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SETTING ASIDE ARBITRAL AWARDS IN THE LAST 25 YEARS IN HUNGARY – A PRO-ARBITRATION APPROACH WITH MINOR DERAILMENTS[2]

INTRODUCTION

Is Hungary a pro-arbitration jurisdiction? The UNCITRAL Model Law[3] ("Model Law") has recently celebrated its 25th anniversary in Hungary, so the time is ripe to assess the case law of Hungarian courts from the last two and a half decades in the field of setting aside arbitral awards to answer the above question. Besides this "silver jubilee", justifying the retrospection in itself, the review of leading Supreme Court[4] decisions in this domain is also useful due to a recent legislative change, since from 1st April of 2020, the lawmaker introduced the so-called "limited precedent system" in Hungary, based on which all Supreme Court decisions have binding effect on lower courts.[5] This legislative reform, marking a milestone in the development of Hungarian law belonging to the Romano-Germanic legal family, can be interpreted as a shift from the traditional Roman law principle of "*praetor ius dicere potest, ius facere non potest*", towards common law, where the existence of judge-made law is widely accepted. Therefore, in addition to the celebration of the first quarter century of the Model Law in Hungary, practical considerations also justify a short time travel to the past, to overview the landmark decisions of the Hungarian Supreme Court in relation with the annulment of arbitral awards.

SETTING ASIDE AS BENCHMARKING DOMESTIC APPROACH TO ARBITRATION

Arbitral awards are the "outputs" of the arbitral process, and their first "control" takes place in the framework of annulment procedure in front of state courts in the country, where the arbitration was conducted. Prior to the Model Law, a major diversity characterised the landscape of national legal systems in terms of the type of recourses

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[3] Model Law on International Commercial Arbitration adopted by the United Nations Commission on International Trade Law ("UNCITRAL") on 21 June 1985, revised by UNCITRAL on 7 July 2006. United Nations documents A/40/17, and A/61/17.

[4] The Fundamenal Law of Hungary, entered into force on 1st January 2012 has changed the name of the Supreme Court to Curia. Given that the case law analysed in this article is earlier than this legislative change, we use the term "Supreme Court".

[5] Act CXXVII of 2019 on modification certain acts in connection with the introduction of one-instance procedure before district offices

against arbitral decisions, and the grounds based on which arbitral awards could be annulled. As an extreme example for the so-called *final Kompetenz-Kompetenz* principle, in the pre-Model Law era, arbitral awards were not challengeable in Hungary in front of state courts at all, and this system even stood the test of the Constitutional Court, elected after the democratic transition in 89-90, which laid down that the absence of court control against arbitral awards had not violated the right to an effective legal remedy or the right to court.[6] At the other end of the scale, there were jurisdictions, which established quasi parallel regimes for the recourse against arbitral awards and state court decisions, thereby allowing the parties to challenge arbitral decisions on extensive grounds, sometimes in lengthy deadlines. This significant diversity created legal uncertainties and considerable risks for under-informed parties on the one hand, and increased transactional costs for parties wishing to be well-prepared for arbitration on the other. To address these problems, one of the most important innovations of the Model Law was the reduction of the number of legal remedies available to challenge arbitral awards. By allowing only one type of recourse against an arbitral award, the so-called setting aside procedure, to the exclusion of every other type of recourses permitted by domestic procedural laws, the Model Law made a giant step towards the efficiency of international arbitral awards.

The second innovation of the Model Law in the field of the efficiency of arbitral awards was the harmonisation of the grounds for setting aside with Article V of the New York Convention.[7] The latter contains an exhaustive list of grounds that can be invoked by the award-debtor to resist the recognition and enforcement of the award, and the grounds for setting aside were aligned with this list in the Model Law. As the explanatory note to the Model Law points out[8], by mirroring the list of grounds for refusal of the enforcement as grounds for setting aside arbitral awards, the Model Law took the philosophy of the European Convention on International Commercial Arbitration[9] one step further. Indeed, Article IX of the latter instrument only indirectly limited the grounds for refusal of the enforcement of the award – by providing that the setting aside of the arbitral award by a foreign court can be only invoked as reason for not enforcing the award, if the court decision was based on one of the grounds listed in Article V of the New York Convention – while the Model Law directly limits the grounds for setting aside of awards.

Due to the above mentioned two major innovations, the Model Law created a simplified and effective regime for controlling arbitral awards by state courts in the country of origin. Given that the states were encouraged to make as few changes as possible when enacting the Model Law in their national legal system, this harmonised setting aside regime can serve as a benchmark to measure the different model law jurisdictions, how their courts apply these harmonised rules in practice, to which extent they control the "output" of the arbitral process. By reviewing these issues we find answer to the most important question for parties wishing to make a decision on the place of arbitration: is that jurisdiction an arbitration-friendly one?

[6] Decision No. 604/B/1990. and No. 1282/B/1993. of the Hungarian Constitutional Court

[7] United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards done at New York, on 10 June 1958)

[8] Explanatory Note by the UNCITRAL secretariat on the 1985 Model Law on International Commercial Arbitration as amended in 2006

[9] European Convention on International Commercial Arbitration done at Geneva on 21 April 1961

Given that more than two and a half decades have passed since Hungary harmonised its arbitration law with UNCITRAL Model Law in 1994, the body of available case law in respect of the annulment of arbitral awards allows us to make a deeper analysis, before answering the above question. For this reason, after a short introduction, in which we examine how the basic principles of the setting aside regime of the Model Law were internalised by Hungarian courts, we will review the application of the grounds of annulment set forth in Article 34 (2) (a)-(b) of the Model Law in the judicial practice.

ADOPTION OF MODEL LAW AND RECEPTION OF ITS GUIDING PRINCIPLES

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[10] countries on 14 October 1994 and the entry into force of the Act LXXI of 1994 on Arbitration ("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. When it comes to the basic principles of the setting aside procedure, Hungarian Courts were willing to accommodate the philosophy of the Model Law from the very beginning.

While the reception of the principle of territoriality was not unequivocal in some jurisdictions, since certain national courts showed willingness to set aside arbitral awards made in foreign countries,[11] Hungarian courts fortunately interpreted the principle of terriotoriality in line with the spirit of the Model Law. In an early case, 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.[12] 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.

When it comes to another issue of admissibility, namely the type of arbitral decisions that can be subject of setting aside procedure, it was hold by the Supreme Court that an order terminating the arbitral procedure without making a decision on the merits of the legal dispute shall not be challenged in setting aside procedure, which is in line with the mainstream application of the Model Law.[13]

The principle that the party challenging the arbitral award must prove one of the grounds of the the list of Article 34 (2) of the Model Law, and the grounds of setting

[10] The Council for Mutual Economic Assistance (Comecon) was an international organisation under the leadership of the Soviet Union

[11] See for example the case of India. In: UNCITRAL 2012 Digest of Case Law on the Model Law on International Commercial Arbitration 136.

[12] BH 1998.11.550.

[13] BH 2004.20.

aside cannot be extended was also laid down quite early, in a case, where the plaintiff failed to indicate the precise grounds of challenge. The 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.[14]

The impossibility of the *"révision au fond"* in setting aside procedure, as another general standard of the recourse against arbitral awards was also proclaimed some years later by the highest judicial forum in a case, where 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 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.[15]

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

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

The first ground of setting aside of arbitral awards on the basis of Article 34(2)(a) i) of the Model Law is the situation where the arbitration agreement is not valid, or the party to the arbitration agreement was under some incapacity. When it comes to the invalidity of the arbitration agreement, two cases from the 2000s merit the attention. In the first case, the Internet Providers' Council's ('IPC') set up an 'ad-hoc' arbitration tribunal, effectively absorbing all domain-related disputes in Hungary under its jurisdiction. In a setting aside procedure against one of its awards, the Supreme Court qualified this tribunal as a *de facto* arbitral institution created without proper legal basis and declared the underlying arbitration clause invalid.[16] In another case the Supreme Court 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.[17] It must be noted that in some other jurisdictions (e.g., Austria, France etc.) setting aside of an award denying jurisdiction despite the existence of a valid arbitration agreement is possible.[18]

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 and French approach. Even if countries allowing the *review of negative jurisdictional decisions* are in minority

[14] BH 1996.159.
[15] EH 2008.1705.
[16] BH 2004.73.
[17] BH 2009.10.299
[18] UNCITRAL 2012 Digest of Case Law in the Model Law on International Commercial Arbitration, p.138.

amongst the Model Law jurisdictions, this approach better serves the parties' right to access to justice, which, all things considered, is a fundamental right.

When it comes to the *lack of legal capacity* this ground for setting aside led to the annulment of awards only in exceptional circumstances in the last two decades, like in a case, where the condominium representative entered into a loan contract with an arbitration clause on behalf of condominium in the absence of specific legal provision or condominium resolution[19], or in another case where an embassy of a foreign state in Hungary signed a lease contract with a local lessor, despite the relative provisions of the Vienna Convention on Diplomatic Relations of 1961.[20] These decisions clearly show that Hungarian courts interpret this ground of setting aside in a restrictive manner.

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

The second ground for setting aside of arbitral awards is set forth in Article 34 (2) (a) ii) of the Model Law, covering the situations, when the party was not given proper notice of the appointment of an arbitrator or of the arbitral proceedings or was otherwise unable to present his case.

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 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.[21] In another case, the same result was reached as the request for arbitration was sent to the service agent of the shareholder and not directly to the foreign defendant.[22] 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[23], or the method of calculation of purchase price in a post-merger dispute[24], but failed to inform the parties of such developments, who were unable to present their standpoints and make their motions for evidence.

While annulling awards because of postal service issues may seem to be too formalistic, the approach of 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.

[19] BH 2014.154.
[20] BH 2009.252.
[21] BH 2016.122.
[22] EH 2010.2150.
[23] EH 2011.2421.
[24] EH 2008.1794.

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

The third ground of annulment of arbitral awards is set forth by Article 34 (2) (a) iii) of the Model Law and deals with cases, where the award goes beyond the scope of submission of the parties, while the fourth ground of setting aside is regulated by Article Article 34 (2) (a) iv) and covers situations, where the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties, or with national law. It must be noted that 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[25], while in B2C relations there was a presumption that individual negotiation had not taken place.[26] This jurisprudence 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 Arbitration Act, with effect from 1 January 2018.[27]

Sometimes, the highest judicial body took perhaps a too conservative approach, for example, when it annulled the award made by two arbitrators, after the third withdrew from office during the deliberation, reproaching to the truncated tribunal that it failed to wait for a new arbitrator appointment.[28] Some years later the Supreme Court went even further 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.[29] 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, 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)

Article 34 (2) b) includes two further grounds based on which arbitral awards can be set aside: the lack of arbitrability and the violation of public policy, both of which can be taken into account by the state courts "*propro motu*", without the need that the party

[25] EH 2007.1624.
[26] BH 2012.296.
[27] Hungarian Act LX of 2017 on Arbitration.
[28] BH 2010.96.
[29] BH 2017.126.

expressly invoking them. While the issue of inarbitrability has not caused too much problem for courts, the interpretation of the public policy exception sometimes was a hard nut to crack.

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 Supreme Court also pointed out that the violation of public policy shall go beyond the bilateral relationship of the parties to infringe the public interest of the whole society.[30] While the above jurisprudence conforms to the narrow interpretation of the public policy expression, in its infamous decision from the early 2000s, the Supreme Court took the opposite direction, when it annulled an award because the arbitral tribunal awarded unusually high attorney's fees in a high-volume arbitration, which was "unacceptable for the social common sense" according to the appreciation of the judges of the highest judicial body.[31] This latter ruling was subsequently strongly criticised by the academics and practitioners because of its too extensive interpretation of public policy. As pointed out by one of the commentators, the concept of public policy can be interpreted only within the legal system, therefore an arbitral award, which does not infringe any legal provisions, can not violate the public policy of a country.[32]

Fortunately, in the following years the Supreme Court took a more pro-arbitration approach, and it was reluctant to set aside arbitral awards on the basis of public policy in case of a minor breach of procedural or substantive law, or when the award failed to clarify the contradictions of the expert opinion.[33] Similarly, the request for annulment based on the violation of public policy was dismissed by the highest judicial forum in a case in which the arbitral tribunal disregarded the motions for evidence submitted by one of the parties.[34] The same result was reached by the Supreme Court when the arbitral award suffered from an error in calculation, and also when the limitation period of a claim was wrongly calculated.[35] This wave of judgments confirms that after a minor derailment, the Supreme Court has come back to its original strict interpretation of the public policy exception, which is in line with the spirit of the Model Law.

CONCLUSION

The Hungarian case law on setting aside of arbitral awards in the last 25 years shows that, after a strong foundation in respect of the guiding principles (e.g., no review of the merits, exhaustive list of annulment), sometimes minor derailments took place. The excessive conservativism 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, the latter decisions represent rather the exception than the rule. What is

[30] BH 1997.489

[31] BH 2003.3.127.

[32] Dr. Kecskés László: Lehet-e közrendbe ütköző, ami nem jogellenes? *Magyar Jog* 2007/9. 531–536. p.

[33] BH+ 2006.84; BH 2006.257.

[34] BH+ 2015.220.

[35] BH+ 2006.460.; BH 2017.411.

more important from the perspective of an arbitration practitioner is that 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 Supreme Court could apply the pro-arbitration philosophy in practice, thus making Hungary an arbitration-friendly Model Law jurisdiction. Due to the recent legislative reform indicated in the introduction, the binding nature of these landmark judgments of the highest judicial body guarantees this positive approach of the courts *vis-á-vis* arbitral awards in the long term in Hungary.