

INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES

In the matter of the arbitration between

**AES SUMMIT GENERATION LIMITED
AES-TISZA ERŐMŰ KFT**

(Claimants)

- and -

THE REPUBLIC OF HUNGARY

(Respondent)

(ICSID Case No. ARB/07/22)

AWARD

Members of the Tribunal

Mr. Claus Werner von Wobeser, President
Prof. Brigitte Stern, Arbitrator
J. William Rowley QC, Arbitrator

Secretary of the Tribunal

Ms. Frauke Nitschke

Date of Dispatch to the Parties

September 23, 2010

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1. ABBREVIATIONS AND DEFINED TERMS

- 1.1 **1994 Electricity Act** - Act XLVIII of 1994 on the Generation, Supply and Provision of Electricity.
- 1.2 **1995 Framework Decree** - GKM Decree 63/1995 (XI.24.) on the regulation of prices of electricity and hot water and steam sold by public utility electricity units and their heat generating installations.
- 1.3 **2000 Framework Decree** - GM Decree 45/2000 (XII. 24.) on the regulation of prices of electricity and hot water and steam sold by public utility electricity units and their heat generating installations.
- 1.4 **2000 PSA Claim** - The arbitration commenced by the AES Corporation (the ultimate parent company of the Claimants) and AES Summit against APV and MVM in October 2000 for breach of the PSA.
- 1.5 **2000 Treaty Claim** - The arbitration commenced by AES Summit against Hungary in November 2000 under the ECT and also under the Agreement Between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the People's Republic of Hungary for the Promotion and Reciprocal Protection of Investments.
- 1.6 **2001 Amendment Agreement** - The agreement dated 19 December 2001 made between AES Tisza and MVM which amended and extended the original PPA as required by the 2001 Settlement Agreement.
- 1.7 **2001 Electricity Act** - Act CX of 2001 on Electricity.
- 1.8 **2001 PPA** - The Original PPA as amended by the 2001 Amendment Agreement.
- 1.9 **2001 Settlement Agreement** - The agreement settling, amongst other things, the 2000 PSA Claim and the 2000 Treaty Claim, dated 19 December 2001.

- 1.10 **2006 Electricity Act Amendment** - The amendment to the 2001 Electricity made by the Hungarian parliament on 6 February 2006, coming into force on 3 March 2006.
- 1.11 **2006 Price Decree** - Decree GKM No. 80/2006 (XI.24.) issued by GKM on 24 November 2006.
- 1.12 **2007 Price Decree** - Decree GKM No. 14/2007 (I.26.) issued by GKM on 26 January 2007.
- 1.13 **2007 Electricity Act** - Act LXXXVI of 2007 on Electricity.
- 1.14 **AES Corp** - AES Corporation, the ultimate parent company of the company of the Claimants.
- 1.15 **AES Summit** - AES Summit Generation Limited, the First Claimant.
- 1.16 **AES Tisza** - AES – Tisza Erömu Kft, the Second Claimant.
- 1.17 **Amendment Agreement** - The agreement between MVM and all generators and electricity suppliers, amending the terms of the Original PPA, dated 18 December 1995, during the privatization process.
- 1.18 **ÁPV** - Állami Privatizációs és Vagyonkezelő Részvénytársaság (since 8 February 2006 Állami Privatizációs es Vagyonkezelő Zártkörűen Működő Részvénytársaság).
- 1.19 **Availability Fee (Sometimes, Capacity Fee)** - As defined in the 2001 PPA.
- 1.20 **Borsod Project** - The construction of a new power plant at Borsod.
- 1.21 **Centre** - The International Centre for Settlement of Investment Disputes.
- 1.22 **Claimants** - AES Summit and AES Tisza.
- 1.23 **Commission** - The Commission of the European Communities.

- 1.24 **Community competition law** - The body of laws of the European Community regarding competition.
- 1.25 **Community law** - The law of the European Community.
- 1.26 **Community State Aid Rules** - The body of rules of the European Community regarding state aid.
- 1.27 **Convention** - The Convention on the Settlement of Investment Disputes between States and Nationals of Other States.
- 1.28 **Development Projects** - The Borsod Project and the Tisza II Retrofit.
- 1.29 **DG Comp.** - The Competition Directorate General of the European Commission.
- 1.30 **ECT** - The Energy Charter Treaty.
- 1.31 **EC** - The European Community.
- 1.32 **Eeckhout Report** - The Expert Report dated 30 October 2008 of Professor Piet Eeckhout.
- 1.33 **Energy Fee** - As defined in the 2001 PPA.
- 1.34 **Facilities Agreement** - The €98 million project finance loan facilities agreement dated 20 December 2002.
- 1.35 **Fazekas Report** - The Expert Report dated 7 July 2008 of Dr. Mariana Fazekas.
- 1.36 **FIDESZ** - The Conservative Party in Hungary.
- 1.37 **First Horrocks Statement** - The First Witness Statement dated 6 March 2008 of Andrew Joseph Horrocks.
- 1.38 **GKM** - The Hungarian Ministry of Economy and Transport.
- 1.39 **HEO** - The Hungarian Energy Office.

- 1.40 **Hungary** - The Republic of Hungary.
- 1.41 **ICSID** - The International Centre for Settlement of Investment Disputes.
- 1.42 **Lithgow Statement** - The Witness Statement dated 7 March 2008 of Peter Lithgow.
- 1.43 **MVM** - Magyar Villamos Művek Részvénytársaság (since 21 October 2005 Magyar Villamos Művek Zártkörűen Működő Részvénytársaság) and its wholly owned subsidiaries, including MVM Trader.
- 1.44 **Navigant Report** - The Expert Report dated 11 July 2008 of Mr. Brent C. Kaczmarek, CFA of Navigant Consulting, Inc.
- 1.45 **Original Tisza II PPA** - The Tisza II power purchase agreement dated 10 October 1995.
- 1.46 **Petersen Report** - The Expert Report dated 30 October 2008 of Mr. Asger Petersen.
- 1.47 **Price Act** - LXXXVII of 1990 on the determination of prices.
- 1.48 **Price Decrees** - The 2006 Price Decree and the 2007 Price Decree.
- 1.49 **PSA** - Purchase and Sale Agreement between MVM, ÁPV, AES Summit and the AES Corporation as guarantor, dated 4 July 1996.
- 1.50 **Request** - The Request for Arbitration dated 6 July 2007.
- 1.51 **Respondent** - The Republic of Hungary.
- 1.52 **Salzburg Report** - Expert Opinions of Professor Thomas Eilmansberger, Thomas Jaeger Mag., LL.M, and Peter Thyri Mag., LL.M on the Compatibility of Hungarian System of Long-term Capacity and Power Purchase Agreement with EU Energy and Competition Law dated 23 November 2004.
- 1.53 **SAMO** - State Aid Monitoring Office of the Ministry of Finance.

- 1.54 **Second Horrocks' Statement** - The Second Witness Statement dated 31 October 2008 of Andrew Joseph Horrocks.
- 1.55 **Second LECG Report** - The Second Expert Report dated 31 October 2008 of Dr. Manuel A. Abdala and Professor Pablo T. Spiller of LECG LLC.
- 1.56 **Slot Report** - The Expert Report dated 4 July 2008 of Professor Piet Jan Slot.
- 1.57 **State Aid Decision** - The Commission's decision on the state aid awarded by Hungary through Power Purchase Agreements adopted 4 June 2008.
- 1.58 **Stranded Costs Decree** - GKM Decree 183/2002 implementing the two solutions mandated by the 2001 Electricity Act, allowing consumers above a certain consumption threshold to choose their suppliers freely and go out to the liberalized part of the market.
- 1.59 **Tisza II Retrofit** - Part of the "Development Project," a defined term in the PSA: Describes a major retrofit of all four units at the Tisza II power station.
- 1.60 **Varga Report** - The Expert Report of Dr. István Varga dated 30 October 2008.
- 1.61 **Vienna Convention** - The Vienna Convention on the Law of Treaties of 1969.
- 1.62 **WACC** - The Weighted Average Cost of Capital.

2. THE PARTIES AND THEIR REPRESENTATIVES

2.1 Claimants

2.1.1 The Claimants in this arbitration are AES Summit Generation Limited ("AES Summit") and AES-Tisza Erömu Kft. ("AES Tisza").

2.1.2 AES Summit, the first Claimant, is a company incorporated under the laws of the United Kingdom ("UK"). AES Tisza, the second Claimant, is a company incorporated under the

laws of the Republic of Hungary. AES Summit owns 99% of, and exercises ownership and control over, AES Tisza.

2.1.3 AES Summit and AES Tisza (the “Claimants”) are represented in this proceeding by Stephen Jagusch, Richard Farnhill, Jeffrey Sullivan, Sophie Minoprio, Orsolya Toth and Alex Hiendl of Allen & Overy, London, and Dr. Csaba Polgár of Polgár & Bebók Law Office, Budapest.

2.2 Respondent

2.2.1 The Respondent in this arbitration is the Republic of Hungary (“Hungary” or “the Respondent”). Hungary is an Eastern European country, which entered into the European Union in the year 2004.

2.2.2 Hungary is represented in this arbitration by Jean Kalicki, Luc Gyselen, Dmitri Evseev, Alessando Maggi, Suzana Medeiros Blades, and Clara Vondrich of Arnold & Porter, Washington and Brussels offices, and Dr. János Katona of the Law Office of Dr. János Katona, Budapest.

3. THE TRIBUNAL AND THE PROCEDURE

3.1 On 9 July 2007, the International Centre for Settlement of Investment Disputes (“ICSID” or the “Centre”) received a Request for Arbitration (“Request for Arbitration” or the “Request”) of the same date from AES Summit Generation Limited, a company incorporated under the laws of the United Kingdom, and AES-Tisza Erömö Kft., a company incorporated under the laws of the Republic of Hungary, against the Republic of Hungary.

3.2 In the Request, the Claimants invoke the ICSID arbitration provision contained in Article 26 of the 1994 Energy Charter Treaty (the “ECT” or the “Treaty”).

3.3 In accordance with Rule 5 of the ICSID Rules of Procedure for the Institution of Conciliation and Arbitration Proceedings (the “ICSID Institution Rules”), the Centre acknowledged receipt of the Request on 9 July 2007, and on the same day transmitted a copy of the Request to the Respondent and counsel for the Respondent.

3.4 The Request for Arbitration was registered by the ICSID Secretary-General on 13 August 2007, pursuant to Article 36(3) of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the “ICSID Convention” or “Washington Convention”) and, on the same day, the Secretary-General, in accordance with ICSID Institution Rule 7, notified the parties of the registration and invited them to proceed to the constitution of an Arbitral Tribunal as soon as possible.

3.5 On 12 September 2007, the parties agreed in accordance with Rule 2 of the ICSID Rules of Procedure for Arbitration Proceedings (the “ICSID Arbitration Rules”) on the method of constitution of the Arbitral Tribunal, providing for an Arbitral Tribunal consisting of three arbitrators, one arbitrator appointed by each party (by 12 September 2007, and 12 October 2007, respectively), and the third, presiding, arbitrator to be appointed by the party-appointed arbitrators by 12 November 2007. In the event that the two party-appointed arbitrators were unable to reach agreement within the agreed time period, the presiding arbitrator was to be appointed by the ICSID Secretary-General.

3.6 By letter of the same date, *i.e.*, 12 September 2007, the Claimants appointed J. William Rowley QC, a national of Canada, as arbitrator. Mr. Rowley accepted his appointment on 14 September 2007.

3.7 By letter of 12 October 2007, the Respondent appointed Professor Brigitte Stern, a French national, as arbitrator. Professor Stern accepted her appointment on 16 October 2007.

3.8 In accordance with the parties' agreement, the two party-appointed arbitrators appointed, on 5 November 2007, Claus von Wobeser, a national of Mexico, as the President of the Tribunal. By letter of 14 November 2007, Mr. Wobeser accepted his appointment.

3.9 By letter of 21 November 2007, the ICSID Acting Secretary-General informed the parties that all arbitrators had accepted their appointments and that the Tribunal was deemed to have been constituted and the proceeding to have begun on that date, pursuant to Rule 6(1) of the ICSID Arbitration Rules. On the same day, Mr. Ucheora Onwuamaegbu was appointed Secretary of the Tribunal. Later, on 26 January 2010, Mr. Ucheora Onwuamaegbu was replaced as Secretary of the Tribunal by Ms. Frauke Nitschke.

3.10 By letters of 29 November 2007 and 3 December 2007, the Centre requested each party to make an initial advance payment to defray the cost of the proceeding in its first three to six months. The Claimants' share was received on 12 December 2007, and the Respondent's payment was received on 28 December 2007. An additional advance payment was requested from the parties by letter of 14 January 2009. Payment from the Respondent was received on 11 February 2009 and the Claimants' share was received on 13 February 2009. A further advance payment was requested from the parties by letter of 12 February 2010. The Claimants' share was

received on 23 February 2010. Payment from the Respondent was received on 5 April 2010. A final advance payment was requested from the parties on 3 June 2010. Payment from the Claimants was received on 28 June 2010, and the Respondent's share was received on 31 August 2010.

3.11 Following an agreement between the parties and the Tribunal to hold the first session in this proceeding on 9 January 2008, the parties submitted, under cover of a letter of 19 December 2007, a joint statement concerning the items of the draft agenda for the first session, which was earlier circulated by the Secretary of the Tribunal.

3.12 By agreement of the parties, the first session was held on 9 January 2008, in London. Present at the session were: Mr. Claus von Wobeser, President of the Tribunal, Mr. J. William Rowley QC, Arbitrator, and Professor Brigitte Stern, Arbitrator. Attending on behalf of the Claimants: Mr. Stephen Jagusch, Mr. Jeffrey Sullivan, and Ms. Caroline Bordas of Allen & Overy, and Mr. Benedek Sipocz of AES-Tisza Erőmű Kft. Attending on behalf of the Respondent: Ms. Jean E. Kalicki and Mr. Dmitri Evseev of Arnold & Porter, Dr. János Katona of the Law Offices of János Katona, Budapest, and Mr. Peter Gordos, Head of the Energy Department at the Ministry of Economy, Republic of Hungary. The Secretary of the Tribunal, Mr. Ucheora Onwuamaegbu, attended by video-conference from Washington, D.C.

3.13 At the first session, the parties' agreement regarding the procedural calendar was noted. Pursuant to this agreement, the following calendar was established for the further written and oral procedure:

- (a) Claimants' Memorial (together with supporting documents, witness statements and expert reports) by 7 March 2008;

- (b) Respondent's Counter-Memorial (together with supporting documents, witness statements and expert reports) by 11 July 2008;
- (c) Claimants' Reply to Respondent's Counter-Memorial, (together with reply witness statements and supplementary expert reports) by 10 October 2008;
- (d) Respondent's Rejoinder to Claimants' Reply, (together with reply witness statements and supplementary expert reports) by 9 January 2009; and
- (e) Hearing on the merits to be held from 9 to 13 March 2009.

3.14 In accordance with the procedural calendar agreed at the first session, the Claimants' Memorial on the merits was filed on 7 March 2008.

3.15 By letter of 17 April 2008, the Respondent filed a request for production of documents before the Tribunal, to which the Claimants objected by letter of 18 April 2008. By letter of 21 April 2008, the Respondent filed observations on the Claimants' objection of 18 April 2008. On 6 May 2008, the Tribunal issued Procedural Order No. 1, on the Respondent's request for production of documents.

3.16 By letter of 19 May 2008, the Respondent filed a further request for production of documents. The Claimants filed observations on this request by letter of 21 May 2008. By letter of 22 May 2008, the Respondent filed a response to the Claimants' observations. On 9 June 2008, the Tribunal issued Procedural Order No. 2, on the Respondent's further request for production of documents.

3.17 On 11 July 2008, the Respondent filed its Counter-Memorial on the merits, which was supplemented by a letter of 23 July 2008.

3.18 Under cover of a letter of 3 September 2008, the office of the Acting Director-General, Legal Service, of the European Commission, filed an application under ICSID Arbitration Rule 37 as a non-disputing party. By letter of 18 September 2008, the Tribunal requested the European Commission to clarify certain aspects of its application. On 3 October 2008, the European Commission filed a response to the Tribunal's request, which was transmitted to the parties the same day, with an invitation from the Tribunal to comment on the European Commission's application by 24 October 2008.

3.19 By letter of 18 September 2008, the parties agreed to amend the procedural calendar for the written procedure, providing for the Claimants to file their Reply on the merits by 31 October 2008, and the Respondent its Rejoinder by 13 February 2009.

3.20 By respective letters of 22 October 2009, each side filed observations on the European Commission's application of 3 September 2008, as supplemented by its letter of 3 October 2008.

3.21 In accordance with the amended procedural calendar, the Claimants filed the Reply on the merits on 31 October 2008. This was followed on 25 November 2008, by a correction to the Reply.

3.22 On 26 November 2008, the Tribunal issued Procedural Order No. 3 concerning the European Commission's application to file a written submission pursuant to ICSID Arbitration Rule 37(2). In its Order, the Tribunal allowed the European Commission to file a submission pursuant to ICSID Arbitration Rule 37, within certain prescribed limits, by 15 January 2009. The Tribunal further denied the European Commission's request for copies of the parties' written submissions in light of the fact that the parties had not reached an agreement on this issue.

3.23 By letter of 1 August 2008, the Claimants filed a request for production of documents, and also filed a renewed request for production of documents on 6 October 2008. Following several rounds of observations by both parties on the Claimants' requests, the Tribunal issued, on 22 December 2008, and 5 January 2009, Procedural Order Nos. 4 and 5 concerning production of documents.

3.24 By letter of 7 January 2009, the Claimants filed a further request for production of documents. Having considered several written observations on this request from both parties, the Tribunal issued, on 13 January 2009, Procedural Order No. 6 concerning the Claimants' requests for production of documents.

3.25 Under cover of a letter of 15 January 2009, the European Commission filed a written submission pursuant to ICSID Arbitration Rule 37, in accordance with the Tribunal's Procedural Order No. 3.

3.26 By letter of 26 January 2009, the Claimants filed a further request for production of documents. Following several rounds of communication by the parties on this request, the Tribunal issued, on 4 February 2009, Procedural Order No. 7 concerning the Claimants' request for production of documents.

3.27 On 13 February 2009, each party filed observations on the written submission by the European Commission of 15 January 2009. On the same day, the Respondent filed its Rejoinder on the merits.

3.28 In accordance with the procedural calendar agreed at the first session, the hearing on the merits was held from 9 to 13 March 2009 in Washington, D.C. At the hearing, both sides

presented oral arguments on the merits of the dispute, and provided witness and expert testimony.

3.29 Following an application by the Claimants, the Tribunal ordered the Respondent during the hearing, on 11 March 2009, to produce certain documents. The Tribunal further specified that certain portions of these documents could be redacted by the Respondent. However, it was agreed by the parties and the Tribunal that any disagreement between the parties on any redactions proposed by the Respondent would be submitted to the Secretary of the Tribunal for decision, without recourse to the Tribunal. Following a number of written exchanges between the parties regarding proposed redactions by the Respondent, the parties invited the Secretary's decision.

3.30 On 27 March 2009, pursuant to the Tribunal's document request during the hearing, the parties jointly filed post-hearing bundles. The parties also exchanged correspondence on the suspense file produced at the hearing. Consequently, further documents were introduced into the suspense file following the hearing.

3.31 On 3 April 2009, the Secretary of the Tribunal issued his decision on the Respondent's proposed redactions to certain documents.

3.32 On 20 April 2009, the Respondent filed a request for the admissibility of new evidence. Following several communications by the parties, the Tribunal issued, on 13 May 2009, Procedural Order No. 8 concerning the admissibility of new evidence and the further procedural calendar.

3.33 On 29 May 2009, the parties filed post-hearing briefs, in accordance with the procedural calendar set forth by the Tribunal in its Procedural Order No. 8.

3.34 Under cover of a letter of 4 June 2009, the Claimants requested to file a further post-hearing submission. The Respondent filed observations on this request by letter of 5 June 2009, which Claimants replied to by letter of 9 June 2009. The Tribunal, having considered the parties' submissions, denied the Claimants' request on 3 September 2009.

3.35 On 24 December 2009, the Claimants filed a request for the admissibility of new evidence. Following several rounds of communications by the parties on this request, the Tribunal issued, on 4 February 2010, Procedural Order No. 9 concerning the admissibility of new evidence.

3.36 On 4 June 2010, the Tribunal declared the proceeding closed pursuant to ICSID Arbitration Rule 38(1).

3.37 By letter of 25 June 2010, the Respondent filed its final Statement of Costs incurred in the proceeding, which amounted to a total cost of US\$ 5,522,883.

3.38 On 8 July 2010, the Claimants filed their final Statement of Costs, which amounted to a total cost of US\$ 8,787,993.70

3.39 The Members of the Tribunal deliberated by various means of communication, including meetings in Washington, D.C. on 13 March 2009 and in New York on 1 September 2009.

4. FACTUAL BACKGROUND

4.1 This arbitration arises from an alleged violation by Respondent of Articles 10(1), 10(7) and 13 of the 1994 Energy Charter Treaty (the “ECT” or the “Treaty”).¹ Claimants argue that an act of the Republic of Hungary, which was the reintroduction in 2006 and 2007 of administrative

¹ Article 10(1) and 10(7), and Article 13 of the ECT read as follows:

Article 10(1) Each Contracting Party shall, in accordance with the provisions of this Treaty, encourage and create stable, equitable, favourable and transparent conditions for Investors of other Contracting Parties to make Investments in its Area. Such conditions shall include a commitment to accord at all times to Investments of Investors of other Contracting Parties fair and equitable treatment. Such Investments shall also enjoy the most constant protection and security and no Contracting Party shall in any way impair by unreasonable or discriminatory measures their management, maintenance, use, enjoyment or disposal. In no case shall such Investments be accorded treatment less favourable than that required by international law, including treaty obligations. Each Contracting Party shall observe any obligations it has entered into with an Investor or an Investment of an Investor of any other Contracting Party.

Article 10(7) Each Contracting Party shall accord to Investments in its Area of Investors of other Contracting Parties, and their related activities including management, maintenance, use, enjoyment or disposal, treatment no less favourable than that which it accords to Investments of its own Investors or of the Investors of any other Contracting Party or any third state and their related activities including management, maintenance, use, enjoyment or disposal, whichever is the most favourable.

Article 13(1) Investments of Investors of a Contracting Party in the Area of any other Contracting Party shall not be nationalized, expropriated or subjected to a measure or measures having effect equivalent to nationalization or expropriation (hereinafter referred to as “Expropriation”) except where such Expropriation is:

- (a) for a purpose which is in the public interest;
- (b) not discriminatory;
- (c) carried out under due process of law; and
- (d) accompanied by the payment of prompt, adequate and effective compensation.

Such compensation shall amount to the fair market value of the Investment expropriated at the time immediately before the Expropriation or impending Expropriation became known in such a way as to affect the value of the Investment (hereinafter referred to as the “Valuation Date”).

Such fair market value shall at the request of the Investor be expressed in a Freely Convertible Currency on the basis of the market rate of exchange existing for that currency on the Valuation Date. Compensation shall also include interest at a commercial rate established on a market basis from the date of Expropriation until the date of payment.

Article 13(2) The Investor affected shall have a right to prompt review, under the law of the Contracting Party making the Expropriation, by a judicial or other competent and independent authority of that Contracting Party, of its case, of the valuation of its Investment, and of the payment of compensation, in accordance with the principles set out in paragraph (1).

Article 13(3) For the avoidance of doubt, Expropriation shall include situations where a Contracting Party expropriates the assets of a company or enterprise in its Area in which an Investor of any other Contracting Party has an Investment, including through the ownership of shares.

pricing pursuant to two Price Decrees, after administrative prices had been abolished as of 1 January 2004, violated their rights under the ECT.

4.2 In 1995, Hungary announced an energy sector privatization as part of a modernization strategy, which included the privatization of certain state-owned power stations.

4.3 On 4 July 1996, a Purchase and Sale Agreement (“PSA”)² was signed between, on the one hand, two Hungarian state-owned entities, ÁPV and MVM, and on the other hand, AES Summit, pursuant to which AES Summit purchased a majority shareholding in the company Tiszai Erőmű Részvénytársaság (now called AES Tisza – the second Claimant in this arbitration). The assets of AES Tisza included a power station known as Tisza II as well as two older coal-fired power stations, known as the Borsod power station and the Tiszapalkonya power station. The investment made by AES Summit was approximately US\$ 130 million.

4.4 As a result of the PSA, Hungary was obliged to amend and extend the term of the existing power purchase agreement with Tisza II – which had been signed on 10 October 1995 (“Original Tisza II PPA”)³ – and to enter into a new long-term power purchase agreement for the Borsod power station (“Borsod PPA”). For its part, AES Summit agreed to pursue and complete a retrofit of all four units at the Tisza II power station and the construction of a new power plant at Borsod.

² Exhibit C-4.

³ The Original PPA required MVM to pay several different types of fees to AES Tisza, of which there were two major components: (a) the Availability Fee (payment for capacity to be in place in case it is needed); and (b) the Energy Fee (payment for the cost of the power it actually requires to have generated).

4.5 In October 2000, AES Corporation (the ultimate parent company of the Claimants) and AES Summit commenced an arbitration against ÁPV and MVM regarding an alleged failure of Hungary, ÁPV and MVM to grant the promised amendment and extension of the Original Tisza II PPA and the Borsod PPA (the “2000 PSA Claim”).⁴

4.6 A month later, in November 2000, AES Summit commenced another arbitration against Hungary under the ECT and the Agreement Between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the People’s Republic of Hungary for the Promotion and Reciprocal Protection of Investments (the “2000 Treaty Claim”).⁵

4.7 Both arbitrations were settled by a Settlement Agreement dated 19 December 2001⁶ (the “2001 Settlement Agreement”), by which the Claimants granted a release by way of a full and final settlement of all claims made in the arbitration proceeding. Hungary was a party to the 2001 Settlement Agreement. The 2001 Settlement Agreement superseded all prior agreements, understandings, negotiations and discussions of the parties. Some other terms of the 2001 Settlement Agreement that concern this arbitration are the following:

- (a) the 2001 Settlement Agreement contained “amendments to the 1995 Tisza PPA [Original Tisza II PPA] to be entered into pursuant to this Agreement, in the form contained in schedule 1 [of the Settlement Agreement];”⁷

⁴ Memorial, ¶ 79.

⁵ Memorial, ¶ 79.

⁶ Exhibit C-7.

⁷ Exhibit C-7, p. 4.

- (b) AES Summit and AES Corporation were released “from any and all obligations and/or liabilities arising under the PSA to pursue the implementation of the Development Projects.”

4.8 The 2001 Settlement Agreement also contained a waiver of sovereign immunity clause, which reads as follows:

“WAIVER OF SOVEREIGN IMMUNITY

Each of APV and MVM (as to (a) through (d)) and the Republic (as to (a) only) unconditionally and irrevocably:

- (a) agrees that the execution and performance by it of this Agreement constitute private and commercial acts rather than public, administrative or governmental acts;
- (b) agrees that should any proceedings arising out of this Agreement be brought against it or its assets, no immunity from such proceedings shall be claimed by or on behalf of itself or with respect to its assets;
- (c) waives any right of immunity which it or any of its assets now has or may acquire in the future in any jurisdiction in connection with proceedings arising out of this Agreement; and
- (d) consents to the enforcement of any arbitration award against it in proceedings brought in accordance with Clause 11 in any jurisdiction (including without limitation the making, enforcement or execution against or in respect of any property whatsoever, irrespective of its use or intended use).”

4.9 The inclusion of the sovereign immunity clause indicates that the parties agreed that the execution and performance of the 2001 Settlement Agreement and its Annexes constituted private and commercial acts, which means that Hungary was acting in its private character rather than in a public or governmental character.

4.10 Also on 19 December 2001, as required by clause 4.1 of the 2001 Settlement Agreement, the Original Tisza II PPA was amended by agreement between MVM and AES Tisza (the “2001 Amendment Agreement”). The Original Tisza II PPA, as amended by the Amendment Agreement, will be referred hereinafter as the “2001 PPA.” The Amendment Agreement was to be governed by Hungarian Law and read and construed as one document with the Original Tisza II PPA.⁸ In pertinent part, the Amendment Agreement provided that:

- (a) the term of the Original Tisza II PPA was to be extended to 31 December 2016;
- (b) AES Tisza would make a four-phased series of improvements (“Retrofit”) to the power stations and, in order to finance the proposed retrofit, it could assign, and/or create security interests in the Amendment Agreement; and
- (c) a new clause was to be inserted into the Original Tisza II PPA, Clause 3.7, regarding a possible change in the law. That clause provides:

“3.7 Change in Law

(a) Illegality

If, during the term of this Agreement, a Change in Law occurs as a result of which either party’s obligations under this Agreement become illegal, unenforceable or impossible to perform, the Parties must give each other notice of the relevant Change in Law and its effect on this Agreement and the Parties shall be obliged for the Negotiating Period following such notice to conduct good faith negotiations and use all reasonable efforts to agree to changes (if any) that can be made to this Agreement in order to reflect the intent of the Parties at the date of the Amendment Agreement

⁸ Exhibit C-9, p. 2.

and the nature of the circumstances in question. If, despite their reasonable efforts, the Parties are unable to agree upon such changes by the expiration of such Negotiating Period, either Party shall have the right to terminate this Agreement by written notice to the other Party. Upon such termination:

- (i) if the Law affected by the relevant Change in Law is of the type specified in point (i) of the definition of “Laws”, the following shall apply:
 - (A) if the relevant Change in Law occurs on or prior to January 1, 2007 or the date of the accession of the Republic of Hungary to the European Union, if later then Section 3.3 (c) shall apply and on the first day of effectiveness of the Utilization Agreement of New PPA, the Transmission Company shall pay to Generator an amount equal to the Recognized Debt, outstanding at the date of the termination notice (and, without prejudice to the terms of the Settlement Agreement, no other termination charge or other compensation, liquidated damages or any indemnification shall be payable by either Party to the other Party relating to a condition or circumstance occurring because of such Change in Law or such termination); and
 - (B) if the relevant Change of Law occurs after January 1, 2007 or the date of the accession of the Republic of Hungary to the European Union, if later, then, without prejudice to the terms of the Settlement Agreement, neither Party shall be obliged to pay a termination charge or other compensation, liquidated damages or any indemnification to the other Party Relating to a condition or circumstance occurring because of such Change in Law or such termination.
- (ii) if the Law affected by the relevant Change in Law is not of the type specified in point (i) of the definition of “Laws”, then Section 3.3 (c) shall apply and on the first day of effectiveness of the Utilization Agreement or New PPA, Transmission Company shall pay compensation to Generator in the amount of the Recognized Debt outstanding at the time of the termination notice.”

4.11 Pursuant to the Amendment Agreement, the existing pricing schedule in the Original Tisza II PPA (Schedule 6) was replaced by a new pricing schedule which provided, *inter alia*, that “... as long as the public utility generator prices are subject to administrative pricing, the prices published by Decree No. 55/1996 (20 December) of the Ministry of Economy (GM) (and any amendments thereof, including currently published GM Decree No. 46/2000 (21 December)) and determined on the basis of the cost review and price review of [the Hungarian Energy Office (“HEO”)] pursuant to the rules and prescriptions set forth in GM Decree No. 45/2000 (21 December) shall be acknowledged and applied.”⁹ The new pricing schedule also went on to set out detailed pricing formula which were to be applied “following the termination of price administration of public utility generator prices.”¹⁰

4.12 In 2004, Hungary acceded to the European Union.

4.13 As of 1 January 2004, the administrative pricing regime for generators was terminated as had been foreshadowed by the 2001 Electricity Act. Thereafter, at least for a time, the specific formula established in the new pricing schedule in the 2001 PPA was used to calculate the prices paid to AES Tisza II.

4.14 By December 2004, AES Tisza had completed three of the four phases of the Tisza II Retrofit at a cost of €98 million.¹¹

4.15 In 2005, a political debate arose in Hungary regarding what were thought by some to be the high profits of the energy generators.

4.16 The debate included argumentations in parliamentary sessions and publication of articles in the media, which discussed the existence of alleged excessive profits being earned by the

⁹ Exhibit C-9, p. 24 of the 2001 Amendment Agreement.

¹⁰ This latter provision is to be understood against Act CX of 2001 on Electricity (“2001 Electricity Act”) which provided for termination of Hungary’s existing administrative pricing regime for generators from 1 January 2004.

¹¹ Claimants’ Request for Arbitration, p. 8. This is not contested by the Respondent.

generators.¹² Amongst other things, MVM was said to be charging less to the consumers than the price it was paying to the generators for such electricity.¹³

4.17 On 23 March 2005, during a debate before the Economic Committee of Parliament, Ferenc Horváth, president of the Hungarian Energy Office, argued that if the HEO was to meet the deadline for market pricing in 2007, a financially feasible solution for the problems of MVM's stranded costs¹⁴ had to be found. He stated that a "reasonable" profit rate for the generators of below 10% could be acceptable.

4.18 On 10 November 2005, HEO sent a letter to AES Tisza in which it claimed that the profits of the company were "unjustifiable high" and suggested that the profits should be capped at a maximum of 7.1%.

4.19 On 28 November 2005, a first meeting took place between representatives of HEO, MVM and the Claimants. At least four more meetings took place without reaching an agreement between the parties.

4.20 On 3 March 2006, the Hungarian parliament amended the 2001 Electricity Act (the "2006 Electricity Act") by reintroducing a regime of administrative prices for electricity sold by generators to MVM.

4.21 On 6 November 2006, the GKM Decree No. 80/2006 was issued, which became effective on 9 December 2006 ("2006 Price Decree").

4.22 On 26 January 2007, the GMK issued Decree No. 14/2007, which was to remain effective until December 2007 ("2007 Price Decree").

¹² As the debate developed, references in the press and elsewhere were made to generators profits as "extra," "too high," "huge" and "luxury." The Hungarian public was described as "defenceless" against rising prices and it was said that such "luxury profits" must be "knocked down."

¹³ Memorial, ¶ 110.

¹⁴ The difference between what MVM paid for electricity and what it could recover.

4.23 Both Decrees provided a fixed price for each generator. Consequently, the formula established in Schedule 6 of the 2001 PPA was no longer applicable.

4.24 The Claimants allege that due to the issue of both Price Decrees, they have suffered a price cut of approximately 43% (under the 2006 Price Decree) and 35% (under the 2007 Price Decree) of the Availability Fee that MVM was obligated to pay pursuant to the 2001 Tisza II PPA.

4.25 The Claimants contend that the Price Decrees were reintroduced for political reasons and that, in addition to the direct loss of revenue for AES Tisza, their lenders have declared it in default under the loan documentation in respect to the €98 million project finance loan facilities made to the company to finance the Tisza II Retrofit.

4.26 The Claimants filed a Request for Arbitration on 6 July 2007.

5. THE CLAIMS

5.1 The Claimants submit that Hungary violated its obligations under the ECT by reintroducing administrative pricing through the issuance of the Price Decrees. Specifically the alleged violations are the following:

- (a) breach of its obligation to provide fair and equitable treatment;
- (b) impairment of AES' investment by unreasonable and discriminatory measures;
- (c) breach of its obligation to provide national treatment;
- (d) breach of its obligation to provide most favoured nation treatment;
- (e) breach of its obligation to provide constant protection and security; and
- (f) expropriation.

5.2 The Respondent did not question the Claimants' right to bring its claims to ICSID arbitration. Nevertheless, there are some conditions which define the jurisdiction of an ICSID tribunal. In order for the Centre to have jurisdiction over a dispute, three – well-known –

conditions must be met, according to Article 25 of the ICSID Convention, to which one must add a condition resulting from the general principle of non-retroactivity:

- (a) a condition *ratione personae*: the dispute must oppose a contracting state and a national of another contracting state;
- (b) a condition *ratione materiae*: the dispute must be a legal dispute arising directly out of an investment;
- (c) a condition *ratione voluntatis*, *i.e.*, the contracting state and the investor must consent in writing that the dispute be settled through ICSID arbitration;
- (d) a condition *ratione temporis*: the ICSID Convention must have been applicable at the relevant time.

5.3 Pursuant to Article 41 of the ICSID Convention, the Tribunal is the judge of its own competence and therefore compliance with certain preconditions must be analyzed.

6. JURISDICTION AND ADMISSIBILITY

6.1 The Parties (*ratione personae*)

6.1.1 The conditions for the existence of ICSID jurisdiction are stated in the Washington Convention and the Energy Charter Treaty.

Claimants

6.1.2 The UK signed the ICSID Convention on 26 May 1965 and deposited instruments of ratification on 19 December 1966. The ICSID Convention entered into force for the UK on 18 January 1967.

6.1.3 The UK ratified the ECT on 16 December 1997 and the Treaty entered into force on 16 April 1998.

6.1.4 AES Summit Generation Limited (“AES Summit”) is a company incorporated under the laws of the United Kingdom on 7 December 1995 and has its principal place of business at 37-39 Kew Foot Road, Richmond, Surrey, TW9 2SS. As a national of the United Kingdom, AES Summit is a national of a “contracting state” for purposes of Article 25(1) of the Convention.

6.1.5 AES-Tisza Eromu Kft (“AES Tisza”) is a company incorporated under the laws of the Republic of Hungary and has its principal place of business at H-3581 Tiszaújváros, Pf: 53, Hungary.

6.1.6 AES Summit owns 99% of, and exercises ownership and control over, AES Tisza. Therefore, pursuant to Article 26(7)¹⁵ of the ECT, AES Tisza shall be treated as a national of “another contracting state” for purposes of Article 25(2)(b) of the Convention.

Respondent

6.1.7 Hungary signed the ICSID Convention on 1 October 1986 and deposited instruments of ratification on 4 February 1987. The ICSID Convention entered into force for Hungary on 6 March 1987.

¹⁵ Article 26(7) ECT reads:

(7) An Investor other than a natural person which has the nationality of a Contracting Party party to the dispute on the date of the consent in writing referred to in paragraph (4) and which, before a dispute between it and that Contracting Party arises, is controlled by Investors of another Contracting Party, shall for the purpose of article 25(2)(b) of the ICSID Convention be treated as a “national of another Contracting State” and shall for the purpose of article 1(6) of the Additional Facility Rules be treated as a “national of another State.”

6.1.8 Respondent signed the ECT on 27 February 1995, ratified the Treaty on 8 April 1998, and the Treaty entered into force on 16 April 1998.

6.2 Legal Dispute Arising Directly out of an Investment (*ratione materiae*)

6.2.1 Claimants allege violations of their rights under the ECT. There are disagreements on different points of law and fact, which creates a conflict of legal views and interests between the parties, and the present dispute hence qualifies as a legal dispute under Article 25(1) of the ICSID Convention.

6.2.2 Claimants claim to have invested approximately US\$ 130 million and €98 million into the Hungarian electricity sector.

6.2.3 First, in 1996, AES Summit entered into a Purchase and Sale Agreement of approximately US\$ 130 million with the Hungarian state privatization and electricity transmission companies, ÁPV and MVM respectively, for a majority shareholding in a Hungarian electricity generation company which, after its purchase, became known as AES Tisza.

6.2.4 Later in 2001, AES Tisza invested approximately €98 million to retrofit the power station.

6.2.5 Both actions (purchasing the company and carrying out the Retrofit of the power station) qualify as investments in accordance with Article 1(6) of the ECT and Article 25 of the ICSID Convention.¹⁶

6.3 Written Consent (*ratione voluntatis*)

6.3.1 In the Request for Arbitration, Claimants provide their written consent to submit the dispute to the jurisdiction of the Centre.

6.3.2 In addition, in their Request for Arbitration and in their Memorial, Claimants maintain that Hungary gave its consent to the submission of the dispute to the jurisdiction of the Centre pursuant to Articles 26(3) and 26(5)(a) of the ECT.

6.3.3 This statement was not disputed by Hungary in its Counter-Memorial, nor was it contested in the Respondent's Rejoinder. Hence, the parties have consented in writing to ICSID jurisdiction in accordance with Article 25 of the ICSID Convention.

¹⁶ Article 1(6) of the ECT reads:

(6) "Investment" means every kind of asset, owned or controlled directly or indirectly by an Investor and includes: tangible and intangible, and movable and immovable, property, and any property rights such as leases, mortgages, liens, and pledges; (b) a company or business enterprise, or shares, stock, or other forms of equity participation in a company or business enterprise, and bonds and other debt of a company or business enterprise; (c) claims to money and claims to performance pursuant to contract having an economic value and associated with an Investment; (d) Intellectual Property; (e) Returns; (f) any right conferred by law or contract or by virtue of any licences and permits granted pursuant to law to undertake any Economic Activity in the Energy Sector. A change in the form in which assets are invested does not affect their character as investments and the term "Investment" includes all investments, whether existing at or made after the later of the date of entry into force of this Treaty for the Contracting Party of the Investor making the investment and that for the Contracting Party in the Area of which the investment is made (hereinafter referred to as the "Effective Date") provided that the Treaty shall only apply to matters affecting such investments after the Effective Date. "Investment" refers to any investment associated with an Economic Activity in the Energy Sector and to investments or classes of investments designated by a Contracting Party in its Area as "Charter efficiency projects" and so notified to the Secretariat.

6.4 Condition *ratione temporis*

6.4.1 Hungary signed the Treaty on 27 February 1995 and expressly declared that it did not accept the provisional application of the ECT (*see* Article 45(2)(a) of the ECT). Nevertheless, in accordance with Article 1(6), the investments protected by the ECT include those made before the entry into force of this Treaty, provided that it shall only apply to matters affecting such investments after the Effective Date.

6.4.2 Consequently this Tribunal can analyze the alleged breaches of the ECT given that they are said to have occurred after the entry into force of the Treaty, and after the entry into force of the ICSID Convention.

6.5 Procedural requirements pursuant to Article 26 of the ECT.

6.5.1 Regarding Article 26(1) and (2) of the ECT,¹⁷ the Tribunal observes that communications between the Claimants and the Respondent regarding negotiations of the dispute began in January 2007. Furthermore, in April 2007, the parties conducted in person negotiations without reaching a resolution of the dispute.

¹⁷ Article 26(1) and (2) of the ECT read:

(1) Disputes between a Contracting Party and an Investor of another Contracting Party relating to an Investment of the latter in the Area of the former, which concern an alleged breach of an obligation of the former under Part III shall, if possible, be settled amicably.

(2) If such disputes can not be settled according to the provisions of paragraph (1) within a period of three months from the date on which either party to the dispute requested amicable settlement, the Investor party to the dispute may choose to submit it for resolution...

6.5.2 Therefore, the Tribunal considers that the three month “cooling-off period” was respected and that the Claimants had the right to submit the dispute to resolution according to Article 26(2) of the Convention.

6.5.3 Based on the evidence provided in the proceeding, there is no record that Claimants chose to submit their dispute before Hungary’s courts or administrative tribunals. Therefore, it is clear to this Tribunal that the dispute does not fall within the scope of Article 26(2)(a) of the ECT.

6.5.4 Similarly, there is no evidence that either party used any applicable or previously agreed dispute settlement procedure in order to settle the dispute.¹⁸

6.5.5 Consequently, the Tribunal concludes that Article 26(3)¹⁹ of the ECT applies to this case.

¹⁸ Even though there was a procedure started by the European Commission to investigate the alleged state aid awarded by Hungary through Power Purchase Agreements, it is to be noted that such procedure was not between the parties to this dispute but between the European Commission and Hungary. In addition, the subject matter in such investigation was to determine whether the Power Purchase Agreements contained state Aid, under European Law (Final Decision C(2008)2223 of June 04, 2008), which is a different dispute than the one subject to this arbitration. The subject matter of that proceeding being different from the subject matter of this dispute, allows the Tribunal to sustain that the claim should not be barred by *res judicata*.

¹⁹ Article 26(3) of the ECT reads:

(3)(a) Subject only to subparagraphs (b) and (c), each Contracting Party hereby gives its unconditional consent to the submission of a dispute to international arbitration or conciliation in accordance with the provisions of this Article.

(b)(i) The Contracting Parties listed in Annex ID do not give such unconditional consent where the Investor has previously submitted the dispute under subparagraph (2)(a) or (b)

(ii) For the sake of transparency, each Contracting Party that is listed in Annex ID shall provide a written statement of its policies, practices and conditions in this regard to the Secretariat no later than the date of the deposit of its instrument of ratification, acceptance or approval in accordance with Article 39 or the deposit of its instrument of accession in accordance with Article 41.

7. APPLICABLE LAW

7.1 Claimants' Applicable Law Arguments as Presented in the Memorial

7.1.1 On 7 March 2008, Claimants filed their Memorial, asserting that the law applicable to the dispute was found in Article 26(6) of the ECT, which provides that “[a] tribunal established under paragraph (4) [referring to ICSID arbitration] shall decide the issues in dispute in accordance with this Treaty and applicable rules and principles of international law.” This was not further developed.

7.2 Respondent's Applicable Law Arguments as presented in the Counter-Memorial

7.2.1 In its Counter-Memorial, Respondent highlighted the inconveniences and the negative consequences of a ruling under the ECT, which, in its opinion, requires Hungary to act inconsistently with mandatory laws of the EU.

7.2.2 It is Hungary's contention that the ECT must be read in light of one of its own objectives, which is to promote the European Union's key energy objectives, market liberalization and free competition, and not as if it was entirely independent of critical EU laws and developments.

7.2.3 Consequently, Hungary states that “it defies logic to suggest, as Claimants do, that the ECT can be read as entirely divorced from EC competition law.” It argues that when a state has obligations under two different treaties involving overlapping subject matter, those obligations should – to the extent possible – be read in harmony and be interpreted to minimize conflict.

7.2.4 In addition, Respondent says that the fact that Claimants' 2001 PPA was governed by the law of Hungary, now an EU member state, further underscores the need to take European

Community (“EC”) competition law into account in determining whether any modification of the 2001 PPA transgressed the limits set forth in the ECT. Hungary relies on part of a text that Bernard Hanotiau wrote in 1995 which states that: “if the applicable law ... is the law of a state of the European Union, such law includes the rules of Community law, and these rules should therefore be applied ...”

7.2.5 Finally, Hungary alleges that there is no true conflict between the provisions of the ECT and the mandatory public policy reflected in the EC competition law (incorporated in Hungarian law governing the 2001 PPA), because:

“Accepting the notion that “legitimate expectations” is the bedrock on which many of the ECT’s investor-protection provisions rest, this notion fully supports a finding that Hungary honored its commitments. As set forth below, Claimants could have had no “legitimate” expectation that Hungary would blithely ignore EC demands to minimize or eliminate prohibited State aid. Nor could they legitimately expect that Hungary would never consider, as a rational vehicle for addressing these concerns, the temporary reintroduction of administrative price controls, predicated on the very notions of “reasonable return” upon which Claimants originally invested.”

7.3 Claimants’ Applicable Law Arguments as Presented in the Reply

7.3.1 On 31 October 2008, the Claimants filed their Reply. There, they stated that the parties to this arbitration made a clear choice as to the applicable law and that choice does not include Community competition law or Hungarian law. They argue that the applicable law will only be the ECT and applicable rules and principles of international law under article 26(6) of the ECT. The law applicable to the merits of this ICSID proceeding is governed by Article 42(1) of the ICSID Convention and, thus, by Article 26(6) of the ECT.

7.3.2 The Claimants say that Community law is irrelevant to the interpretation of the ECT, and that assertions to the contrary ignore the basic principles of treaty interpretation.

7.3.3 According to the Claimants, this is so because the ECT is to be interpreted in accordance with customary international law as codified in the Vienna Convention, Articles 31 and 32. They maintain that the principles set out in the Vienna Convention require that the ECT “be interpreted in accordance with the Law of Nations, and not any municipal code.”

7.3.4 This is also said to be so given that Community law, including Community competition law, is considered the equivalent of internal or municipal law for the purposes of this proceeding. Community law is thus merely a fact to be considered by the Tribunal when determining the applicable law.

7.3.5 Claimants state that Respondent argues that, under Article 32 of the Vienna Convention, there is some unidentified provision of the ECT which is either ambiguous or absurd, and therefore recourse should be had to supplementary means of interpretation, including the preparatory work or the circumstances surrounding the conclusion of the ECT. Nevertheless, in their opinion, Hungary fails to point to any specific provision of the ECT which it believes to be ambiguous or absurd.

7.3.6 In addition, Claimants argue that the ECT was not solely a European initiative, because Russia, Canada, USA, Japan, and other countries were each heavily involved in its inception.

7.3.7 Claimants also mention that their “legitimate expectations” are irrelevant to the interpretation of the ECT and they underscore that Hungary did not identify any provision of

either the Vienna Convention or customary international law which suggests that this Tribunal should interpret the ECT by reference to the expectations of an investor.

7.3.8 Claimants further claim that Community law is not a defence to Hungary's breaches of the ECT, because Article 27 of the Vienna Convention provides that a "Party may not invoke the provisions of its internal law as justifications for its failure to perform a treaty."

7.3.9 Regarding Respondent's alleged "conflict" between Community Law and the ECT, Claimants posit that the EC is a signatory to the ECT and is thus bound by its provisions, including those as to the choice of law. Claimants conclude that it is clear that the "EC institutions are bound by the provisions of an international treaty concluded by the EC, and that all acts of those institutions should comply with such treaties."

7.3.10 Claimants point out that despite not articulating any legal basis for its Community competition law defence, and despite the established legal principle that a state cannot invoke its own internal law as a defence to its violations of international law, Hungary suggests that any finding by this Tribunal that Hungary should be held accountable for its violations of international law would "seriously undermine the integrity of EC State aid law."

7.3.11 In answer to this point, Claimants assert that Respondent's argument ignores the parties' express choice of law in Article 26(6) and the provisions of the ECT on investor protection that flow, automatically, from that choice.

7.3.12 Furthermore, Claimants say that the ECT has addressed this issue and determined that, while the notion of state aid covers all aid granted by a member state to undertakings which

might have the effect of distorting trade, it is fundamentally different in its legal nature from the damages which Hungary may have to pay as a result of this arbitration.

7.3.13 In their view, all Community institutions, including the Commission, must, as a matter of Community law, respect any award issued by this Tribunal.

7.3.14 Claimants' conclusion is that Hungary's alleged "circularity" problem does not exist as a matter of fact or as a matter of Community law, and that the alleged "circularity" problem has been invented by Hungary in an effort to avoid responsibility for its internationally wrongful acts. The Eeckhout Report confirms that this is the case.

7.4 Respondent's Applicable Law Arguments as Presented in the Rejoinder

7.4.1 On 13 February 2009, Hungary filed its Rejoinder and clarified that it never contended, as Claimants asserted, that EC law rather than the ECT governs this arbitration. Hungary insists that it has always acknowledged that the ECT supplies the decisional standards that this Tribunal must apply. But it argues that in applying these standards, the EC law framework as well as the illegality of the 2001 PPA under Hungarian law have to be considered as facts.

7.4.2 The Respondent notes that Claimants themselves admitted that issues of national law are frequently factual predicates for the application of ECT decisional standards.

7.4.3 Consequently, the Respondent concludes that there is thus no real dispute between the parties on this issue.

7.5 Arguments Expressed During the Hearing

7.5.1 During the hearing, Claimants argued (on 9 March 2009) that Hungary had retreated from its previous position as set out in the Counter-Memorial, and thus that this Tribunal no longer had to determine the conflict regarding the applicable law (Transcript, p. 170:5-8). Claimants further asserted that there is “no dispute between the parties that the ECT is the applicable law” (Transcript, page 346:8).

7.5.2 During the hearing (on 13 March 2009), both parties and experts agreed that:

- (a) the ECT was the applicable law;
- (b) the EC law is relevant as a fact (Transcript, Slot: p. 1469: 8-11), (Transcript, Eeckhout: p. 1415: 6-9).

7.5.3 Even though there was a consensus between the parties that the ECT is the applicable law to this dispute, and that the EC law is to be taken into account as a relevant fact, the parties maintained different interpretations regarding the following issues:

- (a) should the ECT be interpreted due to ambiguous provisions? And, in such case, should the interpretation method be a historical interpretation of the formation of the ECT, or the Vienna Convention?
- (b) does Article 16 of the ECT apply to this dispute?
- (c) should Article 307 of the EC Treaty be applied to this dispute?

Interpretation of the ECT

7.5.4 The Respondent alleged that the ECT should be interpreted using a historical method that takes into account the formation of the ECT, and therefore the EC law principles. Claimants disagreed, stating that any interpretation of the ECT had to be made in accordance with the Vienna Convention.

Application of Article 16 of the ECT

7.5.5 Claimants also noted that the Respondent failed to make reference to Article 16 of the ECT, which states that if there is a conflict between the ECT and any other treaty which deals with the subject matter of ECT Part III or Part V, then according to the law expressly chosen by the parties, the provisions which are more favourable to the investor or the investment prevail. The Respondent denied that Article 16 of the ECT was applicable to the dispute.²⁰

Application of Article 307 of the EC Treaty

7.5.6 During the hearing, Claimants' expert Professor Eeckhout stated that, in his opinion, Article 307 of the EC Treaty is a "crucial provision which enables member states to honor international obligations under an agreement they signed and concluded before joining the European community, and that insofar as there are those obligations, Article 307 of the EC Treaty authorized Hungary to ignore the Commission's order for the benefit of a EU member state company."²¹

7.5.7 For its part, Respondent argued that as the admitted purpose of Article 307 was to protect non-member states, Article 307 of the EC Treaty should be read as authorizing Hungary to ignore the Commission's binding order for the benefit of an EU member state company "even though AES's home state (from which its ECT rights derive) by no means could be deemed a beneficiary of Article 307."²²

²⁰ Respondent's post-hearing submission, ¶ 95.

²¹ Transcript, p. 1422: 1-6

²² Respondent's post-hearing submission, ¶ 96.

7.6 Findings of the Tribunal

7.6.1 Article 41(2) of the ICSID Convention provides that this Tribunal shall decide the dispute “in accordance with such rules of law as may be agreed by the parties.”

7.6.2 Article 26(6) of the ECT provides that “a tribunal established under paragraph (4) shall decide the issue in dispute in accordance with this Treaty [ECT] and applicable rules and principles of international law.”

7.6.3 Given that this Tribunal is established under paragraph (4) of Article 26 of the ECT, it is Article 26(6) of the ECT which contains the rules of law agreed by the parties and the ones that this Tribunal will use to decide the dispute.

7.6.4 We therefore conclude that the applicable law to this proceeding is the ECT, together with the applicable rules and principles of international law.

Interpretation of the ECT

7.6.5 If interpretation of the ECT is required, the general rules of interpretation of the Vienna Convention, established in its Articles 31 and 32 should be applied. Although Article 32 provides for the use of historical interpretation, the Tribunal notes that such use is only as a complementary method of interpretation.

7.6.6 Regarding the Community competition law regime, it has a dual nature: on the one hand, it is an international law regime, on the other hand, once introduced in the national legal orders, it is part of these legal orders. It is common ground that in an international arbitration, national laws are to be considered as facts. Both parties having pleading that the Community

competition law regime should be considered as a fact, it will be considered by this Tribunal as a fact, always taking into account that a state may not invoke its domestic law as an excuse for alleged breaches of its international obligations.

Application of Article 16 of the ECT

7.6.7 The Tribunal observes that the application of Article 16 of the ECT only requires to be analyzed in the event the ECT contains a provision that conflicts with EC law. In the case of any conflict that is said to exist between the ECT and Community law, the relevant provision is Article 16 of the ECT:

“Where two or more Contracting Parties have entered into a prior international agreement, or enter into a subsequent international agreement, whose terms in either case concern the subject matter of Part III or V of this Treaty,

(1) nothing in Part III or V of this Treaty shall be construed to derogate from any provision of such terms of the other agreement or from any right to dispute resolution with respect thereto under that agreement; and

(2) nothing in such terms of the other agreement shall be construed to derogate from any provision of Part III or V of this Treaty or from any right to dispute resolution with respect thereto under this Treaty, where any such provision is more favourable to the Investor or Investment.”

7.6.8 However, the Tribunal concludes that, properly understood, the dispute under analysis in the present arbitration is not about a conflict between the EC Treaty or Community competition law and the ECT.

7.6.9 Rather, the dispute is about the conformity or non-conformity of Hungary’s acts and measures with the ECT. Therefore, it is the behaviour of the state (the introduction by Hungary of the Price Decrees) which must be analyzed in light of the ECT, to determine whether the

measures, or the manner in which they were introduced, violated the Treaty. The question of whether Hungary was, may have been, or may have felt obliged under EC law to act as it did, is only an element to be considered by this Tribunal when determining the “rationality,” “reasonableness,” “arbitrariness” and “transparency” of the reintroduction of administrative pricing and the Price Decrees.

Application of Article 307 of the EC Treaty

7.6.10 Finally, the Tribunal concludes that Article 307 of the ECT is not applicable, as such, in this arbitration. Article 307 (ex Article 234) states:

“The rights and obligations arising from agreements concluded before 1 January 1958 or, for acceding States, before the date of their accession, between one or more Member States on the one hand, and one or more third countries on the other, shall not be affected by the provisions of this Treaty.

To the extent that such agreements are not compatible with this Treaty, the Member State or States concerned shall take all appropriate steps to eliminate the incompatibilities established. Member States shall, where necessary, assist each other to this end and shall, where appropriate, adopt a common attitude.

In applying the agreements referred to in the first paragraph, Member States shall take into account the fact that the advantages accorded under this Treaty by each Member State form an integral part of the establishment of the Community and are thereby inseparably linked with the creation of common institutions, the conferring of powers upon them and the granting of the same advantages by all the other Member States.”

7.6.11 Article 307 only applies to agreements between member states and non-member states, and Hungary and the United Kingdom are both member states. Moreover, the Claimants are not states, and even if sometimes individuals are granted rights under international law, Article 307 of the EC Treaty specifies that it only applies to states.

7.6.12 In summary, the Tribunal determines that the Respondent's acts/measures are to be assessed under the ECT as the applicable law but that the EC law is to be considered and taken into account as a relevant fact.

8. THE TRIBUNAL'S APPROACH TO THE SUBSTANTIVE CLAIMS

8.1 The Tribunal starts its analysis of the substantive issues before it by dealing first, in Section 9 below, with Hungary's obligation to provide fair and equitable treatment to Claimants and their investment(s). This is followed, successively, by the Tribunal's analysis of Claimants' claim regarding unreasonable and discriminatory measures (Section 10), national treatment (Section 11), most favoured nation treatment (Section 12), constant protection and security (Section 13), and, finally expropriation (Section 14).

8.2 In addressing each claim, the Tribunal summarizes briefly the scope of Claimants' and Respondent's positions as advanced in their initial pleadings, written memorials, during the course of oral argument and in their written post-hearing submissions. The Tribunal also acknowledges the efforts made by the European Commission to explain its own position to the Tribunal and has duly considered the points developed in its *amicus curiae* brief in its deliberations. After having thus thoroughly examined the whole file, the Tribunal presents its analyses and conclusions.

9. OBLIGATION TO PROVIDE FAIR AND EQUITABLE TREATMENT

9.1 Claimants' Position

9.1.1 Regarding the obligation of Hungary to provide fair and equitable treatment, the Claimants advance four main arguments which are summarized under the relevant descriptive headings below.

Contractual Obligations

9.1.2 The Claimants state that the obligation of Hungary to provide fair and equitable treatment includes the obligation of honouring contractual obligations, upon which the investor reasonably relied.²³ These are said to include promises by Hungary “not to interfere with Claimants’ PPA,” “not to frustrate ...[the 2001 Settlement Agreement’s] purposes and intent” and to require another overall price and cost review prior to the introduction of any new pricing mechanism.²⁴

9.1.3 Specifically, Claimants allege that with the March 2006 amendment of the 2001 Electricity Act and the introduction of the 2006 and 2007 Price Decrees, Hungary caused and encouraged MVM to refuse to fulfill its contractual commitments to AES Tisza under the 2001

²³ In order to support this claim, Claimants mention that: a) in *CME v. Czech Republic*, the Tribunal found that the breach of legal security of contract rights underpinned the Claimants’ investment; b) Schreuer has maintained that “a willful refusal by a government authority to abide by its contractual obligations, abuse of government authority to evade agreements with foreign investors and action in bad faith in the course of contractual performance may well lead to a finding that the Standard of fair and equitable treatment has been breached”; and c) in the *CMS v. Argentina* case, the Tribunal considered that the fair and equitable treatment standard was violated when the state put a freeze on contractually agreed tariff adjustments intended to increase gas prices. Claimants’ Memorial, ¶¶ 200-204.

²⁴ Claimants’ post-hearing submission, ¶¶ 101-103.

PPA, and refused to fulfill its own contractual obligations to the Claimants as set out in the 2001 Settlement Agreement.²⁵

Breach of the Obligation to Act in Good Faith and to Respect Legitimate Expectations

9.1.4 Claimants argue that, by amending the 2001 Electricity Act in 2006 and by introducing the Price Decrees, Hungary failed to act in good faith and in accordance with the basic and legitimate expectations (described above) upon which the Claimants relied when making their investments in Hungary in 1996 and following the 2001 Settlement Agreement and the execution of the 2001 PPA.

Stability and Predictability of Business

9.1.5 Claimants say that Hungary agreed to provide a certain level of financial and legal stability to the Claimants' investment by way of the 2001 PPA. The ECT also expressly requires Hungary to provide "stable, equitable, favourable and transparent conditions" for Claimants' investment.²⁶ But Claimants argue that the promised stability was short-lived, as the organs of the state began accusing AES of earning luxury profits and tried to force a re-negotiation of the PPA, and the Hungarian parliament finally amended the 2001 Electricity Act which would re-introduce administrative pricing. This action eviscerated the legal framework upon which the Claimants had legitimately relied.²⁷

²⁵ Memorial, ¶ 215.

²⁶ Exhibit C-1, Article 10(1).

²⁷ Claimants note that in *Metalcald* and in *Tecmed*, the Tribunals found that stability and predictability of business framework was an accepted element of the fair and equitable standard. Memorial, ¶ 202.

The Reintroduction of the Price Decrees was Arbitrary, Non-Transparent and Lacking in Due Process

9.1.6 Claimants also contend that Hungary’s conduct was non-transparent, arbitrary, lacking in due process, and discriminatory.²⁸

9.1.7 In support of this claim, they argue that the 2006 Electricity Act Amendment was adopted for purely political reasons (arising out of the political debate about the generators’ “excessive” and “intolerable” profits), and was aimed specifically at reducing the profits being earned by generators such as AES Tisza. Claimants note that even minister Kokka acknowledged that it was a measure that would “effect centralization or take over by the state.”

9.1.8 In addition, Claimants allege that the manner in which the Price Decrees were issued demonstrates a lack of transparency, lack of due process and inherent arbitrariness in Hungary’s actions.

9.1.9 Claimants point out that the maximum profit figure of 7.1% set forth by the HEO was based on the profit figure used for distribution companies, which bears no rational relationship to generation companies.

²⁸ In order to support this claim, Claimants mention that: a) the *Tecmed* Tribunal resolved that “the foreign investor expects the host state to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor”; b) in *Maffezini v. Spain*, the Tribunal said that “the lack of transparency with which this loan transaction was conducted is incompatible with Spain’s commitment to ensure the investor a fair and equitable treatment in accordance with Article 4(1) of the same treaty. Accordingly, the Tribunal finds that, with regard to this contention, the claimant has substantiated his claim and is entitled to compensation...”; and c) the Tribunal in *Waste Management* determined that the lack of due process may be a “manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candor in an administrative process.” Memorial, ¶¶ 205-208.

9.1.10 Moreover, the HEO gave no explanation as to how it actually arrived at the prices set out in the Price Decrees. Unlike previous administrative prices, AES Tisza was given no opportunity to comment on the prices before the Price Decrees were issued. Hungary is also said to have demanded that Claimants comment on the draft language of the draft Price Decrees within four business days, and on the language of the Price Decrees themselves within one business day.²⁹ And Hungary failed to perform a costs and assets' review prior to issuing the Price Decrees.

9.2 Respondent's Position

9.2.1 Hungary's defence may be summarized as follows:

- (a) Claimants can have had no legitimate expectations that administered prices would not be reintroduced;
- (b) Hungary's decision to do so was neither arbitrary, nor an abuse of state power;
- (c) Hungary's dealing with Claimants prior to the decision to reintroduce administered pricing were both reasonable and in good faith having regard to the concerns being expressed in various quarters about the generators' PPAs;
- (d) there were no due process failings (*i.e.*, there was nothing arbitrary or unfair in HEO's methodology or its procedures) which led to the adoption of the Price Decrees themselves.

²⁹ Claimants' post-hearing submission, ¶¶ 84-86.

Legitimate Expectations

9.2.2 Hungary says that Claimants invested originally in the full expectation of administrative price regulation. Even though Claimants rely on the 2001 expectations, the expectations that should count are the ones that Claimants had at the moment of deciding to make the investment, which was in 1996.

9.2.3 Hungary accepts that there were limitations on the future regulation, *i.e.*, (a) prices would be set at levels sufficient to provide a “reasonable return” on investment; and (b) returns of 8% on equity had been targeted, but it was understood that this figure might change.

9.2.4 For these reasons, Hungary contends that no legitimate expectations were created that administrative prices would never be reintroduced. Hungary points out that, in their submission to the EC, Claimants themselves stated that the price controls were simply “suspended for a brief interlude” commencing 1 January 2004.

9.2.5 In order for legitimate expectations to exist, Hungary says that two elements are necessary:

- (a) the existence of government representations and assurances. In this regard, Hungary maintains that the 2001 Settlement Agreement mentioned nothing in connection with prices and that although the 2001 PPA contained a pricing schedule for when the regulatory prices regime ended, it contained no representations by MVM or anyone else that the pricing regime would never change again in the future; and
- (b) the reliance of the investor on such assurances to make its investment. Hungary claims that the fact that clause 3.7 of the 2001 PPA referred to a change in the law

shows that the investor knew that there could be changes as regards regulatory pricing, amongst other changes in the law.

9.2.6 Hungary accepts that “[a]s of 2001, based on the new 2001 Electricity Act, it did appear that administrative price caps would be phased out beginning 2004.”³⁰ However, it says that this did not create legitimate expectations because those were created in 1996 and not in 2001.

9.2.7 But even if expectations could have been created by the 2001 PPA, in the absence of stability agreement or the like (*e.g.*, an undertaking that the government would never again regulate prices), Claimants could have had no such legitimate expectation in 2001.

9.2.8 Hungary argues that even if new “expectations” were created, this did not create objective rights because the expectations were not “legitimate.” In order for the expectations to be legitimate, they have to be based on affirmative government representations or assurances and these were not made. Some tribunals say that the investor’s expectations are legitimate if the investor received an explicit promise or guaranty from the host state.³¹

No Abusive or Arbitrary Behaviour

9.2.9 Hungary says that, in the absence of legitimate expectations, only “manifestly arbitrary conduct” or the “abuse of state power” can provoke a violation of the fair and equitable treatment obligation.

³⁰ Counter-Memorial, ¶ 125.

³¹ Hungary refers to the *Saluka* case and says “that the tribunal found that regulatory changes, if not discriminatorily applied, would not amount to a fair and equitable treatment violation.” Counter-Memorial, ¶ 326.

9.2.10 Hungary contends that its decision temporarily to restore administrative pricing was neither arbitrary nor an abuse of state power. It places special emphasis on the fact that countries which are in the process of becoming members of the European Community are likely to have legislative changes.

9.2.11 Hungary further says that Claimants did not show that the temporary reintroduction of administrative price caps was either an abuse of state power or manifestly arbitrary.

9.2.12 Hungary points out that Claimants submitted no expert opinion on Hungarian law regarding the power of the state to regulate maximum prices.

9.2.13 Regarding Claimants assertion that the Price Decrees were enacted for “purely political reasons” and without any “rational public policy” objective of the state, Hungary notes that the generators’ PPAs had been a concern to Hungary since 2002 and that “it was under serious pressure from the EC to take action at least to minimize the effects of what the EC considered to be unlawful state aid, if not to terminate the PPAs outright. In these circumstances, it tried to increase the pressure on the generators (including AES Tisza) to renegotiate the PPAs. Hungary insists on the fact that AES Tisza refused any renegotiation of the PPA which created great difficulties for Hungary in its endeavour to develop a free market, in line with the European Community standards. When the authorities were unable to renegotiate the PPAs, they took the next step, which was the least drastic of the alternatives available. They temporarily restored the system of administrative price caps, based on notions of reasonable return that had long been used in Hungary.

9.2.14 Hungary responds to Claimants' argument, that the expiration of the 2007 Price Decrees demonstrates that it "could not have been related to any rational policy goal," by stating that, to the contrary, there were rational and legal reasons why administrative price regulation could not be continued in 2008, because it was contrary to the notion of full liberalization which had been introduced by the 2001 Electricity Act and which entered into effect on 1 January 2008. Hungary had also become legitimately concerned about the profit levels generators enjoyed under non-competitive PPAs, at the expense of consumers, as well as by the failure of generators to agree to any reductions in contracted PPA capacity, to free up electricity for direct sale to the parallel free market. These were thus transitional measures, put in place while Hungary sought to negotiate with the generators to find alternative commercial arrangements that would meet the EC's competition law concerns and address its own political issues.

Dealings were Reasonable and in Good Faith

9.2.15 As regards Claimants allegation that Hungary threatened AES Tisza to terminate the PPA, Hungary contends that Hungarian officials were simply acknowledging what the EC had indicated, that there was a possibility that the PPAs would have to be terminated.

9.2.16 Hungary did not violate fair and equitable treatment in its consultations with Claimants. Hungary says that Claimants equate a notion of a failure to act in good faith with Hungary's unwillingness to capitulate to Claimants' unilateral demands that they receive the full value of PPA pricing, notwithstanding the EC's condemnation of that pricing as illegal state aid. In fact, Hungary argues, it was Claimants who acted unreasonably in the negotiations which preceded the reintroduction of administered pricing, by refusing even to acknowledge the new realities imposed by the EC's position and by market liberalization.

Due Process Observed in Implementing Price Regulation

9.2.17 Hungary asserts that neither HEO's methodology and procedures for implementing maximum prices, nor the resulting prices were arbitrary or irrational.

9.2.18 According to Hungary, no "due process" or transparency rights were violated because, even though Claimants allege that there was no explanation as to how the HEO actually arrived at the prices set out in the Price Decrees, AES Tisza was well aware that the HEO was planning to use the 7.1% profit level as the target for determining appropriate prices, and knew that the HEO had drawn that figure from the level used to set maximum prices for distribution companies.

9.2.19 Hungary argues that the 7.1% rate of return on assets is comparable to the 8% return on equity target in place at the time of privatization, particularly given the fact that return on assets is a more favorable measure than return on equity. It also contends that there was nothing wrong in applying the same Weighted Average Cost of Capital ("WACC") calculation to different players in the regulated electricity market. Hungary says that, according to Navigant's report, AES Tisza could have paid all its debt prior to 2007.

9.2.20 As to Claimants' allegation that, unlike in previous administrative price cycles, AES Tisza was given no opportunity to comment on the prices set out in the Price Decrees before they were issued, Hungary responds that Claimants were invited to comment on the appropriateness of this approach, and did so, in November 2005 and in May 2006.

9.2.21 In addition, Hungary says that, as Dr. Fazekas discusses in her expert report, the obligation of the state to address petitions for review of individual price levels arises only after

their publication and not prior to it and that AES Tisza did not submit any request for price review during 2006 and 2007. In addition, Hungary recalls that Dr. Fazekas also said that the AAP (administrative proceeding) rules do not apply because it is a lawmaking function and not an administrative case or proceeding.

9.2.22 Hungary argues that even if the Tribunal finds that there were imperfections in the execution of the state's obligation of transparency, this is not enough to determine that a violation of fair and equitable treatment occurred.³²

9.2.23 In connection with a state's obligation to act in a transparent manner, Claimants maintain that the ECT imposes its own transparency obligations, separate and apart from the requirements of national law. In this regard, Hungary says that Article 10(1) does not impose a particularly high threshold for transparency.³³

9.2.24 Hungary also says that the general investment treaty jurisprudence does not require states to comply with ideal notions of transparency, in which every single consideration in policy making is first publicly announced.

³² Hungary notes that in the *Eastern Sugar* case, the Tribunal stated that an investment treaty may not be invoked "each time the law is flawed or not fully and properly implemented by a State," otherwise "every aspect of any legislation or its implementations could be brought before an international arbitral tribunal under the guise of a violation of a BIT." Counter-Memorial, ¶ 359.

³³ Hungary indicates that "As Thomas Wälde has explained, "[t]he general investment standards under Article 10(1) ... need to be specified and applied in light of Article 20(2)," which is the ECT's specific provision on transparency. This imposes a "relatively toothless obligation," requiring only that States promptly publish laws and regulations affecting investments." Counter-Memorial, ¶ 360.

9.3 Findings of the Tribunal

Findings Concerning Contractual Obligations

9.3.1 The Tribunal makes it clear at the outset that it only has jurisdiction over Treaty claims. In connection with the alleged breach of contractual rights and consequently the violation of fair and equitable treatment obligation, the Tribunal considers that it cannot hear this claim as such.

9.3.2 It is true that Article 26 of the ECT contains an umbrella clause which allows the submission to international arbitration of disputes concerning an alleged breach of an obligation under Part III of the Treaty. Specifically the last sentence of Article 10(1) – which is contained in Part III of the ECT – establishes that “[e]ach Contracting Party shall observe any obligations it has entered into with an Investor or an Investment of an Investor of any other Contracting Party.”

9.3.3 However, Annex IA of the ECT contains a List of Contracting Parties, which includes Hungary, which do not allow an Investor or Contracting Party to submit a dispute concerning the last sentence of Article 10(1) to international arbitration.³⁴

9.3.4 Therefore, this Tribunal cannot rule on the scope of contract obligations and consequently cannot determine if the Claimants’ contract rights under the 2001 Settlement Agreement – and the 2001 PPA – were eviscerated because it has no jurisdiction to do so.

9.3.5 Nonetheless, the Tribunal considers that it has the right and duty to determine whether Hungary’s conduct – which include acts that could have breached contractual obligations –

³⁴ Counter-Memorial, footnote 561; Memorial, footnote 222.

violated a specific Treaty obligation. In making this assessment, the Tribunal should not be considered to be analyzing the performance of contractual obligations as such.

Findings Concerning Legitimate Expectations

9.3.6 In connection with the reintroduction of administrative prices in 2006 and 2007, and the context in which such reintroduction took place, Claimants allege a breach of the basic and legitimate expectations upon which they relied when making their investment and consequently a violation of the fair and equitable treatment standard.

9.3.7 As stated above, the Respondent argues that no new expectations could be created in 2001 due to the fact that the original investment was made in 1996, and that legitimate expectations can only be created at the moment of the investment, which, in its eyes, was 1996.

9.3.8 This rule that legitimate expectations can only be created at the moment of the investment, has been supported by several ICSID tribunals (for example: *Duke Energy Electroquil Partners and Electroquil S.A. v. Republic of Ecuador* (ICSID Case No. ARB/04/19), Award, Aug. 18, 2008, ¶ 340; *Técnicas Medioambientales Tecmed, S.A. v. United Mexican States* (ICSID Case No. ARB(AF)/00/2), Award, May 29, 2003, ¶ 154 and *LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc. v. Argentine Republic* (ICSID Case No. ARB/02/1), Decision on Liability, Oct. 6, 2006).

9.3.9 In *Duke Energy*, the Tribunal stated that “[t]o be protected, the investor’s expectations must be legitimate and reasonable at the time when the investor makes the investment.”

9.3.10 The above interpretation was confirmed by the *Tecmed* Tribunal, which concluded that “this provision of the Agreement, in light of the good faith principle established by international

law, requires the Contracting Parties to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment.”

9.3.11 The *LG&E* Tribunal determined that “[i]n addition to the state’s obligation to provide a stable legal and business environment, the fair and equitable treatment analysis involves consideration of the investor’s expectations when making its investment in reliance on the protections to be granted by the host state.”

9.3.12 Indeed, several other tribunals have established, as quoted above, that the expectations can only be created at the time of the investment. Nevertheless, the interpretation of “time of the investment” has been quite broad. For example, in *CMS Gas Transmission Company v. Argentine Republic* (ICSID Case No. ARB/01/8), the Tribunal held that it is the time when “the investment was decided and made.” (Award, May 12, 2005, ¶ 275).

9.3.13 As an initial question, this Tribunal therefore has to determine whether Claimants’ investment(s) was/were decided and made in 1996, at the time AES Summit purchased the outstanding shares of Tiszai Erömi Részvénytársaság (now AES Tisza), and/or in 2001, at the time AES Tisza actually began to invest in (spend money on) the Retrofit of the Tisza II plant.

9.3.14 Dealing first with the 1996 PPA, there is no question that AES Summit made an investment in Hungary at that time. Accordingly, it is proper to consider whether it had legitimate expectations at that time, with which Hungary has wrongfully interfered.

9.3.15 As to that question, the Tribunal concludes that AES Summit can have had no legitimate expectation at that time regarding the conduct of Hungary about which it now

complains (*i.e.*, the fact of, motivation for and methodology relating to the reintroduction of administrative pricing in 2006/2007). Both the privatization materials and the relevant investment agreements (the Original Tisza II PPA and the 1996 PSA) were explicit that Hungary would continue to set maximum administrative prices for electricity sales indefinitely into the future. This was subject only to the principle that such pricing would provide a “reasonable return” on investment, which would “target” returns in the general range of 8% on equity for the first regulatory period beginning in 1997.

9.3.16 Turning to the year 2001, there can also be no question that AES Tisza then and thereafter made an investment in Hungary as the term “investment” is defined in the Treaty. It is not contested that, between 2001 and 2005, AES Tisza spent approximately € 98 million to complete three of the four phases of the Tisza II Retrofit. It is also clear that the decision to make the investment was re-confirmed at the time of the 2001 Settlement Agreement. This fact is self-evident from the terms of the relevant agreements that were then executed.

9.3.17 The enquiry therefore turns to whether: (a) there were government representations and assurances made or given to Claimants at that time, and upon which they relied, of the sort alleged; and (b) Hungary acted in a manner contrary to such representations and assurances.

9.3.18 And as to this, the Tribunal concludes that Hungary made no representations/gave no assurances of a nature that go to the heart of Claimants’ complaint – *i.e.*, that following the termination of price administration on 31 December 2003, regulated pricing would not again be introduced.

9.3.19 As regards Claimants' reliance on statements found in the 1996 Industry Information Memorandum relating to "an 8% return on shareholder funds"³⁵ and the requirement for "another overall price and cost review" prior to the introduction of "any new pricing mechanism,"³⁶ the first was simply a target rate for a "reasonable return" for the first regulatory period and the second was made in the context of the HEO not expecting radical changes in Hungary's administrative pricing system. It is of course true that Hungary moved away from administrative pricing at the end of 2003 (and that this future course was known in 2001 at the time of the 2001 Settlement), but the 1996 statement simply does not relate in a sufficiently material way to Claimants' central complaint (the reintroduction of administrative pricing in 2006/2007) for the Tribunal to find that Hungary's conduct in 2006/2007 was contrary to representations and assurances said to have been made to AES Summit in 1996.

9.3.20 As regards Hungary's letter of 21 October 1999 from Mr. Pal Ligati (Head of Department, Ministry of Economic Affaires), which Claimants classify as an "express promise not to interfere with Claimants' PPA," as well as a promise that "the contractual pricing formula set out in the PPA would not be altered by political considerations,"³⁷ all that sensibly can be said is that, whatever the context of the letter (it was produced only during the hearing and never explained), it does not say what Claimants' say it does. Moreover, it predated the 2001 Tisza II PPA by approximately two years and no evidence was led to suggest that such a new PPA was then contemplated. Indeed, the letter was written immediately before Claimants commenced the

³⁵ Exhibit C-111, pp. 102 *et seq.* and F(i).

³⁶ Claimants' post-hearing submission, ¶ 101.

³⁷ Claimants' post-hearing submission, ¶ 102.

PSA and Treaty arbitrations in 2000. Accordingly, the Tribunal does not consider it plausible that Claimants can be said to have relied on this assurance when, two years later, they entered into the 2001 Settlement Agreement and the 2001 Amendment Agreement.

9.3.21 This then leaves for consideration Claimants' contention that, as a party to the 2001 Settlement Agreement, Hungary, by reason of clause 21, "expressly promised ... not to frustrate the purposes and intent" of the agreement, which promise it breached through the reintroduction of regulated pricing which was said to be directly contrary to the object and intent of that agreement.

9.3.22 Again, the Tribunal concludes that Claimants' reliance on frustrated legitimate expectations based on clause 21 is unavailing.

9.3.23 Clause 21 of the 2001 Settlement Agreement provides as follows:

"Each of the Parties agrees to execute and deliver all such further instruments and documents and to do and perform all such acts and things as may be necessary and any Party may reasonably request to enable it to carry out the provisions of this Agreement and/or to effect the purposes and intent of this agreement" (Emphasis added).

9.3.24 Such "further acts" clauses are commonplace in commercial agreements, including settlements. Properly construed, the plainly worded provisions of clause 21 do no more than obligate a party to the 2001 Settlement Agreement, if requested reasonably by another party, to execute and deliver specific instruments/documents or to take specific steps as may be necessary, to enable the requesting party to carry out or effect the purposes and intent of the 2001 Settlement Agreement. This does not, as alleged, constitute a specific promise by Hungary not to

frustrate the purposes and intent of the 2001 Settlement Agreement by the reintroduction of administrative pricing.

9.3.25 It is also common ground that the 2001 Settlement Agreement does not contain a so-called “stabilization clause” – *i.e.*, a covenant not to change the relevant law, usually for a certain period. To the contrary, the 2001 Settlement Agreement introduced a “Change in Law” provision (clause 3.7) into the Original Tisza II PPA (or the 2001 PPA), which dealt carefully with the PPA parties’ rights (including financial) should a change of law occur during the now extended term of the PPA. And “Law,” as defined, included all acts of the Hungarian parliament, as well as other governmental or ministerial decrees as might be issued from time to time. In the case under consideration, in 2001, there was a great probability that there would be no administrative pricing after 2004, but this does not equate to absolute certainty, giving rise to internationally protected legitimate expectations.

9.3.26 In these circumstances, the Tribunal concludes that Claimants cannot legitimately have been led by Hungary to expect that a regime of administrative pricing would not be reintroduced under any circumstances during the term of the 2001 Tisza II PPA.

Findings Concerning Stable Legal and Business Framework

9.3.27 The analysis of the duty to provide a stable legal and business framework has to be made in light of the ECT and the applicable rules and principles of international law.³⁸

³⁸ Article 26(6) ECT.

9.3.28 Specifically, article 10(1) of the ECT provides that “each contracting Party shall, in accordance with the provisions of this Treaty, encourage and create stable ... conditions for investors of other Contracting Parties”

9.3.29 The stable conditions that the ECT mentions relate to the framework within which the investment takes place. Nevertheless, it is not a stability clause. A legal framework is by definition subject to change as it adapts to new circumstances day by day and a state has the sovereign right to exercise its powers which include legislative acts.

9.3.30 Therefore, to determine the scope of the stable conditions that a state has to encourage and create is a complex task given that it will always depend on the specific circumstances that surrounds the investor’s decision to invest and the measures taken by the state in the public interest.

9.3.31 In this case, however, the Tribunal observes that no specific commitments were made by Hungary that could limit its sovereign right to change its law (such as a stability clause) or that could legitimately have made the investor believe that no change in the law would occur.³⁹

9.3.32 Moreover, it is clear from clause 3.7 of the 2001 PPA that the parties to the agreement were aware that a change in the law could occur that could make the obligations under the agreement become illegal, unenforceable or impossible to perform.

³⁹ Specifically, the 2001 Settlement Agreement and the 2001 PPA did not contemplated that after 2004 no reintroduction of regulated pricing could take place.

9.3.33 Mechanisms were established in clause 3.7 of the 2001 PPA, which dealt with the possible actions that could be taken by the parties in the event that a change of law, as defined, occurred. Consequently, the Tribunal concludes that the investment(s) by the Claimants in 2001 and thereafter were made in the knowledge that a change in law could occur that could make the obligations of the 2001 PPA illegal, unenforceable or impossible to perform.

9.3.34 In these circumstances, absent a specific commitment from Hungary that it would not reintroduce administrative pricing during the term of the 2001 PPA, Claimants cannot properly rely on an alleged breach of Hungary's Treaty obligation to provide a stable legal environment based on the passage of Act XXXV and the Price Decrees. This is because any reasonably informed business person or investor knows that laws can evolve in accordance with the perceived political or policy dictates of the times.

9.3.35 The Tribunal therefore concludes that no breach of the fair and equitable treatment standard took place based on Hungary's alleged failure to provide a stable legal and business framework.

Findings Concerning Due Process / Arbitrariness / Transparency

9.3.36 In their unfair and inequitable treatment case, Claimants rely both on the irrational and unreasonable character of Hungary's decision to reintroduce administrative pricing, as well as the arbitrary and unfair manner (failures in due process) in which the Price Decrees were issued.

9.3.37 For reasons which are set out in Section 10 below (dealing with Unreasonable and Discriminatory Measures), the Tribunal has concluded that there was nothing so irrational or otherwise unreasonable in Hungary's policy decision to reintroduce administrative prices in 2006

as would constitute a breach of its Treaty obligation to ensure that Claimants were treated fairly and equitably and that their investments were not impaired by unreasonable or discriminatory measures.

9.3.38 For this reason, the Tribunal limits its analysis here to the manner or methodology in or by which the Price Decrees were brought into force, with a view to assessing whether “process” failures existed which were such as would constitute a failure to provide Claimants with fair and equitable treatment.

9.3.39 To the Tribunal, this ultimately became the heart of the case, and this is why it asked the parties to address this question in detail in their post-hearing submissions.

9.3.40 The Tribunal has approached this question on the basis that it is not every process failing or imperfection that will amount to a failure to provide fair and equitable treatment. The standard is not one of perfection. It is only when a state’s acts or procedural omissions are, on the facts and in the context before the adjudicator, manifestly unfair or unreasonable (such as would shock, or at least surprise a sense of juridical propriety) – to use the words of the *Tecmed* Tribunal⁴⁰ – that the standard can be said to have been infringed.

9.3.41 And for the reasons noted below, the Tribunal does not believe the process of implementing the Price Decrees was so flawed as to amount to a breach of the fair and equitable standard of the ECT.

⁴⁰ Award, May 29, 2003, ¶ 154, quoting the International Court of Justice, Case: *Eletronica Sicula S.p.A. (ELSI)* (*United States of America v. Italy*), 128, p. 65, July 20, 1989, ICJ, General List No. 76.

9.3.42 In reaching this conclusion, the Tribunal was greatly assisted by the testimony offered by György Békés, the head of the Electricity Office Preparation Department of the HEO at the time. To our minds, his evidence describes a not culpably unreasonable implementation process in relation to the Price Decrees.

9.3.43 It is also to be noted that Mr. Békés was not cross-examined. This was, of course, Claimants' right. Mr. Jagusch made the point during the hearing that, in international arbitration, it is not necessary for a party to cross-examine a witness with whose testimony that party may disagree. While this may be so, Mr. Békés was not confronted by Claimants on his evidence and his relevant testimony on process also stands un-contradicted by other testimony or contrary documentation.

9.3.44 Turning to the implementation process itself, Respondent's post-hearing brief provides a useful comparison of Hungary's three administrative pricing cycles for the public utility sector that bears on the issue before the Tribunal.⁴¹ Because Claimants do not fault the first two cycles, it is relevant to their allegation of procedural failings that each and every of the three cycles were somewhat similar.

9.3.45 Mr. Békés recalled that, following the Hungarian parliament's authorization of a return to administrative pricing for generators in early March 2006, the Ministry expected a proposal for an implementing decree from HEO by the end of May, which it intended would go into effect by July 2006.

⁴¹ First Cycle, 1992-2000; Second Cycle, 2001-2004 (generators exempted for 2004); Third Cycle, 2005-2008 (applied to generators from December 2006-2007).

9.3.46 Mr. Békés explained that for HEO to have done a bottom up cost study in the spring of 2006, in the time frame the Ministry had in mind to issue a decree, was impractical.

9.3.47 However, at this time, the HEO had in hand a study for 2005-2009, that indicated a 7.1% WACC for the electricity sector as a whole.⁴² The generators had also previously been informed, on 10 November 2005, in Mr. Horvath's (the HEO president) letter, that a 7.1% return on assets was the target.

9.3.48 Capping profits was the objective at this time. Thus, on 14 March 2006, HEO asked AES and other generators for their financial figures for the 2003-2005 calendar years, *i.e.*, their books. AES supplied its figures by letter, dated 30 March 2006. HEO had previously identified four generators whose returns exceeded 7.1%. It thus determined (based on the generators' own figures) by how much each generator exceeded the 7.1% return concept, and proceeded on the basis that each generator's fees would be reduced accordingly. The same methodology was then applied to all generators. Mr. Békés also made the point that the value of AES's post-retrofit assets were taken into account in determining the price that AES would be able to charge.

9.3.49 On 11 May 2006, the HEO sent each generator the text of the draft 2006 Price Decree, and solicited comments by 18 May 2006 on its proposed approach. (Although no specific prices were provided – this was the same approach HEO had applied in the previous two cycles).

⁴² This study had been done earlier by HEO economists to determine the appropriate figure for return on assets for the initial price calculation for the 2005-2009 pricing cycle for electricity supply and distribution companies which had remained under an administrative pricing regime for that period.

9.3.50 AES commented on 18 May 2006 in accordance with HEO's, admittedly short, deadline. It then amended its comments, four days later, on 22 May 2006. These amended comments were substantive, detailed and led to changes to the draft 2006 Price Decree.

9.3.51 HEO next met AES, on 31 May 2006, to discuss possible changes to the draft 2006 Price Decree.

9.3.52 On 2 June 2006, HEO presented the draft 2006 Price Decree to the Ministry. All of the principal comments that had been received from the generators, along with HEO's preliminary views regarding these comments, were summarized in a table that HEO presented to the Ministry.

9.3.53 Subsequent to HEO's initial proposal to the Ministry, several changes were made to the draft 2006 Price Decree, although the capacity fee proposed for AES Tisza II remained unchanged.

9.3.54 Nevertheless, one important change that was made was the elimination of the original post-hoc profit sharing provision that would have required generators to make payments to MVM, if their profits exceeded the 7.1% target.

9.3.55 This change, which was made by the Ministry in response to the objections in May 2006 from a number of the generators, including AES Tisza, provides at least a partial answer to Claimants' allegations of arbitrary behaviour by Hungary at this time. It also moved the proposed Price Decree to a price capping, not a profit capping model.

9.3.56 Thus, each of Hungary's three relevant pricing cycles used price caps (not a profit cap in the third cycle, as alleged by Claimants). Moreover, the prices established in the last two cycles were both based on returns on assets.

9.3.57 The so-called "reasonable" rate of return (of 7.1% return on assets) was also based on a WACC calculated for the electricity sector as a whole. It can therefore not be said that it bore no rational relationship to the generation companies. Generators also had the ability to exceed the target 7.1% rate of return and AES subsequently did so.

9.3.58 On 17 November 2006, AES wrote to Mr. Horvath complaining about there having been no comprehensive cost review and asserting a right to participate in a price determination process.

9.3.59 The final text of the draft Decree was adopted by the Ministry on 24 November 2006 for the 2006 year.

9.3.60 HEO replied to AES's cost review complaint on 30 November 2006, expressing its position that such a cost review was not required.

9.3.61 With the 2006 Price Decree about to take effect, on 5 December 2006, HEO wrote to AES and the other generators to propose that the prices fixed for each generator for 2006 would be adjusted upward (to the same extent the relevant generator's 2007 PPA price was predicted to exceed the relevant generator's 2006 PPA price) for use in 2007. A two-day comment period was given. AES did not comment.

9.3.62 The 2006 Price Decree went into effect on 9 December 2006.

9.3.63 The 2007 Price Decree was adopted on 26 January 2007, and came into force on 1 February 2007.

9.3.64 The March 2006 amendments to the 2001 Electricity Act (that provided for the reintroduction of administrative prices) did not affect its existing provisions which allow generators to petition for individual price review. Mr. Békés testified that AES Tisza did not submit a request for price review during the relevant review period applicable to the Price Decrees.

9.3.65 AES also had the opportunity to seek to review the process under which the Price Decrees were introduced by proceedings in the Hungarian courts, but did not do so.

9.3.66 Having regard to this uncontested procedural history, the Tribunal does not feel that the several procedural shortcomings in Hungary's implementation of the price decrees (the most obvious being the short-fused periods given by HEO on 11 May and 5 December 2006 to AES to comment on the text of the draft Price Decrees) are sufficient to constitute unfair and inequitable treatment.

9.3.67 The Tribunal was comforted in this view because HEO made it clear to the generators, not later than November 2005, that it considered a 7.1% return on assets to be an appropriate rate of return.

9.3.68 Thus, pre-warned as it had been, AES found it possible to respond to HEO's 11 May 2006 letter requesting comment on the draft 2006 Price Decree within the very short (in the Tribunal's view, over-short) time specified. AES did not apparently consider it necessary to seek

an extension of the deadline. Moreover, it supplemented and amended its comments four days later.

9.3.69 AES's 'late' amendments were not only accepted by HEO as being timely; HEO also acted on some of them. This is not conduct that can substantiate in this case allegations of such a degree of arbitrariness, a lack of transparency, or a lack of due process that amounts to unfair or inequitable treatment.

9.3.70 And, as already indicated, the fact that HEO, following criticism from the generators, eliminated its proposed post-hoc profit sharing provision, shows that it was not behaving in an arbitrary manner. In short, while HEO's consultations with Claimants on the Prices Decrees may not have been optimal, they do not amount to a culpable "failure to consult properly" as alleged.

9.3.71 As regards HEO's failure to perform a costs and assets review, it is true that this was done in the case of the two previous prices cycles. Nevertheless, the Tribunal has concluded that HEO's decision not to follow this practise at this time was not unfair to AES.

9.3.72 This is because HEO accepted AES's costs as reflected in AES's 2004 and 2005 own financial statements as supplied to HEO and its return-on-assets calculations were based on the book value of assets, also as reported in AES's financial statements, precisely as it had done for the second price cycle with which Claimants have no complaint.

9.3.73 In summary, Respondent's process of introducing the Price Decrees, while sub-optimal, did not fall outside the acceptable range of legislative and regulatory behaviour. That being the case, it cannot be defined as unfair and inequitable.

10. UNREASONABLE AND DISCRIMINATORY MEASURES

10.1 Claimants' Position

10.1.1 As regards the Treaty's prohibition of the impairment of investments by unreasonable or discriminatory measures, Claimants say that Hungary's actions must be judged against a standard that its conduct bears a reasonable relationship to some rational policy – rationality to be assessed objectively by the Tribunal.

10.1.2 To support these claims, Claimants say that a return to regulated pricing was irrational, if it was aimed at state aid concerns, because:

- (a) Hungary did not believe, at the time, that there was a state aid problem;
- (b) there is no obligation under Community law to introduce profit caps – profitability having no direct relationship to state aid;
- (c) Hungary had promised to respect civil law contracts; and
- (d) Hungary never consulted the State Aid Monitoring Office of the Ministry of Finance (“SAMO”), which was the state agency responsible for dealing with state aid issues.

10.1.3 On discrimination, Claimants point to the fact that HEO's letter of 10 November 2005 was sent to just four generators, indicating that they should voluntarily give up their contractual rights and reduce their PPA prices. And when the 2006 Price Decree was issued on 24 November 2006, it affected only these four generators. Discrimination is thus evident having regard to the fact that the Commission was concerned that all generator PPAs contained state aid.

10.2 Respondent's Position

10.2.1 Hungary contends it is well settled that states may implement regulatory change as long as they do so for rational, non-arbitrary reasons, and that such regulatory changes do not discriminate unlawfully against a foreign investor that is protected by an applicable investment treaty.

10.2.2 The standard for examining a state's reasons for acting is not a testing one. States have a broad discretion in deciding whether and how to regulate and the burden is on the challenger to demonstrate irrationality, arbitrariness, or a lack of a reasonable relationship to some rational policy.

10.2.3 As regards Claimants' allegations that Hungary's decision to re-regulate prices was a "money grab" to help MVM, based on nothing more than domestic policy grandstanding about "luxury profits," Hungary says that there were legitimate and inter-related reasons for temporarily reintroducing price regulation in 2006:

- (a) Hungary was legitimately concerned about the failure of generators to agree to negotiate any reductions in contracted PPA capacity, to free up electricity for sale to the free market;
- (b) Hungarian policymakers were well aware of the Commission's state aid investigations and of the Commission's concern that generator PPAs contained state aid and prevented new market entrants; and
- (c) the Hungarian authorities were legitimately concerned about the profit levels that some generators were enjoying under non-competitive PPAs.

10.2.4 Thus, Hungary says that there were rational reasons that led it to reintroduce the price regulation for a transitional period, pending full market liberalization and while awaiting the EC's Final Decision on the legality of the PPAs'.

10.2.5 Hungary also argues that there was nothing irrational about the government's use of its right to exercise supervisory authority over generator prices by setting certain maximum levels, for generators that were not under market conditions. Moreover, the fact that the methodologies for implementing the policy evolved over the intervening decade does not suggest that the underlying policy itself was no longer rational.

10.2.6 As to Claimants' discrimination case, Hungary says that Claimants must show there was: (a) differential treatment between parties similarly situated; and (b) no justification for such differentiation.

10.2.7 In this regard, Hungary argues that Claimants cannot succeed because there was no differential treatment at all. This is because prices (and especially capacity fees) were never uniform across generators in Hungary – they were always set in relation to each power plant's underlying costs, and the generators' cost structures varied substantially. Also, Tisza II's capacity fee had always been lower than that of other generators, whether under administrative or PPA pricing, because of its lower fixed costs.

10.2.8 In addition, Hungary maintains that price caps were set by a uniform methodology which was applied to all generators and was based on a uniform measure of reasonable return

(i.e., a 7.1% return on assets). It was simply the fact that each plant had a different starting point of prior returns that made the resulting price outcomes different.⁴³

10.2.9 In response to Claimants' allegation that only four generators were targeted and affected by the Price Decrees, Hungary relies on Mr. Békés's uncontradicted explanation that the HEO reviewed financial performance data for all generators and determined that only four had exceeded the identified target return of 7.1%. The fact that only those generators whose returns exceed a maximum permitted level would be affected by a price cap does not constitute unlawful discriminatory targeting.

10.3 Findings of the Tribunal

10.3.1 Article 10(1) of the ECT provides that "no Contracting Party shall in any way impair by unreasonable or discriminatory measure their [investment's] management, maintenance, use, enjoyment or disposal."

10.3.2 Hungary was thus obliged to avoid any impairment of Claimants' investment as a consequence of either: (a) unreasonable or (b) discriminatory measures.

10.3.3 An analysis of the nature of a state's measures, in order to determine if they are unreasonable or discriminatory, is only necessary when an impairment of the investment took place.

⁴³ Counter-Memorial, ¶ 376.

10.3.4 It is undisputed that, as a result of the reintroduction of the Price Decrees, Claimants received lower prices than they had been receiving pursuant to the formula set out in the 2001 PPA.

10.3.5 It follows that AES's receipt of a lower payment from MVM, whilst burdened by unchanged costs, had a detrimental impact on Claimants' investment, as it altered – in a negative way – AES Tisza's regular income.

10.3.6 However, for such impairment to amount to a breach of the ECT, it must be the result of an unreasonable or discriminatory measure.

10.3.7 There are two elements that require to be analyzed to determine whether a state's act was unreasonable: the existence of a rational policy; and the reasonableness of the act of the state in relation to the policy.

10.3.8 A rational policy is taken by a state following a logical (good sense) explanation and with the aim of addressing a public interest matter.

10.3.9 Nevertheless, a rational policy is not enough to justify all the measures taken by a state in its name. A challenged measure must also be reasonable. That is, there needs to be an appropriate correlation between the state's public policy objective and the measure adopted to achieve it. This has to do with the nature of the measure and the way it is implemented.

10.3.10 Hungary has argued that it had three main reasons for introducing the Price Decrees.⁴⁴

⁴⁴ Respondent's post-hearing submission, ¶ 65.

10.3.11 First, Hungary was concerned about the failure of generators to agree over several years to any reductions in contracted PPA capacity, to free up electricity for direct sale to the parallel free market, that had to be developed during the period of transition from the centralized economy to a liberal market.⁴⁵

10.3.12 As to this point, the Tribunal finds that it cannot be considered a reasonable measure for a state to use its governmental powers to force a private party to change or give up its contractual rights. If the state has the conviction that its contractual obligations to its investors should no longer be observed (even if it is a commercial contract, which is the case), the state would have to end such contracts and assume the contractual consequences of such early termination.

10.3.13 This does not mean that the state cannot exercise its governmental powers, including its legislative function, with the consequence that private interests – such as the investor’s contractual rights – are affected. But that effect would have to be a consequence of a measure based on public policy that was not aimed only at those contractual rights. Were it to be otherwise, a state could justify the breach of commercial commitments by relying on arguments that such breach was occasioned by an act of the state performed in its public character.

10.3.14 Therefore, the Tribunal cannot consider it to have been reasonable for Hungary to have issued the Price Decrees because of Claimants’ failure to agree to, or even to negotiate for, a reduction in the capacity to which it was contractually entitled under the 2001 PPA.

⁴⁵ Respondent’s post-hearing submission, ¶ 67.

10.3.15 Hungary's second stated reason for the introduction of the Price Decrees was the pressure of the EC Commission's investigations and the foreseeable obligation to correct (recover) state aid that the Commission's decision would impose.

10.3.16 Had Hungary been motivated to reintroduce price regulation with a view to addressing the EC's state aid concerns, there is no doubt that this would have constituted a rational public policy measure. However, the Tribunal notes that as long as the Commission's state aid decision was not issued, Hungary had no legal obligation to act in accordance with what it believed could be the result of the decision and to start a limitation of potential state aid.

10.3.17 During the hearing, it became clear to the Tribunal that SAMO, the Hungarian agency in charge of dealing with state aid issues, had not even been consulted when the government reintroduced regulated pricing in March 2006. Another important fact is that the use of the 7.1% cap on profits had no direct relation with state aid, because state aid occurs when the entity is receiving above-market prices. The elimination of above-market prices is not achieved by a cap on profits. To address such price concerns requires a general market price analysis.

10.3.18 Consequently, the majority concludes that Hungary's decision to reintroduce administrative pricing was not motivated by pressure from the EC Commission.

10.3.19 Arbitrator Stern considers that it was not exclusively so motivated, but that the enquiry and subsequent pressures from the Commission certainly was in the Hungarian authorities' mind when they decided to reintroduce price regulation. In her view, it appears from the record that the high prices were also a serious problem for the Commission and it is quite evident that even before Hungary was under a legal obligation to follow the Commission's decision, it had been

made abundantly clear to Hungary that the PPAs raised considerable concerns at the European level, as being in contradiction with the European free market policies. For example, in a meeting with the Commission in Brussels on 15 July 2004, concerns were expressed by the Commission that the stranded costs mechanism of Decree 183/ 2002 constitutes state aid to the generators, stating that “it must be ensured that none of the power plants reaches *extra profits* under the PPAs.” In other words, the EC position on the PPAs cannot be separated from the motivation that was behind the Price Decrees. It is noticeable that it is on 10 November 2005, one day after a European Commission’s decision strongly critical of the PPAs, that HEO sent the letter to AES Tisza in which it claimed that the profits of the company were “unjustifiable high” and suggested that the profits should be capped at a maximum of 7.1%. Several factors – the state aid investigation, the obstacles to liberalization and the generators’ excessive returns – were clearly interrelated, in the minds of the Hungarian government and regulators, when faced with the high profits of the generators. To arbitrator Stern, the evidence is overwhelming that the decision to reintroduce maximum administrative prices was a rational, non-arbitrary response to a complex set of legitimate policy concerns.

10.3.20 Hungary’s third reason for acting had to do with the allegations that the profits enjoyed under the PPAs, in the absence of either competition or regulation, exceeded reasonable rates of return for public utility sales. Hungary does not deny that one of its reasons for acting had to do with these concerns.

10.3.21 In 2005, HEO made calculations that showed that several generators were earning returns in excess of the WACC level for the regulated electricity sector as a whole. After a series

of unsuccessful attempts at PPA renegotiations, HEO presented the data regarding the generator's returns to the parliament's Energy Subcommittee.⁴⁶

10.3.22 In the meantime, the level of the generators' returns became a public issue and something of a political lightning rod in the face of upcoming elections.

10.3.23 However, the fact that an issue becomes a political matter, such as the excessive profits of the generators and the reintroduction of the Price Decrees, does not mean that the existence of a rational policy is erased.

10.3.24 In fact, it is normal and common that a public policy matter becomes a political issue; that is the arena where such matters are discussed and made public.

10.3.25 Eventually, an amendment to the 2001 Electricity Act and the Price Act, to enable the reintroduction of regulatory pricing, was proposed to parliament by Mr. Podolák on 5 December 2005. The objective of the amendment was that "the transmission and distribution of electricity, the controlling of the system, the selling of electricity contracted for public utility purposes by generators, trading between the public utility wholesaler and the public utility service provider and the electricity sold to consumers in the public utility sector are subject to the regulatory pricing stipulated under the act on the determination of prices."⁴⁷

10.3.26 This amendment proposal contained a general explanation in the following terms:

⁴⁶ Exhibit R-196.

⁴⁷ Exhibit C-82.

“This act shall be enacted by the Parliament to include the generators’ price of electricity contracted for public utility purposes in the scope of regulatory pricing.

During the privatization of power stations in 1995-96, long-term power purchase agreements were concluded between power stations and MVM Rt. State revenue resulting from the conclusion of long-term power purchase agreements represented revenue from privatization. By way of the agreements stable and foreseeable returns are ensured to those investors who secure the availability of electricity generation capacities necessary to meet domestic demand through the modernization of existing power stations (or the construction of new ones).

Price formulas had been identified in the agreements but the application of these formulas was abrogated by regulatory pricing.

In the Government Decree 1074/1995 (4th August) on the regulation of electricity prices and price correction to be in effect until 1st January 1997 the Horn Cabinet guaranteed an 8% return on capital by way of regulatory pricing during the conclusion of privatization agreements. Pursuant to the above decree an administrative price regulation scheme came into effect for a period of 4 years (JKM Decree No. 63/1995 (24th November) Annex 1).

In 1997 the generators’ average profit was 8.23%, a percentage that steadily increased until 2000 as a result of the efficiency improvement of power stations. By 2000 the average profit of generators was 15.71%.

In 2000 PriceWaterhouseCoopers International consulting company, upon engagement by the Orbán Cabinet, indicated in its report titled “Energy Market Opening Program” that the long-term agreements are impeding the liberalization of the energy market as the agreements contract nearly all domestic power station capacities until 2010-2015 and as such there is no free marketable electricity remaining in the market. Due to the above the international consultant proposed to the Orbán Cabinet to reduce regulatory prices during the new price regulatory period using this as an additional measure to encourage generators to renegotiate the agreements.

Had the Orbán Cabinet given consideration to the proposal presented by the international consultant engaged by it, then the Hungarian Energy Office (lead by Director General Péter Kaderják, appointed by György Matolcsi Minister of Economy) would have been required to propose an administrative price determination that would have repeatedly reduced the generators’

profit to 8% in relation to the on-coming 4-year price regulation period to be determined in 2000. On the contrary the administrative price decree (No. 45/2000 (21st December) issued by the Ministry of Economy) abrogated the regulation concerning the 8% profit margin and introduced new price formulas.

As a result of the decision made by the Minister of Economy on the Orbán Cabinet, the 2001 profit of power stations was 22.83% as opposed to the expected 8%. This price regulation was in effect until the end of 2003 ensuring a steadily high profit level to power station investors. Act 110 (in its final clauses, Section 117 paragraph (2)) on electricity presented by the Orbán Cabinet and approved by the Fidesz-FKGP MPs on 18th December 2001 terminated administrative price regulation for generators as of 1st January 2004. Therefore the previously unapplied price formulas that are based on administrative pricing and are stipulated in the agreements came into effect.

The margins generated by power stations between 1997 and 2004 were as follows:

1997	1998	1999	2000	2001	2002	2003	2004
8.23%	12.73%	12.70%	15.71%	22.83%	21.62%	14.49%	22.36%

This draft legislation includes a proposal for correcting the regulatory error by the Orbán Cabinet and allows for the Government to exercise the measure of administrative pricing in the absence of agreement between the parties, which measure also affects the sale prices stipulated in long-term power purchase agreements providing high profit levels.”

10.3.27 For its part, the FIDESZ presented an independent representative proposal,⁴⁸ which did not propose the reintroduction of the Price Decrees but requested the government, among other

⁴⁸ Exhibit C-83.

things, to review the PPAs, to create the conditions of fair competition in the national electric energy market and to ensure affordable prices.

10.3.28 The reasoning behind the FIDESZ proposal was similar to Mr. Podolák’s proposal, as it indicated that:

“the prices of electric power are unfairly high compared to the price level of countries around us. For the security of the people and in order to lighten the financial burden of families and to increase the competitiveness of enterprises and with the intention to perceivably reduce the price of electric energy and to create honest competition in the market, the National Assembly passes the following resolution ...

REASONING

Of all new EU members states, it is we, Hungarians, that pay the most for electric energy. A Hungarian household and family pays twice as much for electricity as the Baltic States, 40% more than the Polish and the Czech and 20% more than Slovaks. The price of electric energy turned out like this despite of the fact that there is official price setting giving the State the opportunity to set a more favorable price ...”⁴⁹

10.3.29 On 3 March 2006, the Electricity Act was amended by the Hungarian parliament, reflecting the amendment proposed by Mr. Podolák on 5 December, 2005.⁵⁰ The FIDESZ abstained from voting on the proposal.

10.3.30 Based on the debates in parliament and outside parliament, the majority of the Tribunal has concluded that Hungary’s decision to reintroduce administrative pricing was not based on the

⁴⁹ Exhibit C-83.

⁵⁰ Exhibit C-82.

EC Commission's investigation. Nor, however, was it made with the intention of affecting Claimants' contractual rights

10.3.31 Rather, against this factual background, the majority has concluded that Hungary's reintroduction of administrative pricing in 2006 was motivated principally by widespread concerns relating to (and it was aimed directly at reducing) excessive profits earned by generators and the burden on consumers.⁵¹

10.3.32 This is because virtually all of the debate in parliament at the relevant time was about "profits." Indeed, government minister Mr. Tibor Kovács specifically asked the opposition parties if they were prepared to support the proposal, which he said "gives tools for the government to limit the alleged and so-called luxury profits."⁵²

10.3.33 There is also no reference to be found to EC state aid or negotiations with EC in the official reasons for Act XXXV.

10.3.34 Having concluded that Hungary was principally motivated by the politics surrounding so-called luxury profits, the Tribunal nevertheless is of the view that it is a perfectly valid and rational policy objective for a government to address luxury profits. And while such price regimes may not be seen as desirable in certain quarters, this does not mean that such a policy is irrational. One need only recall recent wide-spread concerns about the profitability level of banks to understand that so-called excessive profits may well give rise to legitimate reasons for governments to regulate or re-regulate.

⁵¹ Transcript, pp. 844:2-845:2; Exhibit R-172, ¶ 229.

⁵² Exhibit SF 19, p. 9.

10.3.35 As to the need for a reasonable correlation between the state's policy objective and the measures adopted to achieve it, the Tribunal notes that before the amendment of the 2001 Electricity Act, Hungary had approached the generators to renegotiate the PPAs. Given that no agreement was reached, and in the absence of a specific commitment to the Claimants that administrative pricing was never going to be reintroduced, the Hungarian parliament voted for the reintroduction of administrative pricing, which parliament considered to be the best option at the moment.

10.3.36 The Tribunal finds that both the 2006 Electricity Act and the implementing Price Decrees were reasonable, proportionate and consistent with the public policy expressed by the parliament.

10.3.37 Having determined that the decision to introduce the Price Decrees was not an arbitrary or unreasonable measure, it is also necessary to determine if, as stated by Hungary, the generators were still going to receive a reasonable return.

10.3.38 The regulatory regime in place at the time of the privatization was provided by the 1994 Electricity Act. Under the 1994 Act, the HEO would issue detailed rules on pricing, based on which the minister would determine prices to be announced in the form of a decree.⁵³ The 1994 Electricity Act also provided, in Article 55(3), that the HEO should review the price levels and actual prices on the basis of the initiative of any interested party, and shall make the results of the process public. This provision is understood by the Tribunal as providing the right to any

⁵³ Exhibit C-58, Article 55 of the 1994 Electricity Act.

interested party (obviously including generators) to request a costs review of the prices, but only after they have been issued by the minister.

10.3.39 In addition, the Original PPA provided that payment was to be made by reference mainly to both the Availability Fee which is “paying the need for capacity to be in place in case it is needed” and the Electricity Fee which is “the cost of the power it actually requires to have generated.”⁵⁴ Both fees’ values to be specified in the Annual Commercial Agreement should be considered based upon the order of the Ministry of Industry and Trade.

10.3.40 The HEO issued a detailed framework pertaining to the pricing every four years, beginning in 1997. Under the 1994 Electricity Act, there were two pricing frameworks:

- (a) the 1995 Framework Decree. Both parties agree that with this decree, the profit was supposed to be an 8% return on equity, approximately;⁵⁵
- (b) the 2000 Framework Decree. The starting point of the price regulation mechanism was provided by the base prices on 1 January 2001 and the preceding assets and cost reviews carried out by HEO. A mechanism of yearly price correction was established, and inflation was also taken into account.

10.3.41 The 2000 Framework Decree was valid until 1 January 2004, which was the date established in the 2001 Electricity Act for the abolishment of regulated prices.

10.3.42 Therefore, starting on 1 January 2004, the formula established in Schedule 6 of the 2001 PPA was applied to AES Tisza’s payments.

⁵⁴ Memorial, ¶ 65.

⁵⁵ On the one hand, Claimants stated that the 8% return on equity was a starting price, on the other hand, Respondent stated that the 8% return on equity was a maximum cap.

10.3.43 The Price Decrees provided a 7.1% pre-tax return on assets.

10.3.44 Against the factual background which preceded the March 2006 price re-regulation, the Tribunal considers that the 7.1% rate of return on assets, which it prescribed, to be comparable to the 8% return on equity target that was in place at the time of the privatization.⁵⁶ Consequently, in the Tribunal's view, the prices fixed for AES Tisza pursuant to the Price Decrees were reasonable, taking into account their consistency with the original returns it earned at the time of the Claimants' original investment.

10.3.45 Turning finally to Claimants' case based on discrimination, the Tribunal observes that the Price Decrees, which were applicable to all the generators, established a specific price per KHUF/MW/YR to be paid for the Availability Fee (Capacity Fee) depending on the generator.

10.3.46 Claimants contend that this constitutes discrimination, given that the price fixed for AES Tisza was the lowest of all the generators (including foreign and local).

10.3.47 However, the Tribunal finds that the price established for each of the generators was reached using the same methodology. The fact that the price for each generator was different was simply the result of the use of a different starting point of prior returns which was fed into the methodology.⁵⁷

10.3.48 Moreover, to suggest that AES's low capacity fee ranking (in comparison to other generators) is indicative of discrimination is misleading. AES's capacity fees were always at the

⁵⁶ Kovacs Statement, ¶ 39.

⁵⁷ Békés First Statement, p. 36 and p. 38.

bottom of the scale (*see* Appendix C, Respondent’s post-hearing brief) in each of the three relevant price cycles. But, as Mr. Békés explained, that was because capacity fees were based on cost structure, and the Tisza II plant had relatively low fixed costs per unit of capacity.

10.3.49 By contrast, energy fees (Electricity Fees) were based on variable operating costs, which were relatively high at Tisza II. This resulted in AES Tisza always receiving amongst the highest energy fee of any of the generators.

10.3.50 The Tribunal thus concludes that neither its low capacity fees, nor its high energy fees suggest discrimination. Both were the logical result of a uniform methodology that was applied equally to all generators, based on their differing assets and operating cost structures.

10.3.51 The same can be said for Claimants’ assertions of discrimination based on the fact that only four generators were affected (“targeted”) by the reintroduction of price regulation. This is because the notion of a cap on prices based on a starting target of “reasonable returns” means that generators that are already earning below that return will not be affected by the regulation.

10.3.52 And having regard to the objective of 2006/2007 price cap regulation, of protecting consumers from having to fund so-called “excessive profits” of generators, it is perfectly logical that generators whose returns were not “excessive” at the time of re-regulation would not be affected by the cap.

10.3.53 Discrimination necessarily implies that the state benefited or harmed someone more in comparison with the generality. In this case, on the uncontradicted facts, the Tribunal finds that there has been no different treatment of AES Tisza in comparison with the other generators and, thus, that it was not the subject of discriminatory treatment.

11. NATIONAL TREATMENT

11.1 Claimants' Position

11.1.1 Claimants argue in support of their national treatment case that the treatment received by the Paks power station, a domestically owned electricity generator, and wholly-owned subsidiary of MVM, was more favorable than the treatment received by all the other generators, because Paks actually received a price increase under the Price Decreases in comparison with the one agreed in its PPA.⁵⁸

11.2 Respondent's Position

11.2.1 The Respondent denies a breach of the ECT's national treatment obligation and asserts that the Price Decreases "only overrode contractual pricing when it exceeded the "maximum" level set by the uniform 7.1% return-on-assets methodology" and that such situation did not happen in the case of Paks because, based on contractual formula in its PPA, its actual return was significantly lower than the target level.⁵⁹

11.3 Findings of the Tribunal

11.3.1 Article 10(7) of the ECT obliges each signatory party to accord "treatment no less favorable than that which it accords to Investments of its own Investors or for the Investors of any other Contracting Party or any third state and their related activities."

⁵⁸ Memorial, ¶ 239.

⁵⁹ Counter-Memorial, ¶ 383.

11.3.2 The alleged breach of the obligation to provide national treatment is based on the same facts that Claimants alleged amounted to a discriminatory measure,⁶⁰ where the Tribunal found that no discriminatory measure was taken by the government. Indeed, Claimants’ admitted that the generator with the highest capacity fee was, like itself, foreign.

11.3.3 Therefore, as was concluded in Section 10 above, the Tribunal finds that Hungary did not breach its ECT obligation to provide national treatment to AES Tisza.

12. MOST FAVOURED NATION TREATMENT

12.1 Claimants’ Position

12.1.1 The Claimants allege that the facts relied on in relation to discriminatory measures also establish a violation of the most favoured nation treatment obligation.

12.2 Respondent’s Position

12.2.1 The Respondent claims that “the application of a uniform methodology to all power plants with PPAs, based on the objective of capping returns at prescribed rates of reasonableness, is not rendered discriminatory simply because some plants had previously exceeded the “reasonable” level by more than others.”

⁶⁰ With the difference that Claimants specify that the national generator that received a better treatment is Paks. Memorial, ¶ 239.

12.3 Findings of the Tribunal

12.3.1 Article 10(7) of the ECT obliges each signatory party to accord “treatment no less favorable than that which it accords to Investments of its own Investors or for the Investors of any other Contracting Party or any third state and their related activities.”

12.3.2 The alleged breach of the most favoured nation treatment obligation is based on the same facts that Claimants alleged amounted to a discriminatory measure,⁶¹ where the Tribunal found that no discriminatory measure was taken by the government – *i.e.*, that each generator’s price was determined based on the application of a uniform methodology. This being the case, there can be no suggestion that AES was treated “less favourably” than any other similarly positioned investor.

12.3.3 Therefore, as was concluded in Section 10, the Tribunal finds that Hungary did not breach its ECT obligation to provide most favoured nation treatment to AES Tisza.

13. CONSTANT PROTECTION AND SECURITY

13.1 Claimants’ Position

13.1.1 Claimants maintain that the state’s obligation to provide constant protection and security covers not only the physical security of the investment but also the legal security and protection.

⁶¹ With the difference that Claimants specify that the other generators that received a better treatment are Budapesti, Pannon, Mátra and Csepeli. Memorial, ¶ 245.

13.1.2 In their opinion, Hungary breached the standard when it failed to ensure the legal security of the investments through the 2006 Electricity Act Amendment and the ensuing implementation of the Price Decrees, given that such acts have substantially devalued their investment.

13.1.3 Relying on the duty identified by the Tribunal in *CME*, Claimants say that the 2006 Electricity Amendment Act and the Price Decrees eviscerated their rights under the 2001 Settlement Agreement and the 2001 PPA. Hungary thus made it “impossible to preserve and continue contractual arrangements underpinning the investment” and has therefore breached the most constant protection and security provisions of Article 10(1).⁶²

13.1.4 The requirement to provide constant protection and security is a duty:

“to use the powers of government to ensure the foreign investment can function properly on a level playing field, unhindered and not harassed by the political and economic domestic powers that be.”⁶³

13.1.5 And the level playing field here, which Hungary itself destroyed, was the pre-existing, freely negotiated contractual relationship that the generators enjoyed with MVM.

13.2 Respondent’s Position

13.2.1 To the contrary, Hungary argues that the obligation to provide constant protection and security cannot be understood as a treaty-based stabilization clause, tantamount to a guarantee of a “legal security” under which a state will take no action that interferes with the “contractual

⁶² Memorial, ¶ 254.

⁶³ Exhibit CA-80, T.M. Wälde, Energy Charter Treaty-based Arbitration, Transactional Dispute Management, Vol. 1, Issue 3, p.30.

arrangements underpinning [an] investment.” Respondent says that the standard imposes a duty of “due diligence” that requires the state to afford reasonable protection to investors against foreseeable harm from third parties. It adds that there can be no credible suggestion that the Price Decrees were designed to destroy a “level playing field on which Claimants could properly function unhindered and not harassed by the political and economic powers that be” when their very purpose was to ensure a reasonable return for all generators with PPAs.

13.2.2 Respondent admits that some tribunals have recently expanded the scope of protection beyond the two traditional areas (*i.e.*, physical protection and the provision of reasonable legal avenues to enforce investors’ rights) to include general references to legal security. But even under such an expansive reading, the protection is not absolute, and applies only in exceptional circumstances.

13.3 Findings of the Tribunal

13.3.1 In addition to the fair and equitable standard, Article 10(1) of the ECT establishes that the “investments shall also enjoy the most constant protection and security and no Contracting Party shall in any way impair by unreasonable or discriminatory measures their management, maintenance, use, enjoyment or disposal.”

13.3.2 In the Tribunal’s view, the duty to provide most constant protection and security to investments is a state’s obligation to take reasonable steps to protect its investors (or to enable its investors to protect themselves) against harassment by third parties and/or state actors. But the standard is certainly not one of strict liability. And while it can, in appropriate circumstances,

extend beyond a protection of physical security,⁶⁴ it certainly does not protect against a state's right (as was the case here) to legislate or regulate in a manner which may negatively affect a claimant's investment, provided that the state acts reasonably in the circumstances and with a view to achieving objectively rational public policy goals.

13.3.3 In the words of Brownlie, the duty is no more than to provide "a reasonable measure of prevention which a well-administered government could be expected to exercise under similar circumstances."⁶⁵

13.3.4 Claimants' argument, that the "level playing field," defined as "the pre-existing, freely negotiated contractual relationship that the generators enjoyed with MVM" had somehow to be protected by Hungary is seriously overreaching, given that neither the 2001 Settlement Agreement, nor the 2001 PPA, contemplated that pricing regulation could not be reintroduced. The PPA only stipulated that if the administrative pricing disappeared specific formulas would be applied.

13.3.5 To conclude that the right to constant protection and security implies that no change in law that affects the investor's rights could take place, would be practically the same as to recognizing the existence of a non-existent stability agreement as a consequence of the full protection and security standard.

⁶⁴ *Compañía de Aguas del Aconquija, S.A. and Vivendi Universal S.A. v. Argentine Republic*, Award, 20 August 2007, ¶ 7.4.16

⁶⁵ Brownlie, Ian, *System of the Law of Nations: State Responsibility* (1986), p. 162.

13.3.6 The Tribunal finds that there can have been no breach of the obligation to provide constant protection and security as a result of Hungary’s reintroduction of regulated pricing in 2006-2007, such reintroduction being based on rational public policy grounds.

14. EXPROPRIATION

14.1 Claimants’ Position

14.1.1 Claimants’ argue that Hungary “summarily and arbitrarily expropriated substantial revenues which AES Tisza had been contractually entitled to receive under the 2001 PPA”⁶⁶ by amending the 2001 Electricity Act and issuing of the Price Decrees. This act is considered by Claimants as a conduct “equivalent to nationalization or expropriation.”⁶⁷

14.1.2 In this regard, Claimants state that, as it has been decided by numerous arbitral tribunals, an act tantamount to expropriation occurs when the state deprives an investor of its contractual rights even when the act does not involve a taking of physical property.⁶⁸

14.1.3 In addition, Claimants maintain that the expropriation may be indirect when there is an interference with the use of property, even if is incidental and even if the state does not benefit from such interference.⁶⁹

14.1.4 Moreover, Claimants contend that a state’s measures can amount to expropriation even when they are in force for only a limited period. Reliance is placed on *Wena Hotels v. Arab*

⁶⁶ Memorial, ¶ 255.

⁶⁷ Memorial, ¶ 255.

⁶⁸ Memorial, ¶¶ 256 *et seq.*

⁶⁹ Memorial, ¶ 258.

Republic of Egypt (ICSID Case No. ARB/98/4), in which the Tribunal determined that an expropriation can take place even when the interference was executed only during a limited period of time.⁷⁰

14.2 Respondent's Position

14.2.1 Respondent contends, in brief, that Claimants have no legal basis to claim an expropriation (direct or indirect) given that Hungary's acts did not deprive the Claimants from the use and control of their investment and the investment was not deprived of all meaningful value.⁷¹ Respondent says that such requirements are preconditions to a finding of an expropriation by the Tribunal. Furthermore, the Respondent argues that Claimants do not contend that AES suffered harm remotely equivalent to a traditional expropriation and that they cannot expand the doctrine of indirect expropriation to cover acts which may lead to the temporary diminution of their profits. According to the Respondent, Claimants themselves acknowledged to the EC that regulating prices was more the rule than the exception in Hungary: in a letter dated 13 February 2006, Claimants described price controls as having been simply “*suspended for a brief interlude commencing 1st January 2004.*”⁷²

14.3 Findings of the Tribunal

14.3.1 It is evident that many state's acts or measures can affect investments and a modification to an existing law or regulation is probably one of the most common of such acts or

⁷⁰ Memorial, ¶ 263.

⁷¹ Counter-Memorial, ¶ 406.

⁷² AES's memorandum to the EC, R-93, 13 February 2006.

measures. Nevertheless, a state's act that has a negative effect on an investment cannot automatically be considered an expropriation. For an expropriation to occur, it is necessary for the investor to be deprived, in whole or significant part, of the property in or effective control of its investment: or for its investment to be deprived, in whole or significant part, of its value.

14.3.2 But, in this case, the amendment of the 2001 Electricity Act and the issuance of the Price Decrees did not interfere with the ownership or use of Claimants' property. Claimants retained at all times the control of the AES Tisza II plant, thus there was no deprivation of Claimants' ownership or control of their investment.

14.3.3 Moreover, Claimants continued to receive substantial revenues from their investments during 2006 and 2007, which proves that the value of their investment was not substantially diminished and that they were not deprived of the whole or a significant part of the value of their investments.

14.3.4 In these circumstances, the Tribunal concludes that the effects of the reintroduction of the Price Decrees do not amount to an expropriation of Claimants' investment(s).

15. COSTS

15.1 Claimants' Position

15.1.1 On 8 July 2010, the Claimants filed their final Statement of Costs which amounted to a total cost of US\$ 8,787,993.70 and included legal fees and expenses. To date, Claimants have paid an advance on costs to ICSID and the Tribunal in the amount of US\$ 459,945.00.

15.2 Respondent's Position

15.2.1 For its part, on 25 June 2010, Respondent filed its final Statement of Costs which amounted to a total cost of US\$ 5,522,883.00 which included legal fees and expenses. To date, Respondent has paid an advance on costs to ICSID and the Tribunal in the amount of US\$ 460,000.00.

15.3 Findings of the Tribunal

15.3.1 The cost of the arbitration, which includes, *inter alia*, the arbitrators' fees, the expenses of the Tribunal, the Secretariat's administrative fee and the charges for the use of the facilities of the Centre, at the time of the award, amounts to US\$ 887,839.04.⁷³

15.3.2 Pursuant to Article 61(2) of the ICSID Convention, as well as Rule 28 of the ICSID Arbitration Rules, the Tribunal has the discretion in the absence of a prior agreement between the parties to decide the allocation of the costs and the legal fees and expenses between the parties.

15.3.3 It is the view of the Tribunal that no frivolous claim was filed in the proceeding and that no bad faith was observed from the parties. In fact, the Tribunal notes that the submissions and the argumentations of both parties were presented in a professional manner. Consequently, the Tribunal concludes that each party shall bear its own costs and expenses and share equally in the costs and charges of the Tribunal and the ICSID Secretariat.

⁷³ The total cost of the arbitration proceeding (US\$ 887,839.04) includes an estimate of the courier expenses for the dispatch of the award and may thus be subject to slight change. A final financial statement will be issued by the Centre upon the closure of the trust fund account established for this case.

16. OPERATIVE PART

16.1 On the basis of the foregoing reasons, this Tribunal **ORDERS AND AWARDS** as follows:

- (a) The Tribunal has jurisdiction over all the ECT claims presented in this arbitration;
- (b) The Respondent did not breach Articles 10(1), 10(7) and 13 of the ECT;
- (c) The parties shall bear the costs of the arbitration in equal shares;
- (d) The parties shall bear their own costs and legal fees;
- (e) All other claims are dismissed.

[signed]

Claus Werner von Wobeser
(*President*)

Date: [September 17, 2010]

[signed]

J. William Rowley QC
(*Arbitrator*)

Date: [26 August 2010]

[signed]

Prof. Brigitte Stern
(*Arbitrator*)

Date: [30 August 2010]