When International Investment Arbitration meets Insolvency

António Andrade de Matos and Jorge Bastos Leitão report on the landmark case of Dan Cake S.A. v. Hungary (ICSID Case no. ARB/12/9)

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Dan Cake S.A. is a Portuguese company whose scope of activity is the manufacturing of cakes, cookies, biscuits and toasts. It was incorporated in Portugal in 1979. In 1996 it acquired a capital participation in a Hungarian company that was later renamed Danesita, whose scope was also the manufacturing of cakes, cookies, biscuits and toasts for Eastern European countries.

Danesita pursued its activity until 2007, when it was declared insolvent by a final and binding decision from the High Court of Appeal of Budapest. The Court appointed a liquidator to deal with Danesita's insolvency and the decision was published in the Official Gazette.

Faced with this decision, Dan Cake S.A. pursued then the only available option under Hungarian law in order to avoid the sale of Danesita's assets and hence the liquidation of the company: requesting a composition agreement with Danesita's creditors[1] because in Hungary this is the only available option for this purpose.

A composition agreement first needs a hearing to take place where the creditors will vote the agreement prepared by the debtor company trying to restore its solvency. If the Court considers that the provisions of the Hungarian Bankruptcy Act (HBA) have been complied with, it sanctions the composition agreement.

In order to have a composition hearing convened the debtor shall request the Court to order it. The debtor's request shall be accompanied by: (i) a plan to restore solvency, (ii) a composition proposal and (iii) the list of creditors. The Judge shall then convene a hearing within 60 days following the receipt of the request.[2]

However, as further discussed below, upon receiving the request for a composition hearing[3] the Metropolitan Court of Budapest ("Court") rendered on April 22, 2008 a decision which refused the request. At the same time the Court strongly recommended that the liquidator should proceed with the sale of Danesita's assets. As a result, the liquidator launched a second tender and ultimately the assets were sold. The decision of the Metropolitan Court of Budapest was not appealable.

Thus, finally, Dan Cake S.A. started arbitration proceedings before the International Centre for the Settlement of Investment Disputes ("ICSID") in 2012, according to the Bilateral Investment Treaty between Portugal and Hungary.

Dan Cake S.A. claimed that its investment in Danesita was lost due to the arbitrary and discriminatory measures ordered by the Metropolitan Court of Budapest in the course of Danesita's liquidation. It also claimed that the decision of the Metropolitan Court of Budapest not to convene a composition hearing was a denial of justice. Lastly, Dan Cake S.A. took the view that the acts of the liquidator were attributable to Hungary.

On August 24, 2015, the ICSID Tribunal, composed of Professor Pierre Mayer (Chair), Professor Jan Paulsson and Toby Landau QC, delivered a decision on jurisdiction and liability whereby the Tribunal unanimously held that Hungary:

> *"- has breached its obligation to ensure that Dan Cake's investment be accorded fair and equitable treatment;*
> *- has breached its obligation not to impair by unfair measures the liquidation of Dan Cake's investment."*

The liquidation procedure

As seen above, pursuant to the HBA provisions, once a company faces liquidation proceedings the only available option to avoid the sale of the assets and hence the demise of the company as a legal entity is to reach a composition agreement. However, in order to reach a composition agreement a debtor needs the Court to convene a composition hearing[4].

Dan Cake S.A. did request that the Metropolitan Court of Budapest convene a composition hearing and the request was accompanied by all the relevant documents prescribed by law. As stated in its request, the prompt convening of a hearing was the only way to safeguard Dan Cake's investment in Danesita, but the Court declined to convene the hearing. On April 22, 2008 the Court served a decision ("Decision") on Dan Cake's Counsel whereby it demanded Danesita to make several supplementary filings, none of which was imposed by law and most of which were unnecessary for the purposes of convening a composition hearing, while some others were simply impossible to comply with.

Additionally, by the same

Decision, the Court strongly recommended that the liquidator was duty-bound to proceed with the sale of the assets and took care to serve it to the liquidator. As a result, the liquidator, soon thereafter, proceeded with the second sale tender which led to the sale of Danesita's assets.

In the Tribunal's view "*the accumulation of seven unjustified obstacles, coupled with the reminder of the liquidator's obligation to proceed with the sale of the assets*"[5] was "*a manifest sign that the Court simply did not want, for whatever reason, to do what was mandatory.*"

Therefore the Tribunal concluded that indeed "*the violation of the obligation to treat the investor in a fair and equitable manner took the form of a denial of justice*"[6]. Quoting some similar cases of denial of justice, such as Robert Azinian v. Mexico, Mondev International v. USA, Loewen v. USA and Elettronica Sicula v. Italy the Tribunal found that "*[T]he decision of the Metropolitan Court of Budapest does shock a sense of legal propriety.*"

Notably, notwithstanding that this was a first instance's decision, the fact that no appeal against such Decision was available decision led the Tribunal to treat the breakdown as "*systemic*"[7].

In the authors' view this landmark decision stands as one of the most relevant decisions adopted by an ICSID Tribunal in recent years. Not only did the Tribunal find that a State has denied justice to an international investor as it also determines that the violation of the fair and equitable treatment took place in the course of a liquidation proceeding, which makes this a singular case. This decision sheds some light in the understanding regarding denial of justice in international law as it also inevitably establishes a higher threshold for national judges and legislation when dealing with the liquidation of investments made by international investors. ■

Footnotes:

1 Section 44 of the Hungarian Bankruptcy Act ("HBA") at the time read as follows: "a composition agreement shall be deemed valid upon the consent of at least half of the creditors with proper entitlement to conclude a composition agreement in all groups, provided that their claims account for two-thirds of the total claims of those entitled to conclude the composition agreement".
2 Section 41(5) of the HBA.
3 Such request was filed before the Court on April 11, 2008.
4 Unlike bankruptcy proceedings, whereby the debtor prepares an agreement to restore solvency and the creditors vote it in a meeting and not before the judge. The only intervention of the Court is the approval by decree of the agreement made by the debtor and its creditors as long as such an agreement complies with the provision of the HBA (cf. section 18-21 in force at the time).
5 § 142.
6 § 146.
7 § 154.

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