Arbitrating Energy Disputes: Hot Topics

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National Report of Hungary

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1. ARBITRATING LONG-TERM CONTRACTS IN THE ENERGY SECTOR

1.1 In your jurisdiction: Is arbitration a widely accepted and used dispute resolution method in the energy sector when long-term contracts are in dispute? Do you see arbitration clauses in the agreements executed in the development of power plants? Do you normally include arbitration clauses in EPC and O&M Contracts? Do banks accept introducing arbitration clauses in credit agreements with the SPV and in the security package? What are the reasons for choosing arbitration as a preferred dispute resolution method over proceedings before state courts?[1]

Yes, it can be said so. Arbitration clauses in commodity trade, especially wholesale, agreements and EPC agreements are quite common. They can also be included in O&M and other project agreements (fuel supply, land lease), especially if being part of the same project.

Reasons for selecting arbitration as a forum is several fold: (i) conceived expertise; (ii) speed; (iii) given the significant fee of arbitration, possible deterrence of the other party from going to dispute settlement. Especially item (i), as the energy sector requires special technical, financial and also legal knowledge, which ordinary courts might lack.

1.2 Do parties choose ad hoc or rather institutional arbitration for disputes regarding the revision of long-term contracts? What are the reasons?

They opt for institutional arbitration. Especially that in Hungary, there is a special arbitration tribunal for energy matter, the Energy Arbitration Court ("EAC") (www.eavb.hu).

1.3 Expertise and Multiple Appointment of Arbitrators

1.3.1 Do arbitrators have the necessary legal, technical and economic expertise to decide on the revision of long-term contracts? Should technical experts be appointed as arbitrators in order to bring the required know-how to the panel?

They usually have the necessary legal knowledge. They also tend have, at least, a certain business or technical acumen.

For reference, a significant part members on the roll of arbitrators are not lawyers but have a different background economists or engineers.

1.3.2 Multiple appointments of arbitrators: The number of arbitrators having the necessary legal, economic and commercial expertise for these kinds of disputes might be limited in certain jurisdictions. Accordingly, the potential arbitrators are drawn from

[1] Maximum flexibility? That parties can choose arbitrators experienced in the energy sector? That they can choose the venue? That they can agree on confidentiality and privacy? That it is easier to enforce an award in the international context than judgments in foreign jurisdictions? The neutrality of the arbitration proceedings? Any other considerations?

a smaller or specialized pool of arbitrators. However, Part II, Article 3.1.5 IBA Guidelines on Conflicts of Interest in International Arbitration 2014 ("IBA Guidelines 2014") states: The arbitrator currently serves, or has served within the past three years, as arbitrator in another arbitration on a related issue involving one of the parties, or an affiliate of one of the parties" Further, Part II, Article 3.1.3 IBA Guidelines 2014 states that "The arbitrator has, within the past three years, been appointed as arbitrator on two or more occasions by one of the parties, or an affiliate of one of the parties." Both provisions are listed in the Orange List of the IBA Guidelines 2014. A potential arbitrator has to disclose any circumstances constituting these two grounds. Have these grounds been used by recalcitrant parties to object to the appointment of an arbitrator?

Even thought the rules of procedure of the EAC contains similar provisions and a green, orange and red list, there is little public information on whether or not these are invoked by parties to object the appointment of an arbitrator.

1.3.3 Does the nationality of arbitrators play a more important role in arbitrations regarding the revision of long-term contracts than in other commercial arbitrations?

Given the extremely few publicly available cases, I would say no.

1.4 Do parties to long-term contracts favor a settlement over an award in which the arbitral tribunal decides on the revision of the price formulae or even ascertains a new price formula? If so, for which reasons?

I would say that just like in any other disputes, the parties do favor a bilateral settlement over a price review related dispute than an arbitral award. The reasons are several fold: (i) in a settlement, the parties can decide which factors take or not take into consideration, even if provided for in a review clause; (ii) faster and cheaper; (iii) there may be factors which require knowledge and expertise other than legal (e.g. financial, market specific, even technical), which might not be present with the arbitrators.

1.5 "Price Review Clause" or Price Re-Opener Clauses"

1.5.1 Were (and are) price formulae usually indexed directly or indirectly to alternative competing fuels, e.g. oil, coal products? What are the (historical) reasons for this indexation?

Yes. Long term natural gas supply agreements ("**GSA**") were, historically, oil index based. Up until the 2000's, the exclusive source of gas was Russia. Since Gazprom applied oil based prices *vis-á-vis* the importer, it, in turn, applied the same formula towards its partners. Recently, this changed because of (i) other, competing sources of import gas; and (ii) presumably, Gazprom's flexibility, to some extent, to apply spot prices.

1.5.2 What is the difference between a "Price Review Clause" or a "Price Re-Opener Clause" in contrast to a "loyalty"-or "hardship-clause"? In your jurisdiction: Is the "Price Review Clause" a provision specialis in contrast to a general hardship clause?

Hungarian civil (private) law provides for a hardship (or rather a change of circumstances */clausula rebus sic stantibus/*) regime.[2] It does not provide for a specific price review clause.

Several GSAs contain both a hardship clause and a price review clause. I would argue that the two regimes are independent of each other and not one being a *lex specialis* of the other. Naturally, it is up to the actual wording of the clauses and the whole of a contract to determine the relationship between the two.

There certainly are differences (e.g. the triggering event, conditions to be fulfilled, procedural rules, etc.) and similarities (parties to settle bilaterally, recourse to dispute settlement after some time has passed). In case of a GSA having both clauses it was argued that under the hardship clause anything but the price can be amended.

To my knowledge, the relationship between the two clauses have not been addressed by courts or arbitration tribunals.

1.6 "Trigger events"/Significant Change of Circumstances

1.6.1 Please give examples of a simple[3] and of more complex[4] trigger mechanism.

- Either Party may request the review of the price on each n-th anniversary of the GSA entering into force;
- First for the.[....] Gas Year and thereafter for every [n-th] Gas Year either Party may initiate negotiations in good faith on the amendment of the Purchase

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2 Section 6:192 of Act V of 2013 on the Civil Code

"*[Amendment of contract by the court]*

(1) Either of the parties shall be entitled to request to have the contract amended by court order if in the long-term contractual relationship of the parties performing the contract under the same terms is likely to harm his relevant lawful interests in consequence of a circumstance that has occurred after the conclusion of the contract, and:

a) the possibility of that change of circumstances could not have been foreseen at the time of conclusion of the contract;

b) he did not cause that change of circumstances; and

c) such change in circumstances cannot be regarded as normal business risks.

(2) The court shall have powers to amend the contract as of the date it has determined, at the earliest from the date of enforcement of the right to amend the contract before the court, in a manner to ensure that neither of the parties should suffer any harm in their relevant lawful interests in consequence of any change in the circumstances."

3 E.g. that the parties agree that the passage of a certain timeframe will automatically trigger the price review.

4 E.g. that the claimant has to prove firstly the occurrence of circumstances beyond the control of either party and secondly that the circumstance results in a significant change to the energy market of the buyer compared to a specified date.

Price…in the event that any of the below in respect of the Purchase Prices listed below becomes true:

- the justified costs and the fair margin of the Supplier incurred in relation to the performance of this Agreement is not reimbursed;
- the fuel costs of the Buyer cannot be reasonably built in the [output] prices;
- are not of similar level as the fees undertaken by the Supplier in contracts concluded with users not falling in the similar category as the Buyer. In this context, user of similar category as the Buyer shall those whose contracted yearly Natural Gas amount and structure (profile) is similar. Similar fee shall mean a +/- 1 per cent. range of the Gas Price.

1.6.2 Does any definition of the term "significantly" exist in your jurisdiction? If not, how is the term interpreted if the curial law is that of your jurisdiction?

It exists in some branches of law (e.g. labour law) but not *per se* in civil law.

Having reviewed some publicly available cases, it seems that courts interpret the term "significant" as covering cases in which the value exceeded the normal / expectable value, however, without providing a numerical value (e.g. 60%).

1.6.3 Please list facts/circumstances that a claimant has to adduce evidence for in order to prove that the circumstances have significantly changed[5]:

Under the Civil Code, please refer to footnote 2 (long term relationship; unforeseeability; not attributable to the claimant; and extensive character).

Under a GSA, it obviously depends on the clause. Some examples:

- Change in the purchase cost of gas;
- Change in the national market structure;
- Change in the value of gas on the end-user (retail) market;
- Unprofitability for the seller / buyer (e.g. decreased margin, unavailability to have it approved by a price regulator)

[5] E.g. the growing liberalization, the liquidity and transparency in Europe, too much contracted/committed supply; excess of supply of natural gas; that the price of alternative completing fuels, such as oil or other oil products to which the price formulae are usually indexed, has changed etc.

1.6.4 Whether the requirement of a significant change of circumstances if fulfilled is a question of law and fact: Do you agree with this statement if the curial law is the substantive law of your jurisdiction and/or if the place of arbitration is in your jurisdiction?

I do. It is a question of law, since the exact meaning of the term "significant change" needs to be constructed. Then, the claimant would need to prove that it actually incurred such a significant change.

1.6.5 According to Articles 5 and 6 of the IBA Rules on the Taking of Evidence in International Arbitration dated 29 May 2010 ("**IBA Rules**") a party may rely on a "Party-Appointed Expert" or the arbitral tribunal may appoint an independent "Tribunal-Appointed Expert". What is the preference in your jurisdiction: Do counsel, parties and arbitrators rather favor Party-Appointed Experts or Tribunal-Appointed Experts?

In practice, parties often rely on Party-Appointed Experts who, naturally, support their position. In my experience, Tribunal-Appointed Expert are less frequent but, nevertheless, occur, when a completely non-legal question is at issue (e.g. value in the books).

1.6.6 Is the use/appointment of consultants by the arbitral tribunal regarding the "translation" of a decision into a new price formula possible/desirable?

I am not aware of any example. In my view, it certainly would be possible. Whether it is desirable, that is a different issue.

1.7 If the "Price Review Clause" or the "Price Re-Opener Clause" does not require a trigger event: Under what requirements can a party also request revision/review of the price formula if the curial law is the substantive law of your jurisdiction?

Naturally, it depends on the clause. Otherwise, the party would have to invoke Section 6:192 of the Hungarian Civil Code. (please, refer to footnote 2)

1.8 Confidentiality

1.8.1 Does a claimant have to substantiate sensitive business secrets in order to prove that the price formula needs adapting? For example, does a claimant have to submit the prices that its customers pay? Does a claimant have to submit what kind of prices the respondent charges to its customers?

In order to substantiate its claim, most likely yes. If it is a retailer, it would have to show that retail prices are such that its sourcing price would make it impossible / harmful to market the gas it procures. (However, theoretically, a wholesaler could also rely on end user prices and claim that those are so high that the original balance envisaged.

Alternatively, it may solely rely on upstream /midstream market developments, affecting only that part of the supply chain and try to prove that the prices on those markets have significantly altered.

In both cases, the claimant would need to sensitive business information to substantiate its claim.

1.8.2 Do parties usually agree on a Request to Produce phase according to Article 3 IBA Rules? If a party objects to the production of documents invoking commercial confidentiality: Do arbitral tribunals adopt arrangements to ensure a suitable confidentiality protection (Article 9(4) IBA Rules) or do they rather dismiss a party's request to produce?

An arbitration procedure is confidential in itself as a whole, the hearing and even the decision of the tribunal is confidential. Thus, additional confidentiality is not necessary.

1.9 Scope of arbitral tribunal's mandate to revise the price formulae

1.9.1 What are the available remedies in your jurisdiction: Does an arbitral tribunal have the power to amend the contract terms? Does an arbitral tribunal have the power to replace e.g. unreasonable contract terms? Must the arbitral tribunal's power to change/revise the price formula be specifically mentioned in the contract? If not, can arbitrators resort to statutory provisions of the curial law? Or is the power limited to contract interpretation?

If the governing law is Hungarian, it certainly may – please, refer to footnote 2. Further, in principle, also yes, provided, however, that certain criteria are met, e.g. (i) the price review clause allows a revision of the formula, (ii) the claimant has requested it (the tribunal is bound by the claims).

1.9.2 If an arbitral tribunal is only mandated to amend an existing price formula, how are the price formulae usually worded? What are the potential risks, but also advantages if an arbitral tribunal has only this limited mandate?

N/A

1.9.3 If an arbitral tribunal is mandated to ascertain an entirely new price formula, how is the existing price formula then worded? What are the potential risks, but also advantages if an arbitral tribunal has such a broad mandate? What are the necessary "tools" (see 1.3.1/1.76, 1.7.7 – expert arbitrators, appointed experts, consultants or the like) in order for the arbitral tribunal to draft a new price formula? What parts of the award have "res judicata effect"?

N/A

2. ARBITRATING ENERGY DISPUTES UNDER ISDS

2.1 How many BITs has your country signed and how many of them are in force?

2.2 What mechanisms of dispute resolution method does your country favor in its BITs? Do investors have the choice to sue a host state in the state courts and in arbitration? Do investors have to choose between suing the host state either in the state courts or in arbitration (fork-in-the-road provision)?

2.2.1 If investors can choose proceedings before state courts in your jurisdiction: Are there any cases in the last five years in which state courts in your jurisdiction had to decide on claims of (foreign) investors against your state?

2.2.2 If so, were the decisions in favor of the country/host state or were they in favor of the investor?

2.2.3 Has your country signed and ratified the Washington Convention on the Settlement of Investment Disputes between States and nationals of other States (1968) (the ICSID Convention)? If not, does your state intend to accede to/ratify the ICSID Convention soon?

2.3 If an investor can choose (only) arbitration as dispute resolution method:

2.3.1 If an investor can choose arbitration as dispute resolution method, are there conditions attached to it, such as a requirement to resort to state courts for a certain period of time or a requirement to attempt to arrive at amicable settlement within a certain period of time?

2.3.2 If an investor can choose not only ICSID, but also other institutional rules such as SCC, ICC or ad hoc proceedings, or between various institutions in case the ICSID Convention is not signed/ratified by your country, which advantages or disadvantages do investors take into consideration in choosing between these arbitration rules?

2.4 Is your country a member state of the ECT? If not, has your country signed, but never (or not yet) ratified the ECT? If so, has your country exempted the ECT's provisional application prior to its ratification?

2.4.1 If your country is not a member state to the ECT or has recently withdrawn from the ECT: What are the reasons?

2.4.2 According to Article 26 ECT an investor can choose arbitration either under (i) the ICSID Convention, (ii) the ICSID's Additional Facility Rules, (iii) under the arbitration rules of the SCC or (iv) ad hoc arbitration under the UNCITRAL Arbitration Rules. Do investors in your jurisdiction have any preference? If so, for what reasons?

2.4.3 Has your country declared a reservation under Article 26(3)(b(i) ECT? If the answer is in the negative: Are there cases in which an investor has sued your country in parallel before the state courts and in arbitration? Did the parallel proceedings result in conflicting decisions?]

2.5 What are the key features in relation to the concept of "Investor" and "Investment" in your country's BITs? Is a "denial of benefits" clause usual in your country's BITs?

2.6 In light of the EU position on this matter: Is your country planning on withdrawing from the BITs signed in the past? If this is the case: What are the motives for doing so?

2.7 In the context of the intra-EU treaties conflict: How is this issue affecting the commercial relationships between your State and others when it comes to choosing an effective dispute resolution mechanism?

2.7.1 What approach would you take when seeking enforcement of a favorable award resulting from an intra-EU dispute? Would you counsel to seek enforcement in the courts of an EU member state or outside the EU? Have your national courts ever ruled on this issue?

2.8 Does your country have a history of voluntary compliance with adverse investment treaty awards?

2.9 To what extent have local courts been supportive of investment treaty arbitration?

3. ARBITRATING DISPUTES IN CONNECTION WITH RENEWABLE ENERGIES (WIND, SOLAR, WATER)

3.1 Legal Framework

3.1.1 What is the legal framework for renewable energies in your jurisdiction? Can investors take advantage of certain incentives such e.g. premium tariffs, very low taxes on power generators' revenues, subsidies for renewable energy producers etc?

3.1.2 Has such legal framework been amended recently? If so, has it been ameliorated for investors or deteriorated?

3.1.3 May different legal frameworks applicable to renewable energy facilities coexist within your jurisdiction? What is the criterion to benefit from one or other?

3.1.4 If your jurisdiction grants an incentive scheme for renewable energies: Has your country notified it to the European Commission under Article 108(3) TFEU so that it can be assessed under the State aid legislation?

3.1.5 If the answer is in the positive: Has the European Commission issued any decision on your current or former national incentive scheme? On what grounds was its ruling based?

3.2 Law-making process

3.2.1 By what means may the renewable sector exert an influence on the law-making process in your country? Does the renewable sector hold a fluent relation with the national energy authorities of your country? What about foreign investors?

3.2.2 Has any renewable subsector recently or in the past reached any sort of agreement(s) with your State on a particular issue concerning the applicable legal framework?

3.2.3 If the answer is affirmative: What are the agreed-upon terms of such agreement(s)? How is/are that/those agreement(s) regarded from a legal perspective (an administrative act, a bilateral contract, etc.)?

3.3 Development objectives

3.3.1 What policy instruments has your country implemented to meet the EU's binding 2020 renewable energy targets in the last few years (renewable action plans, incentive programs to increase installed capacity, etc.)? Will your country presumably comply with these objectives going forward?

3.3.2 What kind of initiatives have been taken by your national energy authorities in order to foster the proliferation of renewable energy within your country? In contrast, what kind of restrictions have been put in place to restrict the installed capacity within your country's borders?

3.4 Grandfathering policy

3.4.1 Is there any grandfathering regulation or clause included in your jurisdiction's legal framework for renewable energies that prevents existing investors from any retroactive changes in the regulatory paradigm in the future?

3.4.2 If a regulation or clause of this sort exists: How does national case law construe it? Is it applicable to every regulatory aspect or exclusively to particular ones?

3.4.3 Has your country ever undergone a profound change in the legal framework for renewable energies, recently or in the past?

3.4.4 If the answer is positive: What were the alleged reasons by the national authorities leading to those changes? Were acquired rights respected by the new regulatory legislation? What kind of transitional rules were enacted?

3.5 Dispute resolution

3.5.1 Are there any pending claims before either the state courts or arbitral tribunals for changes in the legal framework regarding investor incentives in the renewable energy sector?

3.5.2 Are there any final decisions of your state courts approving/disapproving of changes in the legal framework regarding investor incentives in the renewable energy sector?

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