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Hungary: Setting Aside Arbitral Awards in the Last 25 Years – A Pro-Arbitration Approach with Minor Derailments

Richard Schmidt (SMARTLEGAL Schmidt & Partners) · Sunday, January 26th, 2020

Two and a half decades have passed since Hungary harmonised its arbitration law with UNCITRAL Model Law ('Model Law') in 1994. This marked a giant leap forward, especially as the adopted provisions were made applicable not only in international, but in purely domestic arbitrations as well. This post analyses the Hungarian case law on setting aside procedures that has been produced since the country adhered to the Model Law.

As will be shown by examining the standard of review and the selected grounds of annulment set forth by Article 34 of the Model Law (adopted verbatim in Hungary), apart from some judicial decisions that were rather exceptions than the rule, the Hungarian courts have usually adopted a pro-arbitration approach in the last 25 years.

Background

With the fall of communism in 1989-90 in Hungary, the country started its European integration process in the early 1990s. The termination of the Moscow Treaty of 1972 governing arbitration in Comecon[1)] countries on 14 October 1994 and the entry into force of the Hungarian Arbitration Act[2)] ('Arbitration Act') two months later, on 13 December 1994, were two major symbolic steps on this road.

Hungary was not only the first country from the so-called Eastern Bloc to import the Model Law into its legal system, but also a pioneer among the Model Law jurisdictions by making it applicable to both international and purely domestic arbitral proceedings.

Jurisdiction

In an early case (BH 1998.11.550), in which the arbitration proceedings took place in Germany, and the award-debtor tried to get the award annulled in Hungary, the Supreme Court established that Hungarian courts do not have jurisdiction to set aside awards rendered in proceedings where the place of arbitration was abroad, save where the tribunal applied the Hungarian law.

Even if this exception left open the door to the extraterritorial application of the Arbitration Act, there have not been any domestic decisions diverging from the mainstream direction of the Model Law.

Exhaustive List, No Review of the Merits

In another annulment case (BH 1996. 159), the plaintiff failed to indicate the precise grounds of challenge. The Hungarian Supreme Court decided that the eventual unfavourable outcome of arbitration or a general reference to an unfounded decision of the tribunal shall not be a ground for setting aside, since the *exhaustive list of grounds of annulment* may not be modified.

In another case (EH 2008.1705), a legal dispute arose as a result of the project delay between the employer and the main-contractor of a works contract for the realisation of an industrial plant. The Supreme Court again noted that there is no place *to review of the merits of the arbitral award* by reconsidering in the annulment procedure whether the actual take-over of the plant, excluding the delay and liquidated damages, occurred or not.

Overall, these decisions are a telling illustration that the guiding principles of setting aside procedures in Hungary were laid down in conformity with the spirit of the Model Law.

Invalidity of Arbitration Agreement – Article 34(2)(a)i)

In the mid-2000s, the Internet Providers' Council's ('IPC') set up an 'ad-hoc' arbitration tribunal, effectively absorbing all domain-related disputes under its jurisdiction. In a setting aside procedure against one of its awards, the Supreme Court (BH 2004.73) qualified this tribunal as a *de facto* arbitral institution created without proper legal basis and declared the underlying arbitration clause invalid.

Unlike in some other jurisdictions (*e.g.*, Austria) where setting aside of an award denying jurisdiction despite the existence of a valid arbitration agreement is possible[3)], the Supreme Court (BH 2009.10.299) ruled that an alleged erroneous *denial of jurisdiction* by the arbitral tribunal may not lead to the setting aside of the award, even if the state court had already terminated the litigation in respect of the same claim.

While preventing the fragmentation of arbitral institutions was a wise decision in the IPC case because the knowledge-concentration is crucial in small jurisdictions such as Hungary, when it comes to erroneous denial of jurisdiction, it would have been more appropriate for the Supreme Court to take the Austrian approach. Even if Austria is in minority amongst the Model Law jurisdictions, the review of negative jurisdictional decisions better serves the parties' right to access to justice, which, all things considered, is a fundamental right.

Denial of Opportunity to Present the Case – Article 34(2)(a)ii)

In the period examined, numerous award-debtors were successful in arguing that they were *unable*

to present [their] case.

For example, the award was set aside (BH 2016.122) based on this ground in a case where the request for arbitration had not been sent directly to the defendant, despite what the rules of procedure of the institution had set out. In another case, the same result was reached (EH 2010.2150) as the request for arbitration was sent to the service agent of the shareholder and not directly to the foreign defendant.

Another wave of judgments annulled the arbitral awards on the same ground. Examples of these are cases where the tribunal *reclassified factual or legal issues* like the invalidity of a commercial contract (EH 2011.2421), or the method of calculation of purchase price in a post-merger dispute (EH 2008.1794), failing to inform the parties of such developments.

While annulling awards because of postal service issues may seem to be too formalistic, the approach of the Supreme Court to set aside arbitral decisions because of reclassifying issues should be welcomed since these awards were made by breaching the parties' most fundamental procedural rights in arbitration.

By forbidding the reclassification of factual or legal issues, the Supreme Court successfully prevented the emergence of 'surprise awards' which could have a detrimental effect on domestic arbitration, undermining any reasonable expectation regarding foreseeability.

Scope of Submission and Incorrect Procedure – Article 34(2)(a)iii)-iv)

The wrong delimitation of the scope of the submission to arbitration caused rarely any problem in practice. However, there is an abundance of cases within the last 25 years where the award was annulled by reason of incorrect procedure.

From the 2000s, the Supreme Court started to elaborate its jurisprudence in relation to the arbitration clauses in standard terms. In B2B relations these clauses could be invoked only if they were individually negotiated by the parties (EH 2007.1624) while in B2C relations there was a presumption that individual negotiation had not happened (BH 2012.296).

This resulted in the setting aside of more arbitral awards based on incorrect procedure, and eventually, in the unfortunate step of the lawmaker to render consumer disputes generally non-arbitrable in the New Hungarian Arbitration Act, with effect from 1 January 2018.[4)]

Sometimes, the Supreme Court took perhaps a too conservative approach, for example, when it annulled the award made by two arbitrators (BH 2010.96), after the third withdrew from office during the deliberation, reproaching to the truncated tribunal that it failed to wait for a new arbitrator appointment.

Some years later the Supreme Court went even further (BH 2017.126) by annulling an award because of the non-respect of the deliberation in a 'closed session' rule set forth by the rules of procedure of an arbitral institution.

The above decisions, especially the last one, indicates too strong formalism which is irreconcilable with the mode of operation of modern arbitration. In the contemporary world, the sessions of

arbitral tribunals are mostly ‘virtual’, organised with the aid of modern telecommunications technologies. Thus, it goes without saying that a Supreme Court decision, by reproaching the lack of personal presence of arbitrators at deliberation, is hardly reconcilable not only with the spirit of the Model Law, but also with the realities of modern-day arbitration.

Violation of Public Policy – Article 34(2)(b)

It was laid down in the mid-1990s that the violation of *public policy* can lead to the setting aside of the award only in case of a manifest and serious infringement of the basis of the social-economic order. In addition, to annul an arbitral award on this ground, the violation of public policy shall go beyond the bilateral relationship of the parties to infringe the public interest of the whole society (BH 1997.489).

In a decision from the early 2000s (BH 2003.3.127), which was subsequently strongly criticised by the academics and practitioners because of its too extensive interpretation of public policy, the award was annulled because the arbitral tribunal awarded unusually high attorney’s fees in a high-volume arbitration. This, according to the Supreme Court, was “unacceptable for the social common sense”.

Fortunately, in the following years, Hungarian courts took a more pro-arbitration approach, and they were reluctant to set aside arbitral awards on the basis of public policy in case of a minor breach of procedural or substantive law (BH+ 2006.84), or when the award failed to clarify the contradictions of the expert opinion (BH 2006.257).

Similarly, the request for annulment was dismissed in a case in which the arbitral tribunal disregarded the motions for evidence submitted by one of the parties (BH+ 2015.220). The same result was reached when the arbitral award suffered from an error in calculation (BH+ 2006.460), and also when the limitation period of a claim was wrongly calculated (BH 2017.411).

Conclusion

The examination of the Hungarian case law on setting aside of arbitral awards in the last 25 years shows that, after setting a strong foundation in respect of the guiding principles (*e.g.*, no review of the merits and an exhaustive list of annulment), sometimes minor derailments took place. The excessive conservatism in relation to arbitration clauses in standard terms, the reluctance to accept modern telecommunication technologies, or the broad interpretation of the public policy to cover high attorney’s fees are illustrative examples for this.

Fortunately, due to the Supreme Court’s intervention, the institutional landscape has not become too fragmented, the era of ‘surprise awards’ did not materialise, and in the vast majority of cases, the Hungarian courts were able to apply the pro-arbitration philosophy in practice, thus making Hungary an arbitration-friendly Model Law jurisdiction.

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References

?1 The Council for Mutual Economic Assistance (Comecon) was an international organisation under the leadership of the Soviet Union.

?2 Hungarian Act LXXI of 1994 on Arbitration.

?3 UNCITRAL 2012 Digest of Case Law in the Model Law on International Commercial Arbitration, p.138.

?4 Hungarian Act LX of 2017 on Arbitration.

This entry was posted on Sunday, January 26th, 2020 at 8:57 am and is filed under Hungary, Set aside an arbitral award, UNCITRAL Model Law
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