Investor-State arbitration—USA/Poland—exclusion clauses—tax-most-favoured-nation—Vienna Convention (SCC v Poland)

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Arbitration analysis: US investors brought an ICSID claim against Poland for unfair tax treatment. The Tribunal declined jurisdiction on the basis that tax matters were excluded under the relevant bilateral investment treaty (BIT). The investors applied to set aside the Award to the Paris Court of Appeal who rejected the appeal on the basis that arguments not previously ventilated before the Tribunal could not be relied on before the court. The Court of Cassation quashed this ruling and the investors applied again to the Paris CA to set aside the Tribunal's ruling. The investors argued that the application of the tax rules had been discriminatory and the refusal of jurisdiction by the Tribunal was contrary to the interpretation of the BIT under Vienna Convention principles. The Paris CA refused to set aside the Tribunal's award. Written by Andrew Rigden Green, partner, head of International Arbitration Greater China at Stephenson Harwood, Hong Kong.

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

What are the practical implications of this case?

Where possible the natural meaning of exclusion clauses in BITs will be preferred.

Reference to external sources to interpret the treaty pursuant to the Vienna Convention will only be used where the Tribunal's interpretation is manifestly ambiguous or obscure, or where the result would be patently absurd or unreasonable.

Reliance on the Vienna Convention or most-favoured-nation status clauses to circumvent clear exclusion clauses will only be allowed in very narrow circumstances.

What was the background?

In 1994, Ryan and Schooner Capital Corporation (together 'SCC'), both US investors, made investments in three Polish companies including Kama and WFM. As part of the investment agreement SCC was to provide management services to Kama and WFM and payment was to be made to a third company. Kama and WFM both treated the costs related to the management services as VAT and tax deductible.

In 1996, Poland issued directives regarding the estimation of income related to transactions between related companies. It also adopted a regulation where tax inspectors could be remunerated by bonuses related to the value of tax debts determined.

In the late 1990s both Kama and WFM were subject to tax audits which focused on the VAT and tax treatment of the management service fees. The tax authorities imposed a retroactive tax demand on Kama of €13m. WFM on the other hand was authorised to deduct the management fees from income tax and adjust VAT accordingly. In 2003 Kama declared insolvency.

In 2011, the investors commenced ICSID arbitration against Poland under the 1990 BIT between Poland and the US. In a majority Award in 2015, the Tribunal ruled that it only had jurisdiction to hear claims relating to expropriation and transfer of funds, which it rejected.

In 2016, SCC applied to the Paris Court of Appeal (Paris CA) to have the Award set aside. In 2019, the Paris CA dismissed the application ruling that SCC's arguments were inadmissible.

SCC challenged the decision before the Court of Cassation, which quashed the decision stating that, where jurisdiction was challenged before the Tribunal, the parties are not deprived of the right to rely on new grounds and arguments when challenging this issue before the appeal court.

Consequently, this appeal was brought anew before the Paris CA. SCC sought to set aside the Award on the basis that the Tribunal was wrong to decline jurisdiction to deal with the issues of taxation.

What did the court decide?

Article VI of the BIT states that parties should strive to accord fairness and equity in relation to tax policies. However, Article VI(2) restricts the arbitrability of matters of taxation to expropriation, transfers and interpretation of investment agreements.

The Paris CA was asked to set aside the Award on jurisdiction on the basis that:

- the unequal treatment of Kama and WFM demonstrated a lack of fairness and equity in relation to tax policies, and Poland had failed to comply with most-favoured-nation obligations
- the dispute was not about material tax provisions, but an investment dispute related to taxation
- Article VI(2) was wrongly interpreted by the Tribunal, and in light of the Vienna Convention on the Interpretation of Treaties

The Paris CA found that arguments had been run before the Tribunal that Kama would not have become insolvent, but for the tax treatment by the Polish authorities. The Paris CA found, contrary to the arguments put forward by SCC, that the Tribunal had considered both arguments on the merits and the exclusion clause, and nevertheless resolved that it did not have jurisdiction.

The investors argued that the most-favoured-nation clause, which should be interpreted in accordance with the Vienna Convention, had the effect of overlaying Article VI(2) with a standard of non-discrimination. The court ruled that where there is an express exclusion such as Article VI(2) the most-favoured-nation clause cannot be used to extend the jurisdiction of the Tribunal given that this issue had been decided by the state parties.

In support of their attempt to draw a distinction between disputes relating to material tax provisions and disputes about investments related to taxation, the investors relied on Cairn Energy v India. The court noted that Cairn concerned a treaty between the UK and India which did not contain the express tax exclusion in the BIT. Therefore, it could not be relied upon. Furthermore, the Paris CA held that such distinction was contrary to the ordinary meaning of the terms of the BIT.

In respect of the arguments relating to the use of additional means of interpretation in accordance with the Vienna Convention to better understand the BIT, the Paris CA referred to the Convention itself which only permits reliance on such external sources where otherwise the meaning would otherwise be 'ambiguous or obscure' or leads to a result that is patently absurd or unreasonable. The Paris CA held that the meaning of Article VI(2) was in no way ambiguous and did not lead to a manifestly absurd result. The investors' arguments were therefore rejected.

Case details:

- Court: Paris Court of Appeal, international commercial division
- Judges: François Ancel (President), Fabienne Schaller, Laure Aldebert
- Date of judgment: 31 May 2022

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