



School of International Arbitration

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International Arbitration Case Law

**School of International Arbitration, Queen Mary, University of London  
International Arbitration Case Law**

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**Award Name and Date:** Magyar Farming Company Ltd, Kintyre Kft & Inícia Zrt v Hungary (ICSID Case No. ARB/17/27) – Award – 13 November 2019

**Case Report by:** Sachin Nair\*\*, Editor: Ignacio Torterola\*\*\*

**Summary:** Claimants brought an action for relief against Hungary pursuant to the UK-Hungary BIT (“BIT”) alleging that Hungary breached Article 6 of the BIT in expropriating its investment, i.e. its leasehold rights. Respondent disputed this as well as the jurisdiction of Tribunal following the *Achmea* decision. The Tribunal disagreed, finding that it was not bound by the *Achmea* decision and that it had jurisdiction over the present dispute. In relation to the merits of the dispute, the Tribunal held that Hungary had breached Article 6 of the BIT by expropriating the Claimants’ investment without compensation.

**Main Issues:** Intra-EU BITs; objection to jurisdiction arising from intra-EU BITs; unlawful expropriation of investment; doctrine of acquired rights.

**Tribunal:** Professor Gabrielle Kaufmann-Kohler (President), Dr. Stanimir A. Alexandrov (Arbitrator), and Dr. Inka Hanefeld (Arbitrator).

**Claimant's Counsel:** Zannis Mavrogordato, András Dániel László (LFB - László Fekete Bagaméry, Budapest).

**Respondent's Counsel:** Michael Ostrove, Théobald Naud, Maxime Desplats, Clémentine Emery (DLA PIPER FRANCE LLP, Paris), András Nemescsói, Dávid Kőhegyi, Zsófia Deli (DLA Piper Posztl, Nemescsói, Györfi-Tóth & Partners Law Firm, Budapest), Beatrix Bártfai, András Lovas, Viktória Perényi, Fanni Takács (Sárhegyi & Partners Law Firm, Budapest).

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## Digest:

### 1. Relevant Facts

The Claimants are Magyar Farming Company Ltd (“Magyar”), a company incorporated and existing under the laws of the UK, and its Hungarian subsidiaries Kintyre Kft (“Kintyre”) and Inícia Zrt. (“Inícia”). The Respondent is Hungary. The dispute arose out of the Respondent’s measures regulating the possession and disposal of State-owned agricultural land. The Claimants alleged that this resulted in the expropriation of their leasehold rights to 760 hectares of State-owned land located in Hungary’s North-Western region of Ikrény (the “Land”) and in a diminution of the value of their farming business in Hungary (the “Farm”) (¶ 5).

On 27 June 1994, the Hungarian Parliament passed the 1994 Arable Land Act (the “1994 Act”) to regulate the acquisition and ownership of newly privatised agricultural land. The 1994 Act stipulated that only physical persons of Hungarian nationality were allowed to acquire agricultural land. Foreign corporations were, however, allowed to lease agricultural land from Hungarian nationals or from the Hungarian State for a maximum of 10 years. The 1994 Act also conferred a statutory pre-lease right on lessees of agricultural land. The effect of this right was that, upon the expiration of the lease, the State or the owner of the land was required to inform the lessee of any offer from a third party that it intended to accept (¶ 110).

In 1997, Magyar and Kintyre acquired 95.13% shares in Inícia. Inícia owned a livestock farm, which had been privatised in 1994, composed of 2 livestock units and the Land (¶¶ 113 – 114). In acquiring Inícia, the Claimants also acquired a 10-year profit lease covering the Land (¶ 117). This lease agreement (‘Lease’), which was concluded in 1994 and was due to expire in 2004, conferred a pre-lease right on the lessee. Hence, in addition to the statutory pre-lease right conferred by the 1994 Act, Inícia also had a contractual pre-lease right. In 1999, Inícia and the State Privatisation and Property Plc, an agency managing State property, concluded an amendment to the Lease (the “1999 Lease Amendment”); the effect of this was to extend the Lease for an additional 5 years from 2004 to 2009 (¶ 120). In 2002, the 1994 Act was amended, modifying the maximum permissible duration of agricultural leases from 10 years to 20 years. On 16 November 2006, Inícia and the NLA concluded an amendment to the Lease (the “2006 Lease Amendment”) pursuant to this statutory amendment, thus extending the Lease to 25 July 2014. The 2006 Lease Amendment also modified the language of the pre-lease provision to read that this right “may be exercised in accordance with the applicable laws effective at all times” (¶ 122).

In 2010, the Fidesz party returned to power, resuming the agricultural reform that was halted in 2002. On 12 August 2010, the Hungarian Parliament enacted the Act on the Land Agency (the “2010 Act”), the implementation decree of which set out procedures governing tenders for leasing State-owned agricultural land (¶ 129). These procedures favoured local family farmers and individuals with professional agricultural credentials over large farming enterprises (¶ 129). The implementation decree did, however, maintain existing pre-lease rights. This hindered the objectives of the government’s land reform as it did not allow for the redistribution of the land to the aforementioned favourite categories of farmers (¶ 131). Thus, on 9 July 2011, the 2010 Act was amended (“2011 Amendment”) to preclude the exercise of statutory pre-lease rights where State-owned land was leased through a tender (¶ 132). From March 2012, the NLA announced a series of new tenders for leasing State-owned agricultural land (the “Tenders”), the scoring system for which favoured, *inter alia*, local family farmers with agricultural diplomas and young farmers (¶¶ 135 – 136).

Worried about the prospect of losing the Lease, the Claimants undertook several courses of actions, including submitting bids for the Tenders in June 2013. In January 2014, the NLA announced the results of the Tenders in which Inícia lost all 16 of its bids (¶¶ 140 – 141). In February 2014, the NLA proceeded to conclude 20-year lease agreements with the winners (¶ 141). On 31 January and 5 February 2014, Inícia wrote to the NLA affirming the entitlement “to the pre-lease right established in Section 5.1 of the lease agreement concluded with the National Land Agency on 26 November 2006” (¶ 144). Inícia also requested that the NLA disclose the content of the winning bids, to which the NLA did not respond. Inícia thus initiated court proceedings to obtain disclosure of the scoring sheets, with both the first instance court and second instance court finding in favour of Inícia. The Respondent requested an *ex parte* extraordinary review of this decision by the Supreme Court (the “Curia”), which was still pending at the time of the arbitration (¶ 146).

Separately, on 24 April 2014, Inícia formally notified the NLA that it exercised the pre-lease rights and requested the NLA to sign lease agreements with Inícia “with the same conditions as were granted to the winning tender applicants”. Receiving no response, on 6 June 2014, Inícia filed an action against the NLA and the winners of the Tenders before the first instance court at the Pest district, requesting the judicial recognition of its exercise of the pre-lease right under Section 5.1 of the Lease and enjoinder of the NLA to conclude lease agreements with Inícia upon the terms of the winning bids (¶ 147). The dispute was entertained at all levels of the Hungarian judiciary, with the final result prior to the present arbitral proceedings being the Metropolitan Court finding that the 2006 Lease Amendment did not grant Inícia a contractual pre-lease right (¶ 148).

On 21 July 2014, the NLA wrote to Inícia, expressing its intention to retake the possession of the Land. Notwithstanding the several orders obtained by Inícia from the local municipality granting it protection against eviction pending the resolution of the court proceedings, the NLA purported to transfer physical possession of the land to the winners of the Tenders on 16 October 2014. A number of confrontations occurred when the winners started arriving at the Land while Inícia refused to leave. Finally, on 14 July 2015, the Claimants were evicted by armed private security guards. Following the eviction, Inícia continued its farming activities on the remainder of the land that it owned or leased from private owners (¶¶ 149 – 157). Following attempts to settle the present dispute, the Claimants initiated the present arbitration on 4 July 2017 (¶¶ 158 – 165).

## 2. Procedural History

On 14 July 2017, ICSID received a request for arbitration dated 4 July 2017 from the Claimants against Hungary (¶ 29). The Tribunal was constituted on 4 January 2018 (¶ 38). On 26 January 2018, the Tribunal held its first session with the parties by telephone conference (¶ 45). On 30 March 2018, the Respondent raised a jurisdictional objection due to the outcome of the case *Slovak Republic v Achmea* before the Court of Justice of the European Union and requested that the Tribunal issue a decision to bifurcate the proceedings and hear this jurisdictional objection in a preliminary phase (¶ 50). On 10 April 2018, the Tribunal decided on the Respondent’s request of 30 March 2018 stating that the *Achmea* defence could be addressed in the context of the Counter-Memorial and of the further submissions (¶ 53). The Claimants filed their Memorial on the Merits on 27 April 2018 (¶ 54). On 8 May 2018, the Tribunal confirmed that the hearing would be held at the World Bank offices in Paris, France (¶ 58).

On 22 August 2018, the European Commission filed an application to intervene as a non-disputing party (¶ 59). On 5 September 2018, the Tribunal granted the Commission permission leave to file its written *amicus curiae* submission by 20 January 2019 limited to the legal consequences of the *Achmea* judgment for the present case (¶ 61). The Respondent filed its Counter-Memorial on the Merits and Memorial on Jurisdiction on 7 September 2018 (¶ 62). On 20 December 2018, the Claimants filed their Reply on the Merits and Counter-Memorial on Jurisdiction (¶ 72). On 20 January 2019, the Commission filed its *Amicus Curiae* Brief (¶ 78). On 29 January 2019, the Tribunal invited the Parties to comment in their second exchange of written submissions on jurisdiction and, if required, at the oral hearing, on the Declaration of the Representatives of the Governments of the Member States of the European Union of 16 January 2019 on the Enforcement of the Judgment of the Court of Justice in *Achmea* and Hungary’s separate declaration of the same date (the “2019 Declarations”) (¶ 79). The Tribunal also invited the Parties to address the possible effects of the United Kingdom’s pending withdrawal from the European Union on this Tribunal’s jurisdiction. On 26 March 2019, the Respondent filed its Rejoinder on the Merits and Quantum and Reply on Jurisdiction (¶ 86). On 26 April 2019, the Claimants filed their Rejoinder on Jurisdiction (¶ 89).

On 29 April 2019, the President of the Tribunal held a pre-hearing organizational meeting with the Parties by telephone conference (¶ 90). A hearing on the merits and jurisdiction was held in Paris, France, from 27 to 30 May 2019 (the “Hearing”) (¶ 96). On 21 June 2019, further to the Tribunal’s instruction during the Hearing, the Respondent submitted a request to amend the request for relief set out in its Rejoinder on the Merits and Quantum and Reply on Jurisdiction (¶ 100). On 24 June 2019, the Claimants objected to Respondent’s application to amend its request for relief. On 27 June 2019, the Respondent provided its observations on the Claimants’ of 24 June 2019. On 1 July 2019, the Tribunal invited the Parties to address the merits of the Respondent’s modification to the request for relief, without prejudice to its admissibility (¶ 102). Accordingly, the Respondent submitted its observations on 15 July 2019 and the Claimants filed their response on 26 July 2019. The proceeding was closed on 8 November 2019 (¶ 102).

### **3. Jurisdiction**

The Respondent raised two jurisdictional objections: the first concerning its consent to arbitrate being vitiated by its accession to the EU in 2004, and the second relating to the present dispute falling outside the subject-matter scope of the BIT and the ICSID Convention (¶ 167).

#### *3.1. Respondent’s position*

##### *3.1.1. Intra-EU objection*

The Respondent submitted that the Tribunal lacked jurisdiction since the BIT’s offer to arbitrate under Article 8 of the BIT, which the Claimants purported to accept by their trigger letter of 12 November 2015 in the Request for Arbitration, had long been extinguished by virtue of Hungary’s accession to the EU Treaties in 2004 (¶ 171).

The Respondent contended that the BIT’s dispute resolution provision under Article 8 of the BIT is incompatible with the EU Treaties, relying on the decision of the Court of Justice of the European Union (the “CJEU”) in *Slovak Republic v. Achmea B.V.* (the “*Achmea Decision*”) (¶ 172), in which the which the CJEU determined that the dispute resolution provisions in the investment treaties concluded between the EU Member States were contrary to the EU Treaties.

The *Achmea* decision was dispositive of the incompatibility between the BIT's dispute resolution provision and the EU Treaties, since the CJEU decisions have *erga omnes* effect vis-à-vis all EU Member States. According to the Respondent, this was confirmed by the 2019 Declarations as issued by 23 EU Member States, including Hungary and the UK, affirming that "all investor-State arbitration clauses contained in bilateral investment treaties concluded between Member States are contrary to Union law and thus inapplicable." (¶ 173). The Respondent argued that the Claimants were in effect asking the Tribunal to ignore the authoritative decision of the CJEU and the binding interpretation given by the BIT's Contracting States (¶ 174).

The Respondent submitted that the incompatibility between Article 8 of the BIT and the EU Treaties should be resolved in favour of the latter pursuant to the *Achmea* Decision (¶ 176). In particular, the EU Treaties were later in time and should prevail pursuant to Article 30(3) of the VCLT, which contains the rule that *lex posterior derogat priori*. Contrary to the Claimants' assertion, it was irrelevant that the EU Treaties may have been in effect in some form since the 1957 Treaty of Rome; the EU Treaties only became applicable between Hungary and the UK when Hungary acceded to the EU in 2004. Accordingly, in relation to the BIT, the EU Treaties constitute a *lex posterior*.

In addition, Article 30(2) of the VCLT supported the Respondent's contention that the EU Treaties should prevail over the BIT; Article 351 of the TFEU provided that the obligations set out in the EU Treaties prevailed over those contained in agreements concluded prior to the accession to the EU (¶ 178). The Respondent argued the Claimants read Article 351 of the TFEU incorrectly in arguing that it did not apply to agreements between EU Member States (¶ 179). Moreover, the Claimants' reliance on *Vattenfall v. Germany* was unhelpful as the ICSID Tribunal in that case found that there was no conflict between the Energy Charter Treaty's dispute resolution provision and the EU Treaties; there was no need to apply Article 351 of the TFEU in that case.

The Respondent also argued that there existed no international obligation on States to remedy an incompatibility between successive treaties; this matter is dealt with instead by Article 30(3) of the VCLT. Hence, no inferences could be drawn from the fact that the EU Member States have not formally amended or renounced their intra-EU BITs (¶ 181). Finally, contrary to the Claimants' contention, the principles of good faith and estoppel did not justify upholding jurisdiction in the circumstances of the present case (¶ 185).

### 3.1.2. Subject-matter jurisdiction

The Respondent contended that the present dispute did not fall within the subject-matter scope of the BIT's dispute resolution provision, since none of the conduct alleged by the Claimants was capable of constituting an expropriation (¶ 250). First, although the Claimants' farming business in Hungary indisputably constituted an investment, the farm as a whole was not the subject of the expropriation claim, since the Claimants continued to derive profit from it (¶ 251). Second, the Lease could not be the subject of an expropriation either since it expired on 25 July 2014 on its own terms (¶ 252). The Claimants' argument that new lease was formed by virtue of their exercise of the alleged pre-lease right on 29 April 2014 also failed because they no longer possessed a contractual pre-lease right as it was extinguished by the 2006 Lease Amendment. Third, the alleged pre-lease right and right to claim damages for the conduct of the Tenders did not constitute an investment under the BIT and were thus not capable of being expropriated (¶ 254).

### 3.2. Claimants' position

#### 3.2.1. Intra-EU objection

The Claimants submitted that the *Achmea* Decision was not binding on the Tribunal, which should conduct an independent inquiry into its own jurisdiction under Article 41(1) of the ICSID Convention. The Claimants also argued that it was well-established in investment treaty jurisprudence that the dispute settlement provisions in investment treaties were easily reconcilable with the EU Treaties, and in particular with Articles 344 and 267 of the TFEU (¶ 188). The Claimants further observed that the finding of incompatibility in the *Achmea* Decision was based on the Netherlands-Slovakia BIT which, different from the UK-Hungary BIT, chose the law of an EU Member State as part of the governing law (¶ 190).

Even if there was a conflict between Article 8 of the BIT and the EU Treaties, the Claimants argued that the latter would not prevail (¶ 191). The temporal conflict rules under Article 30(3) of the VCLT only applied to successive treaties with the same subject matter, which had to be construed strictly. Moreover, even if Article 30(3) of the VCLT applied, it was unclear how the EU treaties could be considered later in time, as the Tribunal in *Vattenfall v. Germany* held that Article 267 and 344 of the TFEU have existed substantively since the Treaty of Rome 1957 (¶ 192).

In addition, the Claimants contended that the BIT should prevail over the EU Treaties pursuant to Article 30(2) of the VCLT; Article 11 of the BIT was a subordination clause envisaged by Article 30(2) of the VCLT (¶ 193). The obvious *a contrario* reading of Article 11 was that the parties to the BIT intended the BIT to prevail to the extent that any later treaty offered less favourable treatment to the investments of investors (¶ 194).

The Claimants also rejected Respondent's interpretation of the 2019 Declarations; the 2019 Declarations did not constitute joint interpretative statements or notes clarifying the meaning of Article 8 of the BIT and could not remove the consent to arbitrate given in an international treaty. Finally, the Claimants submitted that reasons of good faith and justice mandated the Tribunal to assume jurisdiction under Article 8 of the BIT (¶¶ 196 - 198).

#### 3.2.2. Subject-matter jurisdiction

The Claimants contended that the investment for the present purposes was constituted of the leasehold rights over the Land, which comprised "a lease (created as a result of the exercise of the contractual pre-lease right on 29 April 2014), a contractual pre-lease right, a statutory pre-lease right and a right to damages arising from the manipulated tender scoring" (¶ 260).

First, the Claimants countered the Respondent's argument that the Lease expired on its own terms (¶ 261). According to the Claimants, a new lease was created in April 2014, when Inícia exercised the contractual pre-lease right. Second, the Claimants argued that the definition of "investment" agreed between the parties in the BIT governs as *lex specialis* (¶ 262). The Claimants also asserted that their leasehold rights fell within the definition of investment in the BIT (¶ 264). In particular, the ordinary meaning of the word "asset" used in Article 1 of the BIT was not limited to *rights in rem*. In any case, their leasehold rights were *in rem* rights that attracted protection against expropriation under the functional approach to property adopted by Hungarian constitutional law (¶ 265). The Claimants also contended that the pre-lease right was a transferable right that had an intrinsic financial value (¶ 269). Finally, the Claimants'

argued that their loss of the Land as a result of the manipulated tender scores was actionable under Hungarian law in the form of damages claim; a form of intangible property. Accordingly, this claim was a further right that could be expropriated (¶ 270).

### 3.3. Tribunal's analysis

#### 3.3.1. Intra-EU objection

##### 3.3.1.1. Is the *Achmea* Decision binding on the Tribunal?

The Tribunal held that it was not bound by the CJEU's decision over the conflict between the BIT and the EU Treaties. The Tribunal referred to the fact that the arbitral tribunal constituted under the ICSID Convention "shall be the judge of its own competence" pursuant to Article 41 of ICSID Convention and that in the exercise of this power, it must analyse whether there was valid consent to arbitrate under Article 25 of the ICSID Convention (¶ 207).

Moreover, the CJEU's interpretative authority only extended to the interpretation and application of the EU Treaties; it had not exclusive mandate in relation to the interpretation of the BIT or the VCLT rules on treaty conflicts (¶ 209). The determination of whether Article 8 of the BIT was precluded by the EU Treaties required the interpretation of both the EU Treaties and the BIT, in order to answer crucial questions such as (i) whether the BIT and the EU Treaties governed the same subject matter as provided in Article 30 of the VCLT and, if so, (ii) whether there was a normative conflict between these treaties as understood under the VCLT. The Tribunal averred that not only did the CJEU have no exclusive authority to answer these questions, but it did not even purport to address them in the *Achmea* Decision (¶ 210). Referring to *United Utilities v. Estonia*, the Tribunal stated that the CJEU's reasoning gave no guidance on the issues which must be resolved to determine whether the EU Treaties precluded the application of Article 8 of the BIT as a matter of international law (¶ 211).

##### 3.3.1.2. What is the value of the Member States Declarations?

The Tribunal stated that the UK and Hungary had not terminated the BIT pursuant to the rules of Section 3 of the VCLT by virtue of the 2019 Declarations. Even if they had done so by virtue of the 2019 Declarations, the Claimants had accepted the BIT's offer to arbitrate prior to its purported termination. The consent to arbitrate which is perfected by the investor's acceptance of the State's offer to arbitrate expressed in the BIT could not be retroactively invalidated by a subsequent termination of the BIT (¶¶ 213 – 214).

The 2019 Declarations sought to explain *Achmea* Decision rather than to give interpretation of the meaning of intra-EU investment treaties (¶ 216). This was corroborated by the fact that prior to the *Achmea* Decision, Hungary participated in an ICSID arbitration under the present BIT without objecting that Article 8 was extinguished due to its accession to the EU (¶ 217).

In any case, joint interpretative declarations or agreements were not an exclusive and dispositive method of treaty interpretation (¶ 218). Pursuant to Article 31(3) of the VCLT they are but one circumstance that "shall be taken into account, together with the context" of the relevant treaty terms. If Hungary and the UK intended to modify the express language of the BIT, issuing an interpretative declaration by representatives of their governments was not a suitable means for doing so (¶ 220).

### 3.3.1.3. Do the EU Treaties preclude the application of Article 8 of the BIT?

Two threshold questions had to be answered to determine whether the TFEU prevailed over Article 8 of the BIT: (i) do the BIT and the TFEU have the same subject matter as required by paragraph 1 of Article 30 of the VCLT; and if in the affirmative, (ii) is Article 8 of the BIT in conflict with arts 267 and 344 of the TFEU? (¶ 227) In relation to the former, the Tribunal held that the BIT and EU Treaties did not have the same subject matter and accordingly, Article 30 of the VCLT did not apply; investment jurisprudence was consistent in holding that investment treaties did not share the same subject matter with the EU Treaties (¶¶ 228 – 238). Hence, this finding disposed of the question of whether the BIT's offer to arbitrate was valid at the commencement of this arbitration. In any event, the Tribunal also found that even if the BIT and EU Treaties have the same subject matter, the BIT's consent to arbitrate would not be precluded by operation of the EU Treaties, since there was no conflict between Article 8 of the BIT and Articles 267 and 344 of the TFEU (¶¶ 238 – 248).

### 3.3.2. Subject-matter jurisdiction

The Tribunal stated that the disagreement on whether the Claimants held rights capable of being expropriated and whether Hungary's measures were expropriatory constituted "a legal dispute arising under Article 6" of the BIT, thus falling within the Tribunal's jurisdiction pursuant to Article 8 of the BIT (¶ 281).

## 4. Liability

### 4.1. Claimants' position

The Claimants argued that Hungary's measures were sovereign acts attributable to Hungary, which resulted in the expropriation of the Claimant's leasehold rights (¶ 283), including their contractual and statutory pre-lease rights.

#### 4.1.1. Hungary exercised sovereign powers

The Claimants submitted that the first key act which resulted in the expropriation of the Claimants' statutory pre-lease right was the 2011 Amendment, a legislative Act passed by Parliament and accordingly, a sovereign conduct attributable to Hungary (¶ 284).

Similarly, the Claimants' physical eviction from the Land was carried out by direct participation of the State. The Claimant pointed to several factors which indicated that the NLA was an organ of the state (¶¶ 285 – 286), as well as the fact that Hungary also exercised close control over the NLA (¶ 288). Accordingly, the NLA's conduct was attributable to Hungary. The Claimants further argued that the management of State land was not a commercial activity, pointing to the fact the Respondent itself argued that the NLA's conduct was in line with the State's social policy in the field of agriculture (¶ 289).

#### 4.1.2. Hungary expropriated the contractual pre-lease right

In respect of the contractual pre-lease right, the Claimants requested the Tribunal to discard the Metropolitan Court's decision of 7 December 2017, arguing that it erroneously held that the 2006 Lease Amendment granted no contractual pre-lease right to Inícia (¶ 292). The Claimants argued that the Metropolitan Court's decision did not apply the rule *contra proferentem* set out



in Section 207(2) of the Civil Code to the pre-lease provision in the 2006 Lease Amendment, in which any ambiguity in the provision had to be interpreted against the NLA (§ 294).

The Claimants stated that as they had validly exercised their contractual pre-lease right by a notice of 29 April 2014, this resulted in the conclusion of a new lease agreement. Accordingly, the Respondent's refusal to give effect to this exercise of the Claimants' rights and eventual eviction of the Claimants from the Land constituted an expropriation of the Claimants' contractual pre-lease right and of the new lease that was entered into as a result of the valid exercise of that right (§ 297).

#### *4.1.3. Hungary expropriated the statutory pre-lease right*

Even if the Claimants had no contractual pre-lease right, the Respondent expropriated their statutory pre-lease right by passing the 2011 Amendment which prohibited its exercise in the context of NLA tenders. The pre-lease right that the legislation conferred on lessees of agricultural land was a vested right, guaranteeing legal certainty in order to induce investment. The 2011 Amendment was unconstitutional as it "deprived lessees of their acquired right to renew their leases without appropriate transitory rules or compensation" (§ 298).

#### *4.1.4. Hungary's measures were not a lawful exercise of police powers*

Hungary could not rely on the doctrine of police powers given that the doctrine only applied in the context of regulatory expropriation; a form of indirect expropriation. Here, the Respondent directly expropriated the Claimants' rights, both by removing the leasehold rights and by physically seizing the Land. Additionally, Hungary's measures served none of the grounds justifying the excess of police powers and even if they did, it would not absolve Hungary from the obligation to pay compensation for the expropriation (§§ 300 – 301).

### *4.2. Respondent's position*

#### *4.2.1. The Tenders are irrelevant to the expropriation claim*

The Respondent contended that, as the Lease expired in 2014, the manner in which the Tenders were conducted had no bearing on the alleged expropriation; the Claimants could not seek damages for the expropriation of a lease that it did not hold nor could they claim an unconditional right to win the Tenders (§ 311). In any event, the Respondent rejected the assertion that the Tenders were manipulated (§§ 312 – 313).

#### *4.2.2. Hungary did not expropriate the contractual pre-lease right*

Relying on the decision of the Metropolitan Court in 2017, the Respondent argued that the Claimants had no contractual pre-lease right under the 2006 Lease Amendment (§§ 314 – 316). The Respondent submitted that, as the Claimant was not alleging circumstances akin to denial of justice, the Tribunal could not reopen the ruling; the judgment of the Metropolitan Court must be deemed to carry *res judicate* effects (§§ 316 - 317).

In any event, the Metropolitan Court's interpretation of the relevant provision of the 2006 Lease Amendment was fully tenable (§ 318). Contrary to the Claimants' arguments, the rule *contra proferentem* was not applicable in the present case as the 2006 Lease Amendment was

not a standard term contract nor was the relevant provision in the 2006 Lease Amendment ambiguous (¶¶ 318 – 320).

The Respondent further submitted that, even if the Tribunal were to find that Inícia was entitled to the contractual pre-lease right, the NLA’s refusal to comply with this right would constitute a mere contractual breach rather than an internationally wrongful act (¶ 323).

#### *4.2.3. Hungary did not expropriate the statutory pre-lease right*

The Respondent contended that the statutory pre-lease right was not a vested right under international or Hungarian law; it was a right conferred by general legislation which could change based on policy considerations and bear circumstances (¶¶ 325). The Respondent referred to decisions of investment treaty tribunals, pursuant to which, in the absence of specific measures, the State retains the power to change its laws (¶¶ 326). The present case was not one of direct expropriation as the 2011 Amendment only limited the statutory pre-lease right in connection with tenders organized by the NLA rather than directly remove the right. The Respondent also referred to fact that the Constitutional Court of Hungary held that the statutory pre-lease right was not a vested right and that holders of the right must consider that “the law may change” (¶¶ 327).

#### *4.2.4. Hungary exercised police powers*

The 2011 Amendment was a regulatory measure carried out within the bounds of its police powers (¶¶ 328). The Respondent opposed Claimants’ argument that doctrine of police powers only applies to indirect expropriation on two grounds: First, numerous tribunals have referred to the police powers doctrine when assessing the existence of a direct expropriation; second, the 2011 Amendment was not direct expropriation as it did not remove or invalidate Inícia’s statutory pre-lease right.

The Respondent also disputed the Claimants’ assertion that Hungary’s organs had ulterior motives of political favouritism and xenophobia in respect of land reform (¶¶ 329). The 2011 Amendment, which proscribed the exercise of the pre-lease right in the context of the Tenders, was aimed at implementing Hungary’s general welfare objectives. Moreover, the Respondent argued that the Claimants’ contention of manipulation of the Tenders were unfounded (¶¶ 331). Finally, the Respondent challenged the Claimants’ allegation that Inícia’s eviction did not follow due process; at the time of eviction, the Claimants no longer held possessory title to the land, and the NLA, in its capacity as a landlord, secured eviction following multiple notices to the Claimants to vacate the Land (¶¶ 336).

### *4.3. Tribunal’s analysis*

In its analysis on liability, the Tribunal chose to first review Hungary’s measures in terms of expropriation of the statutory pre-lease right (¶ 339).

#### *4.3.1. Did the 2011 Amendment expropriate the statutory pre-lease right?*

The Tribunal held that at the time of the 2011 Amendment, the Claimants did hold a vested right in the form of the statutory pre-lease right (¶¶ 342). According to the Tribunal, the term expropriation used in Article 6 of the BIT should be interpreted in light of the doctrine of acquired or vested rights as mandated by Article 31(3)(c) of the VCLT (¶¶ 344). The doctrine

stated that where a statute provided for a possibility of acquiring rights with economic value and a private party availed itself of this possibility, subsequent regulatory changes must respect that vested right. Pursuant to *EnCana v. Ecuador*, although a State was free to change its laws, it may be held liable for the expropriation if it retrospectively invalidates these vested rights (¶¶ 345).

The Tribunal agreed with the Claimant's legal expert opinion that the statutory pre-lease right was a vested right as of the conclusion of the Lease (¶¶ 353). Given that enterprises and foreign nationals were barred from owning agricultural land in Hungary, land lease agreements largely fulfilled the same functions as property rights (¶¶ 355). The fact that the exercise of the pre-lease was subject to conditions did not negate its existence or its nature as a vested right (¶¶ 356).

In relation to the 2006 Lease Amendment which provided that the pre-lease right "may be exercised in accordance with the applicable laws effective at all times", the Tribunal stated this language subjected the exercise of the pre-contractual pre-lease right to the applicable law (¶¶ 357 – 358). It had no bearing on the exercise of the statutory pre-lease right, the exercise of which as restricted by the 2011 Amendment. The nature and scope of the statutory pre-lease right had to be assessed by reference to the relevant statute, that is, the 1994 Act, pursuant to which a lessee of a usufructuary lease was entitled to a pre-lease right. It was also immaterial whether the pre-lease right was a right in rem or not (¶¶ 359).

The Tribunal held that, due to the pre-lease right, the lease fulfilled the same functions as ownership in terms of the investor's expectations of legal certainty and stability (¶ 360). Accordingly, the pre-lease right must be deemed to benefit from the protection of uncompensated State interference. A deprivation of already vested pre-lease rights should have been accompanied by compensation even if the State acted with a legitimate public purpose, evenhandedly and with procedural autonomy. Finally, the Tribunal held that a right, albeit a conditional one, to extend a lease agreement has a financial value as the right-holder is in an economically more advantageous position than a lessee without a similar right (¶ 361). The fact that the value of the pre-lease right might be difficult to quantify does not mean that it lacked value.

Therefore, the Tribunal held that the 2011 Amendment resulted in the expropriation of the statutory pre-lease right that Inícia had acquired pursuant to the 1994 Act by entering into the Lease. While Hungary was at liberty to remove or otherwise alter the statutory pre-lease provision contained in the 1994 Act in a prospective manner, such a change should not have applied retrospectively to already vested rights (¶ 362).

Having reached the above conclusion, the Tribunal dispensed with the analysis of whether the Respondent had also expropriated the Claimants' contractual pre-lease right, or whether the right was extinguished as a result of the 2006 Lease Agreement (¶ 363).

#### *4.3.2. Was the 2011 Amendment a non-compensable regulatory measure?*

There were two broad groups of exemptions in which measures annulling the rights of investors, as in the present case, could be exempt from the otherwise applicable duty of compensation (¶ 366). The first group consisted of measures of police powers that aim at enforcing existing regulations against the investor's own wrongdoings, while the second consisted of regulatory measures aimed at abating threats that the investor's activities may pose

to public health, environment or public order. The Tribunal found that the 2011 Amendment did not fall into either of these groups. Accordingly, there was no rationale that would justify exempting Hungary from its duty to pay compensation under Article 6 of the BIT (¶ 367).

#### *4.3.3. Was the expropriation lawful?*

Given that the expropriation of the Claimants' statutory pre-lease right was unlawful for lack of compensation, a finding that the expropriation was unlawful for additional reasons could have only impacted the calculation of damages. (¶ 368). Yet, as the Claimants did not appear to be claiming more than the compensation standard for lawful expropriations under Article 6 of the BIT and were not entitled to more than a normal commercial rate pursuant to Article 6 of the BIT, it made no practical difference whether the expropriation was unlawful for reasons other than lack of compensation (¶¶ 369 – 371). Hence, the Tribunal dispensed with this analysis.

### **5. Quantum**

The parties also disputed the calculation of damages suffered by the Claimants as a result of the Respondent's conduct, with each party relying on their respective valuation expert reports.

#### *5.1. Claimants' position*

The Claimants' valuation expert valued the expropriated leasehold by comparing the actual value of the Farm (without the leasehold rights) with the but-for value of the Farm (with the leasehold rights) (¶ 374). The Claimants' valuation expert took July 2015 as the valuation date, given that this was the time of the physical eviction of the Claimants, and accordingly, when the expropriation crystallized (¶ 375).

In relation to the mitigation of loss, the Claimants argued that the Respondent failed to discharge their burden of proof in demonstrating that there were reasonable and economically feasible alternative actions available to the Claimants (¶ 377). This was because the Claimants had in fact engaged in multiple efforts to continue their farming business in Hungary.

In regard to the interest rates, the Claimants' valuation expert applied 7.87% by reference to the rate of return on capital that the shareholders of Magyar had realized historically and thus could reasonably have expected to enjoy in the future, but for the expropriation (¶ 381). Contrary to the Respondent's criticism, the "normal commercial rate" of interest envisaged in the BIT's expropriation provision was not applicable in the present case, since this was an unlawful expropriation. The Claimants also requested compensation for the costs of the Hungarian court proceedings, pointing to the jurisprudence of investment tribunals, which confirmed that such costs were recoverable under the principle of full compensation (¶ 382).

Thus, the Claimants sought damages in the amount of EUR 17,900,000, plus costs and expenses of the arbitral proceedings, as well as costs and expenses and of the litigation in Hungary in an amount of HUF 57,222,236, together with interest at 7.87% compounded semi-annually (¶ 384).

## *5.2. Respondents' position*

In contrast, the Respondent's valuation expert estimated the range of the Claimants' loss between EUR 3,400,000 and EUR 5,600,000. The Respondent submitted that the standard of compensation should be the "fair market value of the investment expropriated", as envisaged by Article 6(1) of the BIT, and not that of consequential loss, as suggested by the Claimants (¶ 386). The Respondent further submitted that the Claimants failed to mitigate their loss failing to obtain a substitute lease for privately owned land (¶ 389).

The Respondent's valuation expert also disagreed with all three of the Claimants' alternative valuations of the actual value of the Farm for four reasons: (i) the projection of the Farm's future potato production was understated and inconsistent with the Farm's actual performance; (ii) the assumptions of arable farming costs erroneously excluded the portion of State land that Claimants continued to use to grow crops on a "quasi-subletting" basis; (ii) the Claimants' valuation expert did not adequately support his assumptions regarding which costs were fixed costs; and (iii) he erroneously applied an illiquidity discount to the actual value of the Farm (¶ 391).

In relation to the Claimants' alleged costs of litigation in Hungary, the Respondent submitted that such costs were "too remote to be compensable in this arbitration" (¶ 392). Finally, the Respondent argued that the Claimants' proposed interest rate of 7.87% compounded semi-annually was grossly inflated, stating that the historical rate or return is at odds with the BIT's requirement of a "normal commercial rate" (¶ 393).

## *5.3. Tribunal's Analysis*

### *5.3.1. Method of valuation*

The Tribunal began its analysis of the valuation of the loss by selecting the Claimants' secondary valuation as the starting point for the assessment of the Claimants' quantum, given that it used the data available on the date of valuation for both the but-for and the actual scenarios (¶ 407).

### *5.3.2. Contentious points of secondary valuation*

The Tribunal then addressed the Respondent's expert valuation's criticisms of this approach in four respects. First, the Tribunal determined that 5% was an appropriate measure of discount to reflect the increased liquidity risk that the Farm faces in the actual scenario, rejecting the Claimants' 25% discount rate that was unsubstantiated by evidence or relevant valuation authorities (¶¶ 412 – 413). Second, the Tribunal applied the Respondent's suggested discount rate of 9.65% as it was better substantiated than the Claimants' suggested discount rate (¶ 414). Third, the Tribunal dismissed the Respondent's expert valuation's criticism of the secondary valuation in relation to potato production, i.e. the omission from the actual value of the Farm of the value of 3,200 tons of potatoes that the Claimants produced after the eviction on land they managed to sublease from the new lessees (¶¶ 415 – 418). Fourth, the Tribunal agreed with the Respondent that the Claimants' assumption that the potato energy costs would remain fixed in spite of the decrease in production was inappropriate (¶ 419).

Accordingly, the Tribunal reduced the Claimants' secondary valuation of EUR 9,937,495 to EUR 7,148,824, this being the damages amount corresponding to the fair market value of the expropriated investment (¶ 420).

### *5.3.3. Mitigation*

The Tribunal held that the Claimants' mitigation efforts after the date of valuation were not relevant, given that a valuation could not take into account facts that occurred after the valuation date, which a hypothetical buyer could not have considered (¶ 422). The Tribunal also noted that there was ample evidence of the Claimants' multiple efforts to mitigate the consequences of the loss of access to the land (¶ 427). Hence, the Tribunal did not reduce the amount of compensation on the basis of the alleged lack of mitigation (¶ 428).

### *5.3.4. Interest*

The Tribunal opted for a 6-month EURIBOR +2%, compounded semi-annually with interest running from the date of valuation (July 2015) until the date of the payment. This corresponded to the time value of money that would compensate the Claimants for their loss and it also constituted a "normal commercial rate" as envisaged by Article 6 of the BIT (¶ 429 – 432).

## **6. Costs**

The Tribunal ordered the Respondent to reimburse the Claimants for the ICSID and Tribunal costs, the ICSID lodging fee, and the Claimant's legal costs (¶ 438). In relation to the fees and expenses of the local proceedings in Hungary, the Tribunal stated that the Claimant could not recover these costs as the subject matter of those proceedings were not the Claimants' rights under the BIT (¶ 439). The Tribunal also gave post-award interest on costs (¶ 440).