a specific category of IP (e.g., patents), so as not to narrow warranties that refer to such a term (e.g. “non-infringement” warranties would cover patent use, as well).<sup>10</sup> Including express descriptions or separate definitions for certain specific IP types may prove relevant where certain IP types are material for the target business (e.g., the target runs a software business), and, thus, more complex warranties are sought by the buyer in their regard.<sup>11</sup>

Where the target IP is modest and raises relatively few issues, the buyer may compromise and accept a condensed definition. In any case, the buyer should ascertain that the SPA definition does not refer to any owner and covers all IP categories and relevant jurisdictions (even territories where third-party IP could be relevant in respect of the target).<sup>12</sup>

In share purchases it is standard that a separate definition covering “Company Intellectual Property” is introduced, which encompasses IP assets owned specifically by the target. This definition is usually referred to in title, sufficiency and “non-infringement” warranties. The seller typically wants to restrict this definition to registered IP or applications for registration of the target.<sup>13</sup>

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<sup>8</sup> Ibid.

<sup>9</sup> Thomson Reuters Practical Law Corporate & Securities, *Stock purchase agreement (pro-seller long form, USA national/federal), with commentaries*, <https://1.next.westlaw.com/> (Last accessed: 31 December 2020).

<sup>10</sup> Thomson Reuters Practical Law Intellectual Property & Technology, *IP representations: key negotiating points in M&A transactions comparison chart*, <https://uk.practicallaw.thomsonreuters.com/> (Last accessed: 31 December 2020).

<sup>11</sup> Ibid.

<sup>12</sup> See R. Thompson Robert (ed.), *Sinclair on warranties and indemnities on share and asset sales*, (Sweet & Maxwell, 8th ed., London, 2011).

<sup>13</sup> Thomson Reuters Practical Law Corporate & Securities, *Stock purchase agreement...*

### III. COVENANTS

Covenants are “agreements to do something (affirmative covenant), not to do something (negative covenant) or to maintain something (maintenance covenant).”<sup>14</sup> Where the target’s IP is material, it is typical for the buyer to seek to include covenants in the SPA to ensure that the seller (or the target company) on the one hand refrains from taking certain actions, and, on the other hand, takes certain actions in connection with the relevant IP right.<sup>15</sup>

IP-related SPA covenants enhance the buyer’s contractual protection against IP risks, supplementing the protection regime ensured by warranties and indemnities, and may be defined so as to apply to the interim period prior to closing (“pre-closing covenants”), and/or for a limited period after closing (“post-closing covenants”).

#### 1. Pre-closing covenants

Where signing and closing is split in time, the buyer generally seeks a covenant from the seller that it must conduct the target company’s business (and cause the target to conduct its business) in the ordinary course in line with past practice. This covenant is designed to assure the buyer that the target is in substantially the same condition as at signing (and as appraised by the valuation and the DD) and at closing,<sup>16</sup> and is known as the “interim operating covenant”.<sup>17</sup>

The interim operating covenant usually specifies an extensive list of actions, in respect of which the buyer’s (preliminary, written) consent is necessary, the scope varying depending on the relevant industry, certain competition-related considerations<sup>18</sup>

<sup>14</sup> Latham & Watkins LLP, *The book of jargon, global mergers & acquisitions, the Latham & Watkins Glossary of global M&A slang and terminology*, (1st ed., 2013), [https://www.lw.com/admin/Upload/Documents/BoJ\\_Global\\_MandA-locked-March-2015.pdf](https://www.lw.com/admin/Upload/Documents/BoJ_Global_MandA-locked-March-2015.pdf) (Last accessed: 31 December 2020).

<sup>15</sup> Thomson Reuters Practical Law Intellectual Property & Technology, *Promises That Matter: IP Covenants in M&A Transactions*, [https://uk.practicallaw.thomsonreuters.com8-618-0473?transitionType=Default&contextData=\(sc.Default\)&firstPage=true&cbcp=1&comp=pluk](https://uk.practicallaw.thomsonreuters.com8-618-0473?transitionType=Default&contextData=(sc.Default)&firstPage=true&cbcp=1&comp=pluk) (Last accessed: 31 December 2020).

<sup>16</sup> D. Glazer and T. Rubin, *Intellectual Property: Stock Purchases and Mergers*, [https://uk.practicallaw.thomsonreuters.com/6-506-9152?originationContext=document&vr=3.0&rs=PLUK1.0&transitionType=DocumentItem&contextData=\(sc.Default\)#co\\_anchor\\_a988992](https://uk.practicallaw.thomsonreuters.com/6-506-9152?originationContext=document&vr=3.0&rs=PLUK1.0&transitionType=DocumentItem&contextData=(sc.Default)#co_anchor_a988992) (Last accessed: 31 December 2020).

<sup>17</sup> Thomson Reuters Practical Law Intellectual Property & Technology, *IP covenants: stock purchase (pro-buyer), Practical Law Standard Clauses (5-617-7113)*, [https://uk.practicallaw.thomsonreuters.com/5-617-7113?originationContext=document&transitionType=DocumentItem&contextData=\(sc.Default\)&navId=DA96D704F8480FADB58EC330D3165FFE&comp=pluk&view=hidealldraftingnotes](https://uk.practicallaw.thomsonreuters.com/5-617-7113?originationContext=document&transitionType=DocumentItem&contextData=(sc.Default)&navId=DA96D704F8480FADB58EC330D3165FFE&comp=pluk&view=hidealldraftingnotes) (Last accessed: 31 December 2020).

<sup>18</sup> In defining and wording interim covenants, the counsels and the parties should be wary of compliance with antitrust regulation (e.g., “gun-jumping” rules).

and the commercial agreement of the parties. IP-specific parts of the interim operating covenant clause generally include the seller's (and/or the target's) undertaking:

(i) not to transfer, license, encumber, assign or dispose (including entering into proceedings) of, or abandon any IP rights owned by the target without the consent of the buyer, and

(ii) to make filings and payments necessary for maintaining the status of the IP rights owned by the target.<sup>19</sup>

Where the target IP matters and portfolio are limited, the buyer may be fine with narrow IP-specific language that covers at least the above points.<sup>20</sup> By contrast, a more elaborate model addition to the general interim operating covenant could read as follows:

From the date hereof until the Closing Date, the Seller shall not and shall cause the Company not to [...] (i) sell, assign, transfer, grant any security interest in, or otherwise encumber or dispose of any Intellectual Property; (ii) grant license to any Intellectual Property owned and/or used by the Company, or grant sublicense to any Intellectual Property licensed by the Company; (iii) abandon, allow to lapse, disclaim or dedicate to the public, or fail to make any filing, pay any fee or take any other action necessary to maintain the ownership, validity, enforceability in full force and effect of any Intellectual Property registrations of the Company.<sup>21</sup>

In each case, in negotiation, the seller should ensure that the target will be able to operate in the ordinary course without unnecessary or undue interference – key to this principle is the widely accepted exclusion from interim covenants that allow such actions that fall within the scope of the ordinary course of business of the target. More specific pro-seller limitations of the above covenant could include the limitation of the undertaking to “material” target IP, the exclusion of non-exclusive licences from the undertaking in point (ii), and the carve-out of non-material IP from the scope of point (iii) above. Pro-buyer additions to the model clause could include maintenance and protection covenants for non-registered IP, such as trade secrets and confidential information (where reasonable).<sup>22</sup>

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<sup>19</sup> Latham & Watkins LLP, *The book of jargon, global mergers & acquisitions...*

<sup>20</sup> A model condensed addition could read as follows “[...] not to assign, transfer, license, abandon, fail to maintain, or otherwise dispose of any [material] Company Intellectual Property [other than in the ordinary course of business consistent with past practice]” (Latham & Watkins LLP, *The book of jargon, global mergers & acquisitions...*).

<sup>21</sup> Language simplified, taking as a basis the model definition set out in the source referred to: Latham & Watkins LLP, *The book of jargon, global mergers & acquisitions...*

<sup>22</sup> Ibid.

Other pre-closing IP-specific covenants may cover the following matters:<sup>23</sup>

(i) IP portfolio management in respect of any unreleased security interest, chain-of-title updates, registration, and/or renewal and maintenance fee payment issues identified during the DD but not taken care of prior to signing. In such cases, the target (or the seller) would be required to prove, prior to (or upon) closing, that the irregularities have been corrected.

(ii) Disclaimer of IP rights if the target's trademarks or other IP rights are core assets and are in use by seller group entities, in order to prevent consumer confusion and impairment of the target's IP rights due to their use by the seller after closing.

(iii) Obtaining consent from IP counterparties, if the respective arrangements include change-of-control provisions triggered by the transaction. If the buyer finds, based on the DD, that certain licence or maintenance agreements are not beneficial for the buyer or are otherwise problematic, the seller (target) is usually required to terminate certain arrangements prior to closing.

The target company is not usually party to the SPA. Therefore, consideration must be given to draft covenants in a way (and/or to have the target company expressly acknowledge and assume the covenants) that obliges the seller to perform and cause the target company to perform the covenants during the interim period.<sup>24</sup>

Depending on the obligation undertaken, and the obligated party, case covenants are often worded as qualified obligations by some degree of an "efforts" standard. Practitioners differentiate between "best efforts" and "reasonable best efforts", as well as "commercially reasonable efforts" standards, which may be applied in drafting to tone down an undertaking to an acceptable standard.<sup>25</sup>

## 2. Post-closing covenants

In general, post-closing covenants may encompass obligations relating to the completion of the deal (e.g. further assurances, split of assets), as well as compliance with ongoing arrangements between the parties (e.g. retaining records).<sup>26</sup>

If the acquirer takes a strong position from an IP perspective, it may attempt to obtain covenants that ensure that, post-closing, the seller will not (i) challenge (or

<sup>23</sup> Thomson Reuters Practical Law Intellectual Property & Technology, *Promises That Matter: IP Covenants in M&A Transactions*.

<sup>24</sup> See Thompson, *Sinclair on warranties and indemnities on share and asset sales*.

<sup>25</sup> This may be the case in particular in connection with covenants that require actions by third parties (e.g. obtaining approvals, which are out of the control of the parties). In US deals, the "best efforts" standard is interpreted by attorneys and commentators (but not always by courts) as a higher standard than the "commercially reasonable efforts" and the "reasonable best efforts" standard. See Thompson, *Sinclair on warranties and indemnities on share and asset sales*.

<sup>26</sup> *Ibid.*

assist the challenge of) the validity or enforceability of the IP of the target company, (ii) contest (or assist the contest of) target's rights or title to its IP, and (iii) attempt to register or assert any right in the target's IP. However, the success of having the seller agree to these strongly pro-buyer covenants is not likely.<sup>27</sup>

Key considerations for IP-specific post-closing covenants lie in carve-out situations where IP-interdependence is present (i.e. the Target licenses IP to and/or from seller group entities) and the post-closing use of shared IP rights must be agreed on. In these cases, the scope of the shared IP should be clearly defined in the SPA, and the rights of the parties must be laid down in the SPA (and/or ancillary documents). Generally, the seller will aim to retain ownership of IP rights owned by it and primarily or exclusively used by its related businesses, and the buyer is likely to attempt to obtain an assignment to the target (or the buyer) of any IP rights that is owned by the seller (or a seller affiliate) and primarily or exclusively used by the target.<sup>28</sup>

In instances where the buyer (or the target) needs a temporary licence after closing in order to continue using the IP rights of the seller, transitional licence provisions are usually included in the SPA or a separate transitional licence agreement is entered for a relatively brief period (usually 120 days or less). For example, this need may arise in respect of existing stationery and signage on inventory, as well as the corporate name of the target.<sup>29</sup> For shared IP that is not covered by a transition arrangement, the buyer typically seeks a covenant not to sue for use after closing.<sup>30</sup>

Where IP-related third-party consents in respect of the transaction could not be obtained by the seller, the buyer often requires the seller to procure a commercially reasonable and acceptable substitute for the relevant arrangement, or provide the buyer with the benefits of the relevant arrangement.<sup>31</sup>

If ancillary IP-related agreements are concluded, they are typically negotiated and mutually agreed by the parties prior to signing and are attached to the SPA as schedules. The executed, effective copy of these documents are usually defined as completion deliverables.

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<sup>27</sup> Latham & Watkins LLP, *The book of jargon, global mergers & acquisitions...*

<sup>28</sup> Thomson Reuters Practical Law Intellectual Property & Technology, *Promises That Matter: IP Covenants in M&A Transactions*.

<sup>29</sup> Ibid.

<sup>30</sup> Latham & Watkins LLP, *The book of jargon, global mergers & acquisitions...*

<sup>31</sup> Ibid.



## IV. WARRANTIES

### 1. General

A representation is an “assertion as to a fact, true on the date the representation is made, that is given to induce another party to enter into a contract or take some other action”.<sup>32</sup> A warranty is a promise of indemnity in the event that an assertion as to a fact, true on the date of the assertion (representation), is now false.<sup>33</sup> In other words, warranties are “assurances from one party to the others as to the state of affairs subject to the contract (e.g. as to the Target Company or business)”.<sup>34</sup>

The terms “representation” and “warranty” are often used together or interchangeably,<sup>35</sup> as “their technical difference [...] has been proved unimportant in acquisition practice”.<sup>36</sup> Therefore, without making a distinction, this paper refers to these categories as warranties from here on.

Warranties are “where the rubber meets the road,” as they:<sup>37</sup> (i) force disclosure (disclosure schedules work together and qualify representations and warranties), (ii) allocate risk between the seller and the buyer (identifying which party will be liable for which item, including the allocation of risk for unknown liabilities), (iii) may serve as closing conditions (“CP”) (e.g. bringing down “material” representations and warranties is often required as a CP<sup>38</sup>), and (iv) establish a basis for indemnification (a breach of a warranty may serve as a basis for an indemnification claim against the party providing the breached warranty).

<sup>32</sup> Thomson Reuters Practical Law, *Glossary (representations and warranties)*, [https://uk.practicallaw.thomsonreuters.com/8-382-3760?transitionType=Default&contextData=\(sc.Default\)](https://uk.practicallaw.thomsonreuters.com/8-382-3760?transitionType=Default&contextData=(sc.Default)) (Last accessed: 31 December 2020).

<sup>33</sup> *Ibid.*

<sup>34</sup> Thomson Reuters Practical Law Corporate & Securities, *Stock purchase agreement (pro-seller long form, USA national/federal), with commentaries*.

<sup>35</sup> For example a guide defines warranties as “contractual statement of facts made by the warrantor to the warrantee [...]” and adds that “warranties often take the form of assurances from the seller as to the condition of the target company or business” (Ashurst LLP, *Quickguides, warranties and indemnities*, Available at: <https://www.ashurst.com/en/news-and-insights/legal-updates/quickguides-warranties-and-indemnities/> (Last accessed: 31 December 2020).

<sup>36</sup> American Bar Association, Committee on Negotiated Acquisitions, *Model asset purchase agreement with commentary*, (American Bar Association, Chicago, 2001).

<sup>37</sup> Latham & Watkins LLP, *Key provisions of acquisition agreements*. [https://www.lw.com/admin/Upload/Documents/OilAndGasMandA/General%20Concepts/Consolidated\\_General\\_Concepts\\_Part\\_II\\_Key\\_Provisions.pdf](https://www.lw.com/admin/Upload/Documents/OilAndGasMandA/General%20Concepts/Consolidated_General_Concepts_Part_II_Key_Provisions.pdf) (Last accessed: 31 December 2020).

<sup>38</sup> Particularly in US deals, where a wider scope of CPs are generally accepted as compared to the European approach that, as a general rule, restricts CPs to regulatory and antitrust conditions (R. McLaren and N. Cline, *M&A deal terms in 2017: What can deal teams expect?*, (Harvard Law School Forum on Corporate Governance, 2017), <https://corpgov.law.harvard.edu/2017/05/29/ma-deal-terms-in-2017-what-can-deal-teams-expect/> (Last accessed: 31 December 2020).

In the M&A context, warranties are provided by both parties, although the scope of warranties provided by the seller is usually much more exhaustive than those provided by the buyer.<sup>39</sup> The drafting of the warranties sections is of particular importance and is heavily negotiated.

Although initial seller drafts may limit the scope of warranties to minimise indemnification and termination risks, a balanced draft would not exclude customary warranties. As a general rule, while the buyer will attempt to obtain the broadest coverage possible (especially if the DD identified gaps, inconsistencies and a considerable number of irregularities), the seller will insist on making only limited warranties that are qualified.

## 2. IP-specific SPA warranties

IP-specific SPA warranties exhibit wide variations in practice. The scope and language of the IP warranties that are appropriate in respect of a deal will depend on a number of factors: the nature of the business of the target, the level of disclosure and information available to the buyer, the bargaining position of the parties, any agreed general principle regarding warranties (e.g. the parties agree not to include warranties confirming “sufficiency of assets”), the wording of other warranties (e.g. whether warranties on assets confirm sufficiency, and whether those include IP rights), and the buyer’s position (e.g. in management buy-outs, the acquirer usually has more knowledge about the business than the sellers themselves) must be all reviewed and assessed.<sup>40</sup>

Notwithstanding the above, IP warranties in SPAs usually cover the following:<sup>41</sup>

(i) the “complete” and “accurate” particulars of IP rights owned, used, held for use, licensed from, or licensed to third parties by the target, together with the particulars of the respective licences, agreements, authorisations and permissions, are set out in a schedule to the SPA;

(ii) apart from the IP rights listed in the SPA as owned and/or owned by the target, the day-to-day ordinary operation of the target does not necessitate other IP rights;<sup>42</sup>

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<sup>39</sup> Buyer warranties are usually restricted to the incorporation, capacity and solvency of the buyer, as well as the due authorisation of the signature, exchange and performance of the transaction documents.

<sup>40</sup> L. G. Bryer and M. Simensky (ed.), *Intellectual property assets in mergers and acquisitions*, (John Wiley & Sons, New York, 2002).

<sup>41</sup> Thomson Reuters Practical Law Global, *Share purchase agreement: cross-border*, [https://uk.practicallaw.thomsonreuters.com/Document/I1559faa0eef211e28578f7ccc38dcbec/View/FullText.html?transition-Type=SearchItem&contextData=\(sc.Search\)&comp=pluk&view=hidealldraftingnotes](https://uk.practicallaw.thomsonreuters.com/Document/I1559faa0eef211e28578f7ccc38dcbec/View/FullText.html?transition-Type=SearchItem&contextData=(sc.Search)&comp=pluk&view=hidealldraftingnotes) (Last accessed: 31 December 2020).

<sup>42</sup> The sufficiency warranty should be double-checked by the seller to ensure that it is consistent with (and does not unintentionally enlarge the scope of) general non-infringement warranties (see the source referred to in Thomson Reuters Practical Law Intellectual Property & Technology, *Promises That Matter: IP Covenants in M&A Transactions*).

(iii) the target is the sole legal and beneficial owner of the IP listed (except for inbound licences), free from all encumbrances;<sup>43</sup>

(iv) the IP owned by the target is valid, subsisting and enforceable; nothing has been done or omitted to be done (and/or agreed to be done or omitted) that would result in any of the target IP rights ceasing to be valid, subsisting or enforceable;

(v) all application and renewal fees related to the registration or the maintenance of the protection of the IP have been duly paid;

(vi) all confidential information owned and/or used by the company has been kept confidential;

(vii) there are no outstanding, threatening or potential claims against the target under any contract or law for employee compensation in respect of IP owned and/or used by the target;<sup>44</sup>

(viii) there are and have been no actual, threatening or pending claims in relation to the ownership, use or validity of the IP rights owned and/or used by the target;

(ix) no third party has infringed the IP rights of the target, or breached confidence;

(x) the target (and, if applicable, its licensees) has not infringed any IP rights of third parties; no action by the target may be considered as a breach of confidence, passing off or actionable act of unfair competition, and no actions of the target have given or may give rise to any (royalty, licence fee or compensation) payment obligations;

(xi) the change-of-control in the target purported by the transaction will not result in the termination of, or have a materially negative impact on, the IP rights of the target; and

(xii) the IP rights listed in the relevant SPA schedule are all that are required to enable the target to continue the conduct of its business (in line with practice applied prior to signing).

In addition to the warranty categories listed above, counsel to the buyer should also insist on including specific warranties that aim to induce “additional disclosure” in respect of those known IP issues, the status of which was not or could not be confirmed during the DD.<sup>45</sup>

<sup>43</sup> Attention should be paid by seller to the scope of the „Encumbrance” definition to make sure that licenses granted to third parties are included (if relevant). Alternatively, seller should double-check whether third-party licenses have been disclosed (see the source referred in Thomson Reuters Practical Law Intellectual Property & Technology, *Promises That Matter: IP Covenants in M&A Transactions.*).

<sup>44</sup> The seller may try to differentiate between material in-licensed IP and IP owned by the target. In addition, validity and enforceability could be qualified by knowledge or limited to the confirmation that no Company IP has been held invalid or unenforceable (based on the source referred in Thomson Reuters Practical Law Intellectual Property & Technology, *Promises That Matter: IP Covenants in M&A Transactions.*).

<sup>45</sup> This particular case may emerge, for instance, if the DD uncovers IP litigation, in relation to which the sellers do not provide any documentation or confirmation, and the status of which thus remains unconfirmed.

## V. INDEMNITIES

Indemnities may be defined as contractual arrangements “under which one party promises to protect another person against a loss, or to compensate another person for a specific liability that that person incurs”.<sup>46</sup>

Indemnities entitle the indemnified party to receive an indemnification payment if the event giving rise to the indemnity obligation of the indemnifying party (as set out in the SPA) takes place. In this regard, there is a similarity between indemnities and warranties: both instruments are risk-sharing and burden-allocating contractual provisions that extend beyond deal completion.<sup>47</sup>

The clear distinction between indemnities and warranties in English and continental M&A practice lies in their relatively clear functional difference: warranties protect the buyer against unknown risks, while indemnities provide the buyer protection against specific risks and irregularities that have been identified during the buyer’s DD or that are otherwise known to the buyer.<sup>48</sup>

US M&A practice differentiates between “regular” and “special (standalone)” indemnities. “Regular indemnities” provide the buyer with a basis for indemnification if a representation or warranty is breached, while “standalone indemnities” are not related to warranty breaches, but to specific and/or identified risks or irregularities (typically spotted by the DD). The English and continental concept of contractual indemnities corresponds to the US application of standalone indemnities, which this section intends to address.

Standalone indemnities typically cover two types of matters: (i) matters for which the acquirer is not ready to assume any liability post-closing, and (ii) matters identified by or otherwise known by the acquirer that pose an unquantifiable or unusual risk.<sup>49</sup> The former category usually includes taxation matters, while the latter should cover – from the buyer’s perspective – all irregularities (including IP problems) identified by the DD that pose such a risk that buyer is not willing to bear.

In addition to the difference in functionality, specific indemnities are typically not limited by the regime applicable to warranties, and they are usually explicitly stressed in the SPA. Nevertheless, the scope and (it is not uncommon that the) limitation of specific indemnities may also form the basis of negotiation.

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<sup>46</sup> R. Farnhill, E. Wall and L. Baillie, *Understanding indemnities: clearing the air*, [https://uk.practicallaw.thomsonreuters.com/1-535-7065?originationContext=document&vr=3.0&rs=PLUK1.0&transitionType=DocumentItem&contextData=\(sc.Default\)&firstPage=true&bhcp=1](https://uk.practicallaw.thomsonreuters.com/1-535-7065?originationContext=document&vr=3.0&rs=PLUK1.0&transitionType=DocumentItem&contextData=(sc.Default)&firstPage=true&bhcp=1) (Last accessed: 31 December 2020).

<sup>47</sup> Thomson Reuters Practical Law Commercial, *Using contractual risk allocation provisions to minimize risk and maximize reward*.

<sup>48</sup> J. Jastrzebski, „Sandbagging” and the distinction between warranty clauses and contractual indemnities, (2019) 19 (2) *UC Davis Business Law Journal*, (208–251) 230.

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

Furthermore, consequences for a warranty breach and the occurrence of an event triggering the indemnity mechanism also differ, in the sense that a warranty breach (unlike the triggering of a standalone indemnity) is *per definitionem* a breach of contract and may result in the payment obligation of the seller, as well as the termination of the relevant contract.<sup>50</sup>

In line with the foregoing, US SPA models tend to apply one single indemnification clause, encompassing covenant and warranty breaches (“regular indemnities”), as well as standalone indemnities,<sup>51</sup> while UK models separate them structurally. A model standalone indemnity clause reads, as follows.

Without limiting any other rights or remedies the Buyer may have, the Seller shall indemnify the Buyer[, the Company and the Subsidiaries] against[, and shall pay to the Buyer a sum equal to,] all liabilities, costs, expenses, damages and losses (including but not limited to any direct, indirect or consequential losses, loss of profit, loss of reputation and all interest, penalties and legal costs (calculated on a full indemnity basis) and all other [reasonable] professional costs and expenses) suffered or incurred by the Buyer, the Company or any of the Subsidiaries arising out of or in connection with any of the following matters: (i) [description of dispute, issue or matter in respect of which an indemnity is to be given]; [...].<sup>52</sup>

The specific IP matters to be referred to in a standalone indemnity should be included and worded based on and in line with the relevant IP-related DD finding. Typical issues and irregularities in respect of which standalone indemnification is sought encompass (among others) IP litigation and infringement matters, incurable gaps in the chain-of-title of registered Company IP, irregularities in public registers in respect of the Company IP (covering the term they persisted), as well as the breach of any IP licence, maintenance or related distributorship agreement, all of which the buyer (and its counsel) is aware based on the DD.

The scope and limitation of (IP-specific) indemnities will be ferociously negotiated by counsels, sellers attempting to keep the specific indemnification provisions as void as possible, and buyers trying to include and specify as many issues identified by the DD as possible.

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<sup>50</sup> C. McCall, *IP indemnities in commercial agreements*, <https://united-kingdom.taylorwessing.com/synapse/ti-ip-indemnities-in-commercial-agreements.html> (Last accessed: 31 December 2020).

<sup>51</sup> See Thompson, *Sinclair on warranties and indemnities on share and asset sales*.

<sup>52</sup> Thomson Reuters Practical Law Corporate, *Share purchase agreement: single corporate seller: non-simultaneous exchange and completion (England and Wales)*, <https://uk.practicallaw.thomsonreuters.com/> (Last accessed: 31 December 2020).

## VI. CONCLUSION

IP issues, irregularities and the consequent, accurate application and drafting of the contractual mechanisms designed to eliminate, diminish and/or allocate risks (whether identified or not) will be of utmost importance in deals where IP problems are numerous and material, or where the target IP is valuable and securing it is a primary factor in the acquisition.

Therefore, specialist IP counsel must be consulted and included in the acquisition team, the level of involvement to be defined on a case-by-case basis, depending on the complexity of the IP matters at hand and the budget available for counsel, as well as any time constraints. On the SPA level, the review of IP-related provisions, namely, the definition of “Intellectual Property”, as well as IP-specific RAPs, may require specialist knowledge to ascertain that:

(i) the definition of “Intellectual Property” (a) (from the buyer’s perspective) covers all categories of IP that may be relevant for the target in all relevant jurisdictions, and (b) (from the seller’s perspective) is not unnecessarily broad;

(ii) the interim operating covenant (a) (from the buyer’s perspective) ensures the proper interim protection of the target IP, and (b) (from the seller’s perspective) does not restrict IP-related actions too excessively;

(iii) IP covenants (a) (from the buyer’s perspective) correct as many known irregularities (preferably prior to the transfer of ownership) as possible, and (from the seller’s perspective) do not pose unnecessary or impossible obligations on the target or the seller;

(iv) IP-related warranties (a) (from the buyer’s perspective) are as wide in scope as possible, with little to no caveats and, at a minimum, cover material points that are necessary to ascertain good and unencumbered title to the target IP and undisturbed operation post-closing, and (b) (from the seller’s perspective) are the narrowest possible in scope with strong limitations; and

(v) IP-related standalone indemnities (a) (from the buyer’s perspective) cover all or at least material IP irregularities that pose unquantifiable financial risk, and (b) (from the seller’s perspective) if provided at all, are as narrow and limited as possible.

As demonstrated above, RAPs are focal points of SPAs and the negotiations leading to the agreed forms, as the parties traditionally take opposing positions. The first seller draft will typically contain as few warranties as possible, caveated by disclosure, knowledge, de minimis and basket thresholds, as well as time constraints; perhaps they will include no standalone indemnities and will be restricted only to a customary covenant set. On the contrary, an aggressive buyer mark-up will likely mirror the DD findings meticulously in unlimited standalone indemnities, will eliminate or weaken warranty limits, strengthen interim operating covenants and specify additional covenants so that as many irregularities are corrected as possible prior to closing.

Counsel can only draft and negotiate RAPs correctly if the DD findings, the particularities of the target industry and target business, as well as the instructions and ultimate goals of the client, are considered carefully and reasonably. At the end of the day, outstanding issues will be closed off in line with the commercial compromises brought about by the parties, allocating risks in line with their respective bargaining positions and risk appetite.



Kende, Tamás\* and Puskás, Gábor\*\*

**Never Say Never:**

## **Consequences of the CJEU Decision in Case C-66/18 *Commission v. Hungary*\*\*\***

### **ABSTRACT**

The CJEU's judgment in case C-66/18 made a significant change to the jurisprudence concerning the status of WTO-law in the EU. While it stopped short of making WTO-law justiciable to individuals and companies, it established that WTO-law can be relied on against Member States in infringement cases. It is likely that if the Commission can rely on WTO-law in infringement cases against Member States based on the decision in case C-66/18, then member States will also have the right to start infringement procedures against each other. It is unclear whether the decision could be a basis for using WTO-obligations in other direct procedures, such as annulment.

The judgment significantly extended the scope of the application of the Charter. It was the first instance where a European court provided interpretation as to the scope of protection provided by Article 13 for educational institutions in light of a Member State's measure limiting institutional autonomy. Member States will have to pay more attention when they adopt measures that have the potential effect of limiting any foreign educational institutions' freedoms as established by the ECHR or the Charter.

**KEYWORDS:** applicability of WTO-law in EU law, applicability of the Charter, rule of law, academic freedom

### **I. INTRODUCTION**

The Court of Justice of the European Union ('CJEU') delivered a judgment on October 6, 2020 in case C-66/18 after long deliberations. The case concerned an amendment to the Hungarian law on national higher education [act CCIV of 2011 ('HEA')] in

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2017 requiring both new and already established foreign universities in Hungary (host state) to prove that they have a physical campus in their home state and if their host and home states did not conclude an international treaty on the university's operation in Hungary within a period of six months they were forced to close and leave the Hungarian market ('HEA Amendment'). Of the 24 established foreign university programmes in Hungary in 2017, one was particularly affected by the new requirement, an American university operating in Hungary, the founder of which was in a political conflict with the Hungarian government – was forced to stop admitting students. The dispute, therefore, primarily concerned the rights of a US-based university teaching in Europe and the applicability of certain international agreements and EU law to higher education institutions established in Europe.

The HEA Amendment seemed to be in conflict with certain General Agreement on Trade in Services (hereinafter 'GATS') schedules and the Charter of Fundamental Rights of the EU. In the schedules, each country identifies the service sectors to which it will apply the market access and national treatment obligations of the GATS and any limitations it wishes to maintain. The GATS differentiates between market access rights (which enable newcomers to enter the market) and the standard of national treatment (that allows established service providers the same treatment as others). In 1997, when ratifying the Marrakesh Agreement, Hungary did not make any exceptions in its Schedule of Commitments annexed to the GATS on its national treatment commitment to established higher education service providers, although it did make an exception applicable to new market entrants.

In the case of both the GATS and the Charter, the question was not so much whether – as a matter of substantive law – the HEA Amendment was in line with Hungary's international and/or European legal obligations. Instead, the question was whether the European Commission was willing and entitled to raise the issue of non-compliance with the GATS and the Charter *vis-à-vis* a member state.

## II. BACKGROUND

The Central European University – a New York State accredited university – has been present on the Hungarian higher education market since the early-1990s. Licensed by the US educational authorities, interestingly, it did not have a presence on the US educational markets, it did not initially have a campus in the state of New York, its formal home state: it was only present in Hungary. The Central European University ('CEU') is one of several dozen US licensed universities in the world that are active in foreign jurisdictions, selling US degrees based on US programmes. More than a dozen of these universities operate in EU countries such as Bulgaria, the Czech Republic, Croatia, France, Germany Ireland, Italy and Spain besides Hungary. Many of these

US universities do not have campuses or activities in the US; their entire operation is carried out in the host state.

Since 2004, CEU had a twin-institution, the Közép-Európai Egyetem ('KEE'), created by an Act of Parliament in Hungary. KEE became an accredited Hungarian university. CEU and KEE cooperated in a symbiosis, functioned within the same building and with the same faculty, and students could enrol in both establishments if they wished to receive both a US and a Hungarian degree. After KEE's creation, CEU did not have an independent campus from KEE.

The HEA dealt with foreign-based universities active in Hungary in its chapter XX and with private and church-based universities in chapter XXVI. Chapter XX concerned CEU and Chapter XXVI concerned KEE.

The Hungarian Government submitted a draft law to the Hungarian Parliament on March 28, 2017 to amend the HEA. This HEA Amendment has become Act 25 of 2017 amending chapter XX of the HEA on April 4, 2017. The HEA Amendment radically changed the conditions under which foreign universities could be established or operate in Hungary.

According to the official explanation, the HEA Amendment followed up on the findings of the Hungarian Education Authority, which examined foreign universities in the autumn of 2016 and discovered discrepancies and serious irregularities in their functioning. In addition, the new regulatory framework also aimed to respond to wider policy imperatives and national security concerns. Under the new Section 76(1) of the HEA, a foreign university could admit students and issue diplomas in Hungary only if four cumulative conditions were met. Out of these four conditions, two had existed since the inception of the HEA. The following two were new conditions: (1) an international treaty is concluded between Hungary and the home country government of the foreign university and (2) the foreign university genuinely offers higher education services in its home country and qualifies there as a recognised university. The law made an exception on the new international treaty requirement to universities with a seat in the European Economic Area. The law was applicable to incumbents with 6 months' lead time and to incoming universities. Later this lead time was prolonged.

The EU Commission sent a letter of formal notice to Hungary. The letter claimed that the law was not compatible with the freedom to provide services and the freedom of establishment<sup>1</sup> and also with the right of academic freedom, the right to education and the freedom to conduct a business as provided by the Charter of Fundamental Rights of the EU, the Union's legal obligations under international trade law. The Commission subsequently issued two reasoned opinions on the matter, in July and October 2017. After inconclusive discussions with Hungary, the EU Commission launched an infringement procedure at the CJEU on February 1, 2018 on legal grounds essentially identical to those listed in the formal notice.

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<sup>1</sup> The letter was sent on April 27, 2017.

In addition, on April 27, 2017, the Parliamentary Assembly of the Council of Europe requested the opinion of the Venice Commission on the new law. It delivered its opinion on the matter in July 2017, and accepted that the new regulatory framework introduced by the Law might legitimately be applied to new market entrant foreign universities. It stated, however, that ‘introducing more stringent rules without very strong reasons, coupled with strict deadlines and severe legal consequences, to foreign universities which are already established in Hungary and have been lawfully operating there for many years, appears highly problematic from the standpoint of rule of law and fundamental rights principles and guarantees’.<sup>2</sup>

In the course of 2017 and 2018, Hungary has concluded international agreements with many home states of universities active in Hungary, such as from China and the state of Maryland, but it did not conclude an international agreement with the state of New York to enable CEU to continue operating. In 2017 CEU established a campus in order to fulfil the ‘genuine teaching activities in the State of origin’ requirement. New York State has accepted the campus for US teaching purposes; Hungary inspected the CEU campus in Annandale-on-Hudson but did not recognise that CEU has complied with the requirement. News organizations close to the government indicated that Hungary considered CEU’s new campus to be insufficient to fulfil the requirement.<sup>3</sup>

### III. THE TIME FACTOR

As described above, the Commission and the Venice Commission both reacted exceptionally quickly to legislative events taking place in March–April 2017, and concluded their processes by July 2017. The Commission did not propose to the Court that it applied an expedited procedure and also did not apply for interim measures. The Court held an oral hearing in June 2019 and decided the case in the autumn of 2020. The most contested provisions of the HEA Amendment came into operation by the end of 2018 following a postponement.

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<sup>2</sup> See Council of Europe, Hungary – Opinion on Article XXV of 4 April 2017 on the Amendment of Act CCIV of 2011 on National Tertiary Education, endorsed by the Venice Commission at its 112th Plenary Session (Venice, 6–7 October 2017), CDL-AD(2017)022-e, 77.

<sup>3</sup> It was called a „Potemkin campus” by the *About Hungary blog*. <https://abouthungary.hu/blog/consider-the-ceus-so-called-campus-in-new-york> (Last accessed: 31 December 2020). The campus was called insufficient by Magyar Idők: „Megdöböntő dolog derült ki a Soros-egyetemről”, <https://www.magyaridok.hu/kulfold/megdobbento-dolog-derult-ki-a-soros-egyetemrol-3624335/> (Last accessed: 31 December 2020) and Mandiner: „Magyar Idők: Itt működik az amerikai CEU”, [https://mandiner.hu/cikk/20181030\\_magyar\\_idok\\_itt\\_mukodik\\_az\\_amerikai\\_ceu](https://mandiner.hu/cikk/20181030_magyar_idok_itt_mukodik_az_amerikai_ceu) (Last accessed: 31 December 2020).

## IV. THE PARTIES' ARGUMENTS

The parties' arguments have not been made public and can be understood only from references in the judgment, but the Commission's arguments must have essentially been the same as in its reasoned opinions.

### 1. Commission

#### *a) International treaty requirement*

The Commission argued that Hungary undertook a full commitment without any limitations in respect of the national treatment determined in GATS, as demonstrated by the 'none' word indicated in the column relating to 'limitations on national treatment' in the Schedule of Commitments. The Commission also argued that, although there is a limitation made by Hungary in the column relating to 'limitations on market access' referred to in Article XVI of the GATS, according to which the 'establishment of schools is subject to license from the central authorities', this is too vague and general and therefore it cannot be considered to relate to the national treatment obligation.

The Commission's conclusion was that Hungary has committed itself to applying, to service providers from third country members of the WTO, treatment no less favourable than that which Hungary accords to its domestic providers and that national treatment is infringed when Hungary requires an international treaty to be concluded between Hungary itself and the relevant institutions State of origin. The Commission saw this requirement as clearly arbitrary as Hungary, as a sovereign state, has the discretion to decide whether to enter into such a treaty and, if yes, with what content and even if the other State was ready to enter into a treaty then Hungary had the right to refuse to do so.

The Commission stressed that Hungary's discretion to enter into negotiations with the other State concerned demonstrates that the requirement does not meet the condition for exceptions laid down in Article XIV of the GATS, which Hungary referred to, because such exceptions cannot be 'applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services'.

#### *b) The 'genuine teaching activities in the State of origin' requirement*

The Commission pointed out that this requirement modifies competition for the benefit of Hungarian service providers and may have the effect of preventing foreign providers to enter into the Hungarian market and it infringes the national treatment obligation, fully committed to by Hungary, and is also discriminatory.

As to the justifications argued by Hungary, the Commission was of the opinion that Hungary had failed to provide any substantive evidence as to why this requirement contributes to maintaining public order or what is the genuine and sufficiently serious threat posed to one of the fundamental interests of Hungarian society that justifies the modification of competition. The Commission noted that, even if there was a proper justification for the purpose of maintaining public order, Hungary would have had to demonstrate that there was no other, less restrictive alternative.

According to the Commission, private institutions, such as CEU, carrying out teaching and scientific research activities in Hungary, can indeed rely on their right to the freedom of establishment under Article 49 TFEU and the requirement constitutes a restriction on this freedom.

Finally, the Commission brought in the argument of this requirement breaching the freedom to provide services under Article 16 of the Services Directive and, alternatively, Article 56 TFEU on the same freedom.

## 2. Hungary

Hungary primarily contended – as it follows from an obiter dictum in the AG’s opinion and the judgment – that Hungary’s GATS obligations may not be brought up by the Commission in front of the CJEU and were obliged to have claimed that Arts 49 and 56 of the TFEU and the Services Directive<sup>4</sup> were inapplicable in this case.

### *a) International treaty requirement*

Hungary contended that the general license condition relating to ‘limitations on market access’ constitutes a limitation of the national treatment obligation, despite the fact that the limitation was not indicated in the other, relevant column relating to limitations on national treatment. According to Hungary’s interpretation, the limitation in the ‘wrong’ column was formulated in such a general way so that it enabled the wide discretion of the Member State in restricting the establishment of foreign higher education institutions and the possibility to adjust the relevant legal framework, e.g. by introducing a new requirement to conclude international treaties.

Hungary noted that the requirement’s objective was to intensify the diplomatic relations in the cultural and educational sector and the fact that two different treaties had indeed been concluded<sup>5</sup> shows that the condition was not impossible to fulfil.

As to the justification of an exception under Article XIV of the GATS, Hungary argued that the international treaty requirement is necessary for the ‘purposes of

<sup>4</sup> Directive 2006/123/EC of the European Parliament and of the Council of 12 December 2006 on services in the internal market OJ L 376, 27.12.2006, p. 36–68.

<sup>5</sup> One by Maryland (USA) and the other with the Republic of China.

maintaining public order and preventing deceptive practices' and serves to ensure that the home State (in which the seat of the institution concerned is situated) considers that provider to be 'reliable', in compliance with that other State's laws and supports the institution's future activities in Hungary.

**b) The 'genuine teaching activities in the State of origin' requirement**

Hungary's argument in relation to this requirement was basically identical to its arguments relating to the international treaty requirement. The justification pleaded by Hungary for the modification of the competition rules was maintaining public order and preventing of deceptive practices.

As to the application of Article 49 TFEU (freedom of establishment), Hungary argued that this Article is not applicable to the CEU because it is a school financed mostly from private funds and the education it offers cannot be considered an 'economic activity'. Relating to the restriction element, Hungary contended that this requirement does not qualify as a restriction because it relates to the operation and not the form of establishment and it does not prevent a foreign entity from setting up a branch, for example, in Hungary.

**c) Other arguments**

Regarding the application of Article 49 TFEU (freedom of establishment), Hungary argued that education and training offered by educational institutions financed largely by private funds could not be characterized as 'economic activity' within the meaning of the TFEU if it is the service provider itself which finances the teaching activities and Article 49 TFEU was therefore not applicable.

## **V. THE ADVOCATE GENERAL'S OPINION**

Advocate General Kokott's opinion was rendered on March 5, 2020 and raised important arguments in favour of the Commission, which CJEU agreed with and reflected in the judgment, relating to both the restriction of freedom to provide services under the GATS and the violation of the academic freedom principle and the freedom to establish educational establishments as part of the right to education incorporated into the Charter of Fundamental Rights of the European Union.

### **1. The applicability of the GATS**

According to the AG, with reference to settled case-law, the CJEU has jurisdiction to hear claims related to a Member State's obligation to comply with WTO law and in this case specifically, the GATS, because international agreements concluded by the EU form



an integral part of EU's legal order and they are binding on EU institution and Member States alike under Article 216(2) TFEU.<sup>6</sup> In addition, Article 207 TFEU provides that the external competence of the EU for trade in services, established previously under Article 133 of the Lisbon Treaty, is now exclusively within the framework of the CCP, i.e. the EU's Common Commercial Policy. The AG then went on to conclude that GATS obligations, as obligations stemming from an international agreement on trade in services, were transferred from the Member States to the EU so they also constitute an obligation under EU law and thus, can be subject to an infringement procedure.

The second part of the AG's arguments on the applicability of the GATS was related to the responsibility of the EU under international law for infringements of the GATS by Member States. As outlined above, it is fully binding on the EU. As the EU cannot influence the Member States as to how they implement the GATS within their own regulatory competence, Member States' actions within its scope can ultimately be attributed to the EU itself. According to the CJEU case-law, the Member States, when they implement on a national level their obligations under an international agreement, fulfil an obligation in relation to the EU and the EU has basically assumed responsibility, externally, for the due performance of the agreement.<sup>7</sup>

This is substantiated by the Member States' duty of sincere cooperation under Article 4(3) TFEU, which acts as a limit on the exercise of competence.<sup>8</sup> It follows from this that Member States are free to exercise their internal competence to regulate higher education, but only to the extent that the relevant rules do not infringe their obligations under the GATS. This would not only render the European Union responsible in international law, but also expose the other Member States to the risk of countermeasures.

As it can be seen, the AG took the position that GATS obligations may be brought up in front of the CJEU in infringement proceedings but only in infringement procedures. *The AG did not go so far as to say that, for example, individuals or companies could sue for non-compliance with the GATS.*

## 2. International treaty requirement

On the substance, the AG's opinion first examined the requirement of the conclusion of an international treaty between Hungary and the State of origin (in the CEU's case, the United States) in order to be granted an operating licence in Hungary and

<sup>6</sup> Article 216(2) TFEU: Agreements concluded by the Union are binding upon the institutions of the Union and on its Member States.

<sup>7</sup> Most recently see *Commission v France* (C-239/03, EU:C:2004:598, paragraph 26).

<sup>8</sup> (3) Pursuant to the principle of sincere cooperation, the Union and the Member States shall, in full mutual respect, assist each other in carrying out tasks which flow from the Treaties.

the collision of such requirement with Article XVII:1 of the GATS and Hungary's specific commitment for the higher education sector. According to AG Kokott, an infringement of a Member State's obligation under an international treaty such as the GATS also constitutes an infringement of that particular Member State's obligation under Article 216(2) TFEU, which provides that international treaties concluded by the EU are binding upon both the EU institutions and the Member States.

AG Kokott took the position that the international treaty requirement introduced by the disputed HEA Amendment constituted a manifest infringement of the GATS on multiple levels. First, it was in breach of the principle of the national treatment obligation required by the GATS, as it restricted foreign higher education institutions (that are considered 'service suppliers' under GATS) and distorted competition to the detriment of higher education institutions seated in non-EU countries. Second, the GATS opt-in system enabled sovereigns to include limitations on their national treatment commitments and Hungary could have included such specific limitations regarding the establishment or operation of schools in its Schedule of Commitments annexed to the GATS but, as a matter of fact, Hungary did not list any such limitations. Hungary was, therefore, according to AG Kokott, fully obliged to accord national treatment without any restrictions to US and other higher education service providers.

AG Kokott did not find Hungary's defence based on Article XIV of the GATS to be well-founded either. This Article provides for exceptions if the measure at issue is necessary to guarantee public policy and public security or to prevent deceptive and fraudulent practices. AG Kokott took the position that the international treaty requirement was not a permissible exception but rather a measure enabling the Hungarian authorities to exercise arbitrary discrimination, which is expressly prohibited by the very same Article XIV of GATS, which provides that such exceptions cannot be applied in a manner which constitutes an 'arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services'.

The AG's opinion pointed out that the international treaty requirement could not be regarded as an objective criterion combating fraud because it covered not just newly established institutions but established schools as well, and established schools were already operating under the control of the host state (Hungary) so an international treaty cannot be relevant. The AG was also of the opinion that an international treaty could not prevent any fraudulent activities of the higher education institutions concerned in the host state. AG Kokott also agreed with the Commission's argument that an international treaty necessarily involved the exercise of political discretion and it is not fully amenable to judicial review, which means that the condition requiring an international treaty between Hungary and the State of origin ultimately falls within the control of Hungary.

### 3. The ‘genuine teaching activities in the State of origin’ requirement

The second part of the restrictions provided by the disputed Hungarian laws was that every school was required to have genuine teaching activities in the State of origin if it wished to continue its operation in Hungary. Compared to the international treaty requirement, which affected non-EU and non-EEA third countries, this legal requirement concerned every non-Hungarian school originating in any country other than Hungary. This meant that the possible violation of the freedom of establishment principle incorporated in Article 49 and 54 of the TFEU had to be examined as well.

According to AG Kokott, the requirement of having an ‘establishment’ in a foreign country clearly impedes the ability of foreign institutions to commence (‘the right to take up and pursue activities’ under Article 49 TFEU) higher education activities in Hungary and it does not qualify as a special treatment of foreign nationals as allowed by Article 52(1) TFEU on grounds of public policy, public security or public health, as Hungary did not provide any reasonable grounds that the disputed law fulfils these criteria.

This requirement also raised the question of compatibility with Article 2(1) of Directive 2006/123/EC, aka the Services Directive, which provides in general that ‘Member States shall respect the right of providers to provide services in a Member State other than that in which they are established’ and also that the ‘Member State in which the service is provided shall ensure free access to and free exercise of a service activity within its territory’. As already established by case-law,<sup>9</sup> privately financed schools constitute services, since ‘the aim of such establishments is to offer a service for remuneration’.

As a possible limitation of Article 2(1), Article 16(1) and (3) of the Services Directive enables Member States to regulate access to or exercise of a service activity in their territory subject to compliance with requirements which are non-discriminatory, necessary and proportionate which must serve to maintain public policy, public security, public health or the protection of the environment. According to GA Kokott, however, the reviewed Hungarian law was clearly discriminatory, not justified on the grounds of protection of public policy and there was no overriding public interest behind it.

For reasons already presented above, the AG opinion found that this ‘genuine teaching activity in the State of origin’ requirement also breached Article 13 and 14(3) of the Charter and Article XVII of the GATS in conjunction with Article 216(2) TFEU in the same way as the international treaty requirement.

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<sup>9</sup> Most recently, see para 48 of the judgment dated 27 June 2017 in *Congregación de Escuelas Pías Provincia Betania*, C-74/16, EU:C:2017:496.

#### 4. Applicability of the Charter

As to the possible infringement of the right to education and academic freedom enshrined in the Charter, the Advocate General took the novel position that although the Charter is applicable first and foremost to EU institutions and only secondly to Member States ‘when they are implementing EU law’, the implementation criteria should be interpreted broadly.

According to AG Kokott, the individual commitments of Member States under the GATS constitute obligations on the EU under international law. In her view, Member States basically ‘represent’ the EU when they put into effect the EU’s obligations by implementing measures in their own regulatory competence. In other words, the Member States fulfil an obligation in relation to the EU under international law for which the EU assumed responsibility. Hence, the AG argued, because Article XIV of the GATS imposes an obligation of national treatment on Hungary and the Hungarian legislation is not compatible with this obligation, this invokes the application of Article 14(3) of the Charter providing for the freedom to establish and operate educational institutions and which also protects the commercial side of higher educational institutions operating in the field of privately-financed education. In the view of AG Kokott, the purpose of Article 14(3) of the Charter is to guarantee the continuous existence of private educational establishments in parallel with State-financed colleges and universities and thus provide a diverse spectrum of education opportunities.

#### 5. Right to education and academic freedom

On the substantive matter of the Charter, although the exercise of the freedom to establish and operate educational institutions must comply with the relevant national laws and this gives Member States the possibility to enact legal measures that regulate the conditions and operation of such institutions, such measures must be in line with the proportionality requirement under Article 52(1) of the Charter. Hungary cited various justifications for the disputed national law, including the protection of public policy, in particular against deceptive and fraudulent practices, and the assurance of the quality of teaching courses but, according to the AG, these arguments were not substantiated by Hungary and they do not underline Hungary’s argument that the international treaty requirement is a lawful limitation of Article 14(3), i.e. the freedom to found educational establishments.

In addition, Article 13 of the Charter provides that ‘academic freedom shall be respected,’ which complements the protection provided for the organisational and institutional framework by Article 14. In settled case-law, academic freedom is understood as a broader freedom to hold opinion and as a fundamental right to

communication and a requirement prescribed by national law, which provides that no teaching and no research activity can be continued at an institution unless the condition is fulfilled is in clear breach of these freedoms and, similarly to the Article 14(3) argument, it does not fulfil the proportionality criteria set out in Article 52(1).

## VI. THE COURT'S DECISION

In the oral hearing, the Court extensively questioned both the Commission and Hungary about the GATS arguments and granted until March 2020 to the AG to deliver her opinion. The Court then took six months to deliver its judgment following receipt of AG Kokott's opinion.

### 1. The applicability of the GATS and the applicability of the Charter

#### a) The GATS

Despite settled case law holding that WTO law lacked direct effect and therefore could not be relied on against member states,<sup>10</sup> the Court (and the AG) relied on another precedent decision<sup>11</sup> to come up with a creative solution on the applicability of WTO norms: They maintained the non-justiciability of WTO norms for non-state actors, but opened the gates for infringement actions by the Commission when there is an alleged infringement of a WTO obligation by a member state and a related risk to the EU incurring liability under international law through WTO dispute settlement.<sup>12</sup>

The Court reiterated the arguments raised in AG Kokott's opinion that WTO law formed an integral part of EU law and the GATS falls within the Common Commercial Policy, where the EU has exclusive competence. Second, the CJEU also followed AG Kokott's lead by accepting that if legislative provisions adopted by Hungary were incompatible with the GATS and it is part of the EU's legal regime,

<sup>10</sup> See originally in Joined Cases C-21–24/72, *International Fruit Company*, 1972 E.C.R. 1219, and later restated in Case C-149/96, *Portugal v. Council*, 1999 E.C.R. I-8395.

<sup>11</sup> The AG stated in her opinion in paragraph 63: 'The Court has already answered that question in the affirmative in *Commission v Germany*, where it reviewed a national measure in the light of an agreement concluded within the framework of the General Agreement on Tariffs and Trade (GATT).' [Citing Case C-61/94, *Comm'n v. Germany*, ECLI:EU:C:1996:313, 16 (Sept. 10, 1996).] In paragraph 64 she added: 'I consider that the Court was essentially correct in its view in that decision that the considerations on the basis of which a review of EU acts in the light of the WTO Agreement is precluded cannot be applied to infringements of WTO law by Member States. The possibility of bringing infringement proceedings against a Member State does not run counter to the aims and particular character of dispute settlement in the WTO.'

<sup>12</sup> Para. 39 of Judgment dated 13 November 2003 in *Neri*, C-153/02, EU:C:2003:614.

Hungary indirectly failed to comply with EU law. The CJEU drew the conclusion that the objective of the infringement proceedings was to ensure that the EU does not incur any international responsibility<sup>13</sup> in a situation in which there is a risk of a dispute being brought before the WTO.

### **b) The Charter**

The Charter's applicability raised interesting questions for the Court, because Article 51(1) on the scope of the Charter provides that the provisions of the Charter are addressed to the Member States only 'when they are implementing Union law', so the Court first had to establish whether Hungary implemented EU law. With reference to case-law, the Court established that because an international agreement entered into by the EU is, from its entry into force, an integral part of EU law,<sup>14</sup> the GATS therefore also forms part of EU law. According to the Court, it follows from this that, when a Member State performs its obligations under the GATS; that is, Hungary accord the national treatment obligation under Article XVII(1) in this present case, it is actually implementing EU law within the meaning of Article 51(1) of the Charter.

Furthermore, the Court added when a Member State argues that a particular measure which actually restricts a fundamental freedom enshrined in the TFEU is justified by an overriding reason in the public interest recognised by EU law, such a measure must be regarded as implementing EU law within the meaning of Article 51(1) of the Charter, such that it must comply with the fundamental rights enshrined in the Charter.<sup>15</sup>

## **2. International treaty requirement**

The Court was of the view that the obligations and the limitations of commitments under the GATS were clear and simple. Each and every member had the possibility to make limitations to various undertakings relating to specific sectors and modes of supply. The terms, limitations and conditions relating to 'limitations on market access' and the conditions and qualifications relating to 'limitations on national treatment' are set out in two separate columns and Hungary made no limitation in

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<sup>13</sup> The CJEU uses the term liability but in correct international legal terminology, it should be talking about state responsibility.

<sup>14</sup> See, in particular, judgments of 30 April 1974, *Haegeman*, 181/73, EU:C:1974:41, paragraphs 5 and 6 of 21 December 2011, *Air Transport Association of America and Others*, C-366/10, EU:C:2011:864, paragraph 73; and Opinion 1/17 (EU-Canada CET Agreement) of 30 April 2019, EU:C:2019:341, paragraph 117.

<sup>15</sup> See para. 101 of Judgment dated 18 June 2020, *Commission v Hungary* (Transparency of associations), C-78/18, EU:C:2020:476.



the national treatment section. Article XX(2) of the GATS provides for a rule that enables limitations in the market access column to be applicable to national treatment as well, but only if the particular limitation is discriminatory. The Court therefore examined whether these rules can be applied in the present case but the market access limitation made by Hungary was worded in a way that was applicable across all higher education institutions and it was not discriminatory, so the limitation in the market access column cannot be interpreted in any event as a limitation also affecting Hungary's national treatment obligation.

The Court went on to examine whether the requirement under Hungarian law actually modified the competition in favour of service suppliers seated in Hungary under Articles XVII(2) of the GATS and, by adapting AG Kokott's arguments, it was of the view that Hungary has discretion, both as to whether it is appropriate to conclude such a treaty and as regards its content, which means that third country operators are entirely dependent on Hungary to be able to comply with the international treaty requirement.

As to the justifications for the modification of competition prohibited by the GATS pleaded by Hungary, maintenance of public order and prevention of deceptive and fraudulent practices, the Court found that Hungary did not put forward substantive and detailed arguments on how the operation of a third country higher education supplier like CEU in Hungary would constitute, without the required international treaty, a genuine and sufficiently serious threat affecting a fundamental interest of Hungarian society or how the requirement would prevent such operators from engaging in deceptive and fraudulent activities.

The Court also referred back to AG Kokott's opinion that, in accordance with Article XIV of the GATS, the 'exceptions listed cannot be applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services'.

### **3. The 'genuine teaching activities in the State of origin' requirement**

The second disputed measure was approached by the Court from two different perspectives. First, in relation to third country operators, the measure was examined under Article XVII (national treatment) and XIV (justification of exception) of the GATS, identically to the review of the international treatment measure. Second, in relation to EU operators, it was examined whether it complies with Article 49 TFEU (freedom of establishment) and Article 16 of the Services Directive (freedom to provide services).

The Court's finding regarding the national treatment under the GATS of third country operators like CEU was very similar to the findings made in relation to the



international treaty requirement. As already established for the first measure, the Court took the same position as the Commission and AG Kokott and ruled that Hungary was fully committed to the national treatment obligation without any limitation. The Court also found that the requirement to pursue educational activities in the State of origin is a clear modification of competition and the justifications on which Hungary relied, maintaining the public order and the prevention of deceptive practices were not adequately substantiated by Hungary and, thus, are unfounded.

The more interesting part was the Court's arguments relating to the infringement of Hungary's obligation under the TFEU and the Services Directive in relation to schools having their seat in an EU Member State. Because Article 49 TFEU provides the freedom of establishment for economic activities, the Court had to examine whether a higher education institution can rely on this right or not. Already established by case-law, the Court noted that the provision of higher education courses for remuneration constitutes an economic activity for the purposes of Article 49 (and in a broader sense, Chapter 2 of the TFEU) when provided by a national of one Member State in another Member State.<sup>16</sup>

In another case, the Court has also ruled that the freedom of establishment extends to a higher education institution that has its seat in a Member State other than Hungary and offers education or training for remuneration in Hungary.<sup>17</sup> And finally, the Court also held in another case<sup>18</sup> that any measure 'which prohibits, impedes or renders less attractive the exercise of the freedom of establishment must be regarded as a restriction on that freedom' and, thus, the requirement of pursuing genuine teaching activities not just in Hungary but in the State of origin as well is not in compliance with Article 49 TFEU, unless it is justified by special circumstances.

As to the justification of the measure, Hungary first argued that this requirement serves the maintenance of the public order, second, it is of public interest relating to the prevention of deceptive practices and third, ensures the good quality of higher education but Hungary did not provide sufficient explanation as to why these justifications are applicable and why the measure addresses these concerns.

Following up on the Commission's arguments, the Court also examined whether the measure is in compliance with the Services Directive and Article 56, TFEU both of which provides for the freedom to provide services. Contrary to Hungary's allegation, the Court was of the view that higher education institutions providing courses for remuneration indeed fall into the category of economic activity for the purposes of the Services Directive. Also, the requirement of institutions to provide higher education services in the State of their seat imposes an additional condition on service providers and is capable of restricting the free exercise of the right to provide higher education services in Hungary.

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<sup>16</sup> Para 39 of Judgment dated 13 November 2003 in *Neri*, C-153/02, EU:C:2003:614.

<sup>17</sup> Para 38 of Judgment dated 25 October 2017 in *Polbud – Wykonawstwo*, C-106/16, EU:C:2017:804.

<sup>18</sup> Para 26 of Judgment dated 6 September 2012, *Commission v Portugal*, C-38/10, EU:C:2012:521.

The Court did not accept the justification offered by Hungary that the requirement was necessary for reasons of public policy and public security under Article 16(1) of the Services Directive, as these were not substantiated in detail.

#### **4. Breach of Arts 49 and 56 TFEU and the Services Directive**

As the CJEU established, Arts 49 and 56 of the TFEU and the Services Directive were applicable because Article 49(1) TFEU prohibits any restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State and, according to the Court, the genuine teaching requirement which means that a higher educational institution must provide services in its state of origin (a Member State of the EU) in order to provide higher education services in Hungary (another Member State of the EU) gives rise to the suspicion that the freedom of establishment is restricted.

The Services Directive applies to services supplied by providers established in a Member State and protects the freedom to provide services in any other Member State. The definition of 'service' covers any self-employed economic activity, normally provided for remuneration, as referred to in Article 57 TFEU. Therefore, the Services Directive was applicable because the HEA concerned, in general terms, education services that may be provided by foreign higher education institutions in Hungary and, therefore, also the provision of education or training courses for remuneration.

Although the Commission suggested Hungary's possible infringement of the freedom to provide services enshrined in Article 56 TFEU as well, the Court did not investigate this allegation because it already established the infringement of Hungary's obligations under the Services Directive.

#### **5. Examination of the measures based on the Charter**

After establishing the applicability of the Charter, the Court went to examine whether the measures constituted a limitation of the fundamental rights and if yes, whether they were justified. The Court examined the HEA Amendment as to whether Hungary complied with its obligations under Article 13 (freedom of the arts and sciences), Article 14(3) (right to education) and Article 16 (freedom to conduct a business) of the Charter.

The Court accepted AG Kokott's argument that the concept of 'academic freedom' under Article 13 of the Charter must be understood in a broad way. The Court also referred to a recommendation of the Council of Europe from 2006,<sup>19</sup> according

<sup>19</sup> Recommendation 1762 (2006), adopted by the Parliamentary Assembly of the Council of Europe on 30 June 2006 and entitled 'Academic freedom and university autonomy'.

to which academic freedom ‘also incorporates an institutional and organisational dimension, a link to an organisational structure being an essential prerequisite for teaching and research activities’.

In addition, the freedom to found educational establishments and the freedom to conduct a business, as incorporated, respectively, in Article 14(3) and Article 16 of the Charter also need to be respected as the different freedom applicable to the same higher education institution affected by the measures.

The Court found that the Hungarian measures are capable of restricting these freedoms because they can ‘render uncertain or exclude the very possibility of founding a higher education institution, or of continuing to operate an existing higher education institution, in Hungary’.

According to Article 52(1) of the Charter, the rights and freedoms incorporated in the Charter can be limited only if such ‘limitations are necessary and genuinely meet objectives of general interest recognised by the Union or the need to protect the rights and freedoms of others’ (principle of proportionality). Hungary relied on the same justifications as those mentioned above but the Court found that measures at issue were not justified by any of the objectives of general interest as recognised by the EU.

## 6. Summary of the Judgment

Accordingly, the Court held that, by introducing the ‘international treaty’ requirement, Hungary infringed its national treatment obligation under Article XVII of GATS, and by introducing the ‘genuine teaching activities in the State of origin’ requirement, Hungary (in relation of higher education institutions having their seat in third countries), infringed its national treatment obligation under Article XVII of the GATS and (in relation to higher education institutions having their seat in EU countries) infringed Article 49 TFEU and Article 16 of the Services Directive, both on the freedom to provide services. The Court also held that Hungary failed to fulfil its obligations under Article 13 (freedom of the arts and sciences), Article 14(3) (right to education) and Article 16 (freedom to conduct a business) of the Charter.

## VII. ANALYSIS

Case C-66/18 constitutes interesting developments in the CJEU’s practice on the admissibility of WTO law-based claims in infringement procedures and also on the applicability of the Charter to actions by the Member States.

In case C-66/18, the Commission and the Court was confronted with a dilemma as so often in the preceding years. Facing apparent or alleged breaches of democratic

values of Art 2 of the TEU – so-called ‘democratic backsliding’ – the Commission had no legal tools to speak of. Instead, the Commission had to resort to the technical toolkit consisting essentially of the EU’s four freedoms, such as in the case of the compulsory retirement of judges.<sup>20</sup> While the case was about the independence of the judiciary, it was dealt with as a case of age discrimination. This is why the FBI’s nailing of Al Capone was a fitting parallel. He could not be arrested for his activities as a mobster but he was imprisoned for failing to pay his taxes.<sup>21</sup>

In case C-66/18, the Commission claimed Hungary acted in breach of the freedom to provide services and of the Services Directive, so its claim was similar to the recent NGO case, where Hungary was also found to have acted in breach of the freedom to provide services.<sup>22</sup>

Additionally in case C-66/18, the Commission claimed that Hungary’s action (amendment of the HEA) constituted a breach of the EU’s international obligations (technically, it made the EU breach its obligations and allowed other WTO members to sue the EU). The Commission based its claim on highly technical documents: WTO Schedules from 1997 on exceptions to the freedom to provide certain services by established service providers.

The Commission also claimed that the Charter was applicable and academic freedom was breached.

Everything was disputed in this case, even whether Hungary ticked the rights box on those schedules and whether ticking the other box – the one for new market entrants – also meant an exception regarding established market players. Hungary has also disputed whether the Commission had the right to bring Hungary to court for violation of WTO norms, whether Charter based norms in this case were binding on Hungary and whether EU freedom to provide services and freedom of establishment norms applied to higher education at all, especially if it was fully funded (i.e. the students needed to pay for the services).

Some say that the judgment in C-66/18 is an improvement over previous case-law related to de facto rule of law cases and provides some ammunition for the EU to strengthen its power related to rule-of-law issues *vis-à-vis* Member States.<sup>23</sup> Others also highlight the importance the Court’s innovative approach to the old topic of applicability of WTO law in the EU, especially in procedures where the EU institutions and Member

<sup>20</sup> Case C-286/12, *Comm’n v. Hungary*, ECLI:EU:C:2012:687 (Nov. 6, 2012) on the compulsory retirement of judges, prosecutors and notaries.

<sup>21</sup> See article I. Cs. Nagy, *The Commission’s Al Capone Tricks. Using GATS to protect academic freedom in the European Union*, (2020), <https://verfassungsblog.de/the-commissions-al-capone-tricks/> (Last accessed: 31 December 2020).

<sup>22</sup> C-78/18, *Commission v Hungary* (Transparency of associations) ECLI:EU:C:2020:476.

<sup>23</sup> Case C-286/12, *Comm’n v. Hungary*, ECLI:EU:C:2012:687 (Nov. 6, 2012) on the compulsory retirement of judges, prosecutors and notaries.

States clash.<sup>24</sup> Many claim that case C-66/18 marks the first significant appearance of the protection by the Court of academic freedom as a fundamental human right.<sup>25</sup>

In our view the AG and – following in her footsteps – the CJEU took at least three innovative steps in this case with interesting consequences:

1. Despite settled case law holding that WTO law lacked direct effect and therefore could not be relied on against member states,<sup>26</sup> the CJEU relied on another precedent<sup>27</sup> to come up with a creative solution on the applicability of WTO norms: the Court maintained the non-justiciability of WTO norms for non-state actors, but opened the gates for infringement actions by the Commission when there is an alleged infringement of a WTO obligation by a member state and a related risk to the EU of incurring liability under international law through WTO dispute settlement.

The CJEU accepted the Commission's argument that it had the right to sue a Member State for a breach by the MS of an international obligation of the EU including when no third party has raised the matter of a breach of international law and no international court established illegality. The CJEU accepted the argument that it (and not only the Disputes Settlement Body) had the competence to establish a breach of WTO obligations.

However, to arrive there, the Court first had to tackle why the GATS – a mixed trade agreement to be concluded jointly by the EU and its Member States – can be used as applicable legal grounds in an infringement procedure between the European Commission and a Member State. The CJEU had to come up with a new argument because, in previous cases, the direct application of WTO law was always denied, and it was received wisdom that neither individuals or companies, nor Member States can seek the annulment of EU measures contrary to WTO law. This showed in practice

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<sup>24</sup> See article MTA–DE Public Service Research Group Kutatócsoport 5, *ECJ delivers ruling on the incompatibility with EU law of "lex CEU"*, <https://publicgoods.eu/ecj-delivers-ruling-incompatibility-eu-law-lex-ceu> (Last accessed: 31 December 2020).

<sup>25</sup> See articles R. Uitz, *Finally: The CJEU Defends Academic Freedom*, <https://verfassungsblog.de/finally-the-cjeu-defends-academic-freedom/> (Last accessed: 31 December 2020) and R. Uitz, *Academic Freedom in an Illiberal Democracy: From Rule of Law through Rule by Law to Rule by Men in Hungary*, <https://verfassungsblog.de/academic-freedom-in-an-illiberal-democracy-from-rule-of-law-through-rule-by-law-to-rule-by-men-in-hungary/> (Last accessed: 31 December 2020).

<sup>26</sup> See originally in Joined Cases C-21–24/72, *International Fruit Company*, 1972 E.C.R. 1219, and later restated in Case C-149/96, *Portugal v. Council*, 1999 E.C.R. I–8395.

<sup>27</sup> The AG stated in her opinion in paragraph 63: 'The Court has already answered that question in the affirmative in *Commission v Germany*, where it reviewed a national measure in the light of an agreement concluded within the framework of the General Agreement on Tariffs and Trade (GATT).' [citing Case C-61/94, *Comm'n v. Germany*, ECLI:EU:C:1996:313, 16 (Sept. 10, 1996)]. In paragraph 64 she added: 'I consider that the Court was essentially correct in its view in that decision that the considerations on the basis of which a review of EU acts in the light of the WTO Agreement is precluded cannot be applied to infringements of WTO law by Member States. The possibility of bringing infringement proceedings against a Member State does not run counter to the aims and particular character of dispute settlement in the WTO.'

in the WTO's Bananas decision<sup>28</sup> where the EU decided to ignore the ruling and, as a consequence, the US imposed regulatory tariffs on goods exported from the EU that were not even related to the decision. Nevertheless, the manufacturers, who suffered the consequences of the imposed tariffs, turned to the CJEU but their claims for damages against the Commission were denied. The CJEU was of the opinion that it could not assess the legality of EU measures based on WTO law.<sup>29</sup> So, basically, the Court said that a breach of an international law obligation by the EU does not automatically mean an infringement under EU law, of which that particular international law provision is part. There was a time when an Advocate General argued that both Member State and EU measures should be reviewable for their compliance with WTO law but the Court finally took the opposite position.<sup>30</sup>

And then, in the CEU case, the CJEU held that (1) a domestic measure implemented by Hungary was in violation of WTO law constituting a part of EU law and, therefore, (2) Hungary's infringement can be established.

This could indeed be reminiscent of *Animal farm*<sup>31</sup> where 'some are more equal than others': Member States and individuals cannot enforce their rights arising from the EU's WTO obligations. but the EU can enforce the Member States' breaches of their WTO obligations whether or not third parties are already making claims as a consequence of that breach or the DSB has taken a decision. This also means that the WTO's DSB remains the sole body to assess the compliance of an EU measure with WTO law, while the Member States' responsibility for non-compliance with WTO law can be determined by the CJEU and the DSB.

By examining the relationship between the existence of the WTO's Dispute Settlement Board (DSB) as an international law dispute settlement mechanism and jurisdiction of the CJEU in the CEU case, which was strongly debated by Hungary for various political and legal reasons,<sup>32</sup> the CJEU's judgment established for the first time that the parallel existence of these two legal venues does not prevent the CJEU to establish in an infringement procedure that a Member State has failed to comply with its international law obligations under GATS when the possible liability of the EU under international law arises. The CJEU complemented this finding by clearly making the distinction that the WTO bodies are not bound by the CJEU's decision which

<sup>28</sup> WTO, *European Communities – Regime for the importation, sale and distribution of bananas*, Appellate Body Report, WT/DS27/AB/R, 9 September 1997.

<sup>29</sup> Joined cases C-120/06 P and C-121/06 P, *FLAMM and Fedon v. Council and Commission*, Judgment of 9 September 2008, ECLI:EU:C:2008:476, para. 111.

<sup>30</sup> Case C-61/94, *AG Opinion*, paras 23–24.

<sup>31</sup> G. Orwell, *Animal Farm: A Fairy Story*, (Secker and Warburg, London, 1945).

<sup>32</sup> See article at P. Bárd, *A Strong Judgment in a Moot Case: Lex CEU before the CJEU*, <https://reconnect-europe.eu/blog/a-strong-judgment-in-a-moot-case-lex-ceu-before-the-cjeu/> (Last accessed: 31 December 2020).



means the Member States, or the EU, cannot escape their international law obligations by referring to a court judgment.

In C-66/18 judicial policy appeared in the making: the CJEU does not have a problem with the operation of parallel venues regarding WTO law breaches of Member States but it does have a problem when its monopoly on the interpretation of EU law is threatened by the likes of ICSID.<sup>33</sup>

2. The Court accepted or rather, made it its own,<sup>34</sup> AG Kokott's broad interpretation of the concept of 'academic freedom' under Article 13 of the Charter and found that the HEA – by giving the state the right to block or to stop university programs with absolute discretion – is capable of restricting this freedom. The Court found, therefore, that matters relating to the organization of universities, such as their right of establishment and operation are covered by the principle of academic freedom incorporated in the Charter.

3. It was never disputed that the Charter's applicability to EU Member States is secondary and limited. This results from the plain language of Article 51(1) of the Charter. Even so, the Court has extended the Charter's applicability in several decisions over the past decade.<sup>35</sup>

In case C-66/18 it, held that the Charter was applicable because, (1) The GATS is a part of EU law and (2) in performing their obligations under it, Member States were in fact implementing EU law.

However, there was a small logical problem because the CJEU – in the first part of the judgment – established that Hungary acted in breach of Article XVII of the GATS. Acting in breach of an international obligation normally means failing to implement it.

The CJEU then went to logical step further when it established that the mere fact that a Member State uses a GATS exception or an exception to the freedom to provide services or the Services Directive to justify a national measure triggers the application of the Charter.

The Court established that a measure contrary to EU law 'must be regarded as implementing EU law'.<sup>36</sup> Therefore, such a measure must comply with the fundamental

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<sup>33</sup> *Slovak Republic v. Achmea*, (C-284/16) ECLI:EU:C:2018:158.

<sup>34</sup> J. Bornemann, *Academic freedom in illiberal times – A bittersweet victory for the Central European University*, <https://europeanlawblog.eu/2020/10/21/academic-freedom-in-illiberal-times-a-bittersweet-victory-for-the-central-european-university/> (Last accessed: 31 December 2020).

<sup>35</sup> C-617/10, *Åklagaren és Hans Åkerberg Fransson*, ECLI:EU:C:2013:105; C-06/13, *Cruciano Siragusa kontra Regione Sicilia – Soprintendenza Beni Culturali e Ambientali di Palermo*, ECLI:EU:C:2014:126.

<sup>36</sup> Para 214 of the CJEU judgment provides: 'Second, where a Member State argues that a measure of which it is the author and which restricts a fundamental freedom guaranteed by the FEU Treaty is justified by an overriding reason in the public interest recognised by EU law, such a measure must be regarded as implementing EU law within the meaning of Article 51(1) of the Charter, such that it must comply with the fundamental rights enshrined in the Charter (judgment of 18 June 2020, *Commission*



rights enshrined in the Charter and the Charter's application depends on the assumption that the GATS is EU law and that the CEU act implements EU law under Article 51(1) of the Charter.

The fact that the CJEU has established in C-66/18 that a state measure can be both a violation of WTO/EU law and the Charter may have interesting and potentially unintended consequences. If a directly applicable/effective (mostly but not exclusively economic) right protected by the Charter is also a right protected by the directly inapplicable WTO legal provisions then individuals or companies could try to make claims for EU measures for breaches of the Charter, in EU courts or in domestic proceedings.

So, through the back door of human rights, the economic rights of individuals and companies directly or indirectly originating from the WTO documents could be directly enforced.

However, the same is probably not true for Members States based on C-66/18. It would be hard to imagine a situation where a MS would sue the Commission for breach of a WTO obligation based on the Charter.

But the old saying will be especially true here: 'never say never...!'

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*v Hungary (Transparency of associations)*, C-78/18, EU:C:2020:476, para. 101 and the case-law cited). The same applies with respect to Article 16 of Directive 2006/123.'

Gosztonyi, Gergely\*

# The Contribution of the Court of Justice of the European Union to a Better Understanding the Liability and Monitoring Issues Regarding Intermediary Service Providers

## ABSTRACT

Section 4 of the Directive on electronic commerce (ECD) established significant regulations concerning the liability of intermediary service providers regarding illegal content in the European Union. However, over the past twenty years, it has become apparent that its details are not adequately developed. The Court of Justice of the European Union (ECJ) in Luxembourg performs significant legislative action in this field. Its rulings touch upon the concept of ‘information society services’, the active or passive role of service providers and issues regarding the general prohibition of monitoring obligations. The present study examines the practices and role of the Court of Justice of the European Union, as this organisation has significantly contributed to moving in the direction of having legislation that is more suitable for meeting present-day demands concerning internet liability.

**KEYWORDS:** information society services, notice-and-takedown system, prohibition of general monitoring, case law, Google France, L’Oréal, UPC Telekabel Wien, Sotiris Papasavvas, Tobias Mc Fadden, Eva Glawischnig-Piesczek

## I. INTRODUCTION

One of the current ‘hot topics’ about the regulation of Internet is who can be held liable for infringing content. In the European Union, the central element of the regulatory framework is Section 4 of the Directive on electronic commerce (ECD),<sup>1</sup> which is

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<sup>1</sup> Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market (‘Directive on electronic commerce’), OJ L 178, 17.7.2000 1–16.

entitled ‘Liability of intermediary service providers’.<sup>2</sup> The regulatory framework employs a three-pronged set of definitions, the first two of which (‘mere conduit’ and ‘caching’) give service providers immunity from liability similar to that provided by Section 230(c) (1) of the US Communications Decency Act.<sup>3</sup> Of more interest, however, is the issue of liability of hosting providers, for which rules are set out in Article 14 of the ECD. According to this, the provider is in principle liable for the content hosted on it and is exempt from liability if (a) it has no actual knowledge of illegal activity or information and, as far as claims are concerned, no knowledge of facts or circumstances which would clearly indicate illegal activity or information; or (b) as soon as it becomes aware of such activity or information, it takes immediate steps to remove or disable access to it.<sup>4</sup>

The (relative)<sup>5</sup> novelty of the European system is therefore this commonly used *notice-and-takedown system* (NTDS<sup>6</sup>), which has thus introduced a multi-stage system of conditions and procedures: the intermediary service provider must have certain knowledge of content that is manifestly illegal and must take steps to remove it within a specified time. It can therefore be concluded that, in contrast to US regulation, the European Union has opted for a different model (also known as the ‘safe harbour model’<sup>7</sup>), which focuses on a non-automatic exemption.<sup>8</sup>

In addition to the NTDS, the provisions of Article 15 of the ECD should be highlighted, as it is stated in addition to the above provisions that Member States shall not impose a general obligation on service providers to (a) monitor the information they transmit or store, or (b) that they should investigate facts or circumstances indicating illegal activity.<sup>9</sup> This rule does not therefore oblige service providers, and therefore social

<sup>2</sup> C. Wendehorst, Platform Intermediary Services and Duties under the E-Commerce Directive and the Consumer Rights Directive, (2016) 5 (1) *Journal of European Consumer and Market Law*, 30–33.

<sup>3</sup> Communications Decency Act (CDA), Pub. L. No. 104-104 (Tit. V), 110 Stat. 133 (Feb. 8, 1996).

<sup>4</sup> ECD, [14].

<sup>5</sup> The procedure already appeared in 1998 in the DMCA [The Digital Millennium Copyright Act (DMCA), Pub. L. No. 105-304, 112 Stat. 2860 (Oct. 28, 1998)]; however, only to be applied in copyright infringement issues. See M. Peguera, The DMCA Safe Harbors and Their European Counterparts: A Comparative Analysis of Some Common Problems, (2009) 32 (4) *Columbia Journal of Law & the Arts*, 481–512.

<sup>6</sup> A. de Streel et al., *Online Platforms’ Moderation of Illegal Content Online. Law, Practices and Options for Reform*, (European Parliament, Luxembourg, 2020) 10.

<sup>7</sup> T. Madiaga, *Reform of the EU liability regime for online intermediaries: Background on the forthcoming Digital Services Act*, European Parliamentary Research Service, PE.649.404 (Brussels, 2020), [https://www.europarl.europa.eu/RegData/etudes/IDAN/2020/649404/EPRS\\_IDA\(2020\)649404\\_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/IDAN/2020/649404/EPRS_IDA(2020)649404_EN.pdf) (Last accessed: 31 December 2020) 1–2.

<sup>8</sup> It is important to note, however, that, under Article 14(3) of the ECD, Member States have the possibility to establish procedures to regulate the removal or withdrawal of access to information.

<sup>9</sup> However, it must be stressed – as has been addressed in subsequent case law – that Article 47 of the ECD states that ‘this does not concern monitoring obligations in a specific case and, in particular, does not affect orders by national authorities in accordance with national legislation’.

media, to monitor content posted on their sites on a continuous basis<sup>10</sup> (*prohibition of general monitoring*).<sup>11</sup>

The problem that had to be faced, however, is that ‘the way the ECD is implemented varies widely across the EU and that national jurisprudence on online liability remains very fragmented today’.<sup>12</sup> This is compounded by the *good Samaritan paradox*,<sup>13</sup> i.e. the practice whereby platform providers prefer to remain passive because they lose the possibility of immunity from liability if they are active.

It is fair to say that, in the twenty years since the adoption of the ECD, there have been professional debates on a number of issues (such as when to declare that a provider has actual knowledge; what constitutes manifestly illegal content; what is the time limit within which a provider must act; and whether we are talking about an active or passive type of provider; but it has been suggested that there should be more than one type of procedure for different types of content and greater emphasis should also be placed on cybercrime<sup>14</sup>), but the careful interpretation of the rules – without which it is not possible to determine whether content has been lawfully removed or whether there are censorship effects – is often left to international courts.

## II. LANDMARK LEGAL CASES BEFORE THE COURT OF JUSTICE OF THE EUROPEAN UNION

The two most important international courts for detailing the rules on platform provider liability in the ECD are the Court of Justice of the European Union (ECJ) in Luxembourg and the European Court of Human Rights (ECtHR) in Strasbourg.<sup>15</sup> These courts take into account each other’s judgments in which human rights violations are invoked; furthermore, ‘through judicial law development, the ECJ has developed robust doctrines of fundamental rights protection, even though formally

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<sup>10</sup> J. van Hoboken et al., *Hosting intermediary services and illegal content online. An analysis of the scope of article 14 ECD in light of developments in the online service landscape: final report*, (Publications Office, Luxembourg, 2018) 45–47.

<sup>11</sup> J. Oster, *European and International Media Law*, (Cambridge University Press, Cambridge, 2017) 234–236.

<sup>12</sup> Madiega, *Reform of the EU liability regime for online intermediaries...* Summary.

<sup>13</sup> P. Strömbäck, Good Samaritan Paradox, *Netopia*, 12.06.2020., <http://www.netopia.eu/good-samaritan-paradox-paradox> (Last accessed: 31 December 2020).

<sup>14</sup> Sorbán, K., The role of Internet intermediaries in combatting cybercrime: obligations and liability, in Nemeslaki, A., et al. (eds), *Central and Eastern European eDem and eGov Days*, (Austrian Computer Society, Wien, 2019) 19–31. <https://doi.org/10.24989/ocgv335.1>

<sup>15</sup> For the related practice of the ECtHR see G. Gosztonyi, How the European Court of Human Rights Contributed to Understanding Liability Issues of Internet Service Providers, (2019) (58) *Annales Universitatis Scientiarum Budapestinensis de Rolando Eötvös Nominatae – Sectio Iuridica*, 121–133. <https://doi.org/10.56749/annales.elteajk.2019.lviii.7.121>

the ECJ is not a human rights court, so that fundamental rights protection is a mere secondary corollary of the ECJ's work'.<sup>16</sup> This is all the more important because, as Oreste Pollicino notes, 'The ECtHR and the ECJ protect freedom of expression in very different ways. While the former actually functions as a court of fundamental constitutional law, the latter is more influenced by the original economic nature of the European Community'.<sup>17</sup> These differences are also evident in the practice of the two courts in relation to issues of moderation or content regulation of platform providers.

In the Delphi case<sup>18</sup> before the ECtHR, Estonia noted that the ECJ 'had never adjudicated on a case similar to the Delfi case'.<sup>19</sup> In response, the ECtHR referred to the L'Oréal case but, in fact, the ECJ had already dealt with the issue a year earlier. Before examining the cases concerned in relation to the practice of the ECJ, it is worth referring to Oreste Pollicino's study, in which he writes that 'the ECJ takes its decisions in the context of preliminary procedures. In this case, it is the national courts that play the decisive role, which refer questions to the ECJ. This difference (compared to the ECtHR<sup>20</sup>) leads the Luxembourg court to play a de facto role in the adjudication of fundamental rights'.<sup>21</sup>

In the present study, it is therefore worth following the practice of the ECJ on this issue, as the ECJ – alongside the ECtHR, of course – has contributed a number of key judgments which will allow the EU to move in a more modern direction with regard to liability.

<sup>16</sup> M. Daka, *The European Convention on Human Rights and the European Union's system of fundamental rights protection – convergence and divergence in the European legal space*, PhD Thesis, (PTE AJK, Pécs, 2020), <https://ajk.pte.hu/sites/ajk.pte.hu/files/file/doktori-iskola/daka-marija/daka-marija-muhelyvita-ertekezes.pdf> (Last accessed: 31 December 2020) 72.

<sup>17</sup> O. Pollicino, Judicial protection of fundamental rights in the transition from the world of atoms to the word of bits: the case of freedom of speech, (2019) 25 (2) *European Law Journal*, (155–168) 168. <https://doi.org/10.1111/eulj.12311>

<sup>18</sup> Nádori P., Delfi AS v. Észtország: strasbourgi döntés a névtelen kommentekért viselt szolgáltatói felelősségről (Delfi AS v. Estonia: Strasbourg's decision on service provider liability for anonymous comments), (2013) 10 (56) *Infokommunikáció és Jog*, 131–140.; Nádori P., Úton a tömeges internetes szólás jogi megítélésének új megközelítése felé. A strasbourgi Nagykamara ítélete a Delfi-ügyben (On the way to a new approach to the legal assessment of mass online speech. The Strasbourg Grand Chamber's ruling in the Delfi case), (2019) (2) *In Medias Res*, (343–366) 362.

<sup>19</sup> *Delfi AS v. Estonia*, App no. 64569/09 (ECtHR, 16 June 2015), [85].

<sup>20</sup> Author's note.

<sup>21</sup> Pollicino, Judicial protection of fundamental rights in the transition from the world of atoms to the word of bits: the case of freedom of speech, 161. For more details see G. de Burca, After the EU Charter of Fundamental Rights: The Court of Justice as a Human Rights Adjudicator?, (2013) 20 *Maastricht Journal of European & Competition Law*, 168–184. <https://doi.org/10.1177/1023263X1302000202>

### **1. *Google France SARL and Google Inc. v Louis Vuitton Malletier SA, Google France SARL v Viaticum SA and Luteciel SARL, Google France SARL v Centre national de recherche en relations humaines (CNRRH) SARL and others (2010)***<sup>22</sup>

In the first major case on this issue, several different trademark owners sued Google's French subsidiary and the cases were consolidated. In each case, the lawsuits concerned the use of their trademarks by the Google search engine as part of a paid referencing service called 'AdWords', with the results leading to pages of counterfeit products. All parties concerned asked the national court to find Google liable for the infringement. Google argued that it had no control over the linked sites and therefore could not be held liable. The case was referred to the ECJ, which, in view of the complexity and importance of the case, acted as a Grand Chamber and took the view that, (a) search engine services are clearly 'information society services' under the ECD<sup>23</sup> and, (b) Google is not a passive, technical service provider, since it is the company's criteria that determine the order of the results and, second, it can change the order of the results on the basis of the paid service.<sup>24</sup> The ECJ therefore indicated to the national court in this case that a general exemption is not conceivable in the case in question, but that it is for the national court to examine whether the service provider has an active role in the products in question.<sup>25</sup>

### **2. *L'Oréal SA and others v eBay International AG and others (2011)***<sup>26</sup>

In the second milestone case, the French cosmetics company L'Oréal reported to the online marketplace eBay that counterfeit versions of its products were being sold under the L'Oréal brand name on several occasions, while the marketplace prohibits the sale of counterfeit goods in contracts signed by its users. In addition, L'Oréal products

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<sup>22</sup> Judgments of 23 March 2010 in Joined Cases C-236/08, *Google France SARL and Google Inc. v Louis Vuitton Malletier SA*, C-237/08, *Google France SARL v Viaticum SA and Luteciel SARL* and C-238/08, *Google France SARL v Centre national de recherche en relations humaines (CNRRH) SARL and Others*, ECLI:EU:C:2010:159.

<sup>23</sup> Ibid. [110].

<sup>24</sup> Ibid. [115].

<sup>25</sup> However, it is worth highlighting what the *Harvard Law Review* indicated about the case and the more logical reasoning of Advocate General Poiares Maduro's application to the ECJ: 'The Advocate General's opinion demonstrates, however, that a more traditional analysis could have avoided the flaws in the court's reasoning while still achieving the same result. [...] Traditional doctrine would have served the ECJ well in Google France, even in the age of the internet.' N/A, Joined Cases C-236/08, C-237/08 & C-238/08, *Google France SARL v. Louis Vuitton Malletier SA*, (2010) 124 *Harvard Law Review*, (648–655) 655.

<sup>26</sup> Judgment of 12 July 2011 in Case C-324/09, *L'Oréal SA and others v eBay International AG and others*, ECLI:EU:C:2011:474.

intended for testing (and not for sale) have also been put up for sale on the website. The cosmetics company held eBay (and in particular the European subsidiary that operates eBay.co.uk in this case) liable, while it also sued Google, which, after searching for the name of the cosmetics products, also displayed ads for these counterfeit products, which were not for sale, on eBay.

Judge Arnold in the case raised a number of possibilities that eBay could use to detect or minimise problems without having to monitor the content uploaded to it across the board, but noted that just because all of these things are possible does not mean that it is legally required to do them.

I am in no doubt that it would be possible for eBay Europe to do more than they currently do. For example, it would appear to be possible for eBay Europe to take some or all of the following steps, although some would be more technically challenging and costly than others:

- a) filter listings before they are posted on the Site;
- b) use additional filters, including filters to detect listings of testers and other not-for-sale products and unboxed products;
- c) filter descriptions as well as titles;
- d) require sellers to disclose their names and addresses when listing items, at least when listing items in a manner which suggests that they are selling in the course of trade;
- e) impose additional restrictions on the volumes of high-risk products, such as fragrances and cosmetics, that can be listed at any one time;
- f) be more consistent in their policies, for example regarding sales of unboxed products;
- g) adopt policies to combat types of infringement which are not presently addressed, and in particular the sale of non-EEA goods without the consent of the trade mark owners;
- h) take greater account of negative feedback, particularly feedback concerning counterfeits;
- i) apply sanctions more rigorously; and
- j) be more rigorous in suspending accounts linked to those of users whose accounts have been suspended (although it is fair to say that the evidence is that eBay Europe have recently improved their performance in this regard).<sup>27</sup>

On the basis of all these observations, the English court referred the matter to the ECJ, *inter alia*, as to whether and under what conditions Article 14 of the ECD applies to the operator of an online marketplace. The ECJ clearly took the view that the answer was in the affirmative, namely that the relevant legal position applies to operators of online marketplaces.<sup>28</sup> As regards liability, the ECJ indicated, as in the Google France case, that

<sup>27</sup> *L'Oréal SA v. eBay International AG*, [2009] RPC 21, [2009] ETMR 53, [2009] EWHC 1094 (Ch), [277].

<sup>28</sup> Judgment of 12 July 2011 in Case C-324/09, *L'Oréal SA and others v eBay International AG and others*, ECLI:EU:C:2011:474, [109].



an exemption from liability for neutral, passive-type operators is conceivable, but that in the present case eBay actively contributed to the success of the sales (for example, in some cases by helping to optimize prices or by advertising certain products),<sup>29</sup> hence it does not have a case for exemption from liability. The ECJ therefore indicated to the national court in this case that a general exemption cannot be envisaged in this particular case, but that it is for the national court to assess whether there is an active role for the service provider in relation to L'Oréal's products in the particular case. If the answer to that question is in the affirmative then liability can be established. It should be noted that the ECJ judgment led some scholars (e.g. Christine Riefa)<sup>30</sup> to conclude that service providers would have a general duty to monitor thereafter, but the ECJ did not take such a view in the formal documents in the case.<sup>31</sup>

### **3. *UPC Telekabel Wien GmbH v Constantin Film Verleih GmbH and Wega Filmproduktionsgesellschaft mbH* (2014)<sup>32</sup>**

As a background to the case, two German film distribution companies informed UPC Telekabel in Austria that some of their copyrighted films were being downloaded without their knowledge from the kino.to website, which uses UPC's internet service. The two companies demanded that the kino.to website be completely shut down or made inaccessible. UPC denied responsibility, claiming that it had not been involved in the transmission of the copyrighted content. The case was referred to the ECJ, which, although it did not refer to the ECD but to the Copyright Directive,<sup>33</sup> held that an internet service provider which (also) transmits protected content to the public is an intermediary service provider and that there is no need for a contractual relationship between the internet service provider and the rightholder of the protected content to establish this. The ECJ held that the choice of how and by what technical means an

<sup>29</sup> Ibid. [114].

<sup>30</sup> C. Riefa, The end of Internet Service Providers liability as we know it – Uncovering the consumer interest in ECJ Case C-324/09 (L'Oréal/eBay), (2012) (1) *Zeitschrift für Europäisches Unternehmens- und Verbraucherrecht*, 104–111. <https://doi.org/10.1007/s13590-012-0006-x>

<sup>31</sup> K. Gilbert, L'Oréal v. eBay: ECJ Judgment, (2011) *SCL*, <https://www.scl.org/news/2165-l-or-al-v-ebay-ecj-judgment> (Last accessed: 31 December 2020).

<sup>32</sup> Judgment of 27 March 2014 in Case C-314/12, *UPC Telekabel Wien GmbH v Constantin Film Verleih GmbH and Wega Filmproduktionsgesellschaft mbH*, ECLI:EU:C:2014:192.

<sup>33</sup> Although the present study does not aim to examine the 2019 copyright directive, it is worth noting that its regulation of content removal is a unique phenomenon in the system. Directive (EU) 2019/790 of the European Parliament and of the Council of 17 April 2019 on copyright and related rights in the Digital Single Market and amending Directives 96/9/EC and 2001/29/EC (Text with EEA relevance.), PE/51/2019/REV/1, OJ L 130, 17.5.2019 92–125. See F. Romero-Moreno, Notice and staydown and social media: amending Article 13 of the Proposed Directive on Copyright, (2019) 33 (2) *International Review of Law, Computers & Technology*, 187–210. <https://doi.org/10.1080/13600869.2018.1475906>

internet service provider protects intellectual property is left to its own discretion,<sup>34</sup> and that it is for the national courts to determine whether this is lawful. The solution must, however, take account of two conjunctive conditions: (a) the measures taken must not unnecessarily deprive internet users of the possibility of lawful access to the information available and (b) those measures must prevent unauthorised access to the protected subject-matter or, at the very least, make it more difficult and seriously discourage internet users from accessing content made available to them in breach of intellectual property rights.<sup>35</sup>

#### 4. *Sotiris Papasavvas v O Fileleftheros Dimosia Etaireia Ltd and others* (2014)<sup>36</sup>

In the case, which was referred to the ECJ by a Cypriot court in a preliminary ruling, Sotiris Papasavvas sued a newspaper publishing company, its editor-in-chief and two journalists over online content he felt was defamatory. The national court referred the case to the ECJ on, *inter alia*, whether the rules of the ECD on ‘information society services’ (a) preclude the assessment of civil liability, (b) apply to the online interface of a printed newspaper, and (c) whether it is relevant whether the online interface is available free of charge or in exchange for payment.

On the basis of Article 3(1) of the ECD, the ECJ made it clear that Cyprus may lay down rules (in this case concerning defamation) in relation to ‘information society services’, which are in no way excluded by the ECD. In answering the second question, the ECJ first answered the third question: the relevant element for exemption from liability is not whether the content is paid or free, but whether the provider plays an active or passive role in relation to the content in question.<sup>37</sup> The ECJ clearly stated that, since the content in question was the online publication of content produced by the publisher of a printed newspaper, the active role cannot be called into question. However, the online interface of a printed newspaper was not considered by the ECJ to be an ‘information society service’ and the second question was not answered.<sup>38</sup>

<sup>34</sup> F. F. Wang, Site-blocking Orders in the EU: Justifications and Feasibility, in *14th Annual Intellectual Property Scholars Conference (IPSC)*, Boalt Hall School of Law, University of California, Berkeley, August 7-8, 2014, [https://www.law.berkeley.edu/files/Wang\\_Faye\\_Fangfei\\_IPSC\\_paper\\_2014.pdf](https://www.law.berkeley.edu/files/Wang_Faye_Fangfei_IPSC_paper_2014.pdf) (Last accessed: 31 December 2020) 2.

<sup>35</sup> Judgment of 27 March 2014 in Case C-314/12, *UPC Telekabel Wien GmbH v Constantin Film Verleih GmbH and Wega Filmproduktionsgesellschaft mbH*, ECLI:EU:C:2014:192, [64].

<sup>36</sup> Judgment of 11 September 2014 in Case C-291/13, *Sotiris Papasavvas v O Fileleftheros Dimosia Etaireia Ltd and others*, ECLI:EU:C:2014:2209.

<sup>37</sup> *Ibid.* [46].

<sup>38</sup> *Ibid.* [48].

### 5. *Tobias Mc Fadden v Sony Music Entertainment Germany GmbH* (2016)<sup>39</sup>

Tobias Mc Fadden ran a shop selling light and sound equipment in Germany and, in order to better serve his customers, he also offered them free access to a Wi-Fi network without password protection. In 2010, Sony Music officially notified him that a copyrighted track was available on the network. Mc Fadden went to court, asking for a negative declaration (*negative Feststellungsklage*), as known in German law, confirming that he was not liable for the infringement in providing the network, as he had no right to control the content. Sony Music filed a counterclaim seeking a declaration that Mc Fadden is directly liable in addition to damages. As Mc Fadden did not appear before the national court, the counterclaim of Sony Music was granted. Mc Fadden appealed, and the national court referred the matter to the ECJ, asking, *inter alia*, (a) whether the provision of the Wi-Fi network is an ‘information society service’, (b) whether it is a mere transmission service and whether Article 12 of the ECD applies, (c) whether it is relevant that the provider offered access to the Wi-Fi network as an additional service to its original market profile, and (d) whether the national court could order the provider to provide the Wi-Fi network only with some form of protection.

The ECJ made it clear that the provision of a Wi-Fi network is an ‘information society service’. It came to this conclusion by means of a negative inference, as nothing in the definition of the term excludes it – so this case could be read to be significant for the extension of the scope of the legislation. Moreover, the ECJ noted that it is sufficient for the service provider to offer the service in order to promote the service according to its original market profile,<sup>40</sup> it is not necessary for the concept to be fulfilled either to set a separate remuneration for this service<sup>41</sup> or to have a separate contractual relationship with the users of the network.<sup>42</sup> With regard to liability, the ECJ – maintaining its previous position – pointed out that the exemption applies if the conditions of Article 12 of the ECD are fulfilled. The ECJ specifically underlined that the fulfilment of the conditions of Article 14 of the ECD does not apply *mutatis mutandis* in a case involving a simple transmission service within the meaning of Article 12 of the ECD.<sup>43</sup> Of particular interest for our purposes is the issue of the protection of the national court’s access to the network, where the ECJ (by a majority) accepted Advocate General Szpunar’s Opinion.<sup>44</sup> The ECJ stated that, although the national court is responsible for

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<sup>39</sup> Judgment of 15 September 2016 in Case C-484/14, *Tobias Mc Fadden v Sony Music Entertainment Germany GmbH*, ECLI:EU:C:2016:689.

<sup>40</sup> *Ibid.* [43].

<sup>41</sup> *Ibid.* [41].

<sup>42</sup> *Ibid.* [50].

<sup>43</sup> *Ibid.* [65].

<sup>44</sup> Opinion of Advocate General Szpunar in Case C-484/14, *Tobias Mc Fadden v Sony Music Entertainment Germany GmbH*, ECLI:EU:C:2016:170, [125–150].

the administration of justice under national and EU law, of the three technical solutions hypothetically proposed by the national court (termination of service,<sup>45</sup> password protection<sup>46</sup> or general traffic monitoring obligations<sup>47</sup>), only password protection could pass the test of legality.<sup>48</sup> That is also only if the three conflicting fundamental rights in the present case are duly balanced by the national court, i.e. freedom of expression, freedom to conduct a business and intellectual property rights, are all upheld.<sup>49</sup> The difficulty of all this in the context of constant technological development has been described by Ciarán Burke and Alexandra Molitorisová as a ‘catch me if you can game’.<sup>50</sup> Martin Husovec went even further, arguing that the ECJ, due to its own framing problem, has thus drilled a new hole in the ‘safe harbour’ paradigm of protection.<sup>51</sup>

### 6. *Eva Glawischnig-Piesczek v Facebook Ireland Limited (2019)*<sup>52</sup>

In the *Glawischnig-Piesczek* case, the ECJ had to take a position on another point of the ECD, namely Article 15 and the prohibition of general monitoring. Whereas in the *L’Oréal* case examined above, and also in the two *SABAM* cases,<sup>53</sup> the ECJ had previously concluded that general monitoring was not an obligation for service providers, there appears to be a slight change of direction on this issue in the present case. In it, a defamatory text about the Austrian MEP Eva Glawischnig-Piesczek was published on Facebook along with her photo. She asked the service provider not only to remove the content in question, but also to remove all similar content. The national court ordered the service provider to remove not only the content of the incriminated content but also all similar content brought to the defendant’s attention by the plaintiff.

<sup>45</sup> Judgment of 15 September 2016 in Case C-484/14, *Tobias Mc Fadden v Sony Music Entertainment Germany GmbH*, ECLI:EU:C:2016:689, [89].

<sup>46</sup> Ibid. [99].

<sup>47</sup> Ibid. [87].

<sup>48</sup> In his opinion, Advocate General Szpunar questioned the legality of all three methods.

<sup>49</sup> B. J. Jütte, ECJ sheds light on liability for operators of open Wi-Fi networks, *European Law Blog*, 28.09.2016., <https://europeanlawblog.eu/2016/09/28/ECJ-sheds-light-on-liability-for-operators-of-open-wi-fi-networks-case-c-48414-mc-fadden-v-sony-music> (Last accessed: 31 December 2020).

<sup>50</sup> C. Burke and A. Molitorisová, What Does It Matter Who is Browsing? (2017) (8) *Journal of Intellectual Property, Information Technology and E-Commerce Law*, (238–253) 241.

<sup>51</sup> M. Husovec, Holey Cap! CJEU Drills (Yet) Another Hole in the E-Commerce Directive’s Safe Harbors, (2017) 12 (2) *Journal of Intellectual Property Law & Practice*, (115–125) 125. <https://doi.org/10.1093/jiplp/jpw203>

<sup>52</sup> Judgment of 3 October 2019 in Case C-18-18, *Eva Glawischnig-Piesczek v Facebook Ireland Limited*, ECLI:EU:C:2019:821.

<sup>53</sup> Judgment of 24 November 2011 in Case C-70/10, *Scarlet Extended SA v Société belge des auteurs, compositeurs et éditeurs SCRL (SABAM)*, ECLI:EU:C:2011:771; Judgment of 16 February 2012 in Case C-360/10, *Belgische Vereniging van Auteurs, Componisten en Uitgevers CVBA (SABAM) v Netlog NV*, ECLI:EU:C:2012:85.

However, the national court referred the matter to the ECJ asking, *inter alia*, (a) whether it is possible to apply the NTDS not only to the content in question, but also to any similar content that may be shared, (b) if so, what are the conditions for establishing similarity, (c) whether it is possible by national legislation or a court to impose such a requirement on the provider not only within the country concerned, and (d) whether such obligations do not conflict with the prohibition of a ‘general obligation to monitor’.

In its decision, the ECJ pointed out that ‘information society services are characterised both by its rapidity and by its geographical extent’<sup>54</sup> and that ‘there is a genuine risk that information which was held to be illegal is subsequently reproduced and shared by another user of that network’.<sup>55</sup> On this basis, the ECJ concluded that Member States have the possibility not only to require that content be removed, but also to impose such requirements on any similar content that may be shared.<sup>56</sup> The reasoning behind this decision is that if the ban were to apply only to a particular piece of content, ‘the effects of such an injunction could easily be circumvented by the storing of messages which are scarcely different from those which were previously declared to be illegal’<sup>57</sup> and the aggrieved party would have to bring new proceedings in each case.

However, the ECJ stressed that, contrary to the national court’s finding, the removal of such content should not only be done at the request of the aggrieved party, as this would impose an undue burden on the legislator or the law enforcement authorities. In order to establish identity, it is necessary to compare the content and not merely the words, but this can only be done if it ‘does not require the host provider to carry out an independent assessment’<sup>58</sup> as with that, an undue burden would be placed on it. As these can be achieved by automated means, the ECJ also considered it appropriate to balance the conflicting fundamental rights<sup>59</sup> and, on the other hand, summarised, with reference to Article 47 of the ECD, that the requirement of *ad hoc monitoring* does not conflict with Article 15 of the ECD. With regard to the extraterritorial scope,<sup>60</sup> the ECJ stated

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<sup>54</sup> Judgment of 3 October 2019 in Case C-18-18, *Eva Glawischnig-Piesczek v Facebook Ireland Limited*, ECLI:EU:C:2019:821, [3].

<sup>55</sup> *Ibid.* [36].

<sup>56</sup> This is known as *notice-and-staydown* (NSD). A. Kuczerawy, *Intermediary Liability and Freedom of Expression in the EU: from Concepts to Safeguards*, (Intersentia, Cambridge, 2018) 38.

<sup>57</sup> *Ibid.* 41.

<sup>58</sup> *Ibid.* 46.

<sup>59</sup> The complexity of the issue is illustrated by the fact that, after the decision, some commentators have predicted the ‘legal death’ of active/passive differentiation. A. Andolina and A. T. Ferrari, Court of Rome and ECJ again on Internet Service Providers’ liability: two days of ordinary (dis)harmonization, *Lexology*, 27.01.2020., <https://www.lexology.com/library/detail.aspx?g=f3bcbdbb-1689-46df-a126-100d0868a2b9> (Last accessed: 31 December 2020).

<sup>60</sup> For an illustration of how the issues are interrelated in the field of media law, in relation to extraterritoriality and the right to be forgotten (RTBF), see Láncoš P. L., *Az elfeledtetéshez való jog és az extraterritorialitás kérdései* (The right to be forgotten and extraterritoriality), (2017) (6) *In Medias Res*, 365–370.

that the ECD does not contain a prohibition<sup>61</sup> in this respect, so that national legislation may oblige service providers to apply a prohibition beyond their national borders ‘within the framework of the relevant international law’.<sup>62</sup> All this – however much the ECJ refers to Article 47 of the ECD – seems to be more a general monitoring than a specific case.<sup>63</sup>

### III. SUMMARY

As we have seen, the practice of the ECJ covers a wide range of questions in relation to the ECD. The ECJ has made important clarifying statements on the concept of ‘information society services’, stating that whether a search engine service, an online marketplace or the provision of a Wi-Fi network is covered by the concept and thus by the regulation. Moreover, the ECJ also used negative inference, thereby extending the scope of the regulation.

This also includes the fact that the ECJ has clearly stated, on the basis of Article 3(1) of the ECD, that national legislation may establish civil liability for ‘information society services’, as this option is in no way excluded by the ECD. In addition, the ECJ has consistently maintained in its decisions that, in relation to the active or passive role of service providers, only neutral, passive service providers can be exempted from liability in the application of the rules.

The last significant issue that the ECJ has addressed – and on which the ECtHR has not yet reached a settled position<sup>64</sup> – is the issue of the general prohibition of the obligation to monitor in Article 15 of the ECD. However, it should be noted in this context that the ECJ seems to have made a minor policy change in the time between the *L’Oréal* case in 2011 and the *Eva Glawischnig-Piesczek* case in 2019 and, although it referred to case-by-case monitoring, it seems to have shifted towards the adoption of general monitoring when analysing the case.

Although the decisions of the ECJ and the ECtHR differ on certain issues, the case law of the two international courts contributes significantly to a better understanding of the rules of the ECD and to a more solid basis for the national courts to address the liability issues of internet service providers and of the internet as a complex and constantly changing ecosystem.

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<sup>61</sup> Judgment of 3 October 2019 in Case C-18-18, *Eva Glawischnig-Piesczek v Facebook Ireland Limited*, ECLI:EU:C:2019:821, [34].

<sup>62</sup> *Ibid.* [53].

<sup>63</sup> Koltay A., A szólásszabadság doktrínája és a fake news jelensége az online platformokon (Freedom of expression doctrine and the phenomenon of fake news on online platforms), in Kovács É. M. (ed.), *Ünnepi kötet a 65 éves Imre Miklós tiszteletére (Festive volume in honour of the 65 years old Miklós Imre)* (Ludovika Press, Budapest, 2020, 231–268) 253.

<sup>64</sup> See in details Gosztonyi, How the European Court of Human Rights Contributed to Understanding Liability Issues of Internet Service Providers, 121–133.



Siklósi, Iván\*

## Anmerkungen zum „*ius offerendi*“ im römischen Privatrecht

### ABSTRACT

In this study, some questions of *ius offerendi* (“right of offering”) in Roman law are examined. After introductory remarks, the most basic sources (C. 8, 17, 1; D. 20, 4, 12, 6; D. 20, 5, 5 pr.) are briefly analysed. Then several problems of *ius offerendi* (including, inter alia, the questions of regress and the relationship between *ius offerendi* and “hypothecary succession” [hypothekarische Sukzession]) are scrutinised, also referring to the various interpretations in the Roman law literature (cf. Dernburg, Schulz, Kaser, Wacke, Emunds und Harke, and Schanbacher).

**KEYWORDS:** pledge, “junior” and “senior” creditor (pledgee), right of offering, hypothecary succession, regress

### I. EINFÜHRUNG

In dem vorliegenden Aufsatz wird versucht, eine knappe Darstellung über die komplexe Problematik des *ius offerendi* („Anbietungsrecht“) im römischen Recht zu geben, unter besonderer Berücksichtigung der Analyse der dogmatischen Konstruktion des *ius offerendi* und der Rechtsfolgen dessen Ausübung.

Als Ausgangspunkt der Ausübung des *ius offerendi* dient eine Mehrfachverpfändung.<sup>1</sup>

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<sup>1</sup> Vgl. z. B. J. Miquel, El rango hipotecario en el derecho romano clásico, (1959) (29) *Anuario de historia del derecho español*, 229 ff.; M. Kaser, Über mehrfache Verpfändung im römischen Recht, in *Studi G. Grosso, I*, (Torino, 1968) 27 ff.; A. Biscardi, Die mehrfache Verpfändung einer Sache vom attischen bis zum spätrömischen Recht, (1969) (86) *SZ*, 146 ff. (vor allem aber zum griechischen Recht) <https://doi.org/10.7767/zrgra.1969.86.1.146>; B. Sirks, La pluralité des créanciers hypothécaires sans rang en droit romain classique et Paul. 5 « ad Plaut. » D. 20, 4, 13, (1986) (89) *BIDR*, 305 ff.; aus der spanischen Literatur L. M. Robles Velasco, La segunda hipoteca en el derecho romano, (2001) (668) *Revista crítica de derecho inmobiliario*, 2345 ff.; L. Bernad Segarra, *La pluralidad hipotecaria. Excepciones al principio de prioridad temporal en derecho romano y en el derecho civil español*, (Madrid 2010) 21 ff.



[Das römische Pfandrechtssystem kannte – nach der herrschenden Ansicht – Pfandrechtsmehrheiten bis zur Zeit von Marcellus (vgl. D. 44, 2, 19) – also bis zum Ende der hochklassischen Zeit – nicht (in der früheren klassischen Zeit war die Nachverpfändung zugunsten eines zweiten Gläubigers nur unter der aufschiebenden Bedingung anerkannt, dass das erste Pfandrecht erlischt; vgl. Afr. D. 20, 4, 9, 3 und Gai. D. 20, 1, 15, 2). Später wurde aber anerkannt, dass die Nachgläubiger sofort mit der Verpfändung ein unbedingtes Pfandrecht und damit die dingliche Pfandklage erhalten.<sup>2]</sup>

Die Nachpfandgläubiger sind immer in einer nachteiligen Position: Zum Pfandverkauf ist nur der Erstgläubiger berechtigt. Durch den Verkauf der Pfandsache erlöschen alle Pfandrechte und die Nachpfandgläubiger können sich nur aus dem Überschuss (*superfluum*) beteiligen. Um eine günstigere Position zu erreichen, kann der Nachpfandgläubiger das *ius offerendi* ausüben, d. h. dem Erstgläubiger die Erfüllung seiner Forderung anbieten. Durch die Ausübung des *ius offerendi* kann der Nachgläubiger sein Pfandrecht bestätigen, und damit die *actio Serviana* (die gegen jedermann wirksame dingliche Pfandklage), das Verkaufsrecht der Pfandsache und ein Befriedigungsrecht aus dem Kaufpreis erwerben.

Diese Charakterzüge des *ius offerendi* sind wohl bekannt.<sup>3</sup> Jedoch ist die Problematik des *ius offerendi*, mit vielbestrittenen dogmatischen Fragen und rätselhaften Quellentexten, sehr komplex.

Es handelt sich z. B. in denjenigen Stellen um außerordentlich komplizierte Sachverhalte und schwere Rechtsfragen, in denen drei Pfandgläubiger beteiligt sind (vgl. z. B. Paul. D. 20, 4, 16<sup>4</sup>). Neben der „Drittverpfändung“ ist es z. B. auch eine interessante und

<sup>2</sup> Vgl. M. Kaser, R. Knütel und S. Lohsse, *Römisches Privatrecht*, (München 2017<sup>21</sup>) 186.

<sup>3</sup> Aus der vielfältigen Literatur des *ius offerendi* siehe z. B. A. Thon, *Das „ius offerendi“ des besseren Pfandgläubigers nach römischem Rechte: Eine civilistische Abhandlung geschrieben zur Erlangung der Erlaubniß an der Ruprecht-Carls-Universität zu Heidelberg Vorlesungen zu halten*, (Heidelberg, 1863) (reprint: 2010); A. R. B. Regely, *Das „ius offerendi“ in alter und neuer Zeit, unter Berücksichtigung der dasselbe betreffenden Bestimmungen des Entwurfs eines Bürgerlichen Gesetzbuches für das Deutsche Reich*, (Diss.) (Berlin, 1893); K. Hellmuth, *Das „ius offerendi et succedendi“ beim römischen Pfandrecht*, (Diss.) (Basel, 1959); Ders., *Das „ius offerendi et succedendi“ beim römischen Pfandrecht*, in *Jahrbuch der Basler Juristenfakultät* 38–39 (1959–1960), 40 ff.; A. d’Ors, *El „ius offerendi“ de „Tertius“*, in *Studi B. Biondi, I*, (Milano, 1965) 213 ff.; Ch. Emunds und J. D. Harke, *Das „ius offerendi et succedendi“ des nachrangigen Pfandgläubigers*, in J. D. Harke (Hrsg.), *Facetten des römischen Pfandrechts. Studien zur Geschichte und Dogmatik des Privatrechts*, (Berlin und Heidelberg, 2015) 15 ff. [https://doi.org/10.1007/978-3-662-44989-9\\_2](https://doi.org/10.1007/978-3-662-44989-9_2); D. Schanbacher, *Hypothekarische Sukzession*, (2016) (84) TR, 161 ff. <https://doi.org/10.1163/15718190-08412p04>; Siklósi I., *A ius offerendi problematikája a római magánjogban (Die Problematik des „ius offerendi“ im römischen Privatrecht)*, (Budapest, 2017). – Zur relevanten Literatur der Mehrfachverpfändung in Bezug auch auf das *ius offerendi* siehe oben.

<sup>4</sup> Wenn die Sache dreimal verpfändet worden war und der dritte Pfandgläubiger an den Erstgläubiger Zahlung geleistet hat, so blieb das Pfandrecht des zweiten Gläubigers unberührt. Weder rückt er, was beim Erlöschen des Erstpfandrechts zu erwarten wäre, an die erste Stelle auf, noch wird er von dem

vielbestrittene Frage, ob welcher Pfandgläubiger das *ius offerendi* ausüben kann (vgl. PS 2, 13, 8<sup>5</sup>). (Zur Erörterung der in dieser Hinsicht relevanten, dogmatisch ziemlich problematischen Fragmente würden wir aber einen selbständigen Aufsatz brauchen.)

Im Jahr 2015 wurde die Problematik des *ius offerendi* in einer Abhandlung von *Emunds* und *Harke* analysiert. Dieser gedankenreiche Aufsatz ist für die vorliegenden Anmerkungen eine Inspirationsquelle gewesen, um die dogmatische Konstruktion des *ius offerendi* tiefer zu untersuchen. Zudem wurde 2016 ein ausgezeichnete Aufsatz über das Thema der hypothekarischen Sukzession von *Schanbacher* publiziert, auch mit Berücksichtigung der Abgrenzung zwischen dem *ius offerendi* und der „hypothekarischen Sukzession“.<sup>6</sup>

## II. DIE WICHTIGSTEN QUELLEN

Als *sedes materiae* des *ius offerendi* (und der verschiedenen Fälle der hypothekarischen Sukzession) dienen vor allem die Texte aus dem vierten und fünften Titel des zwanzigsten Buches der Digesten (20, 4: „Qui potiores in pignore vel hypotheca habeantur et de his qui in priorum creditorum locum succedunt“; 20, 5: „De distractione pignorum et hypothecarum“). Grundlegende Texte enthält auch das achte Buch des *Codex Iustinianus* (siehe vor allem: 8, 17: „Qui potiores in pignore habeantur“; 8, 18: „De his qui in priorum creditorum locum succedunt“; 8, 19: „Si antiquior creditor pignus vendiderit“; aber auch 8, 13 „De pignoribus“).

Hinsichtlich der Konfirmation des nachrangigen Pfandrechts ist die Konstitution von *Septimius Severus* und *Antoninus Caracalla* aus dem Jahre 197 zu erwähnen,

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dritten Pfandgläubiger aus seinem Rang verdrängt. Vielmehr tritt der dritte Pfandgläubiger an die Stelle des Erstgläubigers, aber nur *in ea quantitate, quam superiori exsolvit*. Seine eigene Forderung steht der des zweiten Pfandgläubigers weiterhin nach (vgl. *Emunds* und *Harke*, Das „ius offerendi et succedendi“ des nachrangigen Pfandgläubigers, 36<sup>62</sup>; zu diesem Fragment siehe ausführlich z. B. R. Backhaus, „*Casus perplexus*“. *Die Lösung in sich widersprüchlicher Rechtsfälle durch die klassische römische Jurisprudenz*, (München, 1981) 133 ff.; P. Ziliotto, *Effetti del giudicato rispetto ai terzi: due casi in materia di pegno*, (2014) (7) *Teoria e storia del diritto privato*, 54 ff.

<sup>5</sup> Gemäß diesem (vielleicht unechten und dogmatisch gar nicht unproblematischen) Quellentext kann auch der erste Pfandgläubiger das *ius offerendi* ausüben (vgl. dazu z. B. *Kaser*, Über mehrfache Verpfändung im römischen Recht, 65 f.). (*Hapax legomenon*; diese Konstruktion wurde in das justinianische *Corpus iuris* nicht aufgenommen.)

<sup>6</sup> *Schanbacher*, Hypothekarische Sukzession, 149 ff. – Die hypothekarische Sukzession ist nach *Schanbacher* vom *ius offerendi* zu trennen, zum einen was den Tatbestand, zum anderen was die Rechtsfolge angeht. Der deutsche Romanist betont unter anderem, dass der Tatbestand der hypothekarischen Sukzession eine Tilgung der vom Pfandrecht gesicherten Forderung und eine eigene Pfandübereinkunft voraussetzt. Der Tatbestand des *ius offerendi* hingegen verlangt eine Ablösung des Pfandrechts selbst.

die die früheste positivrechtliche Regelung des *ius offerendi*<sup>7</sup> enthält.<sup>8</sup> [Es handelt sich hier eigentlich um eine „staatliche Intervention“ in die Pfandverhältnisse (diesbezüglich siehe noch – aus der nachklassischen Zeit – z. B. das konstantinische Verbot der *lex commissoria*), die sich übrigens grundlegend durch die Vertragspraxis im römischen Recht entwickelt haben.] In diesem – vielleicht von den Kompilatoren gekürzten – Text handelt es sich um eine Konfirmation<sup>9</sup> des zweiten Pfandrechts, nicht aber aus-

<sup>7</sup> Vielleicht anfänglich ohne ein *ius succedendi*? Zu dieser Frage und zum Problem der Datierung des *ius offerendi et succedendi* siehe Emunds und Harke, Das „ius offerendi et succedendi“ des nachrangigen Pfandgläubigers, 37 f. In C. 8, 17, 1 gibt es nämlich keinen Hinweis auf eine Sukzession, nur auf eine Konfirmation (des zweiten Pfandrechts). Ein Ablösungsrecht durfte schon früher (aufgrund D. 20, 4, 11, 4 auch bereits in der Zeit von Gaius) aus der Formel der *actio Serviana* abgeleitet werden. Wahrscheinlich ist es, dass dieses Ablösungsrecht durch die Konstitution von Severus und Caracalla zu einem selbständigen kaiserrechtlichen Rechtsinstitut entwickelt wurde. Dazu siehe überzeugend Emunds und Harke, Das „ius offerendi et succedendi“ des nachrangigen Pfandgläubigers, 38, die zu Recht annehmen, dass Severus und Caracalla nicht nur von einer Konfirmation, sondern auch von einem *ius succedendi* handeln. Es geht hier wahrscheinlich um eine kompilatorische Verkürzung.

<sup>8</sup> „Qui pignus secundo loco accepit, ita ius suum confirmare potest, si priori creditori debitam pecuniam solverit aut, cum obtulisset isque accipere noluisse, eam obsignavit et deposuit nec in usus suos convertit.“ – In einem früheren Text (Gai. D. 20, 4, 11, 4: „Si paratus est posterior creditor priori creditori solvere quod ei debetur, videndum est, an competat ei hypothecaria actio nolente priore creditore pecuniam accipere. Et dicimus priori creditori inutile esse actionem, cum per eum fiat, ne ei pecunia solvatur.“) geht es schon um eine Ablösung des Erstgläubigers durch den Zweitpfandgläubiger (oder um eine hypothekarische Sukzession eines beliebigen Neugläubigers, der dem Schuldner ein Darlehen zur Befriedigung des vorrangigen Gläubigers gewährt?). Aufgrund dieses Textes kann man feststellen, dass sich das Erstarken des zweitrangigen Pfandrechts durch das Angebot der Erfüllung an den erstrangigen Gläubiger schon aus der Formel der *actio Serviana* ergibt (vgl. Emunds und Harke, Das „ius offerendi et succedendi“ des nachrangigen Pfandgläubigers, 18). (Gaius beantwortet die Frage, ob dem *posterior creditor* die *actio Serviana* [*hypothecaria*] zusteht, indem er feststellt, dass die Pfandklage des *prior creditor* erloschen ist. Dies ist nur dann sinnvoll, wenn mit der Klage des Erstgläubigers das einzige Hindernis für die Klage des Zweitgläubigers wegfällt. Zunächst hatte der vorrangige Pfandgläubiger ein durch die *actio hypothecaria* geschütztes Pfandrecht. Die Voraussetzungen dieser Klage sind aber mit der Zahlung oder ihrer Nichtannahme weggefallen: das erstrangige Pfandrecht ist nämlich erloschen, und steht dem Recht des Zweitgläubigers nun nicht mehr entgegen.) Aufgrund dieses Textes war also das aus der Formel der *actio Serviana* abgeleitete Ablösungsrecht schon für Gaius bekannt, und dieses Ablösungsrecht wurde später durch das Kaiserrecht um das *ius succedendi* ergänzt und entwickelte sich dadurch zu einem eigenständigen Rechtsinstitut (vgl. Emunds und Harke, Das „ius offerendi et succedendi“ des nachrangigen Pfandgläubigers, 37). Gaius stützt seine Entscheidung nicht auf ein besonderes Ablösungsrecht, sondern auf allgemeine pfandrechtliche Grundsätze. Als eigenständiges Rechtsinstitut ist das *ius offerendi* erst in C. 8, 17, 1 belegt (vgl. Emunds und Harke, Das „ius offerendi et succedendi“ des nachrangigen Pfandgläubigers, 22<sup>23</sup>). (Der – rein dingliche – Rückgriff des Nachgläubigers wurde also durch ein besonderes kaiserrechtliches Mittel gewährleistet: das nach dem Vorbild der hypothekarischen Sukzession gestaltete, aber *ipso iure* wirkende *ius succedendi*; so Emunds und Harke, Das „ius offerendi et succedendi“ des nachrangigen Pfandgläubigers, 34.)

<sup>9</sup> Zur Konfirmation einer anfänglich wirksamen Pfandbestellung siehe noch z. B. Tryph. D. 49, 15, 12, 12: „[...] ut cum posterior creditor priori satisfacit confirmandi sui pignoris causa“; C. 8, 17, 5: „Prior quidem creditor compelli non potest tibi, qui posteriore loco pignus accepisti, debitum offerre: sed si tu ei omne quod debetur solveris, pignoris tui causa firmabitur“; C. 8, 13, 22: „Secundus creditor offerendo priori debitum confirmat sibi pignus“.

drücklich um eine Sukzession und noch weniger um eine Konvaleszenz<sup>10</sup> des zweiten Pfandrechts (C. 8, 17, 1). Gemäß dieser wohl bekannten Quelle kann ein Zweitgläubiger sein Pfandrecht dadurch verstärken, dass er dem Erstgläubiger den geschuldeten Betrag zahlt oder es, wenn er es angeboten und er sich geweigert hatte anzunehmen, versiegelt und hinterlegt und nicht wieder zum eigenen Gebrauch verwendet.

Die Zahlung des Zweitgläubigers ist kein „Klagenkauf“, sondern eine *solutio*. Als solche führt sie zum Erlöschen der persönlichen Forderung und nicht zu ihrem Übergang. Bei der Ausübung des *ius offerendi* geht es nicht um einen Vertrag. – Der Kauf der gesicherten Forderung ist eine andere Möglichkeit der Ablösung des vorrangigen Pfandrechts (vgl. Marci. D. 20, 6, 5, 2), mit anderen Rechtswirkungen: Der Kauf der Forderung bewirkt eine ausdrückliche Sukzession, während eine „normale“ *solutio* (beim *ius offerendi*) zu keiner („wirklichen“) hypothekarischen Sukzession führt. – Zum Kauf des Pfandrechts siehe Marci. D. 20, 5, 5, 1 und Mod. eod. 6. Beim Kauf des Pfandrechts (wenn ein Nachgläubiger das Pfandrecht dem Erstgläubiger abkauft) wird der Nachgläubiger ausdrücklich ein Nachfolger des vorherigen Erstpfindgläubigers (in diesem Fall handelt es sich deshalb um eine hypothekarische Sukzession [siehe dazu unten]).

Ein Quellentext von Marcianus (D. 20, 4, 12, 6<sup>11</sup>) – der die Ansicht von Papinianus bestätigt – hat im Zusammenhang des Befriedigungsrechts des Nachgläubigers eine grundlegende Bedeutung. Im Sachverhalt dieses Textes ist dieselbe Sache zweimal zur Sicherung eines verzinslichen Darlehens verpfändet worden. Gemäß diesem Text haftet die Sache dem nachrangigen Gläubiger auch gegen Willen des Schuldners nicht nur für seinen Anspruch, sondern auch für den des ersten Gläubigers und für seine Zinsen und für die, die er dem ersten Gläubiger gezahlt hat. Aber er wird von den Zinsen, die er dem

<sup>10</sup> In den Fällen der Konvaleszenz geht es um eine nachträgliche Heilung der anfänglich unwirksamen Pfandbestellung. Siehe zu diesem Problem: Afr. D. 20, 4, 9, 3; Paul. D. 13, 7, 41; Mod. D. 20, 1, 22. Aus der vielfältigen Literatur siehe z. B. F. Wubbe, *‘Res aliena pignori data’*. *De verpanding van andermans zaak in het klassieke Romeinse Recht*, (Leiden, 1960); D. Schanbacher, *Die Konvaleszenz von Pfandrechten im klassischen römischen Recht*, (Berlin, 1987); P. Gröschler, Pfandrecht und Niessbrauch – Mehrfachbestellung und Konvaleszenz beschränkter dinglicher Rechte im römischen, im gemeinen und im geltenden Recht, in *Essays L. Winkel, I*, (Pretoria, 2014) 357 ff. [= in J. D. Harke (Hrsg.), *Facetten des römischen Pfandrechts. Studien zur Geschichte und Dogmatik des Privatrechts*, (Berlin und Heidelberg, 2015) 39 ff.]; zur Verpfändung einer fremden Sache siehe noch z. B. H. Ankum, Spätclassische Problemfälle bezüglich der Verpfändung einer „res aliena“, in *Festschrift R. Knütel*, (Heidelberg, 2009) 35 ff.

<sup>11</sup> „Sciendum est secundo creditori rem teneri etiam invito debitore tam in suum debitum quam in primi creditoris et in usuras suas et quas primo creditori solvit: sed tamen usurarum, quas creditori primo solvit, usuras non consequetur: non enim negotium alterius gessit, sed magis suum. Et ita Papinianus libro tertio responsorum scripsit, et verum est.“ Vgl. z. B. Emunds und Harke, Das „ius offerendi et succedendi“ des nachrangigen Pfandgläubigers, 19 f.

Erstgläubiger gezahlt hat, keine Zinsen erhalten. Der Zweitgläubiger (der Offerent) hat nicht das Geschäft eines anderen geführt, sondern vielmehr sein eigenes.

Eine der wichtigsten Stellen im Hinblick des *ius offerendi* stammt auch von Marcianus (D. 20, 5, 5 pr.<sup>12</sup>). Während die oben erwähnte Konstitution (C. 8, 17, 1) eine Konfirmation des zweiten Pfandrechts befestigt und der früher zitierte andere Text von Marcianus (D. 20, 4, 12, 6) über ein Befriedigungsrecht des Nachgläubigers berichtet, spricht Marcianus in diesem Text ausdrücklich von einer Sukzession („in locum eius successerit“): Weil der zweite Gläubiger, indem er dem ersten das Geld angeboten hatte, an dessen Stelle getreten ist, nimmt er den Verkauf wegen des gezahlten und des dargeliehenen Geldes zu Recht vor. Er ist also in die pfandrechtliche Stellung des Erstgläubigers eingerückt.

Fraglich ist, um was für eine „Sukzession“ es sich hier handelt. Darüber hinaus stellt sich die Frage, inwieweit diese „Sukzession“ als eine in einem technischen Sinne konzipierte, „wirkliche“ und „völlige“ hypothekarische Sukzession betrachtet werden darf, oder ob es sich beim *ius offerendi* um etwas anderes handelt.

### III. DIE DOGMATISCHE KONSTRUKTION DES *IUS OFFERENDI*

a) Die erste moderne Interpretation des *ius offerendi* stammt von *Dernburg*,<sup>13</sup> einer der hervorragendsten Juristen der Pandektenwissenschaft sah in der Ausübung des *ius offerendi* nicht einen Übergang der Forderung des Erstgläubigers auf den Nachgläubiger, sondern ein Erlöschen der Forderung des Erstgläubigers. Nach *Dernburg* ist die alte Schuld als gezahlt und nicht als verkauft zu betrachten. Wenn jedoch die Schuld bezahlt ist, ist auch das Pfandrecht erloschen. Diese Ansicht war damals eine revolutionäre These, weil es in der älteren Fachliteratur – übereinstimmend mit der in dem *ius commune* ausgearbeiteten Neuinterpretation – über den Erwerb des Pfandrechts und damit über eine Klagezession beim *ius offerendi* diskutiert worden war.

Aufgrund der Forschungen von *Dernburg* haben *Schulz* und *Kasier* die in der modernen Romanistik herrschende Auffassung ausgearbeitet.

Nach *Schulz*<sup>14</sup> handelt es sich beim *ius offerendi* zunächst lediglich um die Erlangung der Rangvorrechte des vorstehenden Pfandrechts (Besitz, Pfandklage und Verkaufsbefugnis). Der Offerent erwirbt weder die Forderung des abgefundenen Gläubigers gegen den Schuldner noch sein Pfandrecht an der Sache. Demzufolge geht es im römischen Recht um nicht um eine Klagezession als Rechtsfolge der Ausübung des *ius offerendi*.

<sup>12</sup> „Cum secundus creditor oblata priori pecunia in locum eius successerit, venditionem ob pecuniam solutam et creditam recte facit.“ Vgl. z. B. Emunds und Harke, Das „ius offerendi et succedendi“ des nachrangigen Pfandgläubigers, 21 f.

<sup>13</sup> H. Dernburg, *Das Pfandrecht nach den Grundsätzen des heutigen römischen Rechts, II*, (Leipzig, 1864) 518 ff.

<sup>14</sup> F. Schulz, Klagen-Zession im Interesse des Cessionars oder des Cedenten im klassischen römischen Recht, (1906) (27) *SZ*, 104 ff.



*Kaser*<sup>15</sup> spricht beim *ius offerendi* nur über ein abstraktes Befriedigungsrecht ohne ein Pfandrecht bzw. eine Forderung. Der Offerent erwirbt nur das *ius vendendi* und die Befugnis, sich aus dem Erlös im ersten Rang in gleicher Weise zu befriedigen. Der Nachgläubiger erwirbt aber kein neues Pfandrecht. *Kasers* Ausgangspunkt und Hauptargument ist das Akzessorietätsprinzip: weil die Forderung des Erstgläubigers erloschen ist, erwirbt der Nachgläubiger keine Forderung und kein Pfandrecht, sondern nur ein (abstraktes) Befriedigungsrecht. Nach der Ansicht von *Kaser* bewirkt also die Ausübung des *ius offerendi* keine hypothekarische Sukzession. In den Fällen der hypothekarischen Sukzession erhält nämlich der neue Gläubiger ein Pfandrecht an der Stelle des abgefundenen Gläubigers.

*Wacke*<sup>16</sup> hat schon im Jahre 1976 geschrieben, dass ein Befriedigungsrecht ohne Forderung und Pfandrecht nicht leicht vorstellbar erscheint.

Die Argumentation und Lehre von *Kaser* wurde zuletzt auch von *Emunds* und *Harke* bestritten.<sup>17</sup> *Emunds* und *Harke* weisen darauf hin, dass die Quellen nicht belegen, dass der Offerent sein bisheriges nachstehendes Pfandrecht im bisherigen Rang behält (so *Kaser*) und ein neues erstrangiges Befriedigungsrecht hinzu erwirbt. Obwohl der nachrangige Pfandgläubiger durch die Ablösung des vorrangigen keine neuen persönlichen Klagen gegen den Schuldner erworben hat, folgt daraus nicht, dass die zusätzliche Haftung der Pfandsache auf einem bloßen Befriedigungsrecht beruht. Ein solches Recht – wie die Verfasser überzeugend betonen – wäre ohne Parallele in den römischrechtlichen Quellen. Zum anderen hat der Zweitgläubiger sein eigenes Pfandrecht konfirmiert; er benötigt daher gar kein zusätzliches Befriedigungsrecht, vielmehr genügt eine Erweiterung der bereits bestehenden Pfandhaftung. Diese Argumentation enthält zweifellos Wahrheiten.

b) Unseres Erachtens muss man betonen, dass die Mitwirkung des Schuldners bei der Ausübung des *ius offerendi* nicht erforderlich ist; ebenso wenig darf man in der Ausübung des *ius offerendi* eine Geschäftsführung ohne Auftrag sehen, weil der Offerent das *ius offerendi* nicht im Interesse des Schuldners, sondern in seinem eigenen Interesse ausübt. Der Offerent führt kein fremdes, sondern ein eigenes Geschäft. (Vgl. *Marci. D. 20, 4, 12, 6*.<sup>18</sup>)

Der Offerent ist also weder ein *mandatarius* (des Schuldners) noch ein *negotiorum gestor* (des Schuldners<sup>19</sup>). (Es lohnt sich auch zu bemerken, dass es anfangs kein

<sup>15</sup> *Kaser, Über mehrfache Verpfändung im römischen Recht*, 46 ff.

<sup>16</sup> A. *Wacke*, *Paulus Dig. 10,2,29: Zur Pfand-Adjudikation im Erbteilungsprozess und zur Entwicklung der sog. hypothekarischen Sukzession*, in *Festschrift M. Kaser*, (München, 1976) 527.

<sup>17</sup> *Emunds* und *Harke*, *Das „ius offerendi et succedendi“ des nachrangigen Pfandgläubigers*, 23 f.

<sup>18</sup> Vgl.: „[...] non enim negotium alterius gessit, sed magis suum“. Der Offerent führte also kein fremdes, sondern ein eigenes Geschäft. Daraus folgt, dass der Nachpfandgläubiger das *ius offerendi* in seinem eigenen Interesse ausübt.

<sup>19</sup> Wer als *negotiorum gestor* des Schuldners an den Pfandgläubiger zahlt, erwirbt kein Pfandrecht (bzw. keine dingliche Pfandklage), sondern nur ein Zurückbehaltungsrecht (*retentio*), durch *exceptio doli*

Rechtsverhältnis zwischen dem Offerenten und dem Erstgläubiger gab. Die Zahlung des Nachgläubigers ist aus dem Aspekt des Erstgläubigers im Wesentlichen nichts anderes als eine Drittleistung [im eigenen Interesse].<sup>20)</sup>

Es fehlt hier die reiche Kasuistik, die bei der Bürgschaft gefunden werden kann („Kauffiktion“ bei der *fideiussio*; *actio mandati contraria* und *actio negotiorum gestorum contraria* als Regressklagen; siehe noch die *sui generis* Konstruktion des *beneficium cendarum actionum* im justinianischen Recht). Das Fehlen einer solchen Kasuistik ist offenbar nicht zufällig. Der Bürge leistet nämlich im Interesse des Schuldners. Der Offerent leistet aber in seinem eigenen Interesse, ohne zu dieser Leistung verpflichtet zu sein. (Das Fehlen des Regressrechts<sup>21)</sup> des Nachgläubigers bei dem römischrechtlichen *ius offerendi* – wenn diese Ansicht stichhaltig ist – kann man vielleicht teils auf diese Überlegung zurückführen. [Vgl. „Utilitätsprinzip“ (natürlich in einem anderen Sinne als bei der vertraglichen Haftung).]

Es ergibt sich die folgende Frage: Erlischt das Pfandrecht des erstrangigen Pfandgläubigers durch die Ausübung des *ius offerendi*, wie *Dernburg* es meinte? Erwirbt der Offerent (der originären Konstruktion zufolge) nur den Besitz, die Pfandklage und die Verkaufsbefugnis, wie *Schulz* es verfasste? (Nach *Schulz* ist die erweiterte Haftung der Pfandsache erst später – vermutlich durch eine Kaiserkonstitution – eingeführt worden.) Entsteht nur ein abstraktes Befriedigungsrecht als Rechtsfolge der Ausübung des *ius offerendi*, wie *Kaser* es behauptete?

In den Quellen des römischen Rechts gibt es weder auf das Erlöschen des Pfandrechts (und damit der Forderung) noch auf den Übergang des Pfandrechts (und damit der Forderung) des ersten Gläubigers eindeutige und ausdrückliche Hinweise. Die Frage bezüglich des Regresses bzw. der Klagezession ist noch rätselhafter: Weder auf einen „originären“ Regress noch auf eine Klagezession („Derivatивregress“) befinden sich Hinweise in den *Digesten* oder in anderen Quellen des römischen Rechts, weder in einem positiven noch in einem negativen Sinne.

(vgl. Pap. D. 20, 6, 1 pr.: „[...] qui negotium gessit, utilem Servianam dari sibi non recte desiderabit: si tamen possideat, exceptione doli defenditur.“)

<sup>20)</sup> Der Kauf des Pfandrechts ist etwas anderes (siehe unten). – *Emunds* und *Harke* betonen, dass die Quellen des römischen Rechts keinen Hinweis darauf enthalten, dass die Leistung des Nachpfandgläubigers andere Wirkungen als eine gewöhnliche Drittleistung hätte. [Die deutschen Romanisten weisen aber auch darauf hin, dass die Befreiung des Schuldners in den Quellen ebenso nicht ausdrücklich erwähnt wird (vgl. *Emunds* und *Harke*, Das „ius offerendi et succedendi“ des nachrangigen Pfandgläubigers, 16<sup>6</sup>). Stattdessen ist aber mehrfach von der Abfindung (*dimissio*) des Erstgläubigers die Rede (vgl. z. B. Paul. D. 20, 4, 16: „plane cum tertius creditor primum de sua pecunia dimisit“; Tryph. 49, 15, 12, 12: „ab eo, qui tempore prior fuit, ut infirmiore dimittendus est“; PS 2, 13, 8: „Novissimus creditor priorem oblata pecunia, quo possessio in eum transferatur, dimittere potest.“). Deshalb ist nach *Emunds* und *Harke* davon auszugehen, dass die erstrangig gesicherte Forderung durch die *solutio* des Zweitgläubigers erlischt.]

<sup>21)</sup> Abgesehen von der rein dinglichen Rückgriffsmöglichkeit des zahlenden Nachpfandgläubigers (vgl. *Marci*. 20, 4, 12, 6).



Eine („wirkliche“ bzw. „vollkommene“) „hypothekarische Sukzession“<sup>22</sup> würde zum Übergang des Pfandrechts mit der Zession der Klagen des abgefundenen Gläubigers gegen den Schuldner führen. In den Quellen des römischen Rechts findet man aber keinen Beweis für eine solche hypothekarische Sukzession beim *ius offerendi*. Die Ausübung des *ius offerendi* bewirkt eher nur die Konfirmation bzw. die Erweiterung des Pfandrechts des Nachpfandgläubigers. Der Offerent erwirbt mit der Konfirmation seines Pfandrechts zweifellos die (gegen jedermann) erfolgreiche *actio Serviana*, das *ius distrabendi* und das Befriedigungsrecht aus dem Kaufpreis. Er wird aber kein „völliger“ Sukzessor des abgefundenen Gläubigers, dessen Forderung (gegen seinen Schuldner) mit der Ausübung des *ius offerendi* erlischt.

#### IV. SCHLUSSBEMERKUNGEN

Fraglich ist es, ob eine Klagezession als Rechtsfolge der Ausübung des *ius offerendi* auch im römischen Recht in Betracht kam. Das mittelalterliche und neuzeitliche *ius offerendi* bzw. dessen Ausübung bewirkt eine gesetzliche Surrogation, mit einer Klagezession.<sup>23</sup>

<sup>22</sup> Vgl. Paul. D. 20, 3, 3: im Sachverhalt dieses Textes gab ein neuer Gläubiger dem Schuldner ein Darlehen, um den vorherigen Gläubiger des Schuldners zu befriedigen, unter der Bestimmung, dass der neue Gläubiger ein Pfandrecht anstelle des abgefundenen Gläubigers erwerbe. Dieser Text hat auch in Hinsicht auf die Entwicklungsgeschichte des *ius vendendi* beim Pfandrecht eine große Bedeutung. Im Text findet man den Ausdruck „succedere in ius pignoris“ („Einrücken in das Pfandrecht“); Schanbacher betont zu Recht, dass Titius Aristo „die Lehre von der hypothekarischen Sukzession“ begründet. In der Zusammenfassung von (Schanbacher, *Hypothekarische Sukzession*, 154) ist diese hypothekarische Sukzession nach Aristo „Einrücken eines Darlehensgebers in ein abstraktes Pfandrecht, konkret, in eine vom bisherigen Pfandrecht verlassene, leere Pfandrechtsstelle, wobei diese Verlassenheit selbst das Werk des Darlehensgebers ist, dessen Darlehen zur Abfindung des bisherigen Gläubigers und Pfandrechtsinhabers eingesetzt werden soll und eingesetzt wird“. – Ein anderer Fall der hypothekarischen Sukzession: Im Sachverhalt des Marci. D. 20, 4, 12, 9 verkauft der Schuldner die Sache mit der Zustimmung seines Gläubigers, um den Erstgläubiger des Schuldners aus dem Kaufpreis völlig zu befriedigen. Die Einwilligung des Gläubigers ist ein Verzicht auf sein Pfandrecht. Der zustimmende Gläubiger erwirbt das Pfandrecht des abgefundenen Gläubigers. – Siehe dazu z. B. noch den Fall, wenn ein Nachgläubiger das Pfandrecht (nicht um Eigentümer zu sein) dem Erstgläubiger abkauft. (Vgl. Mod. D. 20, 5, 6; Marci. eod. 5, 1.) Der Nachgläubiger wird bei diesem Kauf des Pfandrechts ausdrücklich ein Nachfolger des vorherigen Erstpfandgläubigers. – Es handelt sich wahrscheinlich auch um einen Fall der hypothekarischen Sukzession, wenn ein *fideiussor* den ersten Rang des vorherigen Pfandgläubigers erwirbt (vgl. Pap. eod. 2).

<sup>23</sup> Die Glossatoren bzw. die Kommentatoren haben nämlich die originelle römischrechtliche Konstruktion des *ius offerendi* weiterentwickelt. In der mittelalterlichen und neuzeitlichen Jurisprudenz bewirkt die Ausübung des *ius offerendi* einen Übergang der Forderung des vorherigen Erstpfandgläubigers, mit einer wirklichen Sukzession auch in Bezug auf die Rechte und Klagen des abgefundenen Gläubigers. Mit anderen Worten: Die Ausübung des weiterentwickelten *ius offerendi* bewirkt eine „gesetzliche Subrogation“. Vgl. H. Coing, *Europäisches Privatrecht*, I, (München, 1985) 330; vgl. noch z. B. J. Hawellek, *Die persönliche Surrogation*, (Tübingen, 2010) 29; J.-Ph. Lévy und A. Castaldo, *Histoire du droit civil*, (Paris, 2002) 1080.

Es ist aber unbestritten, dass die römischrechtlichen Quellen keine Hinweise auf eine Klagezession bei der Ausübung des *ius offerendi* enthalten. Vielleicht darum, weil die Forderung des abgefundenen Gläubigers erlosch und der Offerent allein alle Risiken der Ausübung des *ius offerendi* tragen sollte. Demzufolge (im Zusammenhang damit, dass es anfangs kein Rechtsverhältnis zwischen dem Offerenten und dem Erstgläubiger gab) kann festgehalten werden, dass eine Klagezession (derivativer Regress) beim *ius offerendi* wahrscheinlich bewusst ausgeschlossen wurde. (Grundsätzlich scheint es so zu sein, dass ein originärer und ein derivativer Regress unnötig war, weil der Offerent das Anbiederungsrecht offenbar unter sorgfältiger Berücksichtigung der Risiken ausübte.)

Weil der Nachgläubiger das *ius offerendi* in seinem eigenen Interesse ausübt, bleiben die bei der Bürgschaft angewandten (denn der Bürge leistet im Interesse des Schuldners) Klagen für den Regress gegen den Schuldner (*actio mandati contraria* und *actio negotiorum gestorum contraria*; vgl. Gai. 3, 127; Ulp. D. 17, 1, 6, 2; Paul. eod. 40) außer Betracht. Die bei der *fideiussio* angewandte „Kauffiktion“ (vgl. Iul. D. 46, 1, 17<sup>24</sup>) taucht auch nicht beim *ius offerendi* auf.

Die kritischen Bemerkungen von *Wacke* und zuletzt von *Emunds* und *Harke* gegen die Ansicht von *Kaser* bezüglich des „abstrakten Befriedigungsrechts“ scheinen fundiert zu sein. Auch wir können uns – gegen die Ansicht von *Kaser* – ein „abstraktes“ Befriedigungsrecht (ohne eine Forderung und ein Pfandrecht) kaum vorstellen. *Emunds* und *Harke* weisen mit Recht darauf hin, dass ein abstraktes Befriedigungsrecht ohne Parallele in den Quellen wäre, und weil der Zweitgläubiger sein eigenes Pfandrecht konfirmiert hat, benötigt er kein zusätzliches Befriedigungsrecht. Der Nachpfandgläubiger, der das *ius offerendi* (in seinem eigenen Interesse bzw. auf seine eigene Gefahr) ausübt, wird aber noch weniger ein wirklicher Nachfolger des vorherigen Erstpandgläubigers. Demzufolge erwirbt er die Forderung und damit die Klagen des vorherigen Erstpandgläubigers gegen den Schuldner nicht. Der Offerent erwirbt nur die (gegen jedermann) erfolgreiche Pfandklage, die Verkaufsbefugnis und ein Befriedigungsrecht (das nicht abstrakt ist) durch die Konfirmation bzw. die Erweiterung seines Pfandrechts, und nicht als (echter) Nachfolger des Pfandrechts des bisherigen Erstgläubigers (also nicht durch eine wirkliche hypothekarische Sukzession).

<sup>24</sup> „Fideiussoribus succurri solet, ut stipulator compellatur ei, qui solidum solvere paratus est, vendere ceterorum nomina“. Durch diese Konstruktion fanden die Klassiker den Weg, dass der Bürge dem Gläubiger nur noch zu leisten brauchte, wenn ihm der Gläubiger seine Forderung abtrat. Die Hilfe wurde vermutlich dadurch gewährt, dass der Prätor dem Bürgen eine *exceptio doli* gab, die es dem Richter erlaubte, die Klage des Gläubigers abzuweisen, wenn dieser sich zur Abtretung der Klagen gegen Zahlung des Bürgen nicht bereitfand. Das Problem, dass mit der Zahlung des Bürgen Erfüllung eintrat und damit die Forderungen gegen den Schuldner [und Mitbürgen (vor der *epistula Hadriani*)] erloschen, wurde durch den Kunstgriff einer Kauffiktion überwunden: Der Bürge zahle als Käufer, nicht als Bürge. (Vgl. *Kaser, Knütel und Lohsse, Römisches Privatrecht*, 341.) Die ganze Problematik kann hier nicht ausführlich erörtert werden. [Vgl. zur ganzen Problematik z. B. *D. Medicus, Der fingierte Klagenkauf als Denkhilfe für die Entwicklung des Zessionsregresses*, in *Festschrift M. Kaser*, (München, 1976) 394 ff.; *F. Briguglio, 'Fideiussoribus succurri solet'*, (Milano, 1999) 261 ff.]

Sipos, Attila\*

## The Air Carrier's Liability for Damage Caused to Cargo

### ABSTRACT

The consignment of cargo always lags behind passenger traffic as the focus of attention (as well as from a legal point of view), but under the circumstances of the pandemic it became more important than ever before. Countries closed their borders, but commercial and aid operations between the states were maintained by cargo flights on state and civil aircraft. For this reason, the liability of the air carrier for cargo was also given utmost attention. The liability of the air carrier for damage during international carriage can be established – under the Convention for the Unification of Certain Rules for International Carriage by Air (Montreal Convention – 1999)<sup>1</sup> – in cases when 1) the death or bodily injury of the passenger is caused by an accident; 2) the baggage is destroyed, lost or damaged; 3) the *cargo* is *destroyed, lost* or *damaged*; 4) the carriage of the passenger, baggage or *cargo* is *delayed*. This study introduces the air carrier's strict liability for damage caused to cargo (destroyed, lost, damaged or delayed) as regulated by the Montreal Convention.

**KEYWORDS:** air waybill, international carriage, code-share carriage, successive carriage, combined carriage, exoneration

### I. PREFACE

The role of civil aviation in the global world is of outstanding significance. Its unequalled development was stopped by the COVID–19 pandemic, which as early as in the first months of 2020 took its drastic effect, and consequently, the revenue of air transport fell by 90 per cent worldwide in April. This set-back is well-illustrated by the fact that the number of passengers decreased from more than 4 billion<sup>2</sup> to 1.8 billion in 2020

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<sup>1</sup> ICAO Doc 9740 Convention for the Unification of Certain Rules for International Carriage by Air. Montreal, 28 May 1999.

<sup>2</sup> In 2019, 4.5 billion people travelled by airplane, while in 2018 there were more than 4 billion. Apart from the 3,780 airports for scheduled flights, a further 38,000 airports are available for civil, state (military) and commercial transport. The key performers of the air transport industry produce 3.5 per

in the largest crisis of the aviation industry since World War II.<sup>3</sup> Millions lost their jobs. Aircraft manufacturers downsized their capacities; airports and air navigation service providers registered severe losses. The greatest losers of the pandemic on an industrial level were the airlines, which epitomise the financial driving force of this commercial activity (aircraft are manufactured for them; they carry out the transport of persons, cargo and mail, while the surface and aerial infrastructure depend on them to a large extent). The majority of air carriers requested and received large amounts of state subsidies. Despite all these facts the cargo business<sup>4</sup> was not stricken severely; moreover, it started expanding during the pandemic era.

### 1. The carriage of cargo

The air carrier's liability extends to every *international carriage of persons, baggage or cargo* performed by aircraft for *reward* [Article 1(1)]. As a matter of course, air carriage can be divided into the carriage of persons and cargo with two differences in principle:

- upon the carriage of cargo, the object of carriage is removed from the disposal of the consignor, obviously this does not take place in the case of the transport of passengers;

- upon the carriage of cargo, a triangular legal relation is established (consignor, air carrier and consignee), while the carriage of passengers posits a bilateral legal relation (passenger and the air carrier) with the exception of *code-share* carriage (see III. 1), which also implies a triangular legal relation: the passenger, the contracting carrier and the actual carrier.

(The Montreal Convention contains general and specific provisions; the *general* provisions apply to passengers and baggage, and the *specific* provisions apply to cargo.)

The consignor is the person/company sending the cargo (freight) and may act through a *cargo forwarder* (or its agent) that engages the carrier to ship it. Consignors usually wish the cargo to be delivered to another person. This person, to whom the cargo is sent, is the consignee acting as a customer or client. The drafters of the

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cent of the GDP of the world, which implies an estimated economic potential of 2,700 billion dollars annually. *Aviation Benefits Beyond Borders. Executive Summary*. ATAG Report, Facts and Figures, September 2020., [www.atag.org](http://www.atag.org) (Last accessed: 31 December 2020).

<sup>3</sup> IATA, *Annual Review, 2020.*, <https://www.iata.org/contentassets/c81222d96c9a4e0bb4ff6ced0126f0bb/iata-annual-review-2020.pdf> (Last accessed: 31 December 2020) 11., 18.

<sup>4</sup> Of the total transport of goods in world trade, the air transport sector ships nearly 52 million tons of products annually. By weight, this quantity of products accounts for barely 0.5 per cent of the total shipment of goods in world trade. However, the value of goods shipped by air accounts for 35 per cent of the total value of goods shipped in the world. These numbers suggest that goods of higher value and of smaller volume, as well as time-critical goods are worth shipping by air. *Aviation Benefits Beyond Borders. Executive Summary*. ATAG Report, September 2020.

Convention did not avail themselves of the opportunity to define cargo; therefore, the air carriers circumscribe the scope of objects falling in this category under their General Conditions of Carriage. Accordingly, in the practice of air carriers, cargo includes, for instance, double coffins containing the mortal remains of a deceased person or carried pets and livestock (e.g., dogs, racehorses).<sup>5</sup> For this reason, injuries to animals must be considered under the cargo provisions of the Montreal Convention (Article 18).<sup>6</sup> Live animals may be forwarded pursuant to industry prescriptions and the prior consent of the air carrier. The conditions of forwarding live animals include their confinement in a regular, portable, escape-proof carrier (not hindering the movement of the animal, in compliance with industry specifications and the limitations of size and weight prescribed by the air carrier), the production of valid official, veterinary and vaccination certificates and entry permits, as well as other documents required by the prescriptions of the states concerned by the carriage.

From the enumeration of classical objects (such as baggage, cargo and mail), postal goods forward were omitted, the reason for which is that the provisions of the Convention do not apply to the carriage of postal items. As to the carriage of postal items (letters, parcels, postal orders) the lawmaker merely requires that the air carrier shall only be liable toward the relevant postal administration in accordance with the rules applicable to the relationship between the carriers and the postal administrations [Article 2(2–3)].

## 2. Contractual relationship

Within the framework of civil law, a written contract is concluded between the *consignor of the cargo* and the *air carrier* as an expression of their mutual and unanimous intent, which contains the designation of the place of departure and the place of destination and of the agreed stopping place(s). According to the contract of the carriage of cargo, the air carrier delivers the goods on an aircraft from the airport of departure to the airport of arrival. The air carrier may derogate from the route indicated in the air waybill for a reason related to air traffic. The contract between the parties is concluded if

- the consignor pays the fee determined by the air carrier (with the addition of authority taxes, dues and other contributions); and
- the air carrier issues the *air waybill* (also known as an *air consignment note* or informally designated an *airbill*).

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<sup>5</sup> P. S. Dempsey and M. Milde, *International Air Carrier Liability: The Montreal Convention of 1999*, (McGill University Centre for Research in Air & Space Law, Montreal, 2005) 67.

<sup>6</sup> *Aya v. Lan Cargo, S.A.* (1:14-cv-22260) District Court, S.D. Florida, 18 September 2014.

The air waybill comprises multiple copies, so that each party involved in the shipment can document it. The air waybill, until the contrary is proved, attests at first sight (*prima facie*)<sup>7</sup> content of the legal declaration made by the air carrier and the consignor; that is, the conclusion of the contract. The sections of the journey indicated in one air waybill or connecting air waybills constitute the parts of one contract. A separate air waybill qualifies as a separate contract. The contract of carriage can be concluded freely. Nothing in the Montreal Convention shall prevent the air carrier from:

- refusing to enter into any contract of carriage;
- waiving any defences available under the Convention; or
- laying down conditions which do not conflict with the provisions of the Convention (Article 27).

Pursuant to the above, the air carrier may refuse to enter into a contractual relationship with any client for whom, for some reason, it does not wish to provide service, for instance, if the consignor does not hold appropriate documents (customs clearance form, dangerous goods' or other permits) or does not produce them in time; furthermore, if the condition of the cargo does not facilitate safe carriage. At the same time, the lawmaker expressly formulates that any clause contained in the contract of carriage and all special agreements entered into before the damage occurred, by which the parties purport to infringe the rules laid down under the Convention, whether by deciding on the law to be applied, or by altering the rules as to jurisdiction, shall be null and void (Article 49).

The Convention only generally provides for the formal requirements and the content of the documents of carriage; therefore, the numerous and complex issues emerging during the carriage shall be settled under the General Conditions of Carriage or other separate rules specified by the air carriers. Pursuant to these rules, the air carriers set out the rights and obligations of the consignors and the conditions of the carriage of cargo in detail.

### 3. General Conditions of Carriage

The detailed conditions of the contract of carriage concluded between the air carrier and the consignor not specified under effective regulations are stipulated under the General Conditions of Carriage. The provisions of the General Conditions of Carriage constitute part of the contract between the air carrier and the consignor.

The General Conditions of Carriage, containing the conditions integral to the contract, does not constitute a legal statute, but it regulates the servicing strategy of

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<sup>7</sup> A Latin expression meaning *on its first encounter* or *at first sight*. It is based on first impression; accepted as correct until proved otherwise.



the airline, which is predetermined unilaterally by one of the parties (the air carrier) in order to conclude several contracts via the establishment of the servicing framework, while the other party (the consignor) is not involved in determining the conditions part of the contract.

It is therefore a basic legal requirement that the air carrier may not unreasonably and disproportionately determine the rights and obligations of the contracting parties proceeding from the contract to the detriment of the consignor. This is guaranteed by the obligation of the party applying the General Conditions of Carriage to prove the fact of the contingent violation of the law; furthermore, the General Conditions of Carriage is to be drafted by the airline in consideration of international and EU regulations and the International Air Transport Association (IATA)<sup>8</sup> specifications and recommendations, as well as the national statutes and authority prescriptions with the approval of the authority. The General Conditions of Carriage may not be contrary to statutes but, apart from this, the air carriers decide themselves, maybe differently, what services under what conditions they provide for the consignors. For reasons of flight safety, the air carrier may prohibit or restrict the transport of various goods or items.

The General Conditions of Carriage becomes part of the contract if its applier has enabled the other party to familiarise themselves with its content prior to concluding the contract and the other party consented to this. In this way, the specifications of the General Conditions of Carriage are made accessible to consignors by the air carriers so they can become familiar with them, either in their customer service offices or electronically. The IATA prescribes that consignors shall be notified of the fact that the detailed and all-encompassing system of the conditions of carriage is contained in the General Conditions of Carriage of the air carrier.

The IATA determined the minimum conditions of the contract to be applied by its member airlines as recommended practices in Carrier Agreements.<sup>9</sup> If the General Conditions of Carriage and the contract differ from each other, the latter is decisive and becomes the guideline. Any breach of the obligations determined under the contract of carriage entails legal consequences.

#### **4. International Carriage (extended to passengers)**

According to the nature of the activity, carriage can be divided into international and domestic carriage. The Convention encompasses international air carriage exclusively,

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<sup>8</sup> The active members of the IATA are the acceded airlines which operate scheduled flights on international routes. Today more than 290 airlines, representing 82% of global air traffic, are members of the IATA. IATA, *Annual Review*, 2020. 5.

<sup>9</sup> IATA, *Recommended Practices 9074–40, Cargo Services Conference Resolutions Manual (CSCRM)*, (40th ed., 2020).



not domestic carriage. The lawmaker defines the concept of international air carriage precisely, since this is one of the basic conditions of the applicability of the Convention. The precise definition of the document of carriage, proving the existence of the contractual relationship and of international carriage, provides help in establishing its international character. The document of carriage is the first manifestation and proof of the contractual relationship, which, upon the consignment of cargo, including the air waybill or the cargo receipt (analogically for air passenger is the air ticket and, upon checking baggage in the baggage identification tag).

The air waybill unambiguously indicates the place of departure and the place of destination, as well as the agreed stopping place(s), which are significant for the carriage to qualify as international. For the purposes of the Montreal Convention, the expression “international carriage” means any carriage in which, according to the agreement between the parties,

– *the place of departure and the place of destination* – whether or not there is a break in the carriage – are situated within the territories of two States Parties; or

– *the place of departure and the place of destination* are within the territory of a single State Party, if there is an agreed stopping place within the territory of another State, even if that State is not a State Party to the Montreal Convention.

The latter point aimed to unify the regulation of air cargo in the broadest practicable scope. Initially, the documentation of the carriage is examined, because that is indispensable for establishing the personal and substantive scope of application and jurisdiction. If the carriage qualifies as international, the Convention is applicable; if, pursuant to the Convention, the carriage is not international, liability for damages shall be adjudged under national law of the state which has jurisdiction. In air transport flying over borders is unequivocally deemed to be international carriage, although this fact in itself under the Convention, and emphatically merely here, does not imply the qualification of the carriage as international. Cambodia has not acceded to the Montreal Convention, whereas, it has ratified the Warsaw Convention (just like, for instance, Iraq, Iran or Yemen), thus, the passengers on the flight travelling one way from Phnom Penh to London (PNH–LHR) or from London to Phnom Penh (LHR–PNH) are not governed by the Montreal Convention, therefore, these flights are not international. But in case the flight takes place between Phnom Penh–London–Phnom Penh (PNH–LHR–PNH), it is governed by the Warsaw Convention, therefore, the flight shall be international. At the same time, if the destination is Funafuti (FUN), the capital of Tuvalu in the Pacific Ocean, on the route connecting Funafuti–Phnom Penh–London–Funafuti (FUN–PNH–LHR–FUN) or on the one way route to London from Funafuti (FUN–LHR), the passengers shall be subject to the rules of liability for damage under the national law of Tuvalu, since the flights are not deemed to be international given that Tuvalu has not ratified either the Montreal Convention or the Warsaw Convention.

Pursuant to the rules of the Convention, what is not deemed to be international is determined solely and exclusively by the geographical connecting points designated under the contract of carriage. For instance, in an air waybill the following geographical connecting points need to be indicated:

– *the place of departure*: the town or airport indicated *in the first place* in the air waybill;

– *the place of destination*: the town or airport indicated *as the last place* in the air waybill;

– *the agreed stopping place*: all towns or airports indicated *between the first place and the last place*.

The agreed stopping place may imply more than one geographical connecting point, if, in the air waybill, several landing or transshipment places are indicated. The places of departure and destination are of crucial importance. Whether the states of the geographical connecting points have ratified the Montreal Convention is a further essential aspect.

Let us consider an example, that the country of town [A] ratified the Montreal Convention, whereas the country of town [B] did not ratify it.

Pursuant to the definition under the Convention:

– on route ([A]–[B]), between town [A] and town [B], or

– on route ([B]–[A]) between town [B] and town [A], the carriages are not deemed to be international.

For example, the best way to comment on the variety of the carriages, the *return* air ticket of the passenger:

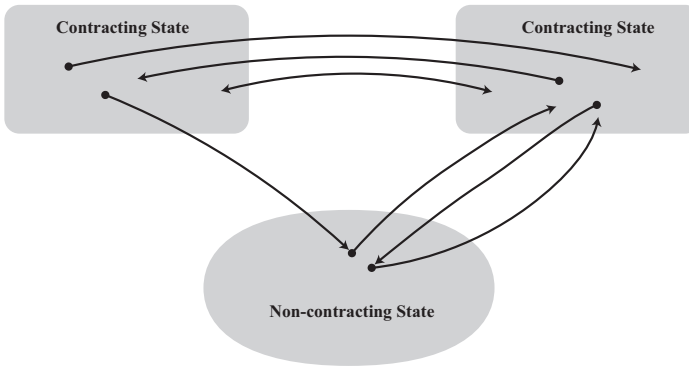
– the return flight on route [A] – [B] – [A], the carriage is deemed to be international;

– the return flight on route [B] – [A] – [B], the carriage is not deemed to be international.

In the case of the carriage of passengers, the flight travelling on route [A]–[B]–[A] qualifies as international carriage, irrespective of the fact that the country of town [B] did not accede to the Convention. This applies even in the event that damage occurs in the territory of the country of town [B], or the flight is operated by the airline of a country not acceded to the Convention with its own crew, and if the citizens of the country of town [B] are on board exclusively. Despite these circumstances, the Convention is governing, since the citizenship of the passengers, the geographical point of the occurrence of damage or the place of business, the headquarters of the airline performing the carriage or the State of the registration of the airplane do not matter in the least, nor does the fact whether the flight is non-scheduled or operated according to a schedule. What matters is merely one aspect: the route delineated by the geographical connecting points indicated in the document of carriage. Precisely this positively determined route may qualify according to the criteria stipulated under

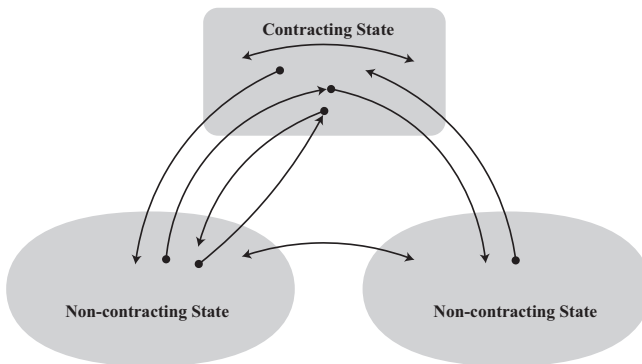
the Convention as international or non-international carriage. The international character of the carriage is key issue because this is one of the basic conditions of the applicability of the Convention.

Figure 1. International air carriage (5 instances)



If the aircraft of the State Party lands in a State that has not acceded to the Convention and then it continues its flight to another State that has acceded to the Convention, the Convention shall be applicable. Pursuant to the provision of the Convention, this carriage qualifies as international, since, for instance on route [A]–[B]–[C], the country of town [C] indicated as a place of destination acceded to the Convention.

Figure 2. Non-international air carriage (6 instances)



Pursuant to the Convention, domestic carriage in itself does not qualify as international. Within the purview of the Convention, the carriage also does not qualify as international

if the carrier travelling between two points of a State Party lands in another State as well, but the parties *did not designate an agreed stopping place* [Article 1(2)]. If the aircraft performs domestic carriage but, for technical, meteorological or other extraordinary reasons (e.g., hijack, forced landing, medical aid) it is forced to land in the territory of another State, the onward carriage qualifies as domestic, because the place of landing was not stipulated jointly and in advance in the contract as an agreed stopping place by the parties.

The examination of the international character of carriage would lose its significance if all the ICAO Member States ratified the Convention, which is utopian. Since this is unlikely in the near future, it will occur further on that, in the actions for damages by two passengers, or two different cargo units on the very same flight, depending on the route to which their air ticket or air waybill entitles them, irrespectively of the citizenship of the passenger or consignor and the nationality of the operating airline, different rules of liability for damages will be applicable.<sup>10</sup>

This implies that the claims for damages of the consignors on a specific cargo flight are adjudged individually and differently (dependant on the applicability of the Convention) in consideration of the place of departure and the place of destination and, if this applies, of the agreed stopping places indicated in the air waybill. Consequently, on a specific flight there may be goods to which different rules of liability apply for the simple reason that these are transported in different contractual relations. For instance, one cargo unit is just arriving at its destination, while, for the other cargo unit, this is an agreed stopping place, from where these goods are carried further or are returned.

It may have been simpler if the drafters of the Convention had not demanded the examination of the applicability of the Convention according to the contracts from consignor to consignor (from passenger to passenger), but if they had taken into account the specific aircraft itself upon the occurrence of damage. This can be conceived as follows: the consignors of all the cargo on the flight subject to the Convention, upon the occurrence of damage, would be without exception indemnified under the same regime

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<sup>10</sup> For instance, in the case of the passenger who travels with an air ticket for route [A]–[B]–[A], on their return flight from town [B] may happen to travel with a passenger holding an air ticket for route [B]–[A]–[B] or just for [B]–[A] leg (the first passenger is returning to town [A] from town [B], while the other passenger is just departing for town [A]). In the event of an accident the two passengers, even if they suffer the same injuries, are entitled to different indemnification; the returning passenger pursuant to the Montreal Convention due to the international character of the carriage, while the passenger departing from town [B] shall be indemnified pursuant to the national rules of the country of town [B]. It may also occur that in the case of another passenger sitting beside them, the Warsaw Convention is applicable, because this passenger, after landing in town [A] is heading for a State which acceded to the Warsaw Convention but not yet to the Montreal Convention. It is easy to comprehend: it may occur that the passenger suffering a minor injury may be indemnified more, in an order of magnitude, than the heir of the deceased passenger. Therefore, it is important that the Montreal Convention achieves its goal and in fact “prevails” in as many potential Member States as possible, because only this way can its rules be capable of forging real unity in the still fragmented system of liability for damage.

of liability for damages; that is, on the same flight, the same private legal rules of liability would apply to each consignor at all times. The legal status of the aircraft subject to the scope of the Convention would be determined by whether the State which registered the aircraft is party to the Convention. However, the drafters of the Convention did not opt for this opportunity, but they chose a more complicated form, in which the emphasis is laid on the contractual relation relevant in the air waybill.<sup>11</sup>

## 5. The air waybill or cargo receipt

The documents of carriage have probative force; they attest the conclusion of the contract by the parties, proving without doubt the route acknowledged by the parties, which is necessary for the establishment of the applicability of the Convention. They are made out in writing; in the case of the consignment of cargo, the *air waybill* or the *cargo receipt* [Article 4(1–2)], [in the case of the passenger, the air ticket and the baggage identification tag (Article 3)].

The provisions of the Montreal Convention simplify and renew the specifications concerning the documentation of the carriage of cargo considerably. Air waybills are designed and distributed by the IATA. There are two types of air waybills: an airline-specific and a neutral one. Each airline-specific air waybill must include the air carrier's name, head office address, logo, and an air waybill number. Neutral air waybills have the same layout and format like airline-specific air waybills. An air waybill has 11 numbers and contains eight sheets of varying colours. However, paper-based air waybills are no longer required; e-air-waybills have been in use since 2010.<sup>12</sup> Due to a strategic objective, the IATA has made the documents of carriage paperless within a simplification programme. In the modern, paperless world, in the reality of the electronic air waybill, it suffices to send a message from an iPhone, by fax or email or to produce either an invoice or a memorandum made out by an agent, furthermore, merely to be registered by the IATA or the air carrier, all of which prove the conclusion of the contract.<sup>13</sup> This new system entails considerable financial and administrative relief not only for the industrial performers, but it also rendered access to air services substantially easier for the consignors (and for the passengers).

In respect of the carriage of cargo, an air waybill shall be delivered [Article 4(1)]. The most important functions of the air waybill include that it emphasises the limited liability provision (only where the Warsaw Convention and its system is applicable),

<sup>11</sup> Dempsey and Milde, *International Air Carrier Liability: The Montreal Convention of 1999*, 75.

<sup>12</sup> IATA, *Resolution 672: Multilateral Electronic Air Waybill Agreement*, <https://www.iata.org/contentassets/783ac75f30d74e32a8eaf26af5696b6/csc-672-en-28dec2019.pdf> (Last accessed: 31 December 2020).

<sup>13</sup> G. N. Tompkins Jr., 2014 Summary of MC99 Court Decisions, (2015) 40 (2) *Air and Space Law*, 153.

provides evidence of the terms and conditions of the contract of carriage, serves as an acknowledgement of the receipt of the cargo by the air carrier and furnishes evidence of the description and the condition of the cargo when it was received by the carrier.<sup>14</sup>

Upon the carriage of cargo, the consignor transfers the cargo to the disposal of air carrier, so it is unable to influence either the process of the carriage or the conduct of the air carrier during the consignment. Therefore, all circumstances of the carriage need to be regularly documented. The Convention permits that the air waybill may be substituted by any other instrument that records the carriage to be performed. Issuing such in electronic form had already been facilitated under the Montreal Additional Protocol 4 (MAP – 1975).<sup>15</sup> If the air waybill is issued electronically, the carrier shall, if so requested by the consignor, deliver to the consignor a cargo receipt permitting identification of the consignment and access to the information contained in the record [Article 4(2)]. The Montreal Convention has incorporated all relevant provisions of the Montreal Additional Protocol 4 (e.g., paperless air waybill, unbreakability (inviolability) of the liability limits, simplification, jurisdictions etc.).

Upon the carriage of *cargo*, the air waybill or the cargo receipt as *prima facie* evidence proves the conclusion of the contract, the acceptance of the cargo and the conditions of carriage mentioned therein [Article 11(1)]. The air waybill or the receipt of cargo proves the route agreed on by the parties without doubt, therefore, it contains three obligatorily prescribed elements:

- an indication of the place of departure and the place of destination;
- if the places of departure and destination are within the territory of a single State Party, one or more agreed stopping places being within the territory of another State, an indication of at least one such stopping place; and
- an indication of the weight of the consignment (Article 5).

In practice, the airway bill will also contain the consignor's (shipper's) name and address, the consignee's name and address, a three-letter departure (origin) airport code, a three-letter destination airport code, a declared shipment value for customs, the number of pieces, gross weight, a description of the goods and any special instructions (e.g., fragile, perishable, dangerous, temperature controlled). If the persons named only in the air waybill are not the cargo forwarder or its agent, the consignor and the

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<sup>14</sup> R. Bartsch, *International Aviation Law: A Practical Guide*, (Routledge, 2nd ed., 2018) 200. <https://doi.org/10.4324/9780203712986>

<sup>15</sup> ICAO, Doc 9148 Montreal Protocol No. 4 to Amend the Convention for the Unification of Certain Rules Relating to International Carriage by Air Signed at Warsaw on 12 October 1929 as Amended by the Protocol Done at The Hague on 28 September 1955. Montreal, 25 September 1975.; A. Sipos, The Modernisation of Air Carrier Liability: Is the New Montreal Convention the Humble Successor to the Warsaw System?, (2019) (58) *Annales Universitatis Scientiarum Budapestinensis de Rolando Eötvös Nominatae – Sectio Iuridica*, 101–119. <https://doi.org/10.56749/annales.elteajk.2019.lviii.6.101>

consignee can enforce rights under the contract of carriage.<sup>16</sup> The air waybill serves on one hand as a receipt of goods issued by the air carrier, and on the other hand as a contract of carriage between the consignor and the air carrier. It is a legal agreement, enforceable by law after the consignor (or the consignor's agent) and the air carrier (or the air carrier's agent) have both signed the document.

The lawmaker significantly simplified the requirements pertaining to the documents of carriage under the Convention. The Warsaw Convention<sup>17</sup> required the mandatory indication of 17 pieces of information and data, of which failure to indicate 10 of them resulted in the carrier forfeiting the opportunity for the application of limited liability guaranteed under the Warsaw Convention and having to perform unlimited liability for any contingent damage to cargo.<sup>18</sup>

The air carriers may oblige the consignor to meet, if necessary, the formalities of customs, police and similar public authorities, to deliver a document indicating the nature of the cargo. This provision creates no duty, obligation or liability for the carrier resulting from it (Article 6). This new rule gives rise to the air carrier's simple obligation to furnish information which otherwise it needs to provide for the proceeding customs, police and other public authorities pursuant to national law. The consignor must furnish such information and such documents as are necessary for the examinations carried out by the customs, police and any other public authorities before the cargo can be delivered to the consignee. The consignor is liable to the carrier for any damage occasioned by the absence, insufficiency or irregularity of any such information or documents, unless the damage is due to the fault of the carrier, its servants or agents. The carrier is under no obligation to enquire into the correctness or sufficiency of such information or documents [Article 16(1–2)].

The carriage of cargo posits a triangular legal relationship. According to this, the air waybill shall be made out by the consignor in three original parts:

- The first part shall be marked “for the carrier”, and it shall be signed by the consignor;

- The second part shall be marked “for the consignee” and it shall be signed by the consignor and the air carrier;

- The third part shall be signed by the air carrier, who shall hand it to the consignor after the cargo has been accepted.

The signature of the carrier and that of the consignor may be printed or stamped. If, at the request of the consignor, the carrier makes out the air waybill, the carrier shall be deemed, unless there is proof to the contrary, to have done so on behalf of the

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<sup>16</sup> DHL Global Forwarding Management Unit Latin America, *Inc. v. Pfizer, Inc.* 13-cv-8218, WL5169033 (S.D.N.Y.), 2014.

<sup>17</sup> Convention for the Unification of Certain Rules Relating to International Carriage by Air, signed at Warsaw on 12 October 1929, Warsaw Convention.

<sup>18</sup> Dempsey and Milde, *International Air Carrier Liability: The Montreal Convention of 1999*, 99.



consignor [Article 7(1–4)]. If cargo consisting of multiple packages or pieces needs to be consigned and, upon the issuance of the air waybill, a document made out electronically (other instrument) is used

- the carrier of cargo has the right to require the consignor to make out separate air waybills;
- the consignor has the right to require the carrier to deliver separate cargo receipts (Article 8).

However, if the aforementioned basic requirements concerning the documents of cargo carriage (Articles 4–8) are not observed according to the specifications of the Convention, non-compliance shall not affect the existence or the validity of the contract of carriage (in a similar manner to air tickets), which shall, nonetheless, be subject to the rules of the Convention, including those relating to limitation of liability (Article 9). The consignor is responsible for the correctness of particulars and statements relating to the cargo. The consignor shall indemnify the air carrier against all damage suffered by it, or by any other person to whom the carrier is liable due to the irregularity, incorrectness or incompleteness of the particulars and statements furnished by the consignor or on its behalf. At the same time, the carrier shall indemnify the consignor against all damage suffered by it, or by any other person to whom the consignor is liable, due to the irregularity, incorrectness or incompleteness of the particulars and statements inserted by the carrier or on its behalf in the cargo receipt or in the record preserved by other means [Article 10(1–3)].

Any statements in the air waybill or the cargo receipt relating to the weight, dimensions and packing of the cargo, as well as those relating to the number of packages, are *prima facie* evidence of the facts stated. The statements relating to the quantity, volume and condition of the cargo do not constitute evidence against the air carrier, except so far as they both have been and are stated in the air waybill or the cargo receipt to have been checked by it in the presence of the consignor, or relate to the apparent condition of the cargo [Article 11(2)]. The furnishing of correct data and the clarification of real circumstances are legal obligations beyond the confidential relationship between the contracting parties, because, if they carry special cargo which requires distinct attention and care (e.g., baby chicks, animals, perishable products), a factual statement concerning its condition is necessary and an agreement on the conditions of carriage can be reached with its due consideration. These pieces of information have significance with respect to the establishment of the scope of liability for damage caused during the carriage.

## 6. Carriage performed in extraordinary circumstances

The provisions concerning the documentation of the carriage of cargo shall not apply in the event of carriage performed in extraordinary circumstances outside the normal scope of a carrier's business (Article 51). The lawmaker does not define flights under extraordinary circumstances. These may include experimental flights, air navigation flights (e.g., the air carrier flies over a polar route) and calibrating flights, when the devices and the navigation system of the airport are checked, as well as when the devices of the aircraft are set during the flight. Similar flights encompass the rescue of persons or merchandise from war zones by state or civil aircraft and flights not aligned with the normal operation of the aircraft due to flight safety risks, meteorological circumstances or other events unrelated to ordinary operation by the air carrier. In these cases, no legal consequences (sanctions) are set forth by the lawmaker *vis-à-vis* the air carrier that is non-compliant with the content and formal requirements of the documents of carriage.

## II. THE TRANSPORTATION OF CARGO

The concept of air cargo is not unfolded by the lawmaker; as such, its interpretation is restricted to national level. Air cargo includes essentially all portable, valuable objects forwarded by the air carrier. With respect to the fact that, in the event of the destruction, loss of or damage to the cargo, it can always be replaced, repaired or reproduced, the lawmaker is less rigorous in this area, and focuses primarily on accidents sustained by persons instead (of course, this is not valid for priceless works of art or treasures, which are generally forwarded by aircraft, but these objects have separate, special insurance from the outset). The destruction of the cargo does not only mean the physical annihilation of the cargo, but it also involves the change of the features or the substance of the cargo, therefore, due to its damage, it cannot be used in compliance with its original designation.<sup>19</sup> The similarity between the loss and the destruction of the cargo is that, in both cases, the cargo forfeits its financial value or utility.<sup>20</sup> Transporting cargo is a complex task for the air carriers. However the cargo does not cause damage "purposefully", or does not act "unlawfully" etc., due to which it would require enhanced protection or attention. It is not accidental that, in the event of damage to cargo, the amount of liability of the air carrier for damage is weight-based and limited.

<sup>19</sup> R. H. Mankiewitz, *The Liability Regime of the International Air Carrier*, (Kluwer Law and Taxation, 1982) 168.

<sup>20</sup> *Dalton v. Delta Air Lines*, U.S. Court Appeals, Fifth Circuit, 7 April 1978. 14. Avi. 18.425.

## 1. The time period of air carriage

The air carrier is liable for damage sustained in the event of the destruction, loss of or damage to cargo on condition that the event which caused the damage so sustained took place during its carriage by air [Article 18(1)]. Air carriage implies the time period during which the cargo is in charge of the air carrier. Its duration, as a main rule, does not extend to any carriage performed outside the airport by land, by sea or by inland waterway.<sup>21</sup>

If, however, such carriage takes place in the performance of a contract for carriage by air in order to load, deliver or transship it, any damage is presumed, unless there is proof to the contrary, to have been the result of an event which took place during the carriage by air. The air carrier may substitute air carriage by another mode of transport, for instance, on public roads by truck, but this possibility shall be due to prior agreement under the air waybill by the parties. In such cases, the liability of the air carrier prevails during the whole section of road transport, with respect to the fact that the parties deem consecutive forwarding to be one carriage.<sup>22</sup>

The carrier may also resort to other modes of transport without the consent of the consignor. If a carrier, without the consent of the consignor, substitutes carriage by another mode of transport for the whole or part of a carriage intended by the agreement between the parties to be carriage by air, it is deemed to be within the period of carriage by air [Article 18(3–4)]. If the cargo is deposited in a bond store outside the area of the airport, but it remains in the charge of the airline and its agent,<sup>23</sup> this time period is deemed to be part of carriage by air. The liability of the air carrier prevails, because upon the establishment of liability for damage, supervision, not the location, has legal preponderance.

## 2. The delivery of cargo

The consignor has a right of disposition over the cargo. This right is due to the consignor if it carries out all its obligations under the contract of carriage. The consignor in possession of the right of disposition may:

- *withdraw* the cargo at the airport of departure or destination; or
- *stop* the cargo in the course of the journey on any landing; or
- *call* for the cargo to be delivered at the place of destination or in the course of the journey *to a person other than the consignee* originally designated; or
- *require* the cargo *to be returned* to the airport of departure.

<sup>21</sup> *Victoria Sales Corporation v. Emery Air Freight Inc.*, 917 F.2d, 705 at 707 2.d Cir. 1990.; *Railroad Salvage of Connecticut v. Japan Freights Consolidators*, 556 F. Supp. 124 (E.D.N.Y. 1983), aff'd mem. 779 F.2d 38 (2nd Cir. 1985).

<sup>22</sup> *Commercial Union Insurance Co. v. Alitalia Airlines*, 347 F. 3rd 448 (2nd Cir. 2003).

<sup>23</sup> *Vigilant v. World Courier*, WL 2332343 (S.D.N.Y.) 2008.

The consignor must not exercise this right of disposition in such a way as to prejudice the carrier or other consignors and must reimburse any expenses occasioned by the exercise of this right. If it is impossible to carry out the instructions of the consignor, the carrier must so inform the consignor forthwith [Article 12(1–2)]. If the carrier carries out the instructions of the consignor for the disposition of the cargo without requiring the production of the part of the air waybill or the cargo receipt delivered to the latter, the carrier will be liable, without prejudice to its right of recovery from the consignor, for any damage which may be caused thereby to any person who is lawfully in possession of that part of the air waybill or the cargo receipt. The right conferred on the consignor ceases at the moment when the carrier delivers the cargo to the consignee. Nevertheless, if the consignee declines to accept the cargo, or cannot be communicated with, the consignor resumes its right of disposition [Article 12(3–4)]. As long as the consignor has not exercised its right of disposition over the cargo, that is, the cargo has arrived at its destination, the consignee, after the payment of the due charges and compliance with the conditions of carriage, becomes entitled to require the air carrier to transfer the delivered cargo and to receive it. Unless it is otherwise agreed, the air carrier is obliged to notify the consignee of the arrival of the cargo. Notification needs to take place at the earliest convenience. Although the Convention does not prescribe a concrete time, action needs to be taken as early as possible in compliance with the situation. For instance, in the case when the consignee was notified 19 hours after the arrival of the expiring cargo, the court did not deem the duration between the arrival and the notification to be suitable and so it obliged the carrier to pay indemnity.<sup>24</sup>

If the cargo was lost and the carrier admits its fact, or, if the cargo did not arrive after the expiry of seven days after the date on which it should have arrived, the consignee is entitled to enforce the rights which flow from the contract of carriage against the carrier [Article 13(1–3)]. Not only the consignee but also the consignor may enforce their rights proceeding from the former provisions (Articles 12–13). During the enforcement of their rights, the obligees, the consignor and/or the consignee each proceed in its own name, whether it is acting in its own interest or in the interest of another, provided that it carries out the obligations imposed by the contract of carriage (Article 14). The provisions above do not affect the relations of the consignor and the consignee with each other, nor the mutual relations of third parties whose rights are derived either from the consignor or the consignee. If the consignor or the consignee intends to derogate from the rules above, they can do so by express provision in the air waybill or the cargo receipt on the intention of modification [Article 15(1–2)].

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<sup>24</sup> *Wea Frams, Lima Peru v. American Airlines, Inc.*, 31 Avi 18,739 (S.d. Fla.) 2007.

### 3. Delay

The air carrier is liable for damage occasioned by delay in the carriage of cargo by air (Article 19). Numerous reasons for flight delays are well-known; most often technical failures and various meteorological circumstances cause problems. At the same time, increased waiting time because of deficient airport infrastructure (e.g., lack of ground handling equipment) or the saturation of the airspace brings about delays. The specific tasks of aviation security and their implementation and even the inappropriate handling of cargo may also lead to delays. Delayed connecting flights contribute to further delays and the reasons deriving from the faults of administration are not scarce either. The lawmaker includes delays under the scope of liability of the air carrier for damages, since the consignors opt for air transport as a mode of carriage not only because of its safety, but chiefly because of its speed. The quality of the service is determined essentially by its rapidity and punctuality; punctual departure is simultaneously the pledge of delivery in time. If the air carrier cannot adhere to the timetable, the quality of its service suffers and damage, calculable in numbers, arises.

The Convention does not define the concept of delay. We think of delay in general when the cargo fails to arrive at the destination in time. The concept provides broad scope for interpretation. It is significant to separate the conceptual scope of delay from all other situations which the applier of the law does not wish to adjudge under the legal title of delay pursuant to the provisions of the Convention. The separation is necessary, since legal cases not falling under the category of delay shall be adjudged under the legal title of breach of contract on the basis of national law.

The category of delay does not extend to the case of non-departing, i.e., cancelled flight. The cancellation of the flight may have several reasons, mainly technical failure, accident, extreme weather circumstances, the act of a third party or strike.<sup>25</sup> From a legal viewpoint, it is essential that the air carrier does not carry the consignor's goods to the destination or to the next stop stipulated under the contract (because another flight is not feasible, there is no connecting flight etc.). In such a case, the air carrier breaches the contract, therefore, it is liable and indemnifies the consignor pursuant to the rules of national law.

If the cargo is delayed, the person entitled to receipt (the consignee) shall make a complaint to the air carrier at the latest within twenty-one days from the date on which the cargo has been placed at its disposal. On the basis of the complaint, the claim of the obligees for damages is adjudicated. Every complaint must be made in writing and given or dispatched to the air carrier within the deadline of twenty-one calendar days. The omission of the deadline entails forfeiture. The delayed initiation of action may not be exempted, with the exception of when the air carrier, in order to evade its obligation of indemnification, commits fraud (e.g., by stalling for time) [Article 31(2–4)].

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<sup>25</sup> *Mullaney v. Delta Airlines, Inc.*, 33 Avi. 12,819 (S.D.N.Y.) 2009.

### III. THE LIMITED LIABILITY OF THE AIR CARRIER

In cases of damage to cargo, as well as upon the delayed carriage of cargo, the liability of the air carrier is limited to an amount of 22 SDR per kilogram [Article 22(3)].<sup>26</sup> The air carrier's liability is strict, limited and unbreakable. As the Montreal Additional Protocol 4 (MAP – 1975) stipulates under Article 8(2) “such limits of liability constitute maximum limits and may not be exceeded whatever the circumstances which gave rise to the liability” (see, I.4.) the claimant cannot break through the limited liability (unless they make a declaration of excessive value or if the Warsaw Convention, or the Warsaw Convention as amended by the Hague Protocol,<sup>27</sup> are applicable to the carriage of cargo).<sup>28</sup>

The rules of the Montreal Convention pertaining to cargo guarantee less legal protection for the consignor than to the passenger, considering that the majority of objects can be reproduced and remanufactured. Therefore, the lawmaker stipulates that the liability of the air carrier for damages in the event of the destruction, loss or delay of, or damage to, the cargo is low and limited. For this reason, the air carrier cannot be obliged to pay more indemnity than the maximum amount. This is a fixed amount binding the parties. It cannot be exceeded even if the conduct of the servant of the air carrier caused the loss of or damage to the cargo. An exception from this is if the damage resulted from the act or omission of the air carrier, its servants or agents, done with intent to cause damage or recklessly and with knowledge that damage would probably result, provided that, in the case of such act or omission by a servant or agent, it is also proved that such servant or agent was acting within the scope of their employment [Article 22(5)].

If the consignor intends to have the air carrier forward cargo of higher value, it may make a special declaration of excessive value (interest). The fixed amount determined in the declaration provides sufficient guarantee for the consignor so that it can be reassured about its cargo. The condition of making a special declaration of interest in delivery at destination is that the consignor of the cargo determines the real value in the declaration and pays a supplementary sum if the case so requires. It means that the air carrier shall be liable up to the declared sum unless the sum is greater than

<sup>26</sup> The amount of 17 SDR per kilogram for cargo specified in 1999 and all other amounts in Articles 21–23 of the Convention, for the purpose of the offset of inflation have been raised by the States Parties pursuant to the rule of Article 24 of the Montreal Convention. The upper limit in the case of cargo became 19 SDR in 2009, then 22 SDR in 2019. The limit reviewed at five-year intervals did not change in 2014 then, in 2019, it was amended again, and the raised amounts have been applied since 28 December 2019. *Revised Limits of Liability Under the Montreal Convention of 1999*, [https://www.icao.int/secretariat/legal/Pages/2019\\_Revised\\_Limits\\_of\\_Liability\\_Under\\_the\\_Montreal\\_Convention\\_1999.aspx](https://www.icao.int/secretariat/legal/Pages/2019_Revised_Limits_of_Liability_Under_the_Montreal_Convention_1999.aspx) (Last accessed: 31 December 2020).

<sup>27</sup> Protocol to Amend the Convention for the Unification of Certain Rules Relating to International Carriage by Air, signed at Warsaw on 12 October 1929, Done at The Hague on 28 September 1955.

<sup>28</sup> *G. D. Searle & Co. v. Federal Express Corporation*, No. C 02-00089 SBA. US District Court N. D. California, 23 January 2003.



the consignor's actual interest in delivery. For this reason, if the consignor declares the value in bad faith and the air carrier proves that the declared sum exceeds the actual interest of the consignor in delivery at destination, the air carrier will not pay the sum exceeding the real value [Article 22(3)].

In the event of the destruction, loss, damage to or delay of the consigned cargo, for the purpose of establishing the upper limit of the liability of the air carrier, the total weight of the package or packages concerned shall exclusively be taken into consideration. Nevertheless, when the damage to or delay of a part of the cargo affects the value of other packages covered by the same air waybill (or the same receipt), the total weight of such package(s) shall also be taken into account in determining the limit of liability [Article 22(4)]. In calculating liability only the weight of the package(s) concerned are taken into account. If some parts of the whole cargo are damaged, the question arises: for which part is the air carrier liable? In the *Motorola versus Federal Express* case, the defendant could not provide evidence that the damage to several mobile telecommunication station modules did not affect the value of the whole station, so the court awarded full restitution to the injured party based on the weight of the entire shipment.<sup>29</sup> In the *Deere & Co. versus Deutsche Lufthansa* case, the shipment consisted of various components together comprising a mainframe computer. The damaged package contained one of those components, namely the "directors frame". These damaged computer parts were not easily replaceable with similar parts, so, upon adjudication, the total weight of the shipment was taken into account by the court.<sup>30</sup> In these cases, the damage to a part of the cargo results in the consideration of the weight of the entire shipment as a basis of indemnification.

The air carrier may stipulate unilaterally that the contract of carriage shall be subject to higher limits of liability than those provided for in the Convention or to no limits of liability whatsoever (Article 25). This new opportunity of application and the client-friendly step manifested on the part of the air carrier rarely ensues in practice.

The lawmaker expressly prohibits provisions aiming to exclude the air carrier from liability or impose a lower limit of liability than that laid down in the Convention. In this way, the air carrier cannot evade the prevalence of the limits of liability stipulated in the Convention. If the air carrier still sets out such a limiting provision, it is null and void, but the nullity of the contested provision does not involve the nullity of the whole contract. Its provisions, apart from the contested part, remain effective (Article 26).<sup>31</sup>

<sup>29</sup> *Motorola Inc. and Fireman's Fund Insurance Company v. Federal Express Corporation and Kuehne & Nagel, Inc.*, No. 00-17374. US Court of Appeals, Ninth Circuit. Argued and Submitted 13 February 2002.

<sup>30</sup> *Deere & Co. v. Deutsche Lufthansa Aktiengesellschaft*, 621 F. Supp. 721 (N.D. Ill. 1985), US District Court for the Northern District of Illinois, 26 April 1985.

<sup>31</sup> The lawmaker prohibits the application of a limiting clause in the relations of contracting and actual carriers (*code-share*) and attaches the nullity of the contested part of the contract as a legal consequence of its breach. Montreal Convention, Article 47.



The drawback of the limited liability for damage is that the amount of compensation to be paid to the obligees is generally deemed low, since it is not always in proportion with the extent of the damage sustained. Therefore, the consignor needs to purchase supplementary insurance so that, in the event of damage, besides the indemnity paid by the air carrier, they can receive further compensation depending on the amount paid and the conditions set out in the insurance contract. This conception does not conform entirely to the basic principle of compensation deriving from the liability for damages, the essence of which is that the claimant needs to be restituted in such a situation as if the damage had not occurred. The entity liable for the damage is obliged to restore the original state (*in integrum restitutio*). Obviously, the phrase of the original state has a literal, but also a metaphorical meaning.<sup>32</sup> If the consignor recovers the object stolen from the cargo unit, the original state is reinstated indeed. However, if the cargo is destroyed, restitution to the former state becomes impossible. In this case, the damaging party indemnifies the damage caused. If the actual damage does not exceed the upper limit, the air carrier indemnifies the damage of the claimant within the limited amount with respect to the extent of the proven damage.

## 1. Limited liability of code-share carriage

It was under the Guadalajara Agreement (1961)<sup>33</sup> that special rules were formulated for the first time pertaining to the contracting and the actual carrier, which were incorporated into the system of rules set forth under the Montreal Convention by the lawmaker. The provisions of the Convention are to be applied to the so-called “code-share” carriage performed by the actual carrier instead of the contracting carrier. The code-share carriage is realised via an agreement between two or more air carriers. On the basis of the agreement, the air carriers operate the specific flight jointly under a common flight number on a route determined by them, on which the whole or part of the carriage shall be performed by the actual carrier.<sup>34</sup> The provisions of the

<sup>32</sup> Petrik F., *Az Ön ügyvédje, (Your Solicitor)*, (Kultúrtrade, Budapest, 1994) 349.

<sup>33</sup> Convention Supplementary to the Warsaw Convention, for the Unification of Certain Rules Relating to International Carriage by Air Performed by Air Performed by a Person other than the Contracting Carrier. Signed Guadalajara on 18 September 1961.

<sup>34</sup> In the so-called *code-share arrangement*, the participating airlines operate the flight jointly on agreed routes with a common flight number. In that case, within the framework of the so-called *block-seat* arrangement, one party or both purchase(s) seat quotas on the aircraft operated by the other party. The non-operating party may purchase *hard-block* seats in fixed number and *soft-block* seats in flexible number on the given flight. The fixed number of seats has to be paid for in advance. If the contracting party cannot sell the purchased quota, this causes damage. At the same time, if more seats are demanded, the revenue arises for the partner, since only the operating party may sell tickets exceeding the fixed number of seats. The sale of seats purchased in a flexible framework is less risky; however, such contracts are seldom concluded.

Convention apply when a contracting carrier makes a contract of carriage governed by the Convention with a consignor or with a person acting on behalf of the consignor, and the actual carrier performs, by virtue of authority from the contracting carrier, the whole or part of the carriage. Such authority shall be presumed in the absence of proof to the contrary (Article 39). Despite the fact that, in such a relation, two or more air carriers are concerned, the legal relation between the parties remains bipolar, since the consignor is only engaged in a legal relation with the contracting carrier. In this case, no contractual legal relation exists with the actual carrier. However, this fact does not imply that the carriage does not qualify as international, and consequently, the Convention is not applicable. In this case, both the contracting carrier and the actual carrier shall be subject to the rules of the Convention:

- the *contracting carrier* for the whole of the carriage contemplated in the contract; whereas

- the *actual carrier* solely for the carriage which it performs (Article 40).

The lawmaker serves the interests of the consignors by stipulating the joint liability of the contracting and the actual carrier for each other's acts and omissions:

- The acts and omissions of the *actual carrier* and of its servants and agents acting within the scope of their employment shall, in relation to the carriage performed by the actual carrier, be deemed to be also those of the *contracting carrier*.

- The acts and omissions of the *contracting carrier* and of its servants and agents acting within the scope of their employment shall, in relation to the carriage performed by the actual carrier, be deemed to be also those of the *actual carrier*.

The lawmaker creates the balance of joint liability by protecting the carrier performing the air carriage *vis-à-vis* the contracting carrier. The essence of the protection is that the lawmaker attaches the contract of the contracting carrier with the customer to conditions, thereby restricting its content. Thus, the contracting carrier may not conclude a special agreement

- on the basis of which the contracting carrier assumes obligations not imposed by the Convention; or

- which pertains to waiving rights or defences conferred by the Convention; or

- under which a separate declaration of interest in delivery at destination with respect to cargo affects the actual carrier unless agreed to by it (Article 41).

No act or omission may subject the actual carrier to liability exceeding the amount referred to under the Convention in Article 22. Any complaint to be made or instruction to be given under the Convention to the air carrier shall have the same effect, whether it is addressed to the contracting carrier or to the actual carrier. Nonetheless, instructions concerning the right of disposal over the cargo shall only be effective if they are addressed to the contracting carrier (Article 42). It is important to highlight that the plaintiff cannot break through the limited liability of the air carrier related to damage to cargo and delay. In relation to the carriage performed by the actual

carrier, any servant or agent of the actual or the contracting carrier is, pursuant to the Montreal Convention, entitled to avail themselves of the conditions and limitations of liability applicable to the air carrier of which they are the servants or agents. In relation to the carriage performed by the actual carrier, the aggregate of the amounts recoverable from that carrier and the contracting carrier, and from their servants and agents acting within the scope of their employment, shall not exceed the highest amount which could be awarded against either the contracting carrier or the actual carrier under the Convention, but neither the contracting nor the actual carrier shall be liable for a sum in excess of the limit applicable to that person (Article 44).

## 2. Limited liability of combined carriage

In the event of combined carriage performed partly by air and partly by any other mode of carriage, the provisions of the Convention shall apply only to the carriage by air, provided that the carriage by air qualifies as international and the aircraft performs the carriage for reward [Article 38(1)]. Different rules are applicable to carriage by other sub-branches of transport.

If for technical or meteorological reasons or because of strike, the aircraft does not land at its destination and is not capable of continuing its journey, or the flight is cancelled, the air carrier may find an alternative mode of carriage (land) within a certain distance, if it cannot perform carriage by air. For instance, if the goods are transported from Vienna (VIE) with transshipment in Frankfurt (FRA), but the flight to Frankfurt is cancelled, the connecting flight can be reached by truck or train. This mode of transport does not qualify as air carriage, since the Convention by its own vigour (*ex proprio vigore*) does not encompass other transport sub-branches. Thus, the damage caused in this period of transportation is adjudged pursuant to the rules of national law pertaining to the sub-branch of transport concerned.

At the same time, the Convention facilitates that, in the case of combined carriage, the contracting parties insert conditions relating to other modes of carriage in the document of air carriage, provided that the provisions of the Convention are observed as regards the carriage by air [Article 38(2)]. Upon the carriage of cargo, if the consignor and the carrier of the cargo stipulate in advance in the air waybill that the carrier will take recourse to means of land (on the surface on public road or railway) or water transportation (ship) for certain sections, these modes of carriage will be governed by the rules of the Convention.<sup>35</sup> If the parties do not stipulate in advance the possibility of the use of other means of transportation in the air waybill, the period

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<sup>35</sup> *Masudi v. Brady Cargo Services Inc.*, No. 1:2012cv02391 - Document 44 (E.D.N.Y.) 8 September 2014.

of the carriage by air will not extend to any carriage by land, sea or inland waterway performed outside the airport.

In the *Siemens versus Schenker International* case,<sup>36</sup> the plaintiff demanded that the defendant indemnify the damage to its manufactured products caused during their consignment. The electronic products manufactured in Germany were consigned to Australia by the Schenker Logistics Company. The cargo arrived at the airport in Melbourne (MEL), from where it was delivered by lorry to the warehouse 4 kilometres away and stored there temporarily. However, during the consignment of the cargo back to the airport, a part of the products, owing to the fault of the lorry-driver, fell from the back of the truck, and significant damage was caused to the cargo. The carriage was deemed international; therefore, the case needed to be adjudged pursuant to the provisions of the Convention. Nevertheless, the damage was caused during the section performed outside the area of the airport and so the Convention was not applicable. However, carriage by air can be extended in writing in the air waybill to consignment by other means of transportation for loading, delivery or transshipment. In such a case, the Convention is governing, because this section is also deemed to be air carriage. Therefore, the Court established that the limited liability indicated in the air waybill had been extended by the parties to the whole carriage; thereby to consignment to the warehouse as well. Therefore, according to the rules of the Convention the carrier, sustaining its limited liability, was liable on the basis of weight for the damage. Finally, the carrier made a payment of 74,680 USD as damages calculated with 20 USD per kilogram [the real damage was valued at 1.7 million Australian Dollars (AUD)].

Essentially, the liability of the air carrier is maintained during the time of storage in the warehouse as well if the disposal of the cargo in the warehouse is deemed to be part of the carriage by air by the contracting parties. The lawmaker extends the section of air carriage to when, upon the performance of a contract for carriage by air, for the purpose of *loading, delivery* or *transshipment*, carriage takes place using other modes of transport. Any damage caused in this period of time is presumed, unless there is proof to the contrary, to have been the result of an event which took place during the carriage by air.<sup>37</sup> If a carrier, without the consent of the consignor, substitutes carriage by another mode of transport for the whole or part of a carriage intended by the agreement between the parties to be carriage by air, such carriage by another mode of transport is deemed to be within the period of carriage by air [Article 18(4)].

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<sup>36</sup> *Siemens Ltd. v. Schenker International (Australia) Pty. Ltd.*, High Court of Australia, S158/2003, HCA 11, 9 March 2004.

<sup>37</sup> *Fuller v. Amerijet International Inc.*, 273 F. Supp. Ed 902, Civil Action H-03-1128, 22 July 2003.

### 3. Limited liability of successive carriage

In successive air carriage, different air carriers in their own right perform the carriage consisting of several sections under their own flight number. Carriage in that case, pursuant to the Convention, is deemed to be one undivided carriage. Its condition is that the contracting parties regard the carriage as a single operation, whether it had been agreed upon under the form of a single contract or of a series of contracts. Successive carriage does not lose its international character merely because one contract or a series of contracts are to be performed entirely within the territory of the same State [Article 1(3)].<sup>38</sup>

For instance, the Air France (AF) airline delivers the cargo on the Paris – Moscow – Vladivostok (CDG–SVO–VVO) route. In the Russian Federation, it is not possible to implement a domestic flight using an aircraft of a foreign airline, since the exercise of the right of cabotage (8th and 9th Freedoms of the Air Rights) is not permitted. Therefore, the cargo on the domestic route between SVO–VVO is transported on an Aeroflot (SU) aircraft. All sections of the transportation, including the domestic one, qualify as undivided carriage considered to be a single operation and, as international carriage, it is subject to the scope of the Montreal Convention (Russia ratified it in 2017).

However, if the original route was only Paris – Moscow and the consignor decided that the cargo which was delivered to Moscow should be transported to Irkutsk (IKT) and makes another contract with the same air carrier or its agent in order to have the goods carried from Moscow to Irkutsk, this separate transport would qualify as domestic carriage; therefore, it would not be subject to the scope of the Montreal Convention.

In the case of carriage to be performed by various successive carriers, each carrier which accepts cargo is subject to the rules set out in the Convention. The air carrier under the supervision of which the carriage is performed is deemed to be one of the parties to the contract of carriage insofar as the contract deals with that part of the carriage which is performed under its supervision [Article 36(1)].

Upon successive carriages as regards cargo, the consignor will have a right of action against the first carrier, and the consignee who is entitled to delivery will have a right of action against the last carrier. Essentially, each may take action against the carrier which performed the carriage during which the destruction, loss, damage or delay took place. These carriers will be jointly and severally liable to the consignor or consignee [Article 36(2–3)], so far as the consignor or the consignee does not take action for various reasons, and the entity of the owner of the cargo is different from these obligees, since the lawmaker does not expressly designate the owner as a person

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<sup>38</sup> *Kathleen Robertson v. American Airlines*, US Court of Appeals, District of Columbia Circuit, No. 03–7129, 18 March 2005.

entitled to take action; they may only sue for damages if they can prove that a real legal relation prevails with any of the parties concerned.<sup>39</sup>

#### 4. Limited liability of the servant or agent

A lawsuit may be filed *vis-à-vis* the servant or agent of the air carrier for causing damage regulated under the Convention. In that case, the servant or the agent, if they can prove that they acted in the scope of their employment upon the occurrence of damage, shall be entitled to avail themselves of the conditions and limits of liability which are applicable under the Convention to the carrier whose servant or agent they are (Article 43).

The aggregate amounts recoverable from the carrier, its servants or agents in that case shall not exceed the limits stipulated under the Convention. Thus, the plaintiff cannot claim more compensation from the servant or agent than from the air carrier itself. At the same time, if it is proved that the damage resulted from an act or omission of the servant or agent done with intent to cause damage or done recklessly and with knowledge that damage would probably result, that prevents them from invoking the limits of liability in accordance with the Convention [Article 30(1–3)].

### IV. EXONERATION OF THE AIR CARRIER FROM LIABILITY

The Convention provides that, in the carriage of cargo, the liability of the air carrier in the event of destruction, loss, damage or delay is limited, unless the consignor, upon transferring the package to the carrier, has made a special declaration of interest in delivery at destination for the excessive value and has paid a supplementary sum charged for this [Article 22(3)].

The air carrier has strict (absolute) liability in the event of damage or delay during carriage by air. It means liability is imposed on the air carrier without regard to fault. Upon the exoneration of the air carrier, the burden of proof is placed on the air carrier [Article 21(2)]. As the cargo is not under the supervision of the claimant, the air carrier “in charge” is in the best position to report on what had happened to the cargo. The claimant (plaintiff), the entity of the consignor, or the shipper (the freight forwarder) is obliged to declare and prove the actual damage in detail, and furnish relevant and specific information about the damage and delay. If necessary, the claimant has to notify the carrier in a preliminary notice and they can specify their claim in this document.

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<sup>39</sup> *Gatewhite v. Iberia Lineas Aereas de Espana*, 1989, 1 All E.r. 944 1 Lloyd's Report 160, 225, 226.; *Western Digital Corp. v. British Airways*, 2 Lloyd's L. Report, 380 (1999), 266.



If the applicability of the Convention has been established, the meritorious adjudication of the legal case commences. The court examines the extent to which the air carrier is liable for the damage and whether there are any circumstances on the basis of which it can be exonerated. It is important to highlight that the air carrier, as a matter of course, does not have to indemnify damage deriving from, the claimant's own fault; that is, the damage caused or contributed to by the negligence or other wrongful act or omission of the person claiming compensation, or the person from whom the claimant derives their right to claim compensation. In this way, the air carrier shall be exonerated from liability to the extent to which such (contributory) negligence or wrongful act or omission caused or contributed to the damage (Article 20).<sup>40</sup>

So far as no own fault prevails, and the responsibility of the claimant cannot be established, the air carrier shall be liable, provided that further reasons for exoneration expounded below do not prevail. If, on the basis of the provisions of the Convention, the air carrier is not liable since it exonerates itself, or its liability on the basis of the provisions of the Convention is not established, the air carrier can no longer be called to account in the concrete case in any other way. This implies that, in the specific case, the plaintiff cannot enforce their claim for damages *vis-à-vis* the air carrier pursuant to national law or any other legal regime. The institution of exclusive remedy is a special protective stronghold which, to all intents and purposes, provides ultimate protection for the air carriers of the States Parties.

In the carriage of (passengers, baggage) cargo, any action for damages, however founded, whether under the Convention or in contract or in tort or otherwise, can only be brought subject to the conditions and such limits of liability as are set out in the Convention without prejudice to the question as to who are the persons who have the right to bring suit and what are their respective rights (Article 29). This intricately formulated but all the more significant rule has been transplanted into the Montreal Convention from the Warsaw Convention without substantial changes; therefore, a considerable amount of case-law pertaining to exclusive application is available. Exclusive remedy means that if the Convention is applicable in the given case but, pursuant to its provisions, the award of compensation is not substantiated and, as a consequence, the liability of the air carrier is null and void, this claim cannot be enforced; that is, the air carrier cannot be sued on any other legal grounds proceeding from national or other law.<sup>41</sup> It does not mean that the consignors do not have an opportunity to enforce their rights solely because they cannot claim compensation from the air carrier itself any longer. The claimants may in their own right bring civil legal or criminal legal action *vis-à-vis* the tortfeasor third party pursuant to the rules of national law.

<sup>40</sup> This rule applies to all provisions related to liability, so to cases of damage to and delays of the cargo.

<sup>41</sup> *Sidhu v. British Airways*, Lloyd's Law Reports. 76. (1997) 2. p. 84.; *EL AL Israel Airlines Ltd. v. Tsui Yuan Tseng*, US Court of Appeals for the Second Circuit, No. 97-475, 122 F. 3d, 1999.



## 1. Exoneration from indemnity for damage caused to cargo

The air carrier is not liable for damage to the cargo if and to the extent it proves that the destruction, loss of or damage to the cargo resulted from one or more of the following:

- inherent defect, quality or vice of that cargo;
- defective packing of that cargo performed by a person other than the carrier or its servants or agents;
- an act of war or an armed conflict;
- an act of public authority carried out in connection with the entry, exit or transit of the cargo [Article 18(2)].

The air carrier's liability for damage to cargo is limited unless the consignor has made, at the time when the cargo was handed over to the carrier, a special declaration of interest in delivery at destination and has paid a supplementary sum to the air carrier. In that case, the carrier will be liable to pay a sum not exceeding the declared sum. The air carrier shall not be liable if it proves that the sum stated in the declaration does not correspond to the facts, since it is greater than the consignor's actual interest in delivery at destination [Article 22(3)]. In the latter case, the extent of indemnification is adjusted to the weight of the cargo, not to the value stated in the declaration.

## 2. Exoneration from the indemnification of damage caused by delay

The carrier shall not be liable for damage occasioned by delay if it proves that

- it and its servants and agents took all measures that could reasonably be required to avoid the damage; or
- it was impossible for the air carrier and its servants and agents to take such reasonable measures (Article 19).

Under the Convention, the lawmaker prescribes that the air carrier, its servants and agents merely *take all measures reasonably required* for the avoidance of damage, in contrast to the more rigorous requirement of the Warsaw system, in which the basic expectation was taking *all the necessary measures*. There are situations when the air carrier cannot fulfil its obligation, since its servants and agents are unable to avert the unforeseeable, external and compelling circumstance or impediment and its consequences. On such occasions, it is impossible to take appropriate measures because one is powerless *vis-à-vis* superior power (*vis maior*), such as wars and emergencies, natural disasters (volcanic ash, earthquakes, tornados), catastrophes, and even strikes.<sup>42</sup>

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<sup>42</sup> *Tismanariu v. Societe Air France*, QCCQ 2847, 2014; Force Majeure Trumps Delay Claim in Québec Aviation Case, (2014) 10 (5) *Transportation Notes*, 2.

It is worth emphasising that the Convention does not mention the legal institution of *vis maior*; hence it entrusts its relevant judgment of the case to national courts.

The eruption of the Icelandic Eyjafjallajökull volcano and the volcanic ashes hanging over a large part of Europe created severe chaos in air traffic in April 2010. In a matter of minutes, the natural phenomenon impeded the journey of more than ten million people and at least 100,000 flights were cancelled. Consequently, the air transport industry of the world suffered a loss of approximately 1.7 billion USD. The insurance companies, with reference to a situation of *vis maior*, denied the fulfilment of claims for damages.<sup>43</sup> The air carriers took all reasonably necessary measures in the interest of the prevention of damage by not taking off; therefore, their exoneration from liability for damage was deemed justified.

A further important aspect of the exoneration of the air carrier in the event of delay is that the delay should be justified. If the flight is performed on another airplane by the air carrier since the change of aircraft is justified for technical or flight safety reasons, its position based on the requirement of flight safety despite the delay remains defensible, if it can prove that it took all reasonably necessary measures to prevent damage. Beyond taking the reasonably necessary measures, the air carrier needs not only to do its utmost to remedy the situation (the prevention of damage), but also to prevent any delay. If the delay had been preventable or the recklessness and negligence of the air carrier underlie the technical failure, and the fault is repaired in vain, the air carrier cannot exonerate itself, and therefore it shall be wholly liable.

A further requirement of the exoneration of the air carrier from liability for delay is that the consignor does not contribute to the avoidance of delay. If the consignor does not follow the instructions of the air carrier and contributes to occasioning the damage, for instance, upon loading the rest of the cargo, it does not arrive in time and the goods miss the flight as a consequence, the consignor may not sue the air carrier since the delay does not occur due to the fault of the air carrier.

## V. DISPUTE RESOLUTIONS

The parties to the contract of carriage of cargo may agree that their dispute will be settled by arbitration. Arbitration organised by the parties is increasingly widespread, which is due to the claim that such disputes are resolved rapidly and efficiently by competent persons proficient in the subject-matter. The decision is made secretly at a closed session, and it is legally binding in the first instance; the opportunity for legal

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<sup>43</sup> G. Bisignani, The Eruption of Eyjafjallajökull Was a Wake-up Call for Change, 1 June (2010) *Airlines International*, *LATA Magazine*.

remedy is very rare. The parties may determine the rules of procedure flexibly; they can decide on the language and place of the proceedings and the persons of the arbitrators.

The parties to a contract of carriage of cargo may stipulate, exclusively in cases of the legal relation of the carriage of cargo, that they shall settle any dispute arising with respect to the liability of carriage by way of arbitration.<sup>44</sup> The clause needs to be made out in writing. The clause or agreement on arbitration contains the following provisions mandatorily:

– The arbitration proceedings shall, at the option of the claimant, be conducted in the territories concerned in compliance with the Convention.

– The arbitrator or the arbitration tribunal shall apply the provisions of the Convention during the proceedings (Article 34.).

The scope of arbitration does not encompass accidents sustained by the person of the passenger; therefore, arbitrators may be elected only in relation to the first four fora of jurisdiction [Article 33(1)].<sup>45</sup>

## VI. CONCLUSION

The majority of the provisions of the Montreal Convention pertain to the carriage of cargo.

The lawmaker meticulously establishes the liability system of the triangular legal relation; however, from the viewpoint of liability for damages, it does not place emphasis on the carriage of cargo, for which it does not guarantee the rights which are due to the passenger and their baggage. The cargo is deemed to be reproducible and replaceable in the case of its damage, loss or destruction; therefore, the legal protection of goods is not so important as that of the person in the event of an accident or their personal belongings in the case of damage to them. Therefore, for damage caused to cargo, the air carrier's liability is limited to an amount of 22 SDR per kilogram, which cannot be broken through, as opposed to the unlimited liability in the case of accidents sustained by persons and to the breakable limited liability for damage to baggage. Nonetheless, the regulation of the carriage of cargo has not lost its significance; surely, the system of liability for damage was formulated so that it encourages the consignor of the cargo to purchase supplementary insurance, make a special declaration of interest in delivery at destination and protect their valuables and assets with all available instruments. The safety of the carriage of cargo, and its adequate legal and financial protection undoubtedly impacts our life. The carriage of cargo is a factor of increasing

<sup>44</sup> ICAO Legal Committee, 30th Session, LC/30-WP/4 (A-19) 5.4.22.

<sup>45</sup> Pursuant to the Convention an action for damages must be brought, at the option of the plaintiff, in the territory of one of the States Parties; (1) before the court of the domicile of the carrier or of its principal place of business; or (2) where the carrier has a place of business; or (3) through which the contract has been made (*lex loci contractus*); or (4) before the court at the place of destination [Article 33(1)].

value; namely, the labour and energy invested in the service of shipment are integrated into the price of the shipped products, therefore, the consumer price of each product includes the cost of carriage, which entails on average a financial surplus of 30–40 per cent in the price. Furthermore, the system of rules regulating the carriage of cargo is extraordinarily complex. The Montreal Convention provides scope for national law, guiding case-law and the IATA resolutions, because it intends to unify the system of the liability of air carriers for damage only regarding the most important issues. At the same time, it will be capable of establishing uniform regulation worldwide only if all, but at least as many states as possible, accede to the Convention. The Montreal Convention for the Unification of Certain Rules for International Carriage by Air unifies merely the most significant rules; consequently, national law, supplemented by the rules of the industry proceeding from the character of air transport, has a prominent role in guaranteeing comprehensively the legal protection of the performers of the carriage of cargo and chiefly of the persons utilising the service.

# HABILITATIO

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Siklósi, Iván

## “Causus medius” in Roman Law? (A Brief Summary)

The following paper – which is a short contribution to the topic of the limits of *custodia*-liability in Roman law – is an edited version of the English-language part of the author’s habilitation lecture entitled “*Causus medius*” a római jogban? (“*Causus medius*” in Roman law?), held on September 28, 2020 at the ELTE Faculty of Law. It summarises the most important thoughts of the author’s habilitation thesis, which will be published in book form in 2021 [*A custodia-felelősség problémái a római jogban (Problems of custodia-liability in Roman law)*, ELTE Eötvös Kiadó, Budapest, 2021, with a summary in French].

### 1.

It is well known that the responsibility for *custodia* is mostly (but even in the modern literature not exclusively) considered an “objective contractual liability” in the literature of Roman law. It did not presuppose fault, being a liability for so-called “lesser accidents” in classical Roman law (cf. e.g. Schulz: “liability for *custodia* implied a liability for lesser accidents”), according to the objective theory of *custodia*-liability (which can be considered to prevail, even nowadays).

However, there are different interpretations regarding the nature of *custodia*-liability. With regard to the subjective interpretation of *custodia*-liability, first and foremost the much-disputed book by Robaye deserves mentioning from the modern bibliography. According to Robaye, “la *custodia* est un critère de responsabilité subjective”. The distinguished Italian Romanist Voci also interpreted the liability for *custodia* in the context of *diligentia* and *culpa* (i.e. from a subjective approach), in his study of the system of liability in Roman private law.

The legal construction of the responsibility for *custodia*, in our view, has to be analysed from a “mixed” approach (i.e. from an objective and a subjective approach as well). It cannot be interpreted exclusively from an objective or a subjective perspective. With regard to the mixed approach of *custodia*-liability, we can refer, for instance, to the works of Cannata and MacCormack. According to Cannata, the term “custodiam praestare” “non esprime un criterio di responsabilità, ma un’obbligazione contrattuale”, and *custodia* “rappresenta l’oggetto di un specifico dovere di diligenza”. MacCormack emphasised – with regard to Ulp. D. 19, 2, 41 – that *custodia*-obligation means an obligation to exercise a certain type of *diligentia*. He also stressed that the term “custodiam praestare” does not express a liability independent of fault.



## 2.

As for “casus minor”, this Latin term was not created by the Roman jurists; it is only applied by modern scholars to identify the accidents for which a *custodiens* is objectively liable. The term “casus minor” (*niederer Zufall*) was created by *Julius Baron*, in the 19th century, for describing accidents which can be avoided by human efforts and for which a *custodiens* is (objectively) liable (i.e. independently of his fault).

It deserves a special mention that a *custodiens* was not liable for all accidents out of the scope of acts of God. Therefore, *custodia*-liability cannot be defined as a liability for all accidents excepting *vis maior*. The *custodiens* was liable for theft (see e.g. Lab. – Iav. D. 19, 2, 60, 2; Gai. 3, 203; Paul. D. 47, 2, 83 [82], 1 [= PS 2, 31, 30]; Ulp. D. 13, 6, 10, 1; Ulp. D. 47, 2, 14, 17; eod. 48, 4) and for other typical lesser accidents, casuistically specified in the sources of Roman law. In this regard, we have to refer to the research by *András Földi*, who strongly emphasises the “case law approach” of the classical jurists in this respect. (Földi devoted numerous works to the topic of responsibility, including *custodia*-liability, as well.) Zimmermann, in a summarised form, also refers to the “casuistical” (i.e. “case law”) approach in this regard.

## 3.

As for the other “traditional” type of accidents, the term “*vis maior*” (see, in addition, the expressions “*vis magna*” [Gai. D. 18, 6, 2, 1], “*vis naturalis*” [Iav. D. 19, 2, 59], “*vis extraria*” [Alf. – Paul. D. 19, 2, 30, 4], “*fatale damnum*” [Gai. D. 18, 6, 2, 1; Ulp. D. 4, 9, 3, 1; Ulp. D. 17, 2, 52, 3], “*casus maior*” [Gai. D. 44, 7, 1, 4; Inst. 3, 14, 2], “*casus fortuitus*” [Alf. – Paul. D. 19, 2, 30, 4; Ulp. D. 16, 3, 1, 35; Inst. 3, 14, 2; Inst. 3, 14, 4], “*casus improvisus*” [C. 4, 35, 13], “*theou bia*” [Gai. D. 19, 2, 25, 6], and “*vis divina*” [Ulp. D. 39, 2, 24, 4]) – in contrast to *casus minor* – appears in the Roman sources. Even a *custodiens* is not liable, of course, for “superior force” (“act of God”), i.e. for such an (inevitable) accident which human weakness cannot provide against.

## 4.

In our opinion, the usual and “traditional” distinction between *casus minor* and *casus maior* does not imply all possible cases of accidents. There are events for which a *custodiens* is not (objectively) liable but which cannot be considered as “acts of God” either, since these accidents can be avoided by human efforts. In this regard – on the basis of our research – certain cases of robbery (*rapina*), the wrongful damage committed by a third person (*damnum ab alio datum*), and certain cases of the flight of slaves (*fuga servorum*) can be mentioned. In order to classify these accidents (“dogmatically”), in our opinion, the introduction and application of a third dogmatic category, the concept of “*casus medius*”, seems to be reasonable.

Applying this new term, the usual dichotomy (*casus minor* – *casus maior*) can be changed to the trichotomy of *casus minor*, *casus medius*, and *casus maior*.

## 5.

A “*casus medius*” can be prevented, in principle, with proper (or extreme) precautions (it cannot be regarded as an inevitable accident) but it would be unjust to make the debtor (objectively) responsible for such an accident. Therefore, “*casus medius*” covers accidents which can be avoided by human efforts on the one hand but for which a *custodiens* is not (objectively) liable on the other hand. It includes, in the light of our research, “simple” robbery (other cases of robbery belong to the scope of acts of God), wrongful damage committed by another, and the flight of a *servus non custodiendus* (when the slave should not have been guarded; this case is out of the scope of lesser accidents; the flight of a *servus custodiendus* can be considered as *casus minor* since such a slave should have been guarded).

As for *rapina*, for example, it is the risk of the purchaser. According to Neratius, when a thing is taken from the vendor by force, although he should guard it (he is liable for *custodia*), there is no further consequence than he is liable for the transfer of his reipersecutory actions to the purchaser, because custody is of little advantage where violence is employed (cf. the translation edited by *Watson*: “for its safekeeping is of slight avail against force”). The robbery is, therefore, the risk of the purchaser for whom the vendor should transfer his reipersecutory actions, due to the (consequently applied) principle “*periculum est emptoris*”. In a summarised form: the vendor is not liable for the robbery, and the purchaser cannot bring an action for damages – based on contractual liability – against him but the vendor is obliged to assign his reipersecutory actions to the purchaser, in accordance with the rule of “*periculum est emptoris*”. (Cf. Ner. D. 19, 1, 31 pr.)

## 6.

Prevention can be considered as the primary principle of legal responsibility (in this regard we have to refer, first and foremost, to *Marton’s* view). Without any doubt, a *rapina*, a *damnum ab alio datum*, or a flight of a *servus non custodiendus* would be extremely difficult to be avoided, foreseen, or prevented. This may be, probably, the main reason for a *custodiens* not being liable for these accidents which, however, cannot be considered as irresistible and, therefore, as “acts of God”. Consequently, in our opinion, a new dogmatic category, of “*casus medius*”, needs to be used in regard of these events. The prevention of a *casus minor* requires, naturally, an improved diligence from the *custodiens*. However, the prevention of the events belonging to the scope of “*casus medius*” would require such an extreme diligence which would not be expectable even from a *custodiens*.

## 7.

We think that there are guiding principles which play a significant role with regard to the cases of “casus medius”. The element of violence in the cases of *rapina* and *damnum ab alio datum*, as well as the above-mentioned differentiation between the two types of the slaves, refer to guiding principles, in spite of the “case law approach”.

Violence seems to be the limit of the *custodia*-liability. If our argumentation is correct, there is no objective *custodia*-liability for robbery or for wrongful damage caused by a third person. The violence is the lynchpin between these two accidents.

There is a clear distinction between *servi custodiendi* and *servi non custodiendi* in the sources of Roman law, which seems to be a very conscious dichotomy.

## 8.

In summarised form, *casus minor* is a term for accidents which can be avoided by human efforts and for which a *custodiens* is objectively liable. *Casus medius* would be a new dogmatic category for accidents which can be avoided by human efforts on the one hand but for which a *custodiens* is not objectively liable on the other. Finally, *casus maior* is an original Roman law term for accidents which human weakness cannot prevent. This would be a “three-stage scale” of the accidents (instead of the dichotomy of *casus minor* and *casus maior*), with the brand-new term of “casus medius”.

