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‘Denial of Justice’ as a Basis for the ICSID Ruling against Hungary

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Introduction

Dan Cake, a Portuguese company and one of the biggest biscuit producers in the world, invested in Hungary by acquiring a Hungarian company’s shares, later named as Danesita. Although Dan Cake had envisaged the expansion of its business to South East Europe too through this investment, after a couple of years, the plan failed as it found Danesita liquidated and its assets sold. From the perspective of the Hungarian Court and the liquidator, on the other hand, nothing unusual has happened as the liquidation of an indebted company was conducted through a procedure in line with the applicable laws.

Dan Cake objected to the Hungarian Court’s procedure and claimed damages, *inter alia*, on the ground that Hungary allegedly breached the fair and equitable treatment standard under the Portugal – Hungary Bilateral Investment Treaty (“**Portugal – Hungary BIT**”) of 1992. Hence the parties submitted their dispute to an ICSID tribunal so as to decide upon the controversy arising out of Dan Cake’s investment in Hungary. Since the Tribunal bifurcated the case, a decision on jurisdiction and liability has been rendered on August 24, 2015 (“**Decision**”). The dispute concerning the quantum will be decided later.

The Facts of the Case

Danesita, a company registered under Hungarian laws which majority of shares was owned by Dan Cake, became indebted towards various creditors in the course of 2006. As a consequence, one of its creditors commenced liquidation proceedings against the company. Since Danesita failed to reply in time or to meet its payment obligations, the Metropolitan Court of Budapest declared Danesita insolvent. Although Danesita settled its debt later and appealed the Court’s order (which was rejected due to formal defects), the order became final and binding on January 18, 2007. This date had an utmost importance since, pursuant to the Hungarian Bankruptcy Act, the liquidator is under the obligation to sell the company’s assets within 120 days from this date.

At this point Danesita had only one option to save its investment: to request the competent Hungarian Court to convene a composition hearing and thus get the deadline for selling the assets postponed. The composition hearing should have served as a forum where Danesita and its creditors could have reached an agreement on the future repayment of the outstanding debts. Accordingly, Danesita filed a request asking the Court to convene a composition hearing. The

Court, however, refused to convene the hearing and ordered supplementary filings on April 22, 2008 (“**Rejection Order**”). Dan Cake did not file the required documents and, as a consequence, the liquidator sold the assets. As a result, Dan Cake’s investment in Hungary reached its end. The question was whether such a conduct by the Hungarian Court breached the Portugal – Hungary BIT.

The ICSID Tribunal’s Decision

The Tribunal decided that Hungary (and not the liquidator!) has breached the Portugal – Hungary BIT’s fair and equitable treatment provision (Art. 3.1) in the form of denial of justice, and the obligation not to impair the use, enjoyment, management, disposal, or liquidation of the investment by unfair or discriminatory measures (Art. 3.2).

The Metropolitan Court of Budapest, despite Danesita’s specific request, did not convene the composition hearing and thus denied any possibility from Danesita to reach an agreement with its creditors (keeping in mind that after the assets are sold such an agreement obviously cannot take place).

It is important to note that even the convening of a composition hearing *per se* would have interrupted the passage of the 120 day time limit, irrespective of whether the composition hearing would have succeeded. Therefore, the heart of the controversy revolved around the lawfulness of the Court’s Rejection Order.

The Rationale of the Decision

These were primary considerations that led the Tribunal to reach its ultimate findings:

1. Danesita did not have an agreement with its creditors at the time it filed the request for the composition hearing. However, as the Tribunal pointed out, such an agreement is not a prerequisite for the hearing.
2. According to the Court, it denied to convene the composition hearing because some information and documents necessary for the success of the hearing were missing. For this reason, the Court required supplementary filings. The Tribunal determined the following in this regard: (i) The debtor has the *right* to get the hearing convened, irrespective of its possible success. (ii) Due to the required filings it was impossible to hold a hearing within the remaining time left of the 120 days. (iii) Though it was reasonable to expect some of the additional documents in the hearing, it does not mean that it is reasonable to demand them to be filed in advance. (iv) Although the Court had the right to demand further necessary filings, those at hand were “*obviously unnecessary*” [Decision, para 117] and some of them defeated common sense [Decision, par. 119] (e.g., the company registry extract of the foreign shareholders).
3. At the same time the Court invited Danesita to file supplementary documents, it delivered the order to the liquidator as well. The order included the Court’s reminder in one paragraph that the liquidator should sell the assets within 120 days. As the Tribunal pointed out, it was impossible to tell whether it was the intention of the Court to instruct the liquidator. However, in any case, the *effect* of this was that the liquidator sold the assets. Therefore the Court actually compelled the liquidator to sell the company’s assets after the 120 day time limit was up.
4. Hungary claimed that the liquidator’s actions were not attributable to Hungary. However, the Tribunal pointed out that it was Hungary and not the liquidator who breached the Portugal – Hungary BIT. Therefore the question, whether the liquidator, by selling the assets, acted on

behalf of the State (as state agent) is without any relevance in the current case.

5. Danesita exhausted all local remedies, since it was not possible for Danesita to appeal against the Rejection Order.
6. Although Dan Cake had a pending objection, i.e. the liquidator wrongfully assessed the creditors' claims as late filed, it would not amount to an obstacle to the approval of a composition hearing.

It is very rare that ICSID tribunals base their decision on denial of justice, since it is an international standard that is very hard to prove by the foreign investor. Denial of justice occurs if a state organ conduct amounts to an act which shows such prejudice that "*would shock the conscience of the outside word*" [M. Sornarajah, *The International Law on Foreign Investment*, Cambridge University Press, 2010., p. 357]. In this case, the Tribunal found that Hungary denied justice to its foreign investor: Whatever the outcome of the composition hearing would have been, it was destroyed by the fact that the hearing had not been convened at all. The required supplementary filings "*coupled with the reminder of the liquidator's obligation to proceed with the sale of Danesita's assets, is in the Tribunal's considered view a manifest sign that the Court simply did not want, for whatever reason, to do what was mandatory*" [Decision, para. 142].

Conclusion

Although the Tribunal's reasoning is clear and consistent, one might have the feeling that one of the core issues have remained untouched: It is an interesting aspect of the case that Dan Cake initially claimed that the Portugal –Hungary BIT's fair and equitable treatment provision was breached due to the fact that the Hungarian bankruptcy and insolvency legislation was not compatible with the required international standards. Therefore, as Dan Cake claimed, the breach stemmed from the domestic law *per se*, and not from the conduct of the Court. However, in the later phase of the proceedings, Dan Cake abandoned this idea and primarily claimed that it the Metropolitan Court of Budapest committed the breach. The Tribunal thus would have moved to the scrutiny of the Hungarian legislation only if the Court had not breached the domestic law in the first place.

Whereas the defendant argued that the Hungarian Court did not do anything but followed the applicable law, the Tribunal's analysis as to the appropriateness of the Hungarian bankruptcy and insolvency legislation would have been very revealing. Anyway, since the Tribunal did not reach this point, the relevant Hungarian legislation's conformity with the international standards still remains as an open question. However, the Tribunal would have settled the issue on a solid basis if it had not examined only whether the Court's conduct was in accordance with the law, but whether the underlying law itself was in compliance with the BIT's fair and equitable standard.

Either way, one thing is certain: Since the decision is based on the very rarely (successfully) invoked legal ground of *denial of justice* on one hand, and since it will not be without considerable affect on numerous domestic insolvency cases on a day-by-day basis on the other, we can be certain that this decision will be subject to extensive legal debate among scholars and practitioners both at a domestic and international level in the upcoming years.

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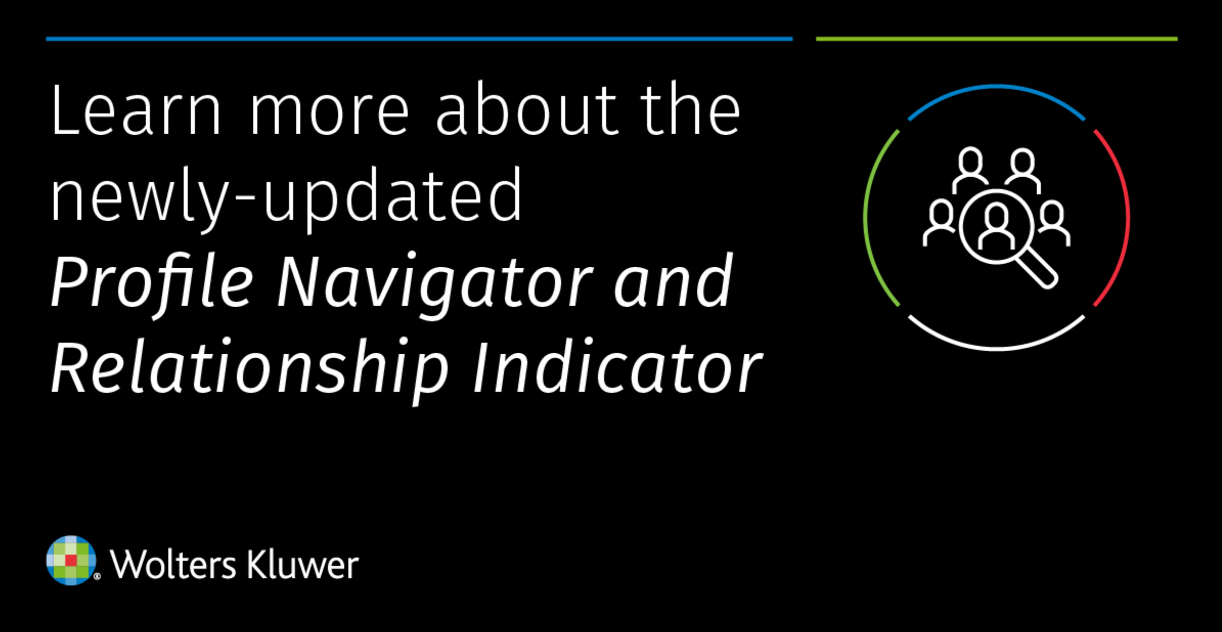

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