



School of International Arbitration

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International Arbitration Case Law

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DAN CAKE (PORTUGAL) S.A.

V.

HUNGARY

(ICSID CASE NO: ARB/12/9)

DECISION ON JURISDICTION AND LIABILITY

Case Report by Maria Davies**

Edited by Ignacio Torterola ***

In its Decision on Jurisdiction and Liability of August 24, 2015 the Tribunal confirmed it had jurisdiction to hear the dispute between Dan Cake (Portugal) S.A. (the Claimant) and Hungary (the Respondent) pursuant to the Agreement between the Republic of Portugal and the Republic of Hungary on the Reciprocal Promotion and Protection of Investments of October 8, 1997 (the "BIT") and the Convention on the Settlement of Investment Disputes between States and Nationals of Other States of October 14, 1966. The Tribunal further found that the refusal of the Metropolitan Court of Budapest to convene a "composition hearing", allowing the Claimant and its subsidiary to enter into a settlement agreement with creditors, and its further order insisting the liquidation of the subsidiary's assets, amounted to a violation of the provisions on fair and equitable treatment and arbitrary and discriminatory measures impairing investment under the BIT.

Main Issues: Jurisdiction – personal – nationality; jurisdiction – temporal; treaty obligations – international law standard – discrimination; treaty obligations – international law standard – fair and equitable treatment; treaty obligations – state responsibility.

Tribunal: Professor Pierre Mayer (President), Professor Jan Paulsson and Toby Landau QC.

Claimant's counsel: Mr. António Andrade de Matos and Mr. Jorge Bastos Leitão of Andrade de Matos & Associados.

Respondent's Counsel: Mr. Eric Ordway, Mr. Chip Roh and Ms. Marguerite Walter of Weil, Gotshal & Manges LLP and Mr. László Nagy, Mr. László Nanyista, Mr. Tamás Simon and Ms. Szandra Wolf of Siegler Ügyvédi Iroda/Weil, Gotshal & Manges LLP.

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Digest

1. *Facts of the Case*

The Claimant, Dan Cake, a Portuguese company, acquired a majority of the shares in a Hungarian company, later renamed Danesita (the “subsidiary”), whose main business consisted of supplying biscuits to Eastern European, Southern European, and Scandinavian countries (¶30). The Claimant had to lend to its subsidiary significant sums of money, which also took out several bank loans (reaching a total of more than €5 million in 2007) (¶37). In 2006, the subsidiary’s creditors pursued the company for unpaid debts and the liquidation of the company was ordered. In the context of liquidation proceedings (as opposed to bankruptcy proceedings) the only way for the debtor company to avoid the sale of its assets is to enter into an agreement with its creditors, which the Claimant tried to do. Section 44(1) of the Bankruptcy Act provides the possibility for the debtor company to request from the Bankruptcy Court, under certain conditions, the convening of a composition hearing during which the creditors may vote on and approve, by a qualified majority, an agreement with the debtor (¶45 – 47).

The subsidiary requested that the Metropolitan Court of Budapest convene a composition hearing, during which it hoped that its creditors would vote in its favor. However, the Metropolitan Court of Budapest declined to do so on April 22, 2008. It considered that the subsidiary’s request in its current form was not suitable to be served on the creditors and to convene a composition hearing. At the same time it insisted that the Liquidator was obliged to proceed to the sale of the assets within 120 days from the publication of the liquidation proceedings. Shortly thereafter, the Liquidator announced the sale of the subsidiary’s factory (¶54). The Claimant thus lost its investment. The Claimant claimed that the Respondent, Hungary, violated the Agreement between the Republic of Portugal and the Republic of Hungary on the Reciprocal Promotion and Protection of Investments (the “BIT”), and in particular its provisions on fair and equitable treatment, full protection and security, arbitrary and discriminatory measures impairing investment, and expropriation without compensation. The Claimant claimed €47,869,000 in damages, plus pre- and post-award interest (¶4).

2. *Legal Issues Discussed in the Award*

2.1 Jurisdiction of the Arbitral Tribunal to Hear the Dispute

The Tribunal reasoned that the Claimant, pursuant to Art. 3 of the Portuguese Companies’ Code, is a national of Portugal because it is incorporated and has its

offices there. Therefore, it is an investor under Art. 1.a. of the BIT who benefits from its protection (§72).

The Tribunal further observed that, although neither the BIT nor the ICSID Convention defines “direct investment”, the Claimant’s shares in the subsidiary constitute a direct investment in Hungary, given that they have been made in conformity with Hungarian law. The liquidation therefore affects the Claimant’s direct investment and it has a right to the protection offered by the BIT in relation to it (§73).

Further, the Tribunal stated that the BIT was applicable *ratione temporis* because it applies to investments made after January 1, 1973, and the Claimant purchased its shares in the subsidiary in 1996 (§74).

Moreover, Art. 8.2 of the BIT constitutes an offer to arbitrate, which the Claimant accepted by filing a request with ICSID (§76).

Finally, the Tribunal declared that it has jurisdiction over the present case since both the host State and the State of which Claimant is a national are parties to the ICSID Convention and the dispute relates to an investment (§79).

2.2 Liability

(a) Scope of Liability

The Tribunal considered the grounds on which the Claimant can rest its case, finding that the Claimant’s complaints can be characterized only as being in breach of the BIT’s provisions on fair and equitable treatment (Art. 3.1) and unfair and discriminatory measures (Art. 3.2). The Tribunal reasoned that it had to consider the harm suffered, which is not the law, whether good or bad, but its violation. Therefore, it rejected the Claimant’s claim based on full protection and security under Art. 5.1. It similarly rejected the Claimant’s claim based on expropriation under the BIT (§§81-82).

(b) Examination of Whether the Decision of the Metropolitan Court of Budapest not to Convene a Composition Hearing Constitutes a Violation of the BIT

The Tribunal reasoned that there is no dispute as to the fact that the act of a State court is attributable, under international law, to the State itself (§143). It found that the prompt convening of a composition hearing was therefore the only way

for the Claimant to avoid the sale of its subsidiary's assets and therefore its disappearance (§93). It further acknowledged that while the composition hearing may fail because it gives rise to negotiations between the creditors and ends with a vote, which can be negative, the debtor had a right that it be at least convened by the court, provided the request is accompanied by the documents required by law, or deemed necessary (§94). The right was destroyed by the Bankruptcy Court's decision to refuse to convene a hearing within 60 days, as required by the law. The decision was also rendered in flagrant violation of the Bankruptcy Act because it purported to condition the mandatory convening of the hearing upon several requirements, all of which were unnecessary; two of which were in direct violation of the Claimant's creditor rights; and at least one of which was impossible to satisfy within a reasonable time. Moreover, the Tribunal considered that the accumulation of seven unjustified obstacles, coupled with the reminder of the Liquidator's obligation to proceed with the sale of the subsidiary's assets, was a manifest sign that the Court simply did not want to do what was mandatory (§142).

(1) Breach of the Obligation to Accord Fair and Equitable Treatment

By rendering its April 22, 2008 decision, the Metropolitan Court of Budapest deprived the subsidiary of the chance to avoid the sale of its assets and its disappearance as a legal person. Hungarian law provides for the possibility of an agreement between the debtor and its creditors. The subsidiary had the right to the convening of a composition hearing, under certain conditions which it met; the Metropolitan Court of Budapest, for its part, had the obligation to convene the composition hearing. By not doing so, it rendered inevitable the sale of the subsidiary's assets and its demise as a legal person. The Tribunal found this to amount to a violation by the Respondent, of which the Metropolitan Court of Budapest is an organ, of its obligation to treat Portuguese investors in a fair and equitable manner (§145).

The Tribunal further found that the violation of the obligation to treat the investor in a fair and equitable manner took the form of a denial of justice. It referred to previous case law where judicial decisions have been characterized as denials of justice, such as "administer[ing] justice in a seriously inadequate way",¹ "clearly improper and discreditable",² and "[m]anifest injustice in the

¹ Robert Azinian et al. v. United States of Mexico, ICSID Case No. ARB(AF)/97/2, Award of 1 November 1999 (para. 102); 5 ICSID Rep. 269, 290; CLA-022.

sense of a lack of due process leading to an outcome which offends a sense of judicial propriety”.³ The Tribunal also cited a case issued by the International Court of Justice, where denial of justice was defined as “a willful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety”.⁴ The Tribunal stated that all the various descriptions of judicial decisions amounting to a denial of justice fit the decision of the Metropolitan Court of Budapest (¶146).

The Tribunal also considered the Respondent’s argument that the Claimant should have exhausted the available remedies first, such as file appeals on time or in proper form, responding to the initial notice of liquidation, or reorganizing through agreement with the subsidiary’s creditors. The Tribunal rejected this argument as the specified actions should have been taken before the April 22 decision. This is because the failure to act prior to the decision cannot be equated to a failure to exhaust a remedy against the decision (¶150).

(2) Breach of the Obligation not to Impair the Use, Enjoyment, Management, Disposal or Liquidation of the Investment by Unfair or Discriminatory Measures

The Tribunal found that the April 22, 2008 judgment of the Metropolitan Court of Budapest was a measure tainted by unfairness, impairing the Claimant’s rights in connection with the liquidation of its investment in Hungary (¶157).

(c) Whether the Respondent can be Held Responsible for the Actions of the Liquidator

The Tribunal observed that pursuant to Art. 5 of the ILC Draft Articles on State Responsibility, the question is whether the Liquidator is “a person or entity . . . which is empowered by the law of [the] State to exercise elements of the governmental authority”, the conduct of which “shall be considered an act of the State under international law, provided the person or entity is acting in that capacity in the particular instance”. The Tribunal found that the Liquidator did not need to be empowered by a court to proceed with the sale of the debtor’s assets in the context of liquidation proceedings; it is not even certain that a court could confer such a power. The power to proceed to the sale results from the law,

² *Mondev International Ltd v. United States of America*, ICSID Case ARB(AF)/99/2, Award of 11 October 2002 (para. 127); 6 ICSID Rep. 192, 226; CLA-025.

³ *The Loewen Group and Raymond L. Loewen v. United States of America*, ICSID Case No. ARB(AF)/98/3, Award of 26 June 2003 (para. 132); 7 ICSID Rep. 442, 467; RLA-021.

⁴ *Eletronica Sicula S.p.A. (ELSI), United States of America v. Italy*, 1989 ICJ 15 (para. 128); CLA-024.

more precisely from §§ 49 (1) and (2) of the Bankruptcy Act (§158). It is not an act which any private person, even representing creditors, could accomplish; it rests on a power specifically conferred by the law to the Liquidator, and it is an act which deprives, under constraint, the debtor of the ownership of its assets. It certainly involves an element of public authority (§159).

However, the Tribunal concluded that the Liquidator's action, even if it were attributed to the Respondent, did not constitute a violation of international law. From the moment the Court refused to convene a composition hearing, the Liquidator, who did not have the power to challenge the decision, could but accept that he was not relieved from his duty to proceed to the sale. Proceeding with the sale of the debtor's assets, as the final act of liquidation proceedings, is not a specific feature of Hungarian law; it is the normal outcome of liquidation proceedings under any law (§160).

3. *Decision*

The Tribunal found that it had jurisdiction over the dispute and that the Respondent had breached its obligation to ensure that the Claimant's investment is accorded fair and equitable treatment and not to impair by unfair measures the liquidation of the Claimant's investment. The Tribunal reserved the establishment of a causal link between the Respondent's breach and the Claimant's loss, as well as the quantification of damages (§161). It further reserved any decision on cost (§162).