



School of International Arbitration

School of International Arbitration, Queen Mary, University of London

# International Arbitration Case Law

Academic Directors: *Ignacio Torterola*  
*Loukas Mistelis\**

**ELECTRABEL S.A.**  
**V.**  
**HUNGARY**  
**(ICSID CASE NO. ARB/07/19)**  
**AWARD**

Case Report by Eduardo Mathison\*\*  
Edited by Lorena Perez Mc Gill \*\*\*

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In the Award issued on 25 November 2015, the International Center for Settlement of Investment Disputes (“ICSID”) Tribunal unanimously dismissed the remaining claim brought by Electrabel, S.A. (a Belgian company) against Hungary, regarding liability under the Energy Charter Treaty’s (“ETC”) fair and equitable treatment (“FET”) standard in respect of its Power Purchase Agreement (“PPA”)<sup>1</sup> Termination Claim. Read together with the Tribunal’s Decision on Jurisdiction, Applicable Law and Liability dated 30 November 2012, the final award dismisses all the substantive claims made by Electrabel in this arbitration against Hungary.

**Tribunal:** Mr. V.V. Veeder (President), Professor Gabrielle Kaufmann-Kohler (Appointed by the Claimant), Professor Brigitte Stern (Appointed by the Respondent).

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<sup>1</sup> Power Purchase Agreement dated 10 October 1995 concluded between *Dunamenti Erőmű Rt* (organized under the laws of Hungary) and the State-owned electricity supply company *Magyar Villamos Művek Zrt.*

**Claimant's Counsel:** Audley Sheppard, Gareth Kenny and Christina Schuetz of Clifford Chance LLP (until March 2012); Peter J. Turner, QC, Jérôme Philippe, France-Hélène Boret and Baxter Roberts of Freshfields Bruckhaus Deringer LLP (as of March 2012); Marie Stoyanov of Allen & Overy LLP; and Zoltán Faludi and László Kenyeres of Faludi Wolf Theiss.

**Respondent's Counsel:** Jean Kalicki, Mara V. J. Senn, Mallory Silberman and Csaba Rusznak of Arnold & Porter LLP; Dmitri Evseev, Lisa Tomas, Peter Nikitin and Bart Wasiak of Arnold & Porter (UK) LLP; Luc Gyselen of Arnold & Porter (Brussels) LLP; and János Katona and Gábor Puskás of Kende Molnár-Biró Katona.

\* Directors can be reached by email at [ignacio.tortero@internationalarbitrationcaselaw.com](mailto:ignacio.tortero@internationalarbitrationcaselaw.com) and [loukas.mistelis@internationalarbitrationcaselaw.com](mailto:loukas.mistelis@internationalarbitrationcaselaw.com)

\*\* Eduardo Mathison is a legal consultant in Crowell & Moring's International Dispute Resolution Group in the Washington, D.C. office, where he focuses his practice on investor-State arbitration. He also works closely with the firm's International Trade group and provides assistance on U.S. sanctions, customs, regulatory and investment-related issues, with focus on Latin American matters. Eduardo earned his law degree from Universidad Católica Andres Bello in Caracas, Venezuela, and his LL.M. from Georgetown University Law Center.

\*\*\* Adjunct Faculty, Georgetown University Law Center and University of Houston Law Center.

## *Digest*

### **1. *Facts of the Case***

Claimant, Electrabel, S.A. (“Electrabel” or “Claimant”) is a Belgian energy generation and sales company. (¶ 5.) Respondent is the Republic of Hungary (“Hungary” or “Respondent”). (¶ 8.) The claim was brought by the Claimant under the Energy Charter Treaty (“ECT”) signed by Hungary and Belgium in 1994; and in force since 1998.

The dispute arose from the termination of the Power Purchase Agreement (“PPA”) between Electrabel’s Hungarian subsidiary *Dunamenti Erőmű Rt* (“Dunamenti”) and Hungarian State-owned electricity supply company *Magyar Villamos Művek Zrt* (“MVM”). Electrabel’s main claim was that Hungary violated its expropriation and fair and equitable treatment (“FET”) obligations under the ECT by terminating the PPA following a Final Decision of the European Commission dated 4 June 2008.<sup>2</sup> Moreover, Electrabel contended that on 27 April 2010 the European Commission approved a scheme for Hungary to compensate Dunamenti for eligible “stranded costs,”<sup>3</sup> but that Hungary failed to provide adequate compensation. Hungary rejected all of the claims advanced by the Electrabel.

The Tribunal found that the methodology used in the compensation scheme approved by the European Commission allowed, but did not require, Hungary to compensate Dunamenti for eligible stranded costs “in whole or in part, or not at all.” According to the figures approved by the Commission, Dunamenti’s total stranded costs were 147 billion HUF, and the amount of State aid that Dunamenti had received during the life of the PPA—an amount that “[t]he Commission required Dunamenti to repay”—was 125 billion HUF. Hungary had the discretion to (i) compensate nothing and require Dunamenti to reimburse 125 billion HUF; (ii) set-off against the 125 billion HUF and additionally pay 22 billion HUF (the “net stranded costs”, which is the difference between the total stranded costs minus the amount of State aid) to Dunamenti; or (iii) set-off against the 125 billion HUF without paying the 22 billion HUF to Dunamenti. Hungary chose the third option, and compensated Dunamenti 125 billion HUF in the form of a set-off (85% of Dunamenti’s eligible stranded costs). (¶¶ 104, 107, 185, 215.)

### **2. *Procedural Background: Decision on Jurisdiction, Applicable Law and Liability dated 30 November 2012***

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<sup>2</sup> *Electrabel S.A. v. Hungary*, ICSID Case No. ARB/07/19, Decision on Jurisdiction, Applicable Law and Liability, 30 November 2012, ¶¶ 2.4-2.36.

<sup>3</sup> The Tribunal refers to “stranded costs” as “relevant losses comprising the notional difference between (i) the electricity undertaking’s relevant investment costs; and (ii) the undertaking’s relevant operating revenues to be generated in the future up to its PPA’s contractual expiry date, *i.e.* post its premature termination.” (¶ 101.)

Electrabel submitted its Request for Arbitration on 13 June 2007, and it was registered by ICSID on 13 August 2007. (¶ 16.) The Tribunal was constituted on 5 December 2007. (¶ 13.) On 21 December 2007, Electrabel filed a proposal for the disqualification of Professor Brigitte Stern as a member of the Tribunal. However, on 25 February 2008 the two other members of the Tribunal rejected that proposal. (¶ 14.)

Upon the initiative and agreement of the parties, the Tribunal ordered the bifurcation of the proceedings in two phases. (¶ 26.) On 30 November 2012, the Tribunal issued a Decision on Jurisdiction, Applicable Law and Liability, declaring jurisdiction over the arbitration proceedings; dismissing most of Electrabel’s claims under the ECT; and postponing to a subsequent phase its final decision in regard to “net stranded costs forming part of Electrabel’s claim for compensation pleaded as the PPA Termination Claim and made under Article 10(1) of the [ECT] in regard to Hungary’s obligation to accord to Electrabel’s investments [FET].”<sup>4</sup>

### 3. *Analysis by the Tribunal*

The Award only addresses Electrabel’s remaining claim with respect to Hungary’s non-payment of stranded costs to Dunamenti as a result of the termination of the PPA. The Tribunal determined that the issue yet to be resolved was whether Hungary wrongfully frustrated Electrabel’s reasonable expectations or took arbitrary measures with respect to the legal framework in Hungary, including EU law. (¶ 114.) The Tribunal then addressed the remaining claim with respect to unlawfully “frustrated legitimate expectations,” and “arbitrariness,” as follows:

- 3.1. *Legitimate Expectations: Electrabel Failed to Establish a Legitimate Expectation that It Would be Awarded All Eligible Stranded Costs; and Even if It had Established a Legitimate Expectation, Dunamenti Received a Form of Partial Compensation through Hungary’s Set-off Against Dunamenti’s Repayable State Aid and thus There Was No Breach of the ECT’s FET Standard.*

The Claimant argued that Hungary’s failure to provide compensation for Duramenti’s stranded costs breached the ECT’s FET provision because it was “contrary to Electrabel’s legitimate expectations.” (¶ 124.) The Tribunal rejected the Claimant’s argument for the following reasons:

First, the Tribunal held that it did not find evidence that Hungary represented to Electrabel—at the time of its investments in Dunamenti—that it would ever act

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<sup>4</sup> *Electrabel S.A. v. Hungary*, ICSID Case No. ARB/07/19, Decision on Jurisdiction, Applicable Law and Liability, 30 November 2012 (Part XI: The Operative Part).

differently from the way that it acted at the time. The Tribunal considered that Electrabel could not succeed in the absence of such a representation. On this subject, the Award refers to the previous Decision on Jurisdiction, Applicable Law and Liability, where the Tribunal acknowledged that while a specific assurance or representation is not always indispensable to a claim advanced under the FET standard,<sup>5</sup> the investor must establish a relevant expectation based upon reasonable grounds, which Electrabel failed to do. (¶ 155.)

Second, the Tribunal concluded that Dunamenti bore (i) the risk of a change in the applicable law; and (ii) the commercial risks of its operations under the PPA “in a difficult transitional period” that Hungary was facing towards market liberalization and membership in the European Union. Moreover, the Tribunal held that the Claimant could not point to EU law for its expectations because Electrabel and Dunamenti were both aware that Hungary was seeking at all times to comply with EU law. Also, the PPA between Dunamenti and MVM did not contain a stabilization clause and expressly allowed MVM to terminate the PPA without compensation “if any obligation became unlawful to perform due to a change in law,” which the Tribunal understood to include EU law. (¶¶ 156-57.)

Third, the Tribunal determined that the Claimant failed to establish that Hungary made any express or implied representation to Electrabel or Dunamenti regarding guaranteed returns or protection from regulatory or legal changes as a result of Hungary’s accession to the European Union.<sup>6</sup> (¶ 162.)

Finally, the Tribunal concluded that even assuming Electrabel had a legitimate expectation of being adequately compensated, Dunamenti received a form of partial compensation under Hungary’s scheme by way of a set-off against repayable State aid. Applying a balancing test, or weighing exercise, of the circumstances of the case by Hungary,<sup>7</sup> the Tribunal noted that such partial compensation did not amount to a breach of the ECT’s FET standard. The Tribunal therefore found that even if Electrabel had an expectation of being awarded the maximum compensation, it did not appear reasonable or legitimate when weighed against Hungary’s legitimate right to regulate in the public interest. (¶¶ 164-66.)

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<sup>5</sup> *Id.* (¶ 7.78).

<sup>6</sup> Electrabel relied on a representation from Hungary concerning pricing arrangements that Dunamenti would be entitled to a reasonable profit and Electrabel a reasonable return on its investment. (¶ 160.)

<sup>7</sup> The Tribunal relied on: *Saluka Investments B.V. v. Czech Republic*, UNCITRAL, Partial Award of 17 March 2006 (“*Saluka award*”); *Arif v. Republic of Moldova*, ICSID Case No. ARB/11/23, Award of 8 April 2013.

3.2. *Arbitrariness: Electrabel Failed to Prove that Hungary's Conduct Was Arbitrary or Disproportionate, or that there Was No Legitimate Purpose.*

The Claimant argued that Hungary's failure to provide compensation for Dunamenti's stranded costs breached the ECT's FET provision because it was "unjust, arbitrary, abusive, inconsistent and disproportionate." (¶ 124.) The Tribunal rejected Electrabel's proposition by concluding that Hungary did not act in an arbitrary manner in exercising its discretion in selecting its scheme for the compensation of stranded costs.

Electrabel also argued that Hungary's sole reason for not fully compensating Dunamenti was to "keep" budgetary monies, and that it never undertook any balancing of actual interests in making its decisions in regard to its scheme. Further, Electrabel contended that Hungary represented its willingness to provide Hungarian generators with compensation for net stranded costs, but that it then failed to do so. Finally, Electrabel alleged discriminatory treatment toward Dunamenti by arguing that Hungary provided to MVM compensation for the costs of market liberalization. The Tribunal rejected Claimant's arguments, and concluded that Electrabel failed to establish that (i) Hungary made a representation that it would pay all stranded costs; and that (ii) MVM's situation was materially similar to that of Dunamenti or Electrabel. On the latter, the Tribunal emphasized that in this case there was a mere showing of differential treatment, which was not sufficient to establish unlawful discrimination toward Electrabel or Dunamenti. (¶¶ 170-75.)

According to the Tribunal, the issue was not whether the European Commission would have approved a compensation for 100% of Dunamenti's eligible stranded costs, but instead whether Hungary acted in an arbitrary manner towards Electrabel in selecting its scheme for the compensation of stranded costs. (¶ 173.) The Tribunal, in agreement with the *Saluka*, *AES*, and *Micula* tribunals, stated that a measure "will not be arbitrary if it is reasonably related to a rational policy."<sup>8</sup> In the Tribunal's view, once the elements established in the *AES* award<sup>9</sup> are met, States have a wide scope of discretion to determine the specific details of the measure. So long as there is an appropriate correlation between

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<sup>8</sup> *Saluka* award, ¶ 307 (" . . . any differential treatment of a foreign investor must not be based on unreasonable distinctions and demands, and must be justified by showing that it bears a reasonable relationship to rational policies not motivated by a preference for other investments over the foreign-owned investment . . . "); *Ioan Micula, Viorel Micula, S.C. European Food S.A., S.C. Starmill S.R.L. and S.C. Multipack S.R.L. v. Romania*, ICSID Case No. ARB/05/20, Award of 11 December 2013, ¶ 525; *AES Summit Generation Limited and AES-Tisza Erömü Kft v. Hungary*, ICSID Case No. ARB/07/22, Award of 23 September 2010 ("AES award").

<sup>9</sup> *AES* award, ¶¶ 10.3.7-10.3.9 ("the existence of a rational policy; and the reasonableness of the act of the state in relation to the policy").

the measure and the policy sought, the decision may be reasonable under the ECT's FET standard even if the government is reasonably mistaken. (¶¶ 179-80.)

Applying a balancing exercise in assessing the impact of Hungary's compensation scheme on Dunamenti and Hungary itself, the Tribunal found that Hungary's decision to compensate Dunamenti for 85% of its total eligible stranded costs was reasonably related to a legitimate policy objective. (¶ 214.) Accordingly, the policy sought by Hungary was not to "keep the money," but instead to align its electricity sector (which comprised other Hungarian generators) with the EU market. Therefore, Hungary carried out a proper balancing exercise between the "interests of generators and those of taxpayers." (¶ 215.) In addition, the Tribunal noted that Hungary made its decision at a time in which the country "was emerging from massive political and economic changes, exacerbated by budgetary constraints caused by the global economic and financial crisis." (¶ 216.)

In conclusion, given Hungary's required balancing exercise, the Tribunal rejected the proposition that Hungary should have fully paid Dunamenti's total eligible stranded costs and that such a failure amounted to a violation of the ECT's FET standard. In the Tribunal's view, Hungary's exercise of its discretion was reasonable and proportionate, even when Dunamenti received compensation for 85% of its total eligible stranded costs. Whether the Tribunal would have come to a different result from that to which Hungary arrived was irrelevant under the ECT's FET standard. The relevant question for the Tribunal was whether Hungary, acting in good faith, could have arrived at that result in a rational manner. The Tribunal found in favor of Hungary. (¶ 219.)

### 3.3. *Different outcome from E.D.F. v. Hungary*

The Tribunal acknowledged that the Award might be considered to be divergent with the UNCITRAL award in *E.D.F. v. Hungary*.<sup>10</sup> The Tribunal, however, stated that it was required to decide based on the parties' submissions and that it could not derive any "material assistance" from the *E.D.F.* award. (¶ 226.) Nevertheless, the Tribunal noted that the *E.D.F.* award did not compensate the claimant-investor for the maximum amount of net stranded costs attributed to its subsidiary.

## 4. *Decision*

The Tribunal dismissed all of the Claimant's substantive claims, together with all its claims for interest and costs. The Tribunal also confirmed its Decision on Jurisdiction,

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<sup>10</sup> *E.D.F. International v. Hungary*, UNCITRAL, Award of 3 December 2014.

Applicable Law and Liability of 30 November 2012, as if it were expressly set out as part of the Award.

## 5. *Costs*

The Tribunal decided that the parties shall each bear their own legal costs and expenses, subject to the administrative costs of the ICSID Secretariat and the fees and expenses of the Tribunal, which Electrabel must bear in full. (¶ 236.)