School of International Arbitration, Queen Mary, University of London
International Arbitration Case Law
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Award Name and Date: UP and C.D Holding Internationale v Hungary (ICSID Case No. ARB/13/35) – Award – 09 October 2018

Case Report by: Mihaela Apostol**, Editor: Diego Luis Alonso Massa***

Summary: UP, formerly known as Le Chèque Déjeuner ("**LCD**"), a cooperative company incorporated under the laws of France, and C.D Holding Internationale ("**CD Internationale**"), a simplified joint stock company, wholly owned by UP and organized under the laws of France (collectively the "**Claimants**") brought an action against Hungary, as a sovereign state (the "**Respondent**") requesting damages of EUR 27.4 million, pursuant to the bilateral investment treaty between France and Hungary - 1986 (the "**BIT**"). The Claimants, primarily active in the food voucher business, alleged that the legislative reform adopted by Hungary in 2011 (the "**2011 Reform**") led to the expropriation of the Claimants' investment (under Article 5 (2) of the BIT) and constituted a breach of the fair and equitable treatment standard (under Article 3 of the BIT). After deciding that the Tribunal has jurisdiction over all the claims, the Respondent brought to the attention of the Tribunal the CJEU judgement in the *Achmea* case. The Tribunal rejected the objection based on several substantial differences between the two cases and concluded that *Achmea* does not have any impact on Tribunal's jurisdiction. On the merits, Hungary was held liable for expropriation and obliged to pay EUR 23,196,000 (plus interest) to the Claimants. For rationale of procedural economy, the Tribunal did not analyze the allegations related to the breach of FET.

Main Issues: What is the relevance, if any, of the *Achmea* Decision; Whether the measures implemented by Hungary are tantamount to expropriation under Article 5 (2) of the BIT; Whether the measures adopted by Hungary led to a breach of the fair and equitable treatment standard under Article 3 of the BIT.

Tribunal: Professor Dr Karl-Heinz Böckstiegel (President), The Honourable L. Yves Fortier PC CC OQ QC (Arbitrator) and Sir Daniel Bethlehem KCMG QC (Arbitrator).

Claimants' Counsel: Ms Isabelle Michou (Quinn Emanuel Urquhart & Sullivan, Paris) and Mr Laurence Shore (until 30 August 2017) (Herbert Smith Freehills, Paris).

Respondent's Counsel: Ms Kiera S. Gans and Ms Natalie Kanerva (DLA Piper LLP, US); Dr András Nemescói, Dr Péter Győrfi-Tóth, Dr. Dávid Kőhegyi and Ms Zsofia Deli (Horváth and Partners Law Firm DLA Piper, Budapest); Dr Beatrix Bártfai and Dr András Lovas (Sárhegyi & Partners, Budapest); Dr Norbert Tátrai (Government Office of the Prime Minister of Hungary).

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** Mihaela Apostol is a Romanian qualified lawyer. She holds an LL.M. degree from Stockholm University in International Commercial Arbitration and an LL.M. degree from Pantheon-Sorbonne University (Paris 1) in European and International Business Law. IACL´s case reports do not offer personal views but strictly reflect the content of the decision. However, in case of doubts, the views set forth herein are the personal views of the author and do not reflect those of ACICA or the IBA. Ms Apostol can be contacted at: apostol.c.mihaela@gmail.com.

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Digest:

1. Relevant Facts

The Parties' dispute concerns Respondent's 2011 Reform of its tax and other laws and Claimants' unwillingness or inability to continue business in the Respondent State as a result.

The Claimants decided to enter the Hungarian market and LCD (now UP) opened an office in Budapest in October 1996. Le Chèque Déjeuner Kft ("**CD Hungary**") is Claimants' wholly-owned subsidiary in Hungary, its operations began in 1997 as a fringe voucher issuer in the food industry (¶111). "Fringe benefits" were defined by the Claimants as remunerations other than wages that are paid to employees as part of their compensation packages (¶106). At that time, the Hungarian legislation provided a tax-free status to meals offered at the workplace (hot meal) and to vouchers used to purchase food (cold meal) (¶110).

On 24 May 2002, Claimants created as a wholly owned subsidiary Le Chèque Déjeuner Výroba – Výroba, s.r.o. to supply CD Hungary and other eastern European LCD (now UP) subsidiaries with pre-printed vouchers (¶115).

The Respondent made several amendments to the regulations which impacted the food vouchers sector. The main measures criticized by the Claimants were part of the 2011 Reform that went into effect on 1 January 2012 and comprised: (i) the SZÉP Card; (ii) the Erzsébet voucher; and (iii) a preferential tax rate.

1.1. The SZÉP Card

The SZÉP Card was introduced on 12 April 2011, by Decree 55/2011, as an electronic card initially conceived to replace the holiday voucher, which, at that time, was exclusively issued by a State-owned entity, MNUA (¶¶112, 126, 138). In September 2011, the Respondent re-conceptualized the SZÉP Card to include other services, such as hot meals (¶146).

The 2011 Reform imposed a few requirements in order to qualify as a SZÉP Card issuer (¶156). According to the Claimants, none of the non-Hungarian issuers, except for a few banks, could have met those criteria (¶158).

1.2. The Erzsébet voucher

On 29 November 2011, IR 2011 Law (the "**2011 PIT Law**") created a new meal voucher, the Erzsébet voucher, which was issued exclusively by MNUA. According to the Respondent, the Erzsébet voucher was meant to: (i) improve health and nutrition of disadvantaged Hungarians; and (ii) fund social welfare programs that would be defunded after 2011 (¶155).

1.3. Preferential tax rate

Prior to the 2011 Reform, Claimants' hot and cold meal vouchers were available below HUF 18,000 at an effective tax rate of 19.04% (¶¶187,190). Claimants alleged that the 2011 Reform reclassified their meal vouchers as "*specific defined benefits*" under 2011 PIT Law and subjected them to the tax of 51.17% (without a ceiling), which was significantly higher than the rate of 30.94% applicable to the other products, the SZÉP Card and Erzsébet voucher (¶162).

According to the Claimants, CD Hungary controlled 18.1% of the Hungarian voucher market by 2011 (¶130) and it dropped to 10 % by 30 January 2012 (¶164), which subsequently led to the implementation of a redundancy plan for 40 of its employees (¶170), and the closure of Claimants' office in Budapest by September 2013 (¶178).

On 10 April 2014, the European Commission (the "**EC**") brought an action before the CJEU against Hungary, *EC v. Hungary*, seeking a declaration that the State had infringed the Services Directive by adopting and maintaining the system governed by Decree No. 55/2011 (¶181). On 23 February 2016, the CJEU found that the 2011 Reform was discriminatory, unjustified, and disproportionate, upholding all the complaints brought by the EC in relation to the SZÉP Card and the Erzsébet voucher (¶184).

2. Procedural History

Claimants filed a Request for Arbitration on 03 December 2013, which was registered by ICSID on 23 December 2013 (¶11). The first session of the Tribunal was held on 12 September 2014, where the Parties confirmed that the Tribunal was properly constituted (¶12). On 19 January 2015, the Claimants filed a Memorial on the Merits, which was followed by a Counter-Memorial on the Merits and Objections to Jurisdiction including a request of bifurcation submitted by the Respondent on 17 July 2015 (¶¶14-15). Subsequently, on 23 October 2015, Claimants filed a Reply on Objections to Jurisdiction and a Response to Request for Bifurcation (¶16). On 12 November 2015, the Tribunal issued Procedural Order No. 2, deciding the bifurcation of the proceedings, jurisdiction being addressed as a preliminary issue. A hearing on jurisdiction was held in London on 13 and 14 January 2016, followed by a Decision on Preliminary Issues of Jurisdiction rendered on 3 March 2016 (¶¶18, 21). On 11 April 2016, Claimants submitted their Reply on the Merits (¶24). On 21 July 2016, Respondent submitted a Rejoinder (¶26). A hearing on the merits was held in London between 22-25 May 2017(¶71). On 22 May 2017, Claimants notified the Tribunal that LCD had changed its company name to UP (¶72). On 6 March 2018, Respondent informed the Tribunal that the CJEU rendered its judgment in the *Achmea* case (the "***Achmea* Decision**") and urged the Tribunal to, therefore, decline jurisdiction or, alternatively, to rule that it is precluded from issuing a decision on the merits (¶89). The Parties submitted their comments regarding the *Achmea* Decision (¶¶90-94). On 20 August 2018 the European Commission lodged an Application for Leave to Intervene as a Non-Disputing Party, which was rejected by the Tribunal, on 27 August 2018, based on

Rule 37(2) of the ICSID Arbitration Rules (¶¶95-98). The proceedings were formally closed on 27 August 2018 (¶99).

2. Jurisdiction of the Tribunal

3.1. The decision on preliminary issues of jurisdiction

On 3 March 2016, the Tribunal issued a Decision on Preliminary Issues of Jurisdiction by which it rejected Respondent's jurisdictional objections regarding the claims for alleged breach of Article 3 of the BIT and held that the Tribunal had jurisdiction over all the claims raised (¶206).

3.2. The Parties' submissions regarding the Achmea Decision

3.2.1. Claimants' arguments

The Claimants submitted that the *Achmea* Decision has no bearing for the case at hand and the Tribunal will not be bound to apply it or to conclude that it robs Tribunal's jurisdiction (¶208).

The Claimants argued that a reconsideration of the Tribunal's decision on jurisdiction would be justified only in exceptional circumstances involving fraud or egregious circumstance or manifest error of law, which were not present in the case submitted to the Tribunal. The Claimants added that the objection was belated and represented an attempt to withdraw consent to arbitration, which is prohibited under the ICSID Convention (¶210).

The Claimants' position was that the Tribunal can only consider *Achmea* Decision as fact, since the Parties agreed that EU law is not relevant to the dispute. According to the Claimants, EU law is not part of the rules and principles of international law, which the Tribunal shall apply, as the EU law relies on a body of law separated from the international law and its binding effects are limited to the Member States. The ICSID arbitration is isolated from the EU legal order and there is no risk of interference with the EU law or with the local courts (¶¶208, 214-215).

As per the Claimants, the Tribunal will still have jurisdiction over the dispute based on the principle of *lex specialis,* even if it decides to take into account the *Achmea* Decision and retain a conflict between the BIT's provisions and the TFEU. The BIT establishes a special regime aimed to protect the investments against a host State, which constitutes a *lex specialis* in comparison with the EU Treaties (¶217).

It was argued by the Claimants that the *lex posterioris* rule of Article 30 of the VCLT is not applicable to the case submitted to the Tribunal, as: (i) there is no fundamental incompatibility between the provisions of the BIT and the EU law; and (ii) the two rules of law do not have the same subject matter (¶218).

The Claimants alleged that there was no *lex superior* primacy of EU law in international law. Article 351 of the TFEU may only apply to the agreements between the Member States and not when third parties are involved. It is the Claimants' view that a different interpretation would be contrary to the rule of international law that a State cannot evade its international obligations on grounds of its internal law (¶219).

The Claimants argued that a decision of the Tribunal to decline or refrain from exercising jurisdiction, would amount to a denial of justice, as the substantive rights contained in the BIT would become infective without access to international arbitration (¶222).

The Claimants submitted that according to the principle of *forum prorogatum*, the jurisdiction of the tribunal can be extended by agreement of the parties in a case that would otherwise be outside of the tribunal's jurisdiction. Such agreement goes beyond the mere participation of the parties to the proceedings, and involves an element of consent. In the case submitted to the Tribunal, the Respondent had repeatedly confirmed its consent to the ICSID proceedings agreeing to settle the dispute by a mechanism which is truly international and isolated from the municipal legal order (¶227).

3.2.2. Respondent's arguments

The Respondent argued that its jurisdictional objection is not time-barred and the *Achmea* Decision cannot be disregarded based on procedural grounds. It further added that the Tribunal has a duty to ascertain jurisdiction *sua sponte,* if there are compelling reasons to do so, such as the *Achmea* Decision (¶231).

Respondent alleged that the *Achmea* Decision: (i) is considered part of the *acquis communautaire*; (ii) is binding in the same way as statutory law; (iii) has *erga omne*s effect, extending the consequences of such rulings to all EU Member States and to private entities, like Claimants; and (iv) has a retroactive effect (¶232).

The Respondent refuted the allegations concerning a denial of justice, arguing that the Claimants have procedural standing to pursue their claims before the national courts. It further added that even if the Claimants had no other forum to bring their claims, that would not override the deficiencies in the Tribunal's jurisdiction (¶248-249).

As for the application of the *forum prorogatum* principle, the Respondent contended that it would have been impossible to raise the issue of lack of its consent to arbitrate before the CJEU decision in the *Achmea* case (250).

3.2.3. Tribunal's considerations and conclusions

The Tribunal stated that its jurisdiction is based on the provisions of the ICSID Convention, which is placed in a public international law context and not in a national or regional one (¶253). It held that the *Achmea* Decision has no impact on the Tribunals' jurisdiction given the determinative differences between *Achmea* and the case at hand, such as: the proceedings are governed by the ICSID Convention and the ICSID Arbitration Rules, not by the national law of an EU Member State or by the EU law; the judicial review of the award and the annulment proceedings are not in the competence of the courts of the EU Member States; the annulment review leads to a final decision which is not subject to review by any court (¶254).

The Tribunal added that the *Achmea* Decision did not contain any reference about its effect on the arbitration conducted under the ICSID Convention (¶263). The Respondent failed to demonstrate that *Achmea* impacted its consent to arbitrate by retroactively terminating the BIT (¶264). Even in those circumstances, the sunset clause of the BIT would remain applicable to the investments made prior 1 May 2004, when the Respondent joined the EU (¶265).

The Tribunal concluded that the *Achmea* Decision did not have any impact on the Tribunal's Decision on Jurisdiction of 3 March 2016, which stated that it had jurisdiction over all the claims (¶266).

4. Applicable law

4.1. Relevant terms of the BIT

The Tribunal stated that the applicable law is governed by the BIT and international law based on Article 9(3) of the BIT which provides: "*The arbitral tribunal shall rule in accordance with the provisions of this Agreement and the rules and principles of international law"* (¶¶280-283).

4.2. *Arguments related to the relevance of other decisions and particularly the Edenred Award*

On 27 March 2017, the Parties submitted their respective comments on the *Edenred* Award to the Tribunal, underlying the similarities of the *Edenred* case with the case before the Tribunal (¶285), although they differed on the role that the *Edenred* Award should have in the case at hand.

4.2.1. Claimants' arguments

Claimants admitted that *Edenred* Award cannot be determinative of the Tribunal's decision, but suggested that it may shed useful light on some issues, given the common factors such as the criteria imposed by Hungary to SZÉP Card issuers, and the intentional exclusion of the Non-Hungarian issuers (¶286).

4.2.2. Respondent's arguments

The Respondent contended that the *Edenred* Award can only offer limited guidance and given its potential prejudicial impact and the absence of a *stare decisis* doctrine in investment arbitration, it should be deemed irrelevant to the Tribunal's deliberations. It further added that the tribunal in the *Edenred* case awarded damages disregarding recent changes to the fringe benefit system undertaken in light of the CJEU Decision against Hungary and thereby gave *Edenred* a double recovery (¶287).

4.2.3. Tribunal's considerations and conclusions

The Tribunal concluded that the *Edenred* Award might be useful in shedding light on a few issues without having a binding effect on the Tribunal (¶¶288-290).

5. Expropriation/dispossession (Article 5(2) of the BIT)

5.1. The existence of a right capable of expropriation / a vested right

5.1.1. Claimants' arguments

The Claimants contended that Respondent expropriated indirectly (in the case of UP) and directly (in the case of CD Internationale) the shareholding in the CD Hungary. According to the Claimants, their shareholding is a vested property right under Hungarian law and, therefore, constitutes a "*right capable of expropriation*" (¶¶292-294).

5.1.2. Respondent's arguments

The Respondent admitted that Claimants' shareholding represents an investment, although the Respondent did not consider this aspect to be relevant, since the Claimants did not argue the loss of those rights. The Respondent contended that Claimants substantiated their case on loss of economic profitability, which is not recognized as a right by the Hungarian law, and thus it does not benefit from the protection of the BIT (¶297).

The Respondent argued that Claimants cannot assert a right to a particular tax or regulatory system, as the BIT contains no stability clause (¶299).

5.1.3. Tribunal's considerations and conclusions

The Tribunal concluded that even if shares remain legally held by a claimant if a State's measures result in the loss of the shares' economic value, this may be considered an indirect expropriation (¶305).

5.2. Indirect expropriation / the existence of a substantial dispossession

5.2.1. Claimants' arguments

The Claimants argued that the term "dispossession" as used in Article 5(2) of the BIT is functionally equivalent to "expropriation" and, therefore, Article 5(2) should be read as codifying the customary international law definition of indirect expropriation (¶¶308-309). The measures adopted by the Respondent had an instant and disastrous impact on Claimants' investment (¶312). The Claimants contended that the Respondent had a clear intention to expropriate, which resulted from the text of the relevant legal provisions, as well from the contemporaneous statements of Respondent's politicians (¶313).

5.2.2. Respondent's arguments

The Respondent submitted that "dispossession" is not a functional equivalent of expropriation, but rather an element of expropriation. According to the Respondent, dispossession requires a loss of possession, it necessarily contemplates a loss of material control and the ability to exercise the rights associated with ownership of the property (¶317). Thus, the Respondent cannot be held liable for the breach of the BIT, and Claimants cannot expect to receive a compensation, since the Claimants remained in control of the shares and were free to manage the operations of CD Hungary as they saw fit (¶316).

The Respondent argued that the arbitration tribunals had denied claims where the impact of criticized measures was temporary. The measures adopted by the 2011 Reform were never intended or expected to be permanent, and had been amended subsequently, creating opportunities that Claimants could have taken advantage of, had they not suspended operations (¶325).

5.2.3. Tribunal's considerations and conclusions

The Tribunal held that the test is not which measure caused which effect, but whether the "measures" taken together as a package resulted in dispossession (¶331). As for the Parties' comments regarding the possible difference between "dispossession" and "expropriation", the Tribunal noted that from the wording of Article 5(2) of the BIT, it is clear that the terms "expropriation", nationalization", and "other measures" describe the action taken by a government and indicate, by inserting the word "other", that the term "measures" includes all three of these terms. Thereafter, the term "dispossessed" describes the result of such measures (¶332).

The Tribunal compared the economic value of the Claimants 'investment (its shareholding before the disputed measures) to the value after such measures, in order to determine if there was a substantial loss in value and whether the substantial loss was an effect of the measures (¶333).

The Tribunal found that the criteria imposed by the 2011 Reform to become a SZÉP Card issuer were obviously tailored such that only a limited number of pre-selected issuers would qualify, certainly excluding the Claimants (¶¶340-341). As for the measures concerning the Erzsébet voucher, the Tribunal stated that it eliminated the remaining segment of the market in which CD Hungary could have continued to sell its vouchers (¶¶343-344). The third measure, change of the taxation rate, created a tax differential in favour of the two new products, the SZÉP Card and Erzsébet voucher, which disadvantaged CD Hungary (¶347).

The Tribunal concluded that as result of the 2011 Reform, CD Hungary was evicted from the meal voucher market, thus the destruction of the value of Claimants' shareholding was permanent, or at least sufficiently permanent for the purposes of expropriation (¶¶351-353).

5.3. The lawfulness of the alleged expropriation

5.3.1. Claimants' arguments

The Claimants submitted that the measures adopted by the Respondent were unlawful: (i) the public policy goal of keeping profits within the country, rather than the prospect of Claimants repatriating them, is not a legitimate public purpose under Article 5(2) of the BIT (¶362); (ii) the measures were disproportionate, and less restrictive measures were available to Respondent; (iii) the measures were discriminatory as they subjected Claimants as investors to a differential treatment without reasonable justification (¶374); (iv) the expropriation was carried out without due process (¶377); and (v) the Respondent never offered Claimants a compensation (¶378).

5.3.2. Respondent's arguments

The Respondent argued that Claimants' expropriation claim fails because the legislative measures: (i) were enacted for a public purpose (¶¶383-393); (ii) were proportional (¶¶394-402); (iii) were non-discriminatory and applicable to all investors (¶¶403-405); (iv) the requirements of due process were met (¶¶406-407); and (v) Claimants are not owed compensation (¶¶408-409).

5.3.3. Tribunal's considerations and conclusions

The Tribunal noted that Respondent had admitted that the 2011 Reform was intended to keep the profit previously "realized by foreign-owned companies" within Hungary. In the Tribunal's view, the public policy goal of keeping profits within the country is not a legitimate public purpose under Article 5(2) of the BIT (¶414). Moreover, measures deliberately targeting an investor or three foreign investors cannot be a legitimate exercise of a state's police powers (¶415).

The Tribunal concluded that Respondent's dispossession of Claimants' investment was not lawful and, therefore, Respondent breached Article 5(2) of the BIT (¶419).

6. Fair and equitable treatment (Article3 of the BIT)

The Claimants also alleged a breach of the fair and equitable treatment standard (Article 3 of the BIT) in support of the same request. Since the Tribunal already held liable the Respondent for expropriation (breach of Article 5(2) of the BIT), in the interest of procedural efficiency, the Tribunal decided that it need not examine whether Respondent also would be liable for a breach of Article 3, as it would not lead to any damages in excess of those which result from the breach of Article 5(2) (¶¶491-493).

7. Damages

The Tribunal awarded compensation based on the full reparation principle of customary international law and took into account the date of 1 January 2012, as a valuation date, since it was the moment when the 2011 Reform entered into effect (¶560). The method applied by the Tribunal to determine the damages was the discount cash flow (DCF) (¶561). The final amount awarded by the Tribunal as compensation was EUR 23,196,000 (¶585).

8. Interest

In deciding the interest that should be applied to the compensation, the Tribunal took as guidance the principle *restitutio ad integrum* under international law. The Tribunal awarded an interest rate of EURIBOR plus 6.01 %, which shall accrue annually (starting with 1 January 2011) and be compounded annually until the date of payment (¶¶595-600).

9. Costs

The Tribunal found that Respondent has to bear its own costs of arbitration, and has to reimburse 75% of the EUR 3,570,753.76 requested by Claimants as legal fees and expenses as well as 75% of the USD 524,783.67 corresponding to the expended portion of the Claimants' advances to ICSID and the ICSID lodging fee, *i.e.* EURO 2,678,065.32 plus USD 393,587.75 (¶621).