Kluwer Arbitration Blog

Storm in a Teacup: A New Ground for Annulling Hungarian Construction Arbitration Awards

Richard Schmidt (SMARTLEGAL Schmidt & Partners) · Friday, September 22nd, 2023

Making an awkward legislative step, the Hungarian legislator introduced a new ground for annulling construction arbitration awards from 5 June 2023, which applies where arbitrators fail to deliberate the opinion of a domestic expert body. While many commentators have criticised this amendment because of its potential retroactive effect and its disharmony with the current international legal framework, this blog post argues that these fears are at least partially unfounded, and paradoxically the new provision may rather strengthen the status of arbitration as an alternative to litigation in construction disputes in Hungary.

The Performance Certification Expert Body

To fully understand the context of the recent amendment to the Hungarian Arbitration Act, it is crucial to summarise first the features and the role of the Performance Certification Expert Body ("**PCEB**") in Hungarian construction matters.

To fight against chain debts and delayed payments characterizing the Hungarian construction industry in the post-crisis period of the early 2010s, the lawmaker decided to set up the PCEB in 2013.

The PCEB is set up as an organisationally independent expert body attached to the Hungarian Chamber of Commerce and Industry (HCCI), which allows it to use the latter's infrastructure.

The PCEB gathers forensic experts and construction supervisors, who are appointed by the government based on the opinion of professional bodies like the HCCI, the Chamber of Engineers, the Chamber of Architects, and the Chamber of Forensic Experts.

The members of the PCEB cannot be instructed. They are subjected to the same impartiality and independence provisions as court-appointed experts in state court litigations.

The PCEB issues expert opinions to establish the scope of works to be carried out by the contractor, the amount of works carried out by him as well as their value. The opinion of the PCEB can be also requested to establish whether the enforcement of collaterals is justified from a technical point of view.

PCEB Opinion-Based Litigations and Arbitrations – An Asymmetric Regime

In 2018, when both the new Civil Procedure Code and the new Arbitration Act entered into force, the lawmaker introduced special provisions for litigations and arbitrations started on the basis of a PCEB opinion.

Several rules were introduced in relation to the PCEB opinion-based litigations. The lawsuit had to be started within 60 days from issuing the PCEB opinion, the procedural deadlines generally applicable in commercial litigations were considerably reduced.

The PCEB opinion had stronger evidentiary force than the expert opinion of party-appointed experts, and the first instance judgment was enforceable regardless of any appeal, in case it upheld the PCEB opinion.

When it comes to PCEB opinion-based arbitrations, the lawmaker introduced only few special provisions in 2018, according to which the arbitrators had to deliberate the PCEB opinion together with other evidence, and if necessary, the experts delivering the PCEB opinion had to be heard by the tribunal.

New Ground of Annulment – Amendment to the Arbitration Act in 2023

With effect from 5 June 2023, the Hungarian lawmaker introduced a new ground for setting aside arbitral awards.

According to the new Section 47 (2) bc) of the Arbitration Act, the court may set aside an arbitral award in case it considers that the tribunal failed to assess in its award the content of the PCEB opinion put forth by either party, including the reasons for its assessment or exclusion as evidence.

The new ground for setting aside cannot be opted out of, and it shall be applied in “ongoing cases”.

Unlike other grounds for annulment which can be applied by the court in case the claimant expressly invokes them, this new ground for annulment can be examined by the court *ex officio*, similarly to the breach of public policy or non-arbitrability of the dispute.

Potential Retroactive Effect – Not a Real Risk

Some critics have highlighted the potential retroactive effect of the new law, since according to the inter-temporary provisions of the Hungarian Arbitration Act, it shall be applied in “ongoing cases”.

It is true that the pure grammatical interpretation of the text opens the door to an expansive construction allowing the retroactive application of the new provision. At the same time, based on the logical and systemic interpretation of the text, the better view is that arbitral awards rendered before 5 June 2023 cannot be set aside for not respecting a legal provision entering into force on that day.

Disharmony with the International Framework – The Role of the European Convention

Since the grounds for setting aside arbitral awards in the UNCITRAL Model Law on International Commercial Arbitration ("**Model Law**") were carefully harmonized with Article V of the New York Convention, in a Model Law jurisdiction like Hungary, which adhered to the Model Law almost verbatim, it cannot be disputed that deviating from this unified legal framework is an awkward legislative step.

However, when it comes to the recognition and enforcement of Hungarian arbitral awards abroad, the picture is not as daunting as some commentators point out.

Dealing only indirectly with the recognition and enforcement of awards, Article IX (1) of the European Arbitration Convention considerably narrows down the grounds for rejecting the recognition and enforcement of arbitral awards by reason of being set aside in the country of origin.

According to the European Convention, the grounds that can be considered as the basis of annulment of a foreign award by the state court acting in the recognition and enforcement phase are almost the same, like the grounds in Article V (1) of the New York Convention. Of course, the failure of deliberating a PCEB opinion is not on that list.

In addition, Article IX (2) of the European Convention limits the application of Article V (1) e) of the New York Convention to the grounds listed in Article IX (1) of the European Convention, in countries being parties to both conventions.

In other words, even if a Hungarian arbitral award would be set aside based on the Hungarian Arbitration Act for not deliberating the PCEB opinion, a foreign court in a jurisdiction party to the European Convention, acting in a recognition and enforcement proceeding based on the New York Convention, should still recognize and enforce the Hungarian award because of Article IX of the European Convention.

Situated in the heart of Europe, the most important commercial partners of Hungary are states that are also parties to the European Convention. In these jurisdictions, the potential annulment of the Hungarian award based on the new law cannot be relied on as an obstacle for recognition and enforcement.

Fewer Surprise Decisions

As noted above, if PCEB-based litigations and arbitration are compared, due to the legislative amendments introduced in 2018, an asymmetric legal regime was created for PCEB opinion-based construction disputes in Hungary.

On the one hand, the regime allowed arbitral tribunals to fully disregard a PCEB opinion, by rendering an award even without mentioning it, without any consequence. On the other hand, in a PCEB-based litigation the same amounted to a substantial procedural breach, justifying new first instance court proceedings.

Mr. János Burai Kovács, President of the Arbitration Court attached to the HCCI, the arbitration institution exclusively competent for commercial arbitration cases in Hungary, recently confirmed that in PCEB-based arbitrations under the auspices of this institution, no arbitral awards have been annulled in the past years.

Nevertheless, it is not difficult to see that the above asymmetrical framework could have negative effects for arbitration.

Watching the above asymmetry from the perspective of the users of dispute resolution services, it is easy to see that under the former regime the risk of surprise decisions was theoretically higher in case of PCEB-based arbitral proceedings than in PCEB-based litigations.

If there is something which can deter parties from arbitration, it is certainly the risk of a so-called surprise award, rendered in a case which was started based on a supporting PCEB opinion, and which was finally lost by the claimant for unknown reasons.

Unlike in litigation, this scenario was theoretically possible in arbitration under the former regime, while the new law tries to eliminate this situation in case the parties opt for the latter method of resolving construction disputes.

Since for the users of dispute resolution, arbitration is always an alternative to state court litigation, it is easy to see that the recent amendment rather strengthens the status of the former.

More Well-Reasoned Arbitral Awards

From the perspective of a would-be arbitral tribunal, the new law does not seem to be so dangerous. A prudent arbitral tribunal that faces a PCEB opinion put forth by any party during the proceedings will presumably give at least some reasons in the award for accepting or disregarding it as evidence.

Since the reasons given by the tribunal, be they logical or not, cannot be reviewed by the annulment court, the new provision will not be a real threat for arbitrators who find the time to draft a well-reasoned award.

Conclusion

To sum up the above, even if introducing a new ground for setting aside is an awkward step in a Model Law jurisdiction like Hungary, the amendment presumably will not cause problems in the ongoing annulment proceedings. In addition, it will not be an obstacle to recognize and enforce Hungarian arbitral awards in jurisdictions that are parties to the European Convention.

When it comes to the potential positive effects, due to the new law, the risk of surprise arbitral decisions is decreased, and there will be presumably more well-reasoned arbitral awards in Hungarian construction arbitrations.

Is that such a big problem? I do not think so.

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