



Is your arbitration clause invalid?

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An arbitration clause referring to the statute of a private arbitration court for the appointment of the arbitrator is invalid. The invalidity of the arbitration clauses concluded in the past could be remedied only by conclusion of a new arbitration clause.



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The arbitration clauses in the future have to comply with the ruling described in this article.

A ruling of the High Court in Prague has become a popular topic of discussion in legal circles after it invalidated certain types of arbitration clauses. While the decision itself was issued on May 28, 2009, (file no. 12 Cmo 496/2008) the far-reaching ramifications are set to have a significant effect on business practices where dispute resolution is foreseen to take place before the more expedient and cost effective arbitration courts.

High Courts are not courts of last instance in the Czech court system and their decisions

could be questioned by the Supreme Court; however, the Supreme Court recommended the above decision be published in the Collection of Rulings. This demonstrates that the Supreme Court expects to decide in the same way if a similar case were brought before it.

In the case itself, the parties negotiated in the contract that any disputes arising from the contract or in connection with it would be resolved by a single arbitrator. The parties had not stated the name of a concrete person in the arbitration clause. The arbitration clause contained only the provision that the arbitrator would be selected by the plaintiff from a list of arbitrators maintained by a private arbitration court. Regarding the determination of the arbitrator, the contractual parties further agreed that the arbitration procedure will proceed according to the rules issued by a private company dealing with arbitration procedures (private arbitration court).

In the ruling, the High Court in Prague stated that a private arbitration court is not a permanent arbitration court established according to the Arbitration Act (Act no. 216/1994 Coll.), and, therefore, an arbitration clause that merely refers to a statute or rules of such a private arbitration court is invalid. This means that the arbitrators have to refuse its competence to solve the dispute and any dispute that arises would be settled in a civil court. If the arbitration proceeding is opened despite the ruling, a party to the proceeding would have to impeach the competence of the arbitration court in the first act of this proceeding.

According to the High Court in Prague, a private arbitration court is not entitled to keep its own list of arbitrators and issue its own statutes and rules for the appointment and selection of the arbitrators and the method of keeping the arbitrations. According to the Arbitration Act, permission to keep a list of arbitrators and to issue its own statutes and rules is granted exclusively to permanent arbitration courts. There is only one general arbitration court in the Czech Republic—the Arbitration Court attached to the Economic Chamber of the Czech Republic and Agricultural Chamber of the Czech Republic—and two special arbitration courts—the Exchange Court of Arbitration at the Prague Stock Exchange and the Arbitration Court attached to the Czech-Moravian Commodity Exchange Kladno (Českomoravská komoditní burza Kladno). Contrary to the legal regulation of permanent arbitration courts, the private arbitration courts do not have to publish their statutes and rules in the publicly available Commercial Bulletin. Also the voluntary publication of rules and statutes does not entitle the private arbitration court to issue its own statutes and rules.

Because the particular arbitration clause in question did not include the direct determination of an arbitrator or specify a method for doing so, and in relation to the selection of the arbitrator and the selection of the arbitration rules it only referred to the rules of the private arbitration court, such reference to the rules of the private arbitration court in the arbitration clause was deemed invalid. Also the arbitration clause as a whole will be considered invalid because there is no legal way to determine the arbitrator according to Arbitration Act in such a case.

Changes for the future

Some lawyers are of the opinion that the invalid arbitration clauses could be remedied by the appointment of the arbitrator by the court according to provisions of the Arbitration Act. However, this applies only in the case when the arbitrator, who has to be

determined by the party, is not determined. This appointment (not determination) of the arbitrator by the court is possible when it was foreseen in the arbitration clause or the contractual parties omitted to determine the arbitrator or the method to do so. The only legal way to remedy the invalid arbitration clause is to conclude a new one, which will reflect the conclusion of the ruling of the High Court in Prague.

So how do arbitration clauses need to be worded in the future? It is advisable that in arbitration clauses, the contractual parties refer only to statutes, rules and lists of arbitrators kept by the permanent arbitration courts. In case the contractual parties decide to use a private arbitration court for solving their potential disputes, they have to determine the concrete arbitrator or to specify a method for doing so without any reference to the rules of the private arbitration court.

The determination of a concrete arbitrator is not very practical, because the selected arbitrator could not be able to decide the dispute for a variety of reasons in the future such as abdication or death, for example. Such an arbitration clause will be also seen as invalid in such a case because the substitute arbitrator could not be determined according to the Arbitration Act. The wording of the arbitration clauses envisaging the solving of a dispute before a private arbitration court has therefore to contain a very detailed specification of the method for determining the arbitrator by the contractual parties.

The parties could determine either one arbitrator or more arbitrators; however, the amount of arbitrators has to be uneven. It is common that disputes are decided by panels—or “senates”—of three arbitrators. Under such circumstances, each party to the dispute usually determinates its arbitrator and these arbitrators elect a third, chair-arbitrator. The arbitration proceeding before a senate of three arbitrators is much more expensive than proceedings before one arbitrator, which is used mainly by disputes concerning lower amounts.

Consumer protection issues

It should be further noted that the arbitration clause could also be considered invalid in cases of consumer contracts, when the conclusion of the arbitration clause or its wording is against good manners or is disadvantageous for the consumer. According to the current wording of the Czech Civil Code, such an arbitration clause is valid if the consumer does not challenge its validity. However, the pending amendment of the Czech Civil Code will change this provision so that disadvantageous conditions in consumer contracts will be absolutely invalid (no challenge of their validity will be required).

Looking ahead, some amendments to the Arbitration Act are also now before Parliament. The amendment of the Arbitration Act is in its second reading in the Chamber of Deputies, the lower house of the Parliament of the Czech Republic. According to the amendment, which primarily amends the Consumer Act, an arbitration proceeding before a private arbitration court will be not allowed in cases of contracts with consumers, involving consumer loans, loans from construction savings and pension and life insurance contracts.

Please be aware that another pending amendment to the Czech Civil Code will narrow the definition of a consumer from a person (natural person or legal entity) that is not

involved in entrepreneurial activities to a natural person only. An amendment has also been announced making the establishment of a private arbitration court more restrictive. According to this proposal, the arbitrators may only be university graduates who passed a special exam and are registered by the state. The arbitration clause has to be contained in a special document outside the contract.

However, it is questionable whether the amendments will be adopted by Parliament before the elections in May 2010 because they do not have the support of a majority of deputies. The proposed wording of the amendments could also be changed by the Senate, the upper house of the Parliament of the Czech Republic.

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