School of International Arbitration, Queen Mary, University of London
International Arbitration Case Law
*Academic Directors: Ignacio Torterola, Loukas Mistelis**

Award Name and Date:

Vincent J. Ryan, Schooner Capital LLC, and Atlantic Investment Partners LLC v. Republic of Poland, ICSID Case No. ARB(AF)/11/3 - Award November 24, 2015.

Case Report by:

Maria Choi**, Katherine Sanoja***

Summary:

In its Final Award of November 24, 2015, an International Centre for Settlement of Investment Disputes ("ICSID") tribunal unanimously denied the claims brought by a US investor against Poland. In a majority opinion, the Tribunal found that the dispute related to "a matter of taxation" under the Article VI(2) of the Poland-US BIT. Even though the Tribunal accepted that the Privatization Agreement is an investment agreement, the Tribunal, by a majority, found that the scope of its jurisdiction was limited to the Claimants' claims related to expropriation and transfer of funds because the dispute did not relate to the observation and enforcement of an investment agreement. In a unanimous opinion, the Tribunal rejected the Claimants' claims, finding that the actions of the tax authorities did not amount to unlawful expropriation or interference with transfer of funds.

Tribunal: Mr. Makhdoom Ali Khan (President), Professor Francisco Orrego Vicuña (Arbitrator), Professor Claus von Wobeser (Arbitrator)

Claimants' Counsel: Kochanski Zieba Rapala & Partners, Warsaw, Poland

Respondent's Counsel: K&L Gates Jamka sp.k., Warsaw, Poland, State Treasury Solicitors' Office, Warsaw, Poland

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Digest:

1. Relevant Facts and Procedural History

In the early 1990s, Mr. Vincent J. Ryan and Schooner Capital ("Schooner") created a special purpose vehicle, White Eagle Industries Poland ("WEIP"), in order to pursue investment opportunities in Poland. In 1994, Schooner entered into a Privatization Agreement with the Polish State Treasury ("State Treasury"). As a result of the Privatization Agreement, Schooner acquired 55% share of Kama, a state-owned enterprise. In accordance with the Privatization Agreement, Schooner was required to vote for increasing the share capital and increase its investment in the company. As a result, Schooner's share of Kama eventually increased to 70.4%, with the State Treasury holding the remaining shares. On October 30, 1997, Schooner transferred its rights, title, and interest in Kama to WEIP ("Assignment Agreement 1"). WEIP voted to increase Kama's share capital and further invested in the company, increased WEIP's shareholding to 75% (¶¶ 53-55). In addition to Kama, Schooner and WEIP also invested in other Polish companies (collectively, the "Polish investments"). On December 28, 2003, WEIP assigned all of its assets to Atlantic Investment Partners LLC ("Atlantic"), WEIP's subsidiary, including any and all legal claims which WEIP may have had against third-parties (¶ 52).

According to Claimants, the Privatization Agreement required Schooner to provide know-how and other management support services for Kama, which Schooner promptly provided shortly after the privatization in November 1994 (¶¶ 76-77). The services were to be provided through a special purpose Polish subsidiary. As a result, the costs and fees associated with the Management Services were incurred by the special purpose Polish Subsidiary and calculated as a percentage of monthly sales of each of the Polish investments (¶¶ 79-80).

In 1997, the tax authority of Poland underwent changes in the administration and procedures related to tax inspections instituted after December 31, 1996 (¶¶ 85-87). As a result, an adverse tax decision had further consequences for the taxpayer, including immediate loss of all investment incentives he was otherwise entitled to where the taxpayer's "arrears exceeded a certain proportion of his tax liability" (¶ 89).

Between 1996 and 1999, the tax authorities conducted tax inspections for Kama's tax returns for fiscal years 1994-1997 (¶ 101). The inspecting authorities did not allow Management Services to be included as deductible costs, and as a consequence Kama had no right to deduct VAT in relation to those costs (¶ 102). In a second decision issued by the tax officer on June 13, 2000, the tax inspector held that Kama lost its rights to investment incentives and a total amount of 31,784,771 PLN were added back to Kama's taxable income (¶¶ 151-52). These tax proceedings resulted in Kama losing all of its investment incentives for fiscal years 1994 to1996 (¶ 153). The addition of the investment incentives to the income increased the tax, and in the end, Kama had incurred a total tax liability of 55,371,330 PLN (¶ 154). Beginning around 2000, Kama faced a loss in liquidity and on June 5, 2003, Kama declared bankruptcy (¶ 57).

On September 24 and 27, 2010, Claimants filed a joint application for approval to access the Additional Facility of ICSID, which was approved by the Secretary-General on November 3, 2010 (¶¶ 6-7). Claimants submitted a request to initiate arbitration under the Additional Facility Rules on April 8, 2011 (¶ 8). Claimants filed their Memorial on the Merits on May 8, 2012; Poland filed its Counter-Memorial on the Merits and request for bifurcation on October 8, 2012 (¶¶ 23, 27). Claimants filed a Reply on Jurisdiction and the Merits on September 3, 2013, and Poland filed a Rejoinder on Jurisdiction and the Merits on March 20, 2014 (¶¶ 37, 39). The hearing was held in Paris from April 28, 2014 to May 6, 2014 (¶ 41). The Tribunal declared the proceedings closed on August 24, 2015 (¶ 48).

2. The Tribunal's Analysis

<u>Jurisdiction</u>

Claimants argued that Kama Foods would not have gone bankrupt but for the tax proceedings and the tax decisions against Kama (¶ 175). As a preliminary matter, the Tribunal addressed Poland's four jurisdictional objections: (1) whether Claimant Atlantic qualifies as an investor under the Treaty (¶¶ 181-208); (2) non-applicability of the Treaty to taxation matters (¶¶ 209-89); (3) scope of Tribunal's jurisdiction given the Double Taxation Treaty (¶¶ 290-320); and (4) scope of Tribunal's jurisdiction over criminal proceedings (¶¶ 321-35).

i. Atlantic's Standing as Investor

Poland argued that Atlantic's acquisition of assets did not qualify it as an investor, relying on the fact that bankruptcy proceedings against Kama were already open at the time of Atlantic's acquisition of Kama shares, making the shares almost worthless. Respondent further argued that Atlantic's shareholding did not meet two of the *Salini* criteria: (i) there was no contribution and (ii) no assumption of transactional risk (¶185).

The Tribunal acknowledged that the *Salini* criteria are tools of guidance, but determined that as the Parties did not contest the existence of an investment, the questions for the Tribunal to consider were whether the investment was made by Atlantic and whether Atlantic had standing to bring a claim based on the investment (¶ 197). The Tribunal noted that Respondent did not dispute that WEIP made an investment in Poland and would have been able to bring a claim under the BIT. The Tribunal found that Atlantic became WEIP's successor when WEIP assigned its assets and associated legal claims to Atlantic (¶ 198). Since WEIP and Atlantic are affiliated companies in the United States, the Tribunal found that Atlantic's ability to bring the claim did not raise the issue of treaty shopping, rejecting Poland's objections that allowing Atlantic to bring the claim would be an abuse of international investment law (¶¶ 199-207). In the absence of any evidence on the record of any abuse of international investment protection, the Tribunal concluded that Atlantic had standing to bring the claim before the Tribunal (¶ 208).

ii. Non-applicability of the Treaty to Taxation Matters

Poland argued that Tribunal had no jurisdiction over taxation matters under the Treaty. Poland relied on the language of the Treaty, specifically Article VI(2) of the Poland-US BIT which reads: "Nevertheless the provisions of this Treaty […] shall apply to matters of taxation only with respect to the following: (a) expropriation, pursuant to Article VII; (b) transfers, pursuant to Article V […] to the extent that they are not subject to the dispute settlement provisions of a convention for the avoidance of double taxation between the two Parties" (¶ 209). Poland argued that the term "matters of taxation" ought to be interpreted "broadly as referring to all issues related to the process or system of imposing and charging taxes" (¶ 211). Poland further argued that the Privatization Agreement was not an investment agreement (¶¶ 219-21).

The Tribunal interpreted Article VI(2) to mean that an investor may bring a claim in relation to a "matter of taxation" if (1) "the claim is either based on the BIT's expropriation or transfer provision, or relates to the observance and enforcement of the terms of an investment agreement" and (2) "claims are not subject to the dispute settlement mechanism in any double taxation treaty between the two State Parties to the BIT or have been raised under such settlement provisions and are not resolved within a reasonable period of time." (¶ 240).

In determining whether the claim was related to a "matter of taxation," the Tribunal found that the actions being challenged by Claimants were tasks that "lie at the heart of the tax assessing and collecting function of a revenue authority (¶ 247). Although Claimants sought to characterize the claim as based on Poland's treatment of Management Services, the actions essentially were the authorities' request for evidence of expenses and subsequent removal of expenses from assessment, resulting in higher tax. Thus, the Tribunal concluded that the dispute involved a matter of taxation and needed to satisfy the two requirements.

The Tribunal disagreed with Poland, finding that the Privatization Agreement was an investment agreement (¶ 255). The Tribunal found that the Privatization Agreement, in which Claimants agreed to and made an investment by acquiring shares in a company, met the definition of "investment" under Article I of the BIT which includes investment in "a company or shares of stock or other interests in a company" (¶ 255). The majority of the Tribunal found, however, that the claim did not relate to observance and enforcement of an investment agreement (¶ 289), concluding that the exception in Article VI(2)(c) was not applicable to the case. As a result, the majority of the Tribunal found that its jurisdiction was limited to claims falling within Article VI(2)(a) and Article VI (2)(b).

iii. Scope of Jurisdiction Given the Double Taxation Treaty

Claimants argued that Double Taxation Treaty was not applicable to the dispute because Kama was subject to taxation only in Poland. In Claimant's opinion, double taxation applies only if income tax was imposed on Kama in both Poland and the United States (¶ 308). On the contrary, Poland argued that the repatriation of investment profits by the Claimants is covered under the double taxation treatment (¶ 295).

The Tribunal analyzed the text of the double taxation treaty, and rejected Poland's argument that the Management Services were covered by the various articles of the treaty (¶¶ 314-17). Claimant's claim is based on the violation of their freedom to freely transfer funds from the Management Services. The Tribunal found that because transfer of funds is not specifically covered under the Double Taxation Treaty, a limitation on transfer of funds is not a violation of the double taxation treaty which subjects the dispute to its dispute settlement mechanism. Therefore, the Tribunal concluded that the dispute at hand was not covered by the double taxation treaty (¶¶ 319-20).

iv. Scope of Jurisdiction in Relation to Criminal Proceedings

Poland's position was that the Claimant's claims "based on developments relating to the criminal proceedings in Poland after the bankruptcy of Kama […] cannot give rise to an investment dispute" (¶ 321). Poland's objection was based on the reasoning that the Claimants' investment had already been lost at the time of the proceedings and that the individuals in the proceedings do not fall under the definition of investors (¶ 321). Claimants countered with the argument that the criminal proceedings were "de facto directed at the Claimants," were related to the Claimants' investment, and were "started before the collapse of Kama" (¶ 326).

The Tribunal concluded that it was beyond the scope of its jurisdiction "to hear any independent claims based on actions or developments in the criminal proceedings" since Tribunal, by a majority, had already concluded that it only has jurisdiction to hear claims based on Article VI(2)(a) and (b) of the Treaty. (¶ 335). However, the Tribunal would consider the actions or developments insofar as they relate to the Claimant's claims based on expropriation or transfer of funds under Article VI2(a) or (b) (¶ 335). In finding that the dispute was related to a "matter of taxation," the Tribunal concluded by a majority that its jurisdiction was limited to the exceptions in Article VI(2), which were claims based on expropriation or transfer of funds (¶341).

Liability

In addressing liability, the parties agreed that the Tribunal should apply the BIT, customary international law, general principles of law. The parties, however, disagreed on the application of national law (i.e US law and Polish law). Applying the settled approach in international arbitration, the Tribunal decided that it would apply U.S. law and Polish law "as questions of fact if and when required an treat them on an equal footing" (¶347).

v. Claim based on expropriation

Claimants argued that their investment in Kama was expropriated as a result of State action, an "indirect and creeping expropriation, where the successive measures of the Host State over a period of time caused the collapse of investment" (¶ 350). Relying on expert witness testimony, Claimants sought to establish a logical chain between the State action and the collapse of Kama by showing that the collapse was not caused by unfavorable market conditions or poor management, but as the result of the tax proceedings.

The Tribunal examined whether Poland's actions in the tax proceedings constituted expropriation, and if so, whether the actions qualify as a lawful expropriation under Article VII. Both Parties agreed that *bona fide* tax measures do not constitute expropriation; Claimants argued the measures were not *bona fide* while Poland argued the measures were and therefore not expropriation (¶¶ 469-70). The Tribunal examined the Claimants' argument that "the conduct of the tax authorities was biased, prejudiced and discriminatory and that they were denied due process" (¶ 479). The Tribunal found that Claimants had the burden to present evidence but failed to present proper evidence to support the expenses , despite been given the opportunity to do so by the tax authorities (¶ 480). In other words, the Tribunal concluded that the tax authorities were not acting with discriminatory intent to deprive the Claimants of their investment but that the tax proceedings were "a *bona fide* and a legitimate exercise of the State's police or regulatory powers" (¶¶ 494-96). As a result, the Tribunal found that there had been no expropriation.

vi. Claim based on Transfer of Funds

The Claimants argued that the authorities' actions interfered with their ability to freely transfer funds under Article V of the Treaty. They argued that the transfer of Management Services fees was a covered transfer of funds under the BIT and that the actions of the tax authorities made it impossible to achieve the transfer (¶ 500). The Tribunal rejected the Claimants' argument that the tax proceedings prevented transfer of funds, noting that "the tax proceedings were initiated and the decisions issued after the Management Fees had already been paid, collected [and] transferred" (¶ 507). Therefore, the Tribunal concluded that the tax proceedings did not interfere with the Claimants' ability to transfer funds (¶ 510).

3. Costs

The Tribunal applied the "*costs should follow the event*" principle and directed the Claimants to pay Poland its part of the arbitration costs (¶ 522). The Tribunal also awarded Claimants costs related to Poland's Request for Bifurcation and costs connected to matters for which Poland's request was rejected or Claimants' concerns were legitimate (¶ 523).

4. The Tribunal's Decision

In a majority decision, the Tribunal decided that the claim related to "matters of taxation" under Article VI(2) of the Poland-US BIT and did not relate to "observance and enforcement of an investment agreement under Article VI(2)(c)." In a unanimous decision, the Tribunal decided that Poland's action did not amount to expropriation and did not interfere with transfer of funds, and as a consequence Claimant was not entitled to any damages.

5. Professor Vicuña's Dissent

In a partial dissenting opinion, Professor Vicuña agreed with the majority opinion that there was no expropriation. However, he found that the tax proceedings were "lengthy, cumbersome, occasionally contradictory, and in more than one aspect failed to observe the standards of due process" (¶ 6). Professor Vicuña would apply the fair and equitable treatment to the claims, noting the non-applicability of the double taxation treaty to the dispute and the general observance of due process. In Professor Vicuña's opinion, even though tax authorities' actions were not wholly responsible for the Claimants' losses, it did not "mean the policies pursued by governmental authorities are entirely separate from the end result" and as a consequence "a measure of liability should have been found" (¶ 3).