INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES
(ADDITIONAL FACILITY)

In the arbitration proceeding between

V J. , S C L LLC, AND
A I P LLC

Claimants

and

REPUBLIC OF POLAND

Respondent

ICSID Case No. ARB(AF)/11/3

AWARD

Members of the Tribunal
Professor Francisco Orrego Vicuña, Arbitrator
Professor Claus von Wobeser, Arbitrator
Mr. Makhdoom Ali Khan, President

Secretary of the Tribunal
Ms. Frauke Nitschke

Date of dispatch to the Parties: 24 November 2015

REPRESENTATION OF THE PARTIES

Counsel for the Claimants:

K Z and P Sp.J.

Mr. P K
Mr. R Z
Mr. R R
Mr. A M
Mr. M J
Mr. A P
Ms. K K
Ms. K Z
Ms. A Z
Ms. S U and
Ms. M P
Metropolitan, P P 1
Republic of Poland

Counsel for the Respondent:

G J Sp.K.

Dr. W S and
Dr. R M
Pl. M
, Republic of Poland

and

State Treasury Solicitors' Office

Ms. K S -T
ul. H
, Republic of Poland

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I. INTRODUCTION AND PARTIES

1. This case concerns a dispute submitted to the International Centre for Settlement of Investment Disputes ("ICSID" or the "Centre") under the Additional Facility Rules on the basis of the bilateral investment treaty between the United States of America and the Republic of Poland Concerning Business and Economic Relations signed on 21 March 1990 (the "BIT" or "Treaty"), which entered into force on 6 August 1994.

2. The Claimants are V J. ("Mr. R "), a national of the United States of America, S C LLC ("S ") and A I P LLC (" "), both of whom are limited liability companies registered in Delaware in the United States of America. All three are hereinafter jointly referred to as the "Claimants."

3. The Claimants are represented in this proceeding by Messrs. P K , R Z , R R , A M , M J , A P and Mmes. K K , K Z , A Z , S U and M P of K Z and P Sp.J. Mr. J A of M T G S formed part of the Claimants' legal team until April 2014.

4. The Respondent is the Republic of Poland and is hereinafter referred to as "Poland" or the "Respondent." The Respondent is represented in this proceeding by Dr. W S and Dr. R M of G J Sp.K., and Ms. K S -T of the State Treasury Solicitors' Office, both located in W

5. The Claimants and the Respondent are hereinafter collectively referred to as the "Parties."

II. PROCEDURAL HISTORY

6. Mr. V J. R , Sc C LLC and A I LLC filed on 24 and 27 September 2010 by email and in hard copy, respectively, a joint application

for approval of access to the Additional Facility pursuant to Article 4 of the Additional Facility Rules and Article I(1)(b) of the BIT.

7. Pursuant to Article 4(5) of the ICSID Additional Facility Rules, and in accordance with Article 4(2) of the ICSID Additional Facility Rules, on 3 November 2010, the ICSID Secretary-General granted approval of access to the Additional Facility in respect of the dispute referred to in the application.

8. On 8 April 2011, ICSID received a request to institute arbitration proceedings under the Additional Facility Rules dated 31 March 2011, from V J. R , S C LLC and A I LLC against the Republic of Poland (the "Request").

9. On 26 April 2011, the ICSID Secretary-General registered the Request in accordance with Articles 4 and 5 of the ICSID Arbitration (Additional Facility) Rules and notified the Parties of the registration. In the Notice of Registration, the Secretary-General invited the Parties to proceed to constitute an Arbitral Tribunal as soon as possible in accordance with Article 5(c) and Chapter III of the ICSID Arbitration (Additional Facility) Rules.

10. By agreement dated 21 July 2011, the Parties agreed that the Tribunal in this proceeding was to consist of three arbitrators, one to be appointed by each Party, and the third, presiding arbitrator to be appointed by agreement of the Parties. The Parties' 21 July 2011 agreement further stipulated that in the event the Parties were unable to agree on the appointment of the presiding arbitrator by 19 September 2011, either Party may request the ICSID Secretary-General to appoint the President of the Tribunal.

11. By letter of 28 July 2011, the Claimants appointed Prof. Francisco Orrego Vicuña, a national of Chile, as arbitrator and Prof. Orrego Vicuña subsequently accepted his appointment. By letter of 4 August 2011, the Respondent appointed Prof. Claus von Wobeser, a national of Mexico, as arbitrator, and Prof. von Wobeser subsequently accepted his appointment.

12. By letter of 22 September 2011 and further to the Parties' 21 July 2011 agreement, the Claimants requested the ICSID Secretary-General to appoint the President of the Tribunal. Further to this request, the Secretary-General appointed Mr. Makhdoom Ali Khan, a national of Pakistan, as President of the Arbitral Tribunal on 8 October 2011.

13. On 11 October 2011, the Secretary-General, in accordance with Article 13(1) of the ICSID Arbitration (Additional Facility) Rules notified the Parties that all three arbitrators had accepted their respective appointments and that the Tribunal was therefore deemed to have been constituted on that date. Ms. Frauke Nitschke, ICSID Legal Counsel, was designated to serve as Secretary of the Tribunal.

14. On 28 November 2011, the Claimants filed a request for the Tribunal to decide on matters concerning participation of counsel. The Claimants requested the Tribunal to decide:

(i) Whether G J Sp.K. as a whole was in a conflict of interest situation given that one of the firm's partners had allegedly provided legal services to predecessors of the Claimants;

(ii) Whether G J Sp.K. had failed to notify the Claimants and their legal representatives of the fact that they were aware of the existence of a conflict of interest prior to providing legal services to the Respondent;

(iii) Whether the legal representation of the Respondent (i.e. both the individual members and the firm as such) may continue to act as counsel for the Respondent in the present dispute; and

(iv) Whether one member on the Claimants' legal team was in a conflict of interest situation given his previous engagement with the Ministry of Foreign Affairs of the Respondent.

15. On 29 November and 6 December 2011, the Respondent filed observations on the Claimants' 28 November 2011 requests. Specifically, the Respondent averred that no conflict of interest existed in relation to one of the managing partners, and further

alleged that, in turn, a conflict of interest existed in the Claimants' team with regard to the Claimants' counsel who had previously had a professional engagement at the Ministry of Foreign Affairs.

16. The Tribunal held a first session and a hearing on the Claimants' 28 November 2011 requests regarding the participation of counsel with the Parties on 8 December 2011 in London.

17. In the course of the first session, the Parties confirmed that the Tribunal was properly constituted. It was further agreed *inter alia* that the 2006 ICSID Arbitration (Additional Facility) Rules would apply to the present proceeding, and that the procedural language would be English. A schedule for the first round of written pleadings was also determined. Given that the Parties were unable to agree prior to and during the session on the legal seat and the governing law of the arbitration, it was determined that each Party would file a written submission on the matter and that the Tribunal would subsequently decide the issue. Summary Minutes of the first session were prepared by the Secretary of the Tribunal and subsequently transmitted to the Parties and the Tribunal.

18. Following the first session, the Tribunal held a hearing on the Claimants' 28 November 2011 requests. Present at this hearing were:

For the Claimants:

- Mr. S D. M — S C LLC
- Ms. K K — K Z and P Sp.J.
- Ms. K Z — K Z and P Sp.J.
- Mr. P K — K Z and P Sp.J.
- Mr. A M — K Z and Sp.J.
- Mr. R B — K Z and P Sp.J.
- Mr. A K -M — K Z and P Sp.J.
- Mr. M J — K Z and P Sp.J.

For the Respondent:

- Ms. K S -T — State Treasury Solicitors' Office
- Dr. R M — G J Sp.K.
- Dr. W S — G J Sp.K.

Also attending the hearing at the request of the Tribunal:
- Mr. M J G J Sp.K.

19. In the course of the hearing, Mr. J was called by the Tribunal to provide oral testimony.

20. Sound recordings of the first session and the hearing were distributed to the Tribunal and the Parties. A verbatim transcript of the hearing was also made and subsequently provided to the Members of the Tribunal and the Parties.

21. On 15 December 2011, the Parties filed simultaneous written submissions concerning the legal seat of the arbitration. The Claimants proposed London (United Kingdom) as the place of the arbitration, while the Respondent favoured Frankfurt am Main (Germany), Paris (France) or The Hague (Netherlands) as the place of these proceedings. Having considered the Parties' oral and written submissions, the Tribunal issued Procedural Order No. 1 on 1 February 2012, selecting Paris as the legal seat of the arbitration.

22. On 22 December 2011, the Claimants filed further observations concerning their 28 November 2011 requests relating to the participation of counsel. The Respondent responded to these observations by letter of 30 December 2011.

23. On 8 May 2012, the Claimants filed a Memorial on the Merits.

24. On 29 June 2012, the Tribunal issued a decision on the Claimants' 28 November 2011 requests and the Respondent's subsequent request relating to the participation of counsel. Specifically, the Tribunal examined in its decision:

> *(i) whether Dr. W Sa , Dr. R M or any other lawyer associated with G J Sp.k. (" G J ") has a conflict of interest and can continue to act as counsel for the Respondent in this arbitration; and/or*
>
> *(ii) whether the law firm of G J as a whole has a conflict of interest and can continue to act as counsel for the Respondent; and/or*

(iii) whether Dr. M J , a member of the legal team of the Claimants, has a conflict of interest and can continue to act as counsel for the Claimants.

25. In its decision, the Tribunal summarized the Parties' positions as follows:

> *Briefly stated, the Claimants submit that a Managing Partner of G J Sp.k., Mr. M j J a – who has not been notified to the Secretariat as being part of the Respondent's legal team in this case – has allegedly provided legal advisory services to predecessors of the Claimants or their companies (…). The Claimants maintained that in view of this conflict of interest Dr. W S , Dr. R M or any other lawyer associated with G J cannot continue to act as counsel for the Respondent in this dispute.*
>
> *The Respondent submits that a conflict of interest exists on the Claimants' side, regarding Dr. M J , who was recently hired by the counsel for the Claimants, and who previously had a professional engagement for the benefit of the Polish Ministry of Foreign Affairs. The Respondent maintains that due to this conflict of interest Dr. M J cannot continue to act as a part of the legal team of the Claimants in this dispute.*

26. The Tribunal ultimately declined the Claimants' request, ordering *inter alia* that (i) the Respondent's legal team was to continue to keep an already existing ethical screen in place and that (ii) the Respondent and the lawyers engaged in the conduct of this arbitration must not interact with Mr. J in respect of any aspect of this case in any manner whatsoever, adding that (iii) they must also not share with or receive any information or documents from Mr. J . The Tribunal further declined the Respondent's request to disqualify the member of the Claimants' legal team who had a professional engagement at the Ministry of Foreign Affairs.

27. On 8 October 2012, the Respondent filed a Counter-Memorial on the Merits, including objections to jurisdiction and admissibility, and a request for the bifurcation of the proceeding.

28. Following observations by the Claimants on the Respondent's Request for Bifurcation on 25 October 2012, the Tribunal issued its decision on this request on 16 January 2013, deciding to join the Respondent's objections to jurisdiction and admissibility to

the merits of the dispute. The Parties subsequently agreed on a timetable for the further written and oral procedure.

29. On 7 February 2013, counsel for the Claimants informed the Tribunal that they had learned that an office manager and senior assistant formerly engaged by the Claimants' counsel had taken up employment with counsel for the Respondent, i.e. G J . The Claimants further expressed concern that her new employment may have an effect on the integrity of the present proceedings.

30. On 15 February 2013, the Claimants requested the Tribunal to (i) convene a hearing on the matter; (ii) order the Claimants and the Respondent to file observations on this issue; and (iii) resolve the matter, and, as the case may be, order the necessary measures to secure the integrity of this proceeding.

31. The Respondent filed its observations on the Claimants' requests on 1 March 2013. In its submission, the Respondent concluded that the employment of the officer manager at G J posed no threat to the integrity of the present proceeding. Specifically, the Respondent averred that the office manager was not a lawyer, had not been involved in any legal work and was not bound by any code of ethical conduct applicable to lawyers. The Respondent further stated that she did not provide any assistance to the legal team working on the present case, and that her prior engagement at the law firm of Claimants' counsel had reportedly been limited to technical assistance such as document formatting. The Respondent further submitted that its legal team had been unaware of her prior employment. Upon learning this fact, she was immediately separated from the lawyers engaged in the case and secured against being involved in it, which had also been notified to the Claimants in early February of 2012. The Respondent did not consider a hearing on the matter necessary in the circumstances.

32. By letter of 5 March 2013, the Tribunal informed the Parties that it did not consider oral argument necessary and that it was ready to decide the matter on the basis of the written submissions. However, on 6 March 2013, the Claimants repeated their request for a hearing.

33. A hearing was held with the Parties on 13 March 2013 by telephone conference. In the course of the hearing, the Claimants requested the Tribunal to "*order G J to disengage from the current proceedings*" and, alternatively, to "*order a strict Ethical Screen…and to confirm the Claimants' rights to question any evidence that may originate from [a] contaminated source.*" At the hearing, the Tribunal requested further information from the Parties, which the Parties submitted on 20 March 2013. Present at this hearing were:

For the Claimants:

- Mr. P K	K Z and P Sp.J.
- Mr. R ł B	K Z and P Sp.J.
- Dr. M J	K Z and P Sp.J.

For the Respondent:

- Dr. R M	G J Sp.K.
- Dr. W S	G J Sp.K.
- Mr. A D	State Treasury Solicitors' Office

34. On 1 July 2013, the Tribunal issued a decision concerning the Claimants' requests. The Tribunal decided *inter alia* to decline the Claimants' request to order G J to disengage as counsel from the present proceedings. The Tribunal further directed that if the office manager returned to work from an ongoing medical leave, the Claimants and the Tribunal be immediately notified and she be put behind an ethical screen. The Tribunal also ordered that Respondent's counsel must not interact with her in respect of any aspect of this case in any manner, nor communicate with her in relation to this case or share with or receive any information or documents. The Tribunal further ruled that the Claimants and the Tribunal must be immediately informed of all measures taken to ensure that the ethical screen is effective.

35. Following the Tribunal's decision, on 20 August 2013, the Respondent's counsel informed the Claimants and the Tribunal that the office manager did not return to work at G J following her medical leave and that her employment contract had been terminated.

36. On 14 April 2013, following several exchanges between the Parties, the Claimants filed a request for the Tribunal to decide on various document production matters. The Respondent produced documents in response to the Claimants' request on 6 May 2013. On 13 May 2012, the Claimants filed observations on the documents produced and renewed their request for document production. On 21 and 22 May 2013, the Respondent produced further documents and filed a response to the Claimants' observations of 13 May 2013. The Tribunal decided on the Claimants' request in its Procedural Order No. 2 on 17 June 2013. The Respondent subsequently filed a request for clarification of Procedural Order No. 2, to which the Claimants responded in writing. The Tribunal decided on the Respondent's request on 20 June 2013.

37. On 3 September 2013, the Claimants filed a Reply on Jurisdiction and the Merits.

38. Following exchanges between the Parties, the Respondent filed, on 26 November 2013, a request for the Tribunal to decide on production of documents, which the Tribunal decided on 7 December 2013 in its Procedural Order No. 3. A further document production request was made by the Respondent, on 26 January 2014. Following the observations of the Claimants of 31 January 2014, the Tribunal on 10 February 2014 issued Procedural Order No. 4 concerning production of documents.

39. On 20 March 2014, the Respondent filed a Rejoinder on Jurisdiction and the Merits.

40. On 8 April 2014, the Tribunal issued Procedural Order No. 5 concerning the organization of the hearing on jurisdiction and the merits. On 11 April 2014, the Claimants requested from the Tribunal certain clarifications of Procedural Order No. 5 and filed a request for the admissibility of further evidence. Following observations filed by the Respondent on 16 April 2014, the Tribunal issued Procedural Order No. 6 on 24 April 2014, deciding the Claimants' 11 April 2014 requests.

41. A hearing on jurisdiction and the merits was held in Paris from 28 April 2014 to 6 May 2014. In addition to the Members of the Tribunal and a representative from the ICSID Secretariat, the following persons were present at the hearing:

For the Claimants:

- Mr. V J. R	
- Mr. S D. M	S C LLC

Counsel:

- Mr. P K	K Z and P Sp.J.
- Dr. A M	K Z and P Sp.J.
- Dr. M J	K Z and P Sp.J.
- Mr. R B	K Z and P Sp.J.
- Mr. A P	K Z and P Sp.J.
- Ms. K K	K Z and P Sp.J.
- Ms. S U	K Z and P Sp.J.
- Ms. M P	K Z and P Sp.J.
- Ms. K Z	K Z and P Sp.J.
- Ms. A Z	K Z and P Sp.J.

Witnesses/Experts:

- Mr. A C	Riverside Europe Partners Sprl
- Mr. C H	
- Mr. F A. M	
- Mr. R T. F	
- Prof. D Z	D E - D Z
- Mr. J L	D E - Z
- Mr. M K	D E - D Z
- Mr. T Z	K Z and P Sp.J.
- Mr. T S	K Z and P Sp.J.
- Prof. R G	R G - Attorney-at-Law

For the Respondent:

Counsel:

- Ms. K S -T	Prokuratoria Generalna Skarbu Państwa
- Dr. W S	G J Sp.K.
- Dr. R M	G J Sp.K.
- Ms. A L	G J Sp.K.
- Mr. T S	G J Sp.K.

Witnesses/Experts:

- Ms. I P	T O ( )
- Mr. R K	T O ( )
- Ms. B Ś	T I O ( )
- Dr. E M i	
- Mr. S Z	C L
- Ms. L F	C L

- Prof. P S — C L
- Prof. H L — W U
- Dr. K T — W U
- Prof. P P — I B of F D , WU V U of E and B , U of S

42. The Claimant, Mr. V J. R , testified personally. Mr. S D. M , Mr. T Z , Mr. T S , Dr. F A. M , Mr. A C , Mr. R T. F , Mr. C B. H , Prof. R G and Prof. D Z also gave oral testimony on behalf of the Claimants.

43. Testifying on behalf of the Respondent were Mr. R K , Ms. I P , Ms. B Ś , Prof. H L , Dr. K T , Prof. P P , Dr. E M , Prof. P S and Mr. S Z .

44. Sound recordings were prepared of the hearing and the proceedings in English were transcribed verbatim. The sound recordings and transcripts were later distributed by the Centre to the Parties and the Members of the Tribunal.

45. The Parties filed simultaneous post-hearing briefs on 6 June 2014.

46. On 4 June 2014, the Respondent filed a request for the Tribunal to decide on the admissibility of new evidence. Following observations by the Claimants filed on 10 June 2014, the Tribunal issued Procedural Order No. 7 concerning the admissibility of new evidence on 19 June 2014.

47. The Parties filed their Statements of Costs on 21 July 2014. The Respondent supplemented its Statement of Costs on 31 December 2014.

48. The proceedings were declared closed on 24 August 2015.

49. The Tribunal has had the benefit of detailed pleadings; an evidential record; and written and oral submissions. It has carefully considered every argument raised, and all materials and evidence adduced, by the Parties. The Tribunal has chosen, however,

not to set out an absolutely complete recitation of each side's case in this Award, but instead simply to summarise the principal points made, in the course of the analysis below. In so far as any argument or evidence has not been specifically identified or recorded in the body of this Award, this does not mean it has not been taken into full consideration.

III. FACTUAL BACKGROUND

A. The Claimants

50. In the early 1990s, Mr. V J. R and S C C ("S ") decided to pursue investment opportunities in Poland. W E I ("W ") was set up as a special purpose vehicle for investing in Poland. From 8 November 1994 onwards, which is the date relevant to the present dispute, the shareholder structure of W consisted of S P L.P. ("S ") as a sole general partner and a number of limited partners, including the E B for R and D ("E ") and S . At the same time, C H C , a D corporation ("C "), served as the sole general partner of S and Mr. R held 100% of the voting shares of C .

51. On 29 May 1998, S merged with S , a D l liability company, and the surviving entity became S , which succeeded to all the assets and liabilities of S . Mr. R has held 73.64366% of S ownership interest since 29 May, 1998.[1]

52. On 28 December 2003 through an Assignment Agreement ("Assignment Agreement 2"), W assigned all its assets to A , including, but not limited to, any and all legal claims which W may have had against third-parties. At that time, W held 100% of the membership interest of At . On the following day – 29 December 2003 - W transferred 100% of the membership interest of A to S and A became a wholly owned subsidiary of S .

[1] Claimants' Memorial dated 8 May 2012, para. 158.

B. The Privatization Agreement

53. As their first investment in Poland, the Claimants chose N Z P T w B S.A. (“K ”), a state-owned enterprise engaged in the production and processing of vegetable fats. On 8 November 1994, i.e. prior to its 1998 merger with S , S had entered into a Privatization Agreement with the Polish State Treasury for the acquisition of 55% of the shares of K for the Polish złoty (“PLN”) equivalent of US$ 18,782,500. In accordance with the Privatization Agreement:

(i) S undertook not to sell, pledge or transfer the K shares for a period of 10 years except to W . This 10 year period was subsequently reduced to 5 years;[2]

(ii) S was required to vote for increasing K share capital and to contribute US$ 10,000,000 to it; and

(iii) As a shareholder, S was required to cause K to invest an aggregate amount of US$ 38,300,000 in its production facilities and infrastructure until 31 December 1997.

54. S fulfilled condition (ii) above on 21 June 1995 when it voted to increase the share capital of K and invested US$ 10,000,000 in the company. As a result, S shareholding increased from 55% to 65.5%. On 17 April 1996, S voted to further increase K share capital and invested the PLN equivalent of US$ 433,929 in the company. As a result, S shareholding increased to 70.4%. The State Treasury continued to hold the remaining shares.

55. On 30 October 1997, S transferred all of its rights, title and interest in and to K shares to W (“Assignment Agreement 1”). On 3 April 1998, W voted to increase K share capital and invested the PLN equivalent of US$ 406,164 in the company. As a result W shareholding in K increased to 75%.

[2] Annex 3 to the Privatization Agreement.

C. Other investments

56. S and W also invested in other Polish companies. On 30 December, 1994 S acquired 49% of the shares in W F M S.A. (“W ”), a company focusing on the business of furniture production. Following an initial public offering of W shares, with effect from 6 May 1998, S interest was reduced to 31.97%. On 28 June 1996, W concluded an agreement with the E. K N I F S.A. Under the agreement W purchased 51% of the shares in B S.A. (“B ”). This company was also engaged in the production and processing of vegetable fats. K , W and B are hereinafter collectively referred to as the “Polish Investments.”

D. K

57. K main business involved the production of raw rapeseed oil, rapeseed meal and refined oil and margarine. The Parties disagree as to the development and growth of K business and its financial position following its privatization. In particular, they disagree about the impact of the general macroeconomic conditions in Poland on the vegetable fats industry and on K . The relevant facts are, therefore, described in the Parties’ positions further below. What is, however, not disputed is that around the year 2000 K faced a loss in its liquidity. It was eventually declared bankrupt on 5 June 2003. The reasons for the company’s demise form a part of the subject matter of the present dispute. These are, therefore, also dealt with in the section setting forth the Parties’ submissions. Only the events leading up to K bankruptcy on 5 June 2003 are described herein.

58. In June 2000, K ceased to pay back its loans. In October 2000, K ceased to pay social security contributions for its employees.

59. On 17 November 2000, K accounts at various banks, including B S S.A., P B S.A., B P S.A. and B B S.A. were seized in favour

of B H S.A. for the purpose of enforcement proceedings.[3] On the same date, K receivables from J H , H B T R , H M and E were also seized in favour of the same bank.[4]

60. On 24 November 2000, K account at B P S.A. was seized to secure B B S.A.'s receivables.[5] In a letter dated 14 May 2001, B P S.A. demanded that K pay the outstanding part of its loan. On 14 May 2001, this amounted to PLN 12,062,962. K was also informed that in case it did not pay, B P S.A. would enforce its receivables through court.[6]

61. On June 2001, K account at B B S.A. was seized in favour of the T O in B for the purpose of enforcement proceedings. The receivables of the T O in B amounted to PLN 3,891,717.30. On 21 June 2001, the interest on these receivables amounted to PLN 2,214,954.98.[7]

62. In November 2001, K ceased to pay its employees.

63. On April 2002, K obtained court approval of a collective settlement with its creditors.[8] Under the terms of the settlement, the company was obliged to repay 60% of the principal amount of the debt in 16 or 24 monthly instalments depending on the value of the claim.[9] These payments were not made.[10]

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[3] Copy of notification of 17 November 2000 regarding the seizure of K bank accounts at various banks in favor of B H S.A. (CE-427).
[4] Copy of notification of 17 November 2000 regarding seizure of K receivables in favor of B H S.A. (CE-429).
[5] Copy of notification of 24 November 2000 regarding seizure of K bank account at B P S.A. in favor of B B S.A. (CE-431).
[6] Copy of the demand of 14 May 2001 for payment of the outstanding loan from B P S.A. to K (CE-433).
[7] Copy of notification of 21 June 2001 regarding seizure of account at B B S.A. in favor of the T O in B (CE-435).
[8] Court's order dated 30 April 2002 (RE-107).
[9] Settlement proposals by K dated 15 April 2002 (RE-108).
[10] K letter to court supervisor dated 2 October 2002 (RE-109).

64. On July 2002, K account at B B S.A. was seized in favour of the C O in B for the purpose of enforcement proceedings.[11]

65. The resulting loss in liquidity meant that the company ceased its normal operations.

66. The Claimants sought to prevent K bankruptcy through various means including sales and sale/leasebacks of certain production facilities, a sale of K power plant, the addition of bio-fuel capabilities, mergers with other companies, a sale of margarine trademarks, negotiations with potential new investors and various other approaches without success.

67. For instance, on May 2000, W received an offer for the purchase of all of the rights to the margarine brand trademarks owned or used by K from U P S.A. ("U ") for an amount of PLN 164,000,000. A further decline in K financial standing, however, caused U to withdraw from the transaction.[12] K and its banks also entered into negotiations regarding a possible merger with K , one of K competitors. The negotiations, however, ultimately failed.

68. K tried to sell its margarine trademarks and to withdraw the production of tub and cube margarines for a period of five years, focusing instead on production of refined rapeseed oil and on its products designed for institutional clients.

69. One of the obstacles to finding a solution to K financial difficulties was pending tax proceedings against it for the fiscal years 1994 to 1997, as a result of which tax arrears and interest thereon had been imposed. K , therefore, sought to restructure

[11] Copy of notification of 2 July 2002 regarding seizure of K bank account at B B S.A. in favor of the C O in B (CE-437); and copy of notification of 2 July 2002 regarding seizure of K bank account at B B S.A. in favor of the F D of the C O in B (CE-439).
[12] Copy of the Non-Binding Indication of Value of 12 May 2000 from U to W regarding the purchase of all the rights to the margarine brand trademarks owned or used by K (CE-440); and copy of Memorandum of 6 October 2000 from the meeting of K representatives and representatives of B P S.A. (CE-441).

its tax liabilities under the Act on Restructuring of Public Receivables of 30 August 2002.

70. On 23 October 2002, K applied to initiate the restructuring process for its tax liabilities in the amount of PLN 50,709,208.72 as of 30 June 2002. On 23 October 2002, the W T O issued a decision determining that as of 30 June 2002, K tax liabilities amounted to PLN 50,709,208.72. A restructuring fee of PLN 2,973,580.20 for the cancellation of these tax liabilities was determined.[13]

71. On 7 November 2002, B P S.A. filed a motion with the District Court for the City of Warsaw seeking a declaration of K bankruptcy. In its motion, the bank claimed that as of 30 September 2002, K debts to the bank totalled PLN 30,088,387.35 and K had ceased to pay its debts.[14]

72. In a letter dated 3 December 2002, D B P informed B P S.A. that it had received US$ 3,650,000 from the Claimants and that these funds were intended for K restructuring and included PLN 9,250,000 to buy back all of K outstanding debt against B P S.A.[15]

73. W provided K with financial support in the form of payment of administration and organizational costs.[16] On 7 February 2003, K I G LLC, S subsidiary, concluded a loan agreement for US$ 545,000 which was primarily intended for the payment of K debts to its creditors in enforcement proceedings and to pay K employees their outstanding salaries.[17]

74. On 5 June 2003, however, the Regional Court for the City of Warsaw declared K bankrupt. The court stated that K pending restructuring process was not a

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[13] Copy of the decision of 23 October 2002, No. US35DP1/4213/R-1/02/MP of the T O in W (CE-457).
[14] Copy of the motion of 7 November 2002 of B P S.A. for the declaration of K bankruptcy (CE-462).
[15] Copy of the letter of 3 December 2002 from D B P to B P S.A (CE-463).
[16] Copy of the fax submission of 12 July 2002 from K to Mr. R (CE-458).
[17] Copy of the Loan Agreement of 7 February 2003 concluded between K I G and K (CE-460).

sufficient defence to B P S.A.'s motion and that K had failed to fulfil the requirements of its arrangement with its creditors and had permanently ceased to pay its liabilities.[18]

E. The Management Services

75. The Parties dispute the scope of the Management Services and the extent to which they were, in fact, provided. The description of the Management Services is based on the Claimants' submissions and does not reflect the agreed position of the Parties.

76. According to the Claimants, under the Privatization Agreement, S was required to provide K with know-how and other support for its development including: (i) making available to K patents, trademarks, technology and other rights on intangible assets (Article VI of the Privatization Agreement); and (ii) causing K to organize training programs for its employees (Article VIII of the Privatization Agreement). In this regard, the Claimants referred to a letter dated 23 September 1993 from the Polish Minister for Industry to S expressing his appreciation for S interest and active participation in Poland's privatization efforts and agreeing that it was necessary to provide training and development programs for the management and employees of Polish companies.[19]

77. The Claimants state that they began providing Management Services to K shortly after its privatization on 8 November 1994. These services were provided through a special purpose Polish subsidiary, W ("W "). W was incorporated in Poland on 12 January 1995. On 26 January 1995, S concluded an agreement for the purchase of all shares in W . Subsequently, on 20 June 1996, W purchased 100% shares in W from S .

78. An agreement was concluded between W and K on 2 December 1994 in relation to the Management Services.[20] In accordance with Clause 1 of this

[18] Copy of the decision of 5 June 2003 of the District Court for the City of Warsaw on the declaration of the bankruptcy of K (CE-465).
[19] Statement of Mr. R , para. 29 (CE-007).
[20] CE-112.

Agreement, W had to provide K with management, advisory and consultancy services, in particular: (i) consulting in the scope of ongoing business activities; (ii) management, investment and marketing services; (iii) monitoring K activity in order to stabilize its market operations, strengthen its market position and win new sales markets; and (iv) coordinating the cooperation among domestic and foreign fat industry research institutes. Similar agreements were executed with the other Polish Investments. Additional agreements in relation to the Management Services were signed in 1995 ("K 1995 Agreements") and 1996 ("K 1996 Agreements").

79. For the most part, the costs of salaries of the executives and consultants who provided Management Services and their fees and expenses were incurred directly by W . W then invoiced W and W invoiced each of the Polish Investments who paid Management Fees to it. In order to allocate the cost of providing the Management Services to the Polish Investments, the Management Fees were calculated as a percentage of monthly sales of each of the Polish Investments. The Management Fees paid monthly to W by K were initially calculated at 1.25% of K monthly sales. This was subsequently increased to 1.5% under the Annex of 3 January 1996 to the Agreement of 2 December 1994.[21] In 1997, the method of calculating the Management Fees was revised to remuneration for specific work or an hourly rate for each individual who provided Management Services.

80. The Management Services were provided jointly to the Polish Investments. S recruited three members of management for its Polish activities – Mr. T P. H , who was hired as W Chief Executive Officer, Mr. P L. B , who was hired as W Chief Financial Officer and Mr. R H. M , who was hired as W Senior Vice President for Business Development. Mr. H and Mr. B agreed to spend 50% of their time in Poland, while Mr. M , who was a Polish national, agreed to spend most of his time in Poland. According to the Claimants, a significant portion of the W expenses that were allocated to the Polish

[21] Statement of Mr. M at para. 45 (CE-008); and copy of the Annex of 3 January 1996 to the Agreement of 2 December 1994 concluded between K and W (CE-114).

Investments through the Management Fee arrangement consisted of the salaries and travel expenses of these three gentlemen.

81. The stated purpose of establishing W was to have a central office, which could serve as the base of operations in Poland and accommodate a local team whose activities would involve supporting the companies acquired by W under the supervision of W management team.

82. S personnel, including Mr. R , Mr. M , Mr. M and Ms. M , also provided consulting services on an as-needed basis to W and the Polish Investments. The services consisted of continuous involvement on a day-to-day basis with the necessary functions of the companies including with respect to general management, finance, sales and marketing. At times other consultants were engaged when the required expertise was not available among the existing executives and consultants. These included Sector Advisors to W such as Mr. R F (Mechanical Engineering) and Mr. R B (Sales and Marketing).

83. The Management Services were provided to the Polish Investments from 1994 to 1997.

F. Legal framework of the tax system in Poland

84. Poland was the first country from the former Eastern Bloc to obtain full sovereignty and independence after the collapse of the U.S.S.R. In 1989, the first non-Communist government in Poland initiated substantial legal and economic reforms to usher Poland's entry into the free market.

(1) Administrative structure

85. Under the regulations in force in 1996,[22] the tax inspection authorities, after performing a tax inspection, would issue an inspection report. If the taxpayer did not

[22] *See* Claimants' Memorial dated 8 May 2012, footnote 42. While the Claimants' discuss the change in the procedure, they do not refer to the specific law that provides this procedure, or how or through which instrument this law was changed to provide a new procedure.

question the inspection report within 14 days of its issuance, the document was treated as a final decision (i.e. one that could be enforced). Otherwise, when the taxpayer questioned the inspection report, the case was referred to the tax authorities in order to conduct additional proceedings if necessary. In such a case, the tax authorities at first instance (i.e. the tax office) would issue a decision based on the evidence described in the inspection report. The taxpayer could challenge the decision before the Tax Chamber, who could either sustain or reject the decision made by the authorities at first instance. Finally, when the Tax Chamber sustained the decision, a challenge could be filed before the Administrative Court. This procedure applied in all cases where a tax inspection was instituted before 31 December 1996.

86. Changes regarding the tax inspection authorities took place on 1 January 1997.[23] According to the new provisions, after the closure of an inspection, a tax inspector would present a taxpayer with the documentation gathered in the course of the inspection. The taxpayer was entitled to present objections to the documentation within three days. The tax inspector would then issue a decision determining tax arrears. The taxpayer could question the decision by filing an appeal before the Tax Chamber. A decision made by the Tax Chamber could be challenged before the Administrative Court. This procedure applied in all cases where a tax inspection was instituted after 31 December 1996.

87. Before 2004, there was only one Administrative Court in Poland. The organizational structure consisted of 12 independent branches of the Supreme Administrative Court. Each branch exercised control and supervision over the decisions of the tax authorities in the relevant region of Poland. In order to contest a decision by the Supreme Administrative Court a taxpayer had to apply for its cancellation by the Supreme Court of Poland through the Minister of Finance.

[23] *Ibid.*

(2) Incentives for tax inspectors

88. In order to motivate tax inspectors to detect tax irregularities more effectively, their remuneration was connected to the value of the tax liabilities they determined. In accordance with Order Number 89 of the Minister of Finance dated 24 December 1996 "Concerning the Types of Budgetary Receipts Recognized as Additional, Manner of Their Distribution and Principles of Awarding Bonuses," additional bank accounts were opened where 20% of the tax determined and imposed on a taxpayer as a result of tax decisions, was deposited. Part of these funds was distributed in the form of bonuses to those tax inspectors who recognized and determined potential tax irregularities.

(3) Consequences of adverse tax decisions

89. A taxpayer whose tax deductible costs were disallowed by the tax authorities faced several further tax-related consequences. First, a taxpayer whose tax arrears exceeded a certain proportion of his tax liability immediately lost all of the investment incentives[24] to which he was otherwise entitled on account of expenditures incurred on modernizing his enterprise. While in its non-binding guidelines the Ministry of Finance advised the tax authorities to apply the law regarding the loss of investment incentives leniently, binding statutory law providing for more lenient treatment with respect to investment incentives was only officially introduced in the Corporate Income Tax Act of 15 February 1992 ("CIT Law") on 1 January 1999.

90. Second, under Article 25, Section 1.3 of the Value Added Tax and Excise Act of 8 January 1993 ("VAT Law"), input tax on costs, which were excluded from a

[24] The issue of investment incentives was regulated by the resolution of the Council of Ministers of 25 January 1994 "On Deducting Investment Expenditures and Reductions from the Corporate Income Tax." This Resolution was repealed on 31 December 1996 although it remained in force with respect to investments made in areas with high unemployment until 31 December 1998. New investments made after 1 January 1997 were generally subject to Article 18a of the CIT Law. At the time relevant to the case, i.e. from 1994 to 1996, investment incentives were divided into tax reliefs and tax bonuses. At the same time, the amount of investment reliefs in one tax year could not generally exceed 25-50% of the taxable base; in 1997 the maximum amount of investment reliefs was decreased to 40 percent; in 1998 to 35 percent; and in 1999 to 30 percent. In addition to the investment reliefs, taxpayers were eligible for a bonus in a subsequent fiscal year amounting to half of the investment reliefs deducted from the taxable base in the previous fiscal year.

taxpayer's CIT-deductible costs, was automatically disallowed.

91. Third, the VAT Law also imposed severe financial penalties for declaring excessive input value-added tax ("VAT"), which would happen where, for instance, input VAT claimed was disallowed because the related costs were not allowed as CIT-deductible costs. Between 1994 and 1996, declaring excessive input VAT resulted in an administrative penalty up to three times the value of excess input VAT that had been claimed. Through an amendment to the law on 1 January 1997, the penalty was lowered to 30% of the difference between a taxpayer's VAT liability as declared in his return and his liability as assessed by the tax authorities (see Article 27, Section 5 of the VAT Law).

92. Fourth, Article 53a of the Tax Ordinance dated 1 January 1998 ("Tax Ordinance") and Article 20 of the Tax Liabilities Act dated 19 December 1980 provided for a severe penalty interest amounting to between 23-67% between 1994 and 2002.

93. Fifth, Article 173 of the Administrative Procedure Code dated 14 June 1960[25] (as applicable until 31 December 2003) provided for immediate enforceability of tax decisions by the tax authorities at the first instance regardless of any appeal having been lodged before a higher forum.

94. Last, Articles 34 to 37 of the Tax Ordinance provided for the institution of a statutory mortgage. As of 1 January 1998, a statutory mortgage could be imposed by the tax authorities with respect to all tax arrears, including tax liabilities determined by a decision at the first instance. For a statutory mortgage to arise, it was sufficient for the tax authority's decision to be delivered to the taxpayer, though to remain valid the mortgage had to be disclosed in the land and mortgage register within one month from the date it arose. Furthermore, the statutory mortgage was superior to any other mortgages disclosed in the land and mortgage register, irrespective of the date of their disclosure. There was an exception in Article 36, Section 6 of the Tax Ordinance for bank mortgages securing long-term housing loans, which were superior to statutory

[25] Later replaced by Article 224 of the Tax Ordinance.

mortgages if previously disclosed in the land and mortgage register.

95. As a result of amendments introduced to the Tax Ordinance on 5 June 2001, for a statutory mortgage to be effective it had to be entered into the land and mortgage register. However, if entered into a land and mortgage register, a statutory mortgage was still superior to any other mortgages with the exception of long-term bank loans. The rule of superiority of the statutory mortgage was declared unconstitutional by the Polish Constitutional Court on 26 November 2007 because it violated provisions on legal equality and non-discrimination in the Polish Constitution.

(4) Transfer pricing

96. Until 1 January 1997, the CIT Law did not provide any method for the calculation of the cost of or income from related party transactions and simply stated that the cost of or income from such transactions should reflect the cost of or income from similar transactions in the local market.

97. On 29 April 1996, the Ministry of Finance issued guidelines on the manner and procedure of income determination by way of estimation ("Guidelines"). These Guidelines were published on 17 May 1996.[26] The Guidelines provided the tax authorities with rules for the estimation of income in connection with transactions between related entities based on the "Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration" issued by the OECD ("1995 OECD Report"). The tax authorities were authorized to apply these Guidelines retrospectively.

98. On 1 January 1997, Article 11 of the CIT Law was amended and price calculation methods proposed in the 1995 OECD Report with respect to transfer pricing were introduced.

99. Until the end of 2000, there were no specific regulations regarding a taxpayer's obligation to prepare transfer pricing documents of transactions with related parties.

[26] CE-065.

Taxpayers were also not able to obtain binding advice as to the application by the tax authorities of the tax regulations regarding income assessment.

G. Tax proceedings in K

100. According to the Claimants, they expected that the costs incurred by K on the Management Fees would be deductible costs for the purpose of calculating the tax base on which CIT was imposed ("CIT-deductible costs") and that the input value-added tax would also be tax deductible.

101. In 1996, 1997 and 1999, the T I O in O completed four tax inspections regarding K tax returns for the fiscal years 1994 to 1997. These inspections focused on the provision of the Management Services.

102. The T I O in O disallowed the Management Fees paid by K to W as CIT-deductible costs and as a consequence, K right to deduct VAT in respect of these Management Fees was automatically disallowed. Following these tax inspections, separate tax proceedings were commenced regarding CIT for the fiscal years 1994 to 1997 and regarding VAT for the fiscal years 1995 to 1997. In total, 7 separate tax proceedings were conducted, lasting for almost 6 years. During the course of these proceedings, the tax authorities issued a total of 29 tax decisions, out of which 13 were eventually quashed by the Tax Chamber.

103. In K case, the decisions regarding the fiscal year of 1995 were issued in accordance with the administrative procedure provided under the regulations in force in 1996. The tax proceedings regarding the fiscal years 1994, 1996 and 1997 were, however, conducted under the new procedure, which came into force on 1 January 1997.

(1) Tax proceedings regarding CIT for the fiscal year 1994

104. The tax inspection concerning the fiscal year 1994 was conducted during the period from 22 April 1996 to 12 June 1997. On 16 June 1997, the record of the tax inspection

("1994 Record") was issued.[27] In the 1994 Record, the T I O in O claimed that the purpose of incorporating W was to create a link between K and S r in order to transfer funds abroad. It was also alleged that the Management Services arrangement was tailored as a disguised form of transferring K funds abroad.

105. As such, Management Fees in the amount of PLN 5,336,200,000 were treated as not having been incurred for the purposes of earning income and were rejected as CIT-deductible cost.[28] As a result of this tax inspection, a tax decision was issued on 10 July 1997 disallowing the Management Fees as a CIT-deductible cost.

106. K filed an appeal against this decision on 31 July 1997 before the T C in O , in which it requested that the decision be quashed in its entirety and that its enforcement be suspended.[29] K denied the allegation that the Management Services were not related to its revenue and that the transfer of income out of K was for the sole purpose of transferring funds abroad. In its decision dated 14 November 1997, the T C in O upheld the decision of the Tax Inspector.[30] Based on the recommendation of A A , whose tax department represented K in the tax proceedings (and provided K with tax advisory services), K did not file any further appeal.[31]

(2) Tax proceedings regarding CIT for the fiscal year 1995

107. The tax inspection concerning the fiscal year 1995 was conducted during the period from 18 December 1996 to 10 June 1997. On 16 August 1997, the record of the tax inspection was issued ("1995 Record").[32]

[27] CE-214.
[28] *Ibid*, pp. 11-12.
[29] CE-198.
[30] CE-176.
[31] *See* copy of the Memorandum of 25 July 1997 of Mr. M to Mr. R (CE-217).
[32] CE-219.

108. In the 1995 Record, the T I O in O claimed that the Agreement of 2 December 1994 had been arranged for the sole purpose of transferring K funds abroad and that the Management Fees paid to W were not incurred for the purpose of earning income.[33]

109. As a result, the Management Fees paid by K to W amounting to PLN 4,547,916.58 were disallowed as CIT-deductible costs. Consequently, K input VAT for the fiscal year of 1995 was automatically decreased by PLN 862,077.[34]

110. Through its letter dated 31 July 1997, K wrote to the Director of the T I O in O contesting the findings of the tax inspection regarding the fiscal year of 1995 and requesting that tax proceedings be instituted before the T O in B .[35] Tax proceedings were instituted as requested[36] and in the course of the proceedings, both the tax inspector and K submitted additional evidence. The additional evidence submitted by K included letters and legal opinions by Prof. W J , Mr. J P from the U B of S , Prof. W M and Prof. A G .

111. In a decision dated 14 June 1999, the T O in B rejected the amount of PLN 4,547,916.58 paid to K as Management Fees as CIT-deductible costs.[37]

112. Under Polish law it is possible to file more than one appeal from a single decision and insofar as all appeals are filed within the time limit, the Tax Chamber is obliged to consider all of them. On 29 and 30 June 1999, therefore, attorney-at-law A S and A A lawyers appealed against the decision of the T O in B . They sought that the decision be quashed and the case be reconsidered on the merits on the grounds that the decision infringed procedural and substantive law.[38]

[33] *Ibid*, pp. 16-17.
[34] *Ibid*, p. 6.
[35] CE-200.
[36] Copy of the decision of 14 June 1999, No. PDII/730B/1/99 of the T O in B (CE-221).
[37] *Ibid*, p. 10.
[38] CE-225 and CE-227.

113. In its decision dated 30 September 1999, the T C in O upheld the decision of the T O in B . The T C acknowledged that the Management Services could be recognized as indirect CIT-deductible costs. It, however, decided that there was no evidence that the Management Services in question had been actually provided.[39]

114. On 2 November 1999, K filed a complaint against the Tax Chamber decision before the Supreme Administrative Court in W raising procedural and substantive objections, including that the consultants providing the Management Services had not been heard by the tax authorities.[40]

115. The Supreme Administrative Court in W in its decision dated 10 August 2000 upheld the decisions of the Tax Office and the Tax Chamber. The Court stated that the tax authorities correctly recognized that the sole purpose of the agreements concluded between K and W regarding the Management Services was to evade the income taxes due to the State Treasury, and that "*[...] if [K] showed that [the Management Services] were actually performed to its benefit, the expenditures on such performance would undoubtedly represent the tax deductible cost.*"[41]

(3) Tax proceedings regarding CIT for the fiscal year 1996

116. The tax inspection concerning the fiscal year 1996 was conducted during the period from 23 May to 22 July 1997. On 25 July 1997, the record of the tax inspection ("1996 Record") was issued.[42]

117. Additionally, according to the instructions of the Tax Chamber in its decision dated 23 June 1999 [described in paragraph 122 below], a supplementary tax inspection was conducted between 1 July 1999 and 24 September 1999 to re-examine the evidence

[39] CE-174, p. 14.
[40] CE-229, p. 7.
[41] CE-231, p. 11.
[42] CE-233.

related to the Management Services. On 1 October 1999, a supplementary tax record ("Supplementary 1996 Record") was issued.[43]

118. As a result of the tax inspection regarding the fiscal year 1996, a decision was issued on 15 September 1997 ("CIT Decision 1996/1") in which the tax inspector, Mr. S , concluded his decision by stating that: "*[...] the expenditure incurred by* [K] *in 1996 for the purchase of the intangible services provided by* [W] *were* [sic] *not incurred in order to generate revenue and that their sole purpose was to transfer income (in the form of a sales commission) to the owner of a majority shareholder [i.e., S]…via [W and W (U)]*." Consequently, the amount of PLN 5,384,945.69 K paid to W as Management Fees in 1996 was rejected as a CIT-deductible cost.[44]

119. On 2 October 1997, K appealed against CIT Decision 1996/1 to the T C in O .[45] Through its decision dated 19 November 1997 ("Chamber CIT Decision 1996/1"), the T C in O quashed CIT Decision 1996/1 as its decision was based on the wrong legal provision.[46]

120. On 24 November 1997, tax inspector S issued a second decision regarding K CIT ("CIT Decision 1996/2").

121. On 9 December 1997, K filed a complaint against Chamber CIT Decision 1996/1 with the Supreme Administrative Court in W .[47]

122. On 22 December 1997, K appealed against CIT Decision 1996/2 to the T C in O . In its decision dated 23 June 1999 ("Chamber CIT Decision 1996/2"), the T C in O quashed CIT Decision 1996/2 on procedural grounds. It returned the case for reconsideration and ordered the tax inspector to consider K motions to admit evidence submitted during the proceedings to

[43] CE-235.
[44] CE-237, p. 6.
[45] CE-202.
[46] CE-241, p. 2.
[47] CE-204.

supplement the evidence regarding the Management Services.[48] K filed a complaint against Chamber CIT Decision 1996/2 with the Supreme Administrative Court in W .[49]

123. On 15 October 1999, Mr. S issued a third decision regarding K CIT ("CIT Decision 1996/3"). The decision was based on the Supplementary 1996 Record. In his decision, Mr. S stated that the Agreement of 2 December 1994 and the Annex of 3 January 1996 constituted the legal framework for the Management Services and that K 1996 Agreements were concluded solely to "cloak" the payments made to W in the form of a commission on sales. As a consequence, all of the payments for the Management Services in 1996 were rejected and disallowed as CIT-deductible cost.[50]

124. On 2 November 1999, K appealed against CIT Decision 1996/3 to the T C in O and requested that the decision be quashed insofar as it related to the rejection of the Management Fees as K CIT-deductible costs.[51] The T C in O issued a decision dated 17 January 2000 ("Chamber CIT Decision 1996/3"), in which it quashed CIT Decision 1996/3 on procedural grounds and returned the case for reconsideration to the T I O in O .[52]

125. On 14 February 2000, K filed a complaint against Chamber CIT Decision 1996/3 with the Supreme Administrative Court in W .[53]

126. On 16 February 2000, K asked Mr. S not to issue a decision regarding K CIT because K had filed an appeal against Chamber CIT Decision 1996/3 with the Supreme Administrative Court in W .[54] Despite this, on 14 April 2000, before the Supreme Administrative Court in W heard any of the complaints

[48] CE-247, pp. 4 and 5.
[49] CE-265.
[50] CE-249, p. 7.
[51] CE-251.
[52] CE-253.
[53] CE-208.
[54] CE-210.

filed against Chamber CIT Decision 1996/1, Chamber CIT Decision 1996/2 or Chamber CIT Decision 1996/3, Mr. S issued yet another decision regarding K CIT for 1996 ("CIT Decision 1996/4"). In this decision, Mr. S reiterated his earlier arguments and rejected all of the Management Fees paid by K in 1996 as CIT-deductible costs.[55]

127. On 28 April 2000, K filed an appeal against CIT Decision 1996/4 before the T C in O .[56] Through a decision dated 21 September 2000 ("Chamber CIT Decision 1996/4"), the T C in O upheld Chamber CIT Decision 1996/4 and held that the Management Fees in the amount of PLN 5,522,859.74 were not CIT-deductible costs. The T C in O stated that the expenditures for the Management Services corresponded to a percentage of K monthly sales. It also stated that it was apparent that all of K 1996 Agreements had been concluded in order to conceal the percentage of fees paid to S for the supervision of K and that the evidence that K submitted was unreliable. The T C in O concluded the decision by stating that K had failed to prove that the Management Services had been rendered.[57]

128. On 24 October 2000, K filed a complaint against Chamber CIT Decision 1996/4 before the Supreme Administrative Court in W .[58]

129. In its decision dated 18 January 2001, the Supreme Administrative Court in W agreed with the arguments raised by K in its complaint regarding Chamber CIT Decision 1996/1 and quashed the Tax Chamber's decision on procedural grounds.[59]

130. In its decision dated 11 September 2001, the Supreme Administrative Court in W quashed Chamber CIT Decision 1996/4 and CIT Decision 1996/4 noting that in its decision dated 18 January 2001, it had quashed Chamber CIT Decision

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55 CE-255, pp. 5-7.
56 CE-212.
57 CE-257, pp. 10 and 12.
58 CE-259.
59 CE-261.

1996/1 which resulted in the "revival" of the first decision regarding K CIT for 1996, i.e. CIT Decision 1996/1.[60]

131. In its judgment of 17 October 2001, the Administrative Court in W quashed Chamber CIT Decision 1996/2 and Chamber CIT Decision 1996/3 on procedural grounds.[61]

132. Following the decision of the Supreme Administrative Court in W of 18 January 2001, the T C in O issued a decision on 28 February 2002 ("Chamber CIT Decision 1996/5") rejecting the Management Fees as CIT-deductible costs because in its view, the purpose of the services performed was to transfer income to S and not to generate revenue. Consequently, K CIT obligation for 1996 was determined in the amount of PLN 12,561,679.[62]

133. On 26 March 2002, K filed a complaint against Chamber CIT Decision 1996/5 before the Administrative Court in W .[63]

134. On 7 November 2002, however, K decided to withdraw its complaint[64] because under Article 15 of the Act on Restructuring of Public Receivables, which came into force on 30 August 2002, a taxpayer who wanted to have his tax arrears restructured and cancelled together with any penalty interest due could only commence such restructuring once his case was resolved or the appeal was withdrawn. Following K request to withdraw the complaint, the Supreme Administrative Court in W decided to discontinue the tax proceedings for the fiscal year of 1996 on 16 December 2002.[65]

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[60] CE-263.
[61] CE-265.
[62] CE-178, pp. 11-13.
[63] CE-269.
[64] CE-271.
[65] CE-273.

(4) Tax proceedings regarding CIT for the fiscal year 1997

135. The last of K tax inspections, for the fiscal year of 1997, was conducted during the period from 3 March to 16 November 1999. Upon its conclusion, the record of the tax inspection for the fiscal year of 1997 ("1997 Record") was issued.[66]

136. In the 1997 Record, the T I O in O expressed several objections regarding the Management Fees. First, the Tax Inspection Office alleged that S had contrived the Management Services in order to exercise strategic control in the company instead of acting in the company's direct interest. Second, it maintained that some of W services had not been performed at all. Third, the tax inspector alleged that the value of some of the Management Services was lower than the price K had paid for them. Finally, some part of the Management Services was alleged to be services for an investment to be launched in 1998 and was therefore not linked to the revenues earned by K in 1997. As a result, Management Fees of PLN 5,755,244.07 paid by K were rejected as CIT-deductible costs.

137. As a result of the tax inspection a decision was issued on 16 March 2000. In this decision, the tax inspector stated that the evidence of the Management Services was unreliable and that K had failed to sufficiently prove that the services had been provided and were related to K revenue. As a consequence, the tax inspector rejected all of the costs of the Management Services provided in 1997 – totalling PLN 5,735,244.07 – and disallowed them as tax deductible costs.[67]

138. On 3 April 2000, K filed an appeal against this decision before the Tax Chamber in O .[68] K requested that the decision be changed or alternatively quashed and returned for reconsideration. K argued that the tax authorities should consider the Management Fees arrangement through the prism of the entire holding structure. K also stated that due to the nature of the Management Services as intangible services, the documents submitted reflected only part of the services. K further

[66] CE-275.
[67] CE-196.
[68] CE-279.

alleged that the tax inspector had not examined crucial witnesses who had knowledge of the Management Services provided and their benefits to the company.

139. Through its decision of 24 November 2000, the Tax Chamber in O quashed the 16 March 2000 decision and returned the case for reconsideration, ordering the tax inspector to further analyse the matters regarding K investment incentives. The Tax Chamber pointed out that K had lost its right to the investment incentives as a result of the tax liabilities imposed on the company for the fiscal year of 1996. The Tax Chamber did not refer to K motion to admit new witnesses in its 24 November 2000 decision.

140. In accordance with the instructions of the Tax Chamber in O which were also included in its decision of 24 November 2000, a supplementary tax inspection for fiscal year of 1997 was conducted. On 14 May 2001, the supplementary tax record ("Supplementary 1997 Record") was issued.[69] In the Supplementary 1997 Record, the tax inspector analysed whether K had lost its investment incentives due to tax arrears for 1996 (as K tax arrears for 1996 were finally confirmed by the Tax Office in B in a letter of 7 March 2001) and consequently, determined K tax arrears for 1997.

141. In the Supplementary 1997 Record, the tax inspector determined the value of investment incentives that K took advantage of in the years from 1994 to 1996 to be PLN 31,784,771. The loss of the investment incentives resulted in an increase in K tax arrears for 1997 to PLN 15,084,931.

142. On 13 June 2001, the tax officer issued a second decision. The tax inspector followed the decision of 16 March 2000 with reference to the Management Fees paid in 1997, stating that the documentation submitted by K did not reflect the actual scope of business operations and therefore could not constitute evidence that the Management Services were provided. The inspector, however, accepted an amount of PLN 20,000 as the company's CIT-deductible cost. Consequently, the tax inspector estimated that

[69] CE-277.

K CIT due for the fiscal year of 1997 amounted to PLN 15,084,931. As a result, the tax arrears and the interest accrued as of 16 March 2000 amounted to PLN 14,063,198.90 and PLN 20,224,883.40 respectively.[70]

143. Through an appeal filed on 26 June 2001, K challenged this decision and sought its suspension until the appeal was considered.[71]

144. On 10 July 2002, the Tax Chamber partially quashed the tax inspector's decision of 13 June 2001. The Tax Chamber also allowed K to treat an amount of PLN 100,000 as CIT-deductible cost rather than PLN 20,000 as the tax inspector had done. It, however, held that, for the most part, the Management Services were not performed and, consequently, the Management Fees were not CIT-deductible costs.

145. On 9 August 2002, K filed a complaint against the Tax Chamber's decision before the Supreme Administrative Court in W and asked for this decision as well as the preceding decision of 12 June 2001 to be quashed.[72] On 7 November 2002, K withdrew the complaint and requested the Supreme Administrative Court in W to discontinue the proceedings since this was a condition precedent for restructuring of K tax arrears under Article 15 of the Act on Restructuring of Public Receivables.

146. On 16 December 2002, the Supreme Administrative Court in W decided to discontinue the case.[73]

(5) VAT proceedings for the fiscal years 1995 to 1997

147. Under the VAT Law, disallowance of expenditure incurred by a VAT taxable entity as a tax deductible cost under the CIT Law disentitles that entity from offsetting the input VAT related to that cost against the output tax due for each month. In K

[70] CE-283, pp. 1 and 28-31.
[71] CE-285.
[72] CE-287.
[73] CE-291.

case, since the cost incurred on account of Management Fees was disallowed under the CIT Law as a tax deductible cost it automatically created VAT arrears for K .

148. As a result, VAT arrears and interest thereon was imposed on K . In addition, further penalties were also imposed on K under the VAT Law. The tax authorities in the VAT proceedings justified their decisions on the basis of assessments by the authorities in the CIT proceedings.

(6) Investment incentives

149. From 1994 to 1996, K deducted its investment expenditures from its income for the purpose of calculating its CIT liability. The amounts deducted totalled PLN 6,489,848 for the fiscal year 1994, PLN 8,100,000 for the fiscal year 1995 and PLN 9,900,000 for the fiscal year 1996.

150. From 1995 to 1996, K deducted its CIT investment bonuses from its income for the purpose of calculating its CIT liability. The amounts deducted totalled PLN 3,244,923 for the fiscal year 1995 and PLN 4,050,000 for the fiscal year 1996.

151. The CIT investment incentives from 1994 to 1996 amounted to PLN 31,784,771.

152. Through the decision of 13 June 2001 relating to K CIT liabilities for the fiscal year 1997, the tax inspector held that K had lost its right to the investment incentives as of 1 April 1997 on the grounds that from 1 April 1997 K liability for the fiscal year 1996 had been outstanding as a result of CIT Decision 1996/4. As a result, the amount of investment incentives, i.e. PLN 31,784,771, were added back to K income for the fiscal year 1997. The tax inspector's findings were confirmed by the Tax Chamber in its decision of 10 July 2002.

153. As a consequence of these proceedings, K lost all of its investment incentives for the fiscal years 1994 to 1996. The total amount of incentives were added back to its income for the fiscal year 1997, which increased the income on which CIT was to be calculated and thus, also K CIT arrears and penalty interest for the fiscal year 1997.

154. K total tax liability as assessed by the tax authorities and upheld by the higher forums was as follows:[74]

Tax arrears	PLN
CIT arrears	18,550,711
CIT late penalty interest	28,826,257
VAT arrears	3,184,463
VAT late penalty interest	4,220,243
Additional VAT liability	589,656
Total Tax Arrears	**55,371,330**

H. Tax proceedings regarding WFM

155. In 1998 and 1999, the Tax Inspection Office in P completed three tax inspections relating to W tax returns for the fiscal years 1995 to 1997. The main focus of these inspections was the Management Services provided to W by W .

156. The first inspection was conducted in 1998 for the fiscal year 1995. The tax inspector issued a decision on 28 December 1998 in which she found that the true purpose of the Management Fees was to transfer W income through W and W to S and that these fees had not been incurred for the purpose of earning income. As a result, the total amount of PLN 1,022,520.95 accrued by W on account of Management Fees was disallowed as a CIT-deductible cost.[75] W challenged this decision before the Tax Chamber in P , which issued its judgement on 20 April 1999 and quashed the decision in relation to the rejection of the Management Fees as a CIT-deductible cost. The Tax Chamber held that indirect costs such as the

[74] Claimants' Memorial dated 8 May 2012, para. 340 (citing CE-174, 176, 178, 180, 182, 184 and 186).
[75] CE-325.

Management Fees could be CIT-deductible costs and that the Management Fees had been incurred for the purpose of earning and the tax inspector had not been able to show otherwise. The Tax Chamber, therefore, allowed the Management Fees as a CIT-deductible cost.[76]

157. The second inspection was also conducted in 1998 for the fiscal year 1996. The tax inspector issued her decision on 30 December 1998 in which she disallowed the Management Fees on the same basis as her earlier order for the fiscal year 1995. W challenged this decision before the Tax Chamber in P , which issued its decision on 20 April 1999, and as it did for fiscal year 1995, found the Management Fees to be a CIT-deductible cost.[77]

158. The third inspection was conducted in 1998-1999 for the fiscal year 1997. The same tax inspector who had earlier issued decisions for fiscal years 1995 and 1996, issued a similar decision on 24 March 1999 for the fiscal year 1997. This decision too was reversed by the Tax Chamber in its judgment dated 6 July 1999 in which it allowed the Management Fees as a tax deductible cost.[78]

159. Similarly, proceedings under the VAT Law were also initiated against W for the fiscal years 1995 to 1997 and the same tax inspector who had concluded the CIT proceedings[79] disallowed the input VAT adjustment claimed by W on the Management Services on the basis of her decisions disallowing Management Fees as a tax deductible cost. These decisions were, however, reversed on appeal to the Tax Chamber in P , which allowed W to adjust the input VAT on the Management Services for the fiscal years 1995 to 1997.[80]

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[76] CE-331.
[77] CE-333.
[78] CE-335.
[79] *See* paras. 155-158 above.
[80] CE-339, CE-347 and CE-353.

I. Tax proceedings regarding W

160. W business activity in Poland consisted of purchasing the Management Services from W and reselling them to K , W and B . The Management Fees it collected from the Polish Investments constituted its revenue and it sought to treat the funds paid to W as CIT-deductible costs.

161. W was also subject to a tax inspection for the fiscal year 1997. The focus of the tax inspection was the Management Fees. The tax authorities held that the scope of the Management Services on the basis of the agreements concluded between W and W was narrower than the scope of the Management Services actually received from W . The tax authorities concluded that the Management Services that were not covered by the W Agreements were received by W from W for free and that W should pay CIT on the value of the Management Services received since this constituted additional taxable revenue. The value of this additional revenue was determined on the basis of the market price of the Management Services, i.e. the price at which they were resold to the Polish Investments. As a consequence, W income was increased by PLN 3,006,700.86.

162. With respect to those Management Services purchased from W that were covered by the W Agreements, the tax authorities held that the Management Fees did not result in generating revenue and therefore could not be allowed as CIT-deductible costs. An amount of PLN 3,023,611.26 was, therefore, excluded from the CIT-deductible costs.

163. The Tax Office in W issued its decision on 16 September 1999 in which it determined W tax arrears of PLN 2,583,069 and interest thereon of PLN 1,578,855.06. W challenged this decision before the Tax Chamber in W , which issued its decision on 20 June 2000 and quashed the decision of the Tax Office and returned the case for reconsideration. The Tax Office, after reconsidering the matter, issued a second decision on 25 July 2000 in which the amount of tax arrears remained the same but the interest thereon was increased to PLN 2,477,977.

164. W once again challenged this decision before the Tax Chamber in W . The Tax Chamber in its decision of 12 April 2001 held that the remuneration for the Management Services paid by W to W was incurred for the purposes of generating revenue and, therefore, the Management Fees constituted CIT-deductible costs.[81] The Tax Chamber also partially accepted W arguments with respect to the free benefits allegedly received from W . As a result, the amount of tax arrears and interest thereon were decreased to PLN 691,973 and PLN 516,022.30 respectively.

165. W filed a complaint against this decision before the Supreme Administrative Court in W . The proceedings were discontinued on 29 May 2006 because of W dissolution.[82]

J. Criminal proceedings

166. From the submissions of the Parties, it is the Tribunal's understanding that under Polish law, pre-court criminal proceedings can be divided into two phases. The first phase, which is a fact-finding exercise, is conducted by the Public Prosecutor or by the police under the supervision of the Public Prosecutor. This phase begins with an order to commence criminal proceedings. The Public Prosecutor or the police then start an investigation into whether a criminal offence may have been committed and if so, who may have committed it. If the Public Prosecutor is of the opinion that on the basis of facts unearthed during the first phase there is sufficient probability of a criminal offence having been committed by an identified person, then a formal decision for presenting charges is issued and the person is then treated as a suspect. From that moment onward, the criminal proceedings are to be held against such person and if his personal conduct so justifies, he may be subject to provisional measures such as arrest or bail.

[81] CE-365.
[82] CE-367

167. The following investigations and criminal cases were initiated in relation to K and the Polish Investments:

(i) An investigation initiated on 18 November 1997 under file No. V.Ds. 33/97 regarding economically groundless capital transfers in the amount of PLN 12,588,343.86 on account of payments made by K to W for the Management Services ("K Criminal Case 1"). This investigation was suspended on 31 August 1999 in order to obtain an expert opinion on the role and significance of the Management Services.

(ii) Criminal case No. V.Ds. 22/03 in the matter of activities to the detriment of K by members of the company's Management Board in 2001 and 2002 ("K Criminal Case 2").

(iii) Criminal case No. Ds. 9/01 in the matter of activities to the detriment of K . The case was discontinued by a decision dated 26 June 2001 but subsequently reopened and included in K Criminal Case 2 by a decision dated 12 December 2003.

(iv) Criminal case No. Ds. 1733/02 in the matter of the alleged breach of rights of K employees by members of the company's Management Board. The case was discontinued by a decision dated 31 December 2002, subsequently reopened and included in K Criminal Case 2 by a decision dated 12 December 2003.

(v) Criminal case No. Ds. 1256/03 in the matter of the alleged liability for K bankruptcy and activities to the detriment of K creditors. The case was discontinued by a decision dated 31 July 2003 but subsequently reopened and included in K Criminal Case 2 by a decision dated 12 December 2003.

(vi) Criminal case No. Ds. 2214/02 in the matter of activities to the detriment of K by members of the company's Management Board from 1997 to 2001 ("K Criminal Case 3"). The case was not officially instituted as a result of the refusal of the Prosecutor in B to proceed with the matter.

(vii) Criminal case No. Ds. 1826/02 in the manner of activities detrimental to K by the members of the Management Board from the date of privatization onwards. This case was discontinued by a decision dated 31 December 2002 (“K Criminal Case 4”).

(viii) Through a decision dated 19 April 2002, Criminal case No. I.Ds. 7/01/s in the matter of purchase of Management Services by B from W was included in K Criminal Case 1.

(ix) Through a decision dated 17 December 2003, the Prosecutor in O reopened the K Criminal Case 1, which was registered under a new case number – V.Ds. 34/03 and included K Criminal Case 2 and K Criminal Case 3 in K Criminal Case 1 and reopened and then included K Criminal Case 4 in K Criminal Case 1.

168. On 2 December 2006, Mr. W B – the former Chairman of K – and Mr. R M – the former President of K Supervisory Board – were detained by the Central Anticorruption Bureau. Mr. B was released on 7 March 2007 and Mr. M on 28 March 2007.

169. On 28 September 2007, an indictment against Mr. B and Mr. M was brought before the Criminal Court in O under Criminal case No. III K 153/07. The indictment contained 50 charges against Mr. B and 88 charges against Mr. M including “*signing the Management Services agreements*” and “*falsifying the documents regarding the Management Services.*”[83] The indictment was based largely on the opinion of the court expert Ms. S , an employee of the Tax Office in O .

170. The first court hearing in K Criminal Case 1 took place on 5 August 2009. Insofar as this Tribunal is informed by the Parties, the case is pending.

[83] CE-485.

171. On 19 February 2010, the Prosecutor's Office in O reopened the investigation into the matter of serious material damage caused to K by its Management and Supervisory Board members other than Mr. B and Mr. M during the period from 1994 to 2003 ("K Criminal Case 5").[84] This investigation was led by a different Prosecutor. On 19 October 2010, Mr. M was called to testify before the Criminal Court in O . Mr. M appeared and testified in a hearing held from 26 to 28 October 2010. He was, thereafter, required to submit his views on the expert opinion of Ms. S . On 11 September 2011, Mr. M submitted his opinion and another 16-page statement to the Prosecutor explaining why the criminal proceedings should be discontinued. A second 91-page statement was submitted by Mr. M on 25 October 2011.

172. On 1 December 2011, the Prosecutor closed K Criminal Case 5 and on 29 December 2011 he issued a Decision on Discontinuation of the Criminal Preparatory Proceedings in the Matter of Material Damages Caused to K by Management and Supervisory Board Members other than Mr. B and Mr. M during the Period From 1994-2003 ("Decision on Discontinuation").[85] In the Decision on Discontinuation the Prosecutor noted that:

(i) The law did not provide any regulation regarding Management Services at the relevant time and this was a new issue even for the tax authorities;

(ii) No evidence was found to prove that Management Services were not provided; and

(iii) K had to create a financial provision for potential tax liabilities in the amount PLN 38,000,000 which affected its financial results for 1998 and affected its credibility, and was one of the reasons that contributed to its bankruptcy.

[84] CE-511.
[85] CE-385.

173. While K Criminal Case 5 has been discontinued, the Prosecutor, according to the information provided to this Tribunal by the Parties, continues to uphold the indictment against Mr. B and Mr. M .

K. Bankruptcy of other Polish investments

174. W was listed on the Warsaw Stock Exchange after an initial public offering held on 26 January 1998. The Claimants sold their shares in W in 2001. Four years later, on 25 November 2005, however, W was declared bankrupt. Insolvency proceedings against B were opened in 2001.

IV. SUMMARY OF THE PARTIES' CLAIMS AND REQUESTS FOR RELIEF

A. Claimants

175. According to the Claimants, if it were not for the tax proceedings and the tax decisions, K would not have gone bankrupt, regardless of the macroeconomic conditions in Poland and the specific conditions of the vegetable fats industry.

176. The Claimants, therefore, request: [86]

(i) An award declaring:

(a) That the Tribunal has jurisdiction in the present arbitration case;

(b) That the Respondent violated its obligation under Article VII(1) of the Polish-U.S. BIT by unlawfully expropriating the Claimants' investment in K ;

(c) That the Respondent violated its obligation under Article II(6) of the Polish-U.S. BIT by failing to accord the Claimants fair and equitable treatment;

[86] Claimants' Memorial dated May 8, 2012, para. 1328.

(d) That the Respondent violated its obligation under Article II(6) of the Polish-U.S. BIT by failing to accord the Claimants full protection and security;

(e) That the Respondent violated its obligation under Article II(6) of the Polish-U.S. BIT by impairing the Claimants' investment by discriminatory and arbitrary measures;

(f) That the Respondent violated its obligation under Article V(1) of the Polish-U.S. BIT to allow the Claimants to freely transfer funds;

(ii) Ordering the Respondent to pay compensation for the expropriation of the Claimants' investment in K in the amount of PLN 396,400,000 supplemented by interest calculated from 31 March 2012 until the date of the award;

(iii) Ordering the Respondent to pay compensation for the legal fees incurred in criminal proceedings in the amount of US$ 549,194.43 supplemented by interest calculated from 30 April 2012 until the date of the award;

(iv) Ordering the Respondent to pay compensation for the loan granted by the Claimants to K after its collapse in the amount of US$ 545,000;

(v) Ordering the Respondent to pay moral damages in the amount of US$ 20,000,000;

(vi) Ordering the Respondent to pay post-award interest calculated from the date of the award until the date of payment by the Respondent of the whole amount of compensation;

(vii) Ordering the Respondent to pay any increase in the amount of the award to offset any tax consequences, in order to maintain the integrity of the award; and

(viii) Ordering the Respondent to pay costs associated with these proceedings, including professional fees and disbursements.

B. Respondent

177. The Respondent seeks the following relief:

(i) The Tribunal declares that it lacks jurisdiction to hear this case or, in the alternative, that the Claimants' claims are inadmissible;

(ii) In the event that the Tribunal rejects the Respondent's objections to jurisdiction and admissibility, that the Claimants' claims are dismissed in their entirety on the merits; and

(iii) In any case, the Respondent be reimbursed by the Claimants for all costs borne by the Respondent in relation to the present proceedings, including the advances on costs of the proceedings, costs of legal representation, translations, expert reports and other costs and expenditures.

V. JURISDICTION

178. The Respondent has raised four jurisdictional objections. The first is with regard to the Claimant A . According to the Respondent, this company has not made or acquired rights to any investment in Poland and therefore does not qualify as an investor under the Treaty.

179. The second and third jurisdictional objections relate to the Claimants' claim based on the alleged irregularities in the tax proceedings and determination of tax liabilities ("Tax Claim"). According to the Respondent, the entire Tax Claim is covered by the tax exception provided in Article VI of the Treaty read in conjunction with Article 22 of the Poland – United States Double Tax Treaty ("DTT") and is, therefore, outside the jurisdiction of this Tribunal.

180. The fourth and final jurisdictional objection relates to the Claimants' claim based on the criminal proceedings ("Criminal Claim"). The Respondent argues that such a

dispute does not fall within the definition of an investment dispute under Article IX of the Treaty and is, therefore, outside the jurisdiction of the present Tribunal.

A. Jurisdictional objection 1: A standing *ratione personae*

(1) The Parties' positions

a. <u>Respondent's position</u>

181. The Respondent argues that that this Tribunal lacks jurisdiction over A claims because A is not an investor. The Respondent submits that on 28 December 2003, when A acquired all of the assets of W , including the shares in K , the bankruptcy proceedings against K were already open and the bankruptcy administrator was in the process of selling K assets. According to the Respondent, the value of K shares when A acquired them was basically zero. The Respondent submits that under Assignment Agreement 2, A did not pay any consideration to W for the shares. The Respondent points to the Claimants' Memorial in which the Claimants supposedly admit that "*the Claimants' investment in K lasted for approximately 6 years*"[87] (i.e. from 1994 to 2000), which implies that even the Claimants did not consider K shares as an investment after 2000.

182. The Respondent relies on the Claimants' counsel's 2009 letter to the District Court in W , which in the Respondent's view confirms that the only reason for the continued existence of K was the continuation of the criminal proceedings against Mr. B and Mr. M . Quoting the Claimants' counsel, the dissolution of K before the completion of these criminal proceedings "*would further constitute the indirect deprivation of the [American] shareholder of the right to appeal and thus the infringement of the Treaty.*"[88]

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[87] Claimant's Memorial dated 8 May 2012, para. 1048.
[88] Letter from K to the National Court Register dated 2 November 2009 (RE-142).

183. In support of its argument, the Respondent relies on the decision in *Phoenix Action v. Czech Republic*, where it was held that:

> *…the fact of buying a bankrupt or inactive company must not necessarily be disqualified as an investment, as the intent of the investor can precisely be to make the company profitable again. The Tribunal has initially given the benefit of doubt to the Claimant, but now that it has refined its analysis, it must come to a different conclusion. It is not contested by the Claimant that, at the time of the alleged investment, when Phoenix bought the two Czech companies, they had no activity. [...]*
>
> *But a more important feature is that no activity was either launched or tried after the alleged investment was made. [...]*
>
> *The evidence indeed shows that the Claimant made an 'investment' not for the purpose of engaging in economic activity, but for the sole purpose of bringing international litigation against the Czech Republic. This alleged investment was not made in order to engage in national economic activity, it was made solely for the purpose of getting involved with international legal activity. The unique goal of the 'investment' was to transform a pre-existing domestic dispute into an international dispute subject to ICSID arbitration under a bilateral investment treaty. This kind of transaction is not a bona fide transaction and cannot be a protected investment under the ICSID system.*[89]

184. According to the Respondent, the only difference between the *Phoenix* case and the present dispute is that in the present dispute A shareholding was not maintained for the purpose of creating an international treaty claim, but to interfere in domestic proceedings. In either case, however, it is clear that A shareholding in K was for the sole purpose of legal proceedings and not as an investment in Poland.

185. The Respondent agrees with the Claimants that the test for whether an investment exists is as set out in *Salini v. Morocco.*[90] According to the Respondent, however,

[89] *Phoenix Action, Ltd. v. Czech Republic*, ICSID Case No. ARB/06/5, Award of 15 April 2009, paras. 140-142 (RLE-058).
[90] *Salini Costruttori S.P.A. and Italstrade S.P.A. v. Kingdom of Morocco,* ICSID Case No. ARB/00/4, Decision on Jurisdiction of 16 July 2001, para. 52 (CE-634).

A shareholding in K does not meet two of the criteria set out in the test: (i) there was no contribution; and (ii) there was no assumption of transactional risk.

186. The Respondent asserts that Mr. R and S indirectly held only 16.57% of the shareholding of K prior to its collapse in mid-2000. Out of the total equity contribution of US$ 46.3 million made into W by all its partners, Mr. R and S did not contribute more than US$ 10 million. Almost 50% of the shareholding in W before mid-2000 was held by non-U.S. partners – the E B for R and D ("E ") and a group of beneficial owners of a Cayman Islands company, W Ltd. While the nationality of all of the stakeholders is not known to the Respondent, it is clear that the E , which held 34.65% of the shares in W , was not a U.S. national and therefore, not entitled to any protection under the B .

187. The Respondent further avers that Mr. R and S only acquired 75.02% of the shareholding of K after W transferred all shares in K to A in December 2003 for zero consideration under Assignment Agreement 2. These two Claimants are using A as a litigation vehicle to multiply their potential gain since the current shareholding of A in K is roughly 5 times higher than the actual, historical equity interest that Mr. R and S held in K at the time the initial investment was made (and when K actually had any value).

188. In this regard, the Respondent relies on Mr. R statement during the hearing that in case the Claimants prevail in this arbitration, all proceeds from the award, after deduction of arbitration costs, would be shared pro rata between W historical partners. By implication this would include the non-U.S. ex-partners in W who were once entitled to almost 50% of the equity in the partnership. According to the Respondent, this is precisely the type of scenario envisaged in a number of investment arbitration cases[91] as being abusive since it would lead to (i) the unjust enrichment of

[91] See *Impregilo S.p.A. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/03/3, Decision on Jurisdiction of 22 April 2005, paras. 146, 148, 151, 152 (RLA-081); *PSEG Global, Inc, and Konya Ilgin Electrik Üretim ve Ticaret Limited Şirketi v. Republic of Turkey*, ICSID Case No. ARB/02/5, Award of 19 January 2007 (CE-658); *Mihaly International Corporation v. Democratic Socialist Republic of Sri Lanka*, ICSID Case No. ARB/00/2, Award of 15

Mr. R and S (in case they do not share the proceeds with their former non-U.S. partners in W); or (ii) to the circumvention of the nationality requirement in the BIT (in case they do share).

b. Claimants' position

189. The Claimants reject the Respondent's objection. First, the Claimants argue that the transfer of W assets to A was part of the reorganization of the investors' corporate structure, which is allowed under both the BIT and international investment law. In this regard, the Claimants assert that Assignment Agreement 2 and Assignment Agreement 3 were transactions between affiliated companies and international investment law recognizes the transfer of an international investment claim from an investor to an affiliated entity within the framework of a BIT without any additional consent from the Respondent. The Claimants rely on Prof. S ICSID Commentary[92] and the decision in *Quasar de Valores v. Russia.*[93] According to the Claimant, the investors were entitled to set up their corporate structure in the most efficient and convenient manner. The fact that Mr. R and S may stand to benefit from this corporate structure if any damages are awarded to A is not forbidden under the Poland-U.S. BIT, particularly where this restructuring was undertaken in good faith and as a matter of good housekeeping after K bankruptcy.

190. Second, the Claimants argue that a change in the corporate structure would only be forbidden if it were made for the sole purpose of creating an international investment claim under the BIT, i.e. treaty shopping. In this case, however, the transfer was not made for this purpose at all and, therefore, the Respondent's reliance on the *Phoenix*

March 2002, paras. 24 and 26, (CE-802); *Occidental v. Republic of Ecuador*, UNCITRAL, Dissenting Opinion of Prof. Brigitte Stern of 20 September 2012, paras. 133 *et seq.* (RLA-082); *ST-AD GmbH (Germany) v. Republic of Bulgaria*, PCA Case No. 2011-06, ST-BG, UNCITRAL, Award on Jurisdiction of 18 July 2013, para. 419 (RLA-083).

[92] Schreuer Ch., Malintoppi L., Reinisch A., Sinclair A., "The ICSID Convention. A Commentary," 2nd edition, Cambridge University Press 2009, para. 362 (CE-801).

[93] *Quasar de Valores SICA V S.A. v. Russian Federation*, SCC Case No 24/2007, IIC 557 (2012), Award of 20 July 2012, para. 40 (CE-800).

case[94] is unjustified. There the Tribunal found that an Israeli company was established by a Czech national for the sole purpose of initiating ICSID arbitration proceedings against the Czech Republic. In the Claimants' view, this was confirmed by the fact that the notification of the investment dispute to the Czech Republic occurred only two months after the acquisition of the shares. In the present case, the transfer of shares took place in 2003, while the Notice of Investment Dispute was filed on 20 January 2010.

191. According to the Claimants, their claim is not based on the argument that A established its own investment in Poland in 2003, but rather on the fact that A succeeded to all the assets, including any legal claims, of W , which had made an investment in Poland.

192. In this regard, the Claimants assert that the only criteria to determine W position are those stipulated in the Poland-U.S. BIT. W was a U.S. company under the Poland-U.S. BIT and W always owned and controlled the investment. The Poland-U.S. BIT does not limit its benefit to U.S. companies to the extent that they are held by U.S. entities. As such, W corporate structure was compatible with the requirements of the Poland-U.S. BIT. The fact that the Respondent has not sought to rely on the denial of benefits clause under Article I(2) of the Poland-U.S. BIT only confirms this.

193. Third, the Claimants submit that the Respondent's organs have issued numerous decisions affirming At succession to W assets:

(i) The decision of the District Court for W dated 25 June 2007 regarding the share distribution plan in which the court held that the agreement between W and A for the transfer of rights and certificate of invalidation issued for W "*constitutes sufficient evidence that W E I was the legal predecessor of the creditor submitting complaints to the division plan.*"[95]

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[94] *Phoenix Action, Ltd. v. Czech Republic* (RLA-058).

[95] CE-804, p. 4.

(ii) A succession was confirmed in the decision dated 12 June 2008 issued by the District Court in W . Based on Assignment Agreement 2 and K collective share certificates, the court accepted A request for authorization to convene K shareholding meeting and stated that A "*sufficiently proved that it is the shareholder of the Participant* [i.e. K]."[96]

(iii) On 26 March 2009, the District Court in W appointed a custodian for K on the basis of A application.

194. In view of these decisions, the Claimants argue that the Respondent accepted A as W successor and cannot deny its status at this stage.

(2) The Tribunal's analysis

195. The central question before the Tribunal in this context is: what is the legal standing of A in this arbitration under the Additional Facility Rules? The facts undisputed by the Parties are that:

(i) W and A are both U.S. companies.

(ii) W transferred its entire shareholding in K to A in 2003 through Assignment Agreement 2 for no consideration.

(iii) At the time A acquired the shares K was effectively bankrupt.

(iv) A , therefore, did not spend any funds in Poland when it acquired the shares in K .

(v) When it acquired these shares, A was a subsidiary of W .

(vi) In the same year, S acquired the entire shareholding of A from W through Assignment Agreement 3.

(vii) The claim in the present arbitration was filed in 2010.

[96] CE-806, p. 3.

(viii) By transferring K ownership from W to A , Mr. R and S acquired a much greater ownership in K (i.e. a direct holding of 75.02%) than they originally had at the time W made the investment in K (i.e. an indirect holding of 16.57%).

(ix) While the Respondent has challenged A standing to bring the present claim, it does not dispute that W could have done so had it still owned K .

196. The Respondent argues that in deciding A standing to bring the present claim under the Additional Facility Rules, the Tribunal should apply the test set out in *Salini v. Morocco*[97] to determine whether an investment by A exists. If this test were adopted, the Respondent concludes that A may not bring this claim since it: i) made no investment in Poland - having acquired the shares in K for no consideration - and ii) A assumed no risk because K was already bankrupt in 2003 and A did not intend to revive it.

197. First, the Tribunal is mindful of the fact that the so-called "*Salini* criteria" are merely tools to assist in the determination of the existence of an investment for the purposes of ICSID arbitration, and are not jurisdictional criteria. If the Tribunal had to determine A standing to bring the claim in isolation then the Tribunal might have been persuaded to adopt the *Salini* criteria to guide its analysis because in such a case, the Tribunal would have had to first determine that it had jurisdiction over the subject matter of the dispute (i.e. *ratione materiae*). In the present case, however, the Parties do not contest the Tribunal's jurisdiction over the subject matter of the dispute. The Parties agree that an investment has been made. The questions are whether the investment has been made by A and whether A can bring a claim on the basis of that investment. It is A *ratione personae* that the Respondent is contesting.

[97] *Salini Costruttori S.P.A. and Italstrade S.P.A. v. Kingdom of Morocco,* ICSID Case No. ARB/00/4, Decision on Jurisdiction of 16 July 2001 (CE-634).

198. Atlantic is the successor of W .W assigned all its assets, including any legal claims relating to those assets, to A . As stated above, the Respondent does not dispute that W would have been able to bring this claim. When W assigned the shares in K to A , A stepped into W shoes. A has brought a claim on the basis of an investment made by its predecessor. It is the view of this Tribunal that in such circumstances, the *Salini* criteria lose their relevance to determine whether an investment has been made.

199. Since both Parties agree that W could have brought this claim, the question is why cannot W successor, i.e. A , bring this claim? To this the Respondent raises two objections. The first is that allowing A to bring this claim would amount to an abuse of international investment law. The Respondent relies on several decisions, including *Phoenix Action v. Czech Republic*,[98] *Caratube v. Kazakhstan*[99] and *Quiborax and others v. Bolivia*,[100] among others.

200. These decisions, however, are primarily concerned with investors seeking to exercise rights under investment treaties by way of after-the-event acquisition of assets from non-protected investors in order to obtain BIT protection. For instance, in *Phoenix Action* the Tribunal declined jurisdiction because an Israeli company was established by a Czech national for the sole purpose of availing remedies available under the Israel-Czech Republic Treaty. In *Caratube*, the Tribunal declined jurisdiction because there was no plausible economic motive for the investor to have acquired the asset for nominal consideration only five months after a dispute had arisen. Though it did not base its conclusion on that ground, the Tribunal found that the evidence before it could lead to the conclusion that "*the sole rationale for Devincci Hourani's* [the investor's] *belated involvement in CIOC* [the asset] *was to invoke later the ICSID jurisdiction in order to seek BIT protection through ICSID, which would otherwise not have been*

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[98] *Phoenix Action, Ltd. v. Czech Republic* (RLE-058).
[99] *Caratube International Oil Company LLP v. Republic of Kazakhstan*, ICSID Case No. ARB/08/12, Award of 5 June 2012 (RLA-084).
[100] *Quiborax S.A. Non Metallic Minerals S.A. and Allan Fosk Kaplun v. Pluinational State of Bolivia*, ICSID Case No. ARB/06/2, Decision of Jurisdiction of 27 September 2012 (RLA-080).

available to either Lebanese or Kazakh investors, who would appear from the evidence to be the real investors."[101]

201. In *Quiborax,* the Tribunal declined jurisdiction over the claims made by one of the claimants, whom the Tribunal found to be only a nominal shareholder who had not paid for his share but had received it in order to comply with the minimum 3 shareholders requirement under Bolivian law. While in *Quiborax,* the claimant whose claim was rejected did not acquire the asset after-the-event, he was making a claim in his own right. His "investment," therefore, had to satisfy the requirements of risk, contribution and duration.

202. The facts of the present case are distinguishable from the cases cited by the Parties. W and A are affiliated companies, A being a subsidiary of W . They are both U.S. companies. The question of treaty shopping or a non-protected investor acquiring assets after-the-event to create ICSID jurisdiction does not, therefore, arise in the present context. A succeeded to W claim because W assigned all its assets, including any legal claims relating to those assets, to A . A has brought the present claim as the successor to W . The facts of this case are, therefore, distinguishable from that of the *Quiborax* case and the other cases referred above.

203. While A acquired the shares in K for no consideration in 2003 after the company was effectively bankrupt, the Request for Arbitration was not filed until seven years later, in 2010. The Claimants have explained the transfer as a permissible internal corporate restructuring. The Respondent has not been able to point to any provision in the Treaty or any principle of international law which prohibits such restructuring. The corporate restructuring in this case appears closer to the transfer contemplated in *Quasar de Valores v. Russia,*[102] where one of the claimants was replaced by a close affiliate, rather than the decisions cited by the Respondent.

204. Having carefully considered the evidence tendered by the Parties, the Tribunal concludes that there is no evidence on the record of any abuse of international

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[101] *Caratube International Oil Company LLP v. Republic of Kazakhstan,* para. 465 (RLA-084).
[102] *Quasar de Valores SICA V S.A. v. Russian Federation* (CE-800).

investment protection in the present case. In fact, the Respondent itself appears to have conceded this point by admitting that "*the shareholding of Atlantic has not been intended by the Claimants to open a path to an international treaty claim, but instead to interfere in the domestic legal proceedings in Poland.*"[103] The Tribunal is, therefore, not persuaded by and dismisses the Respondent's first objection to the Tribunal's jurisdiction with regard to A .

205. The Respondent raises a further objection relating to A standing, which alleges that Mr. R and S are using A as a litigation vehicle to multiply their potential financial gain since A current shareholding in K is five times higher than the actual, historical equity interest that they had in K at the time the initial investment was made. In the Tribunal's view, this objection does not affect A standing to bring a claim, it rather addresses the issue of whether Mr. R and S will be unjustly enriched if A claim succeeds. The Tribunal is of the view that this objection may have a bearing when it considers the question of damages but it does not affect the Tribunal's jurisdiction to hear A claim.

206. As earlier observed by the Tribunal,[104] both W and A being U.S. companies in this case does not raise any issue of treaty shopping. The Tribunal, therefore, fails to see how A being a Claimant would have any bearing on the nationality requirement of the BIT. This objection of the Respondent relating to A standing is, therefore, dismissed.

207. There is no dispute that W made an investment in Poland and could have brought a claim under the BIT. W has assigned all its assets, including any legal claims relating to those assets to A . A like W is a U.S. company. In these circumstances, this Tribunal is of the view that A , as the successor to W , has made an investment in Poland for the purposes of Articles 2(a) and 4(2) of the Additional Facility Rules.

[103] Respondent's Counter-Memorial dated 8 October 2010, para. 458.
[104] *See* para. 205 above.

208. In view of the foregoing, the Tribunal is of the view that A has standing to bring the present claim and the Tribunal has jurisdiction to hear it.

B. Jurisdictional objection 2: lack of jurisdiction based on partial non-applicability of the treaty to matters of taxation

(1) The Parties' positions

<u>a. Respondent's position</u>

209. The Respondent's second jurisdictional objection arises from the language of Article VI(2) of the Poland-U.S. BIT. Article VI reads as follows:

> 1. *With respect to its tax policies, each Party should strive to accord fairness and equity in the treatment of, and commercial activity conducted by, nationals and companies of the other Party.*
>
> 2. *Nevertheless the provisions of this Treaty, and in particular Article IX and X, shall apply to matters of taxation only with respect to the following:*
>
> > *(a) expropriation, pursuant to Article VII;*
> >
> > *(b) transfers, pursuant to Article V; or*
> >
> > *(c) the observance and enforcement of terms of an investment agreement or authorization as referred to in Article IX(1)(a) or (b),*
>
> *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, or have been raised under such settlement provisions and are not resolved within reasonable period of time.*

210. The Respondent also relies on the U.S. Letter of Submission and Letter of Transmittal, which states that: "*Because the United States specifically addresses tax matters in tax treaties, this treaty generally excludes such matters, addressing them only to the*

extent that they relate to expropriation, transfers, or investment authorizations, and are not covered by the bilateral tax treaty."[105]

211. The Respondent argues that the phrase "*matters of taxation*" in Article VI(2) should be defined broadly as referring to all issues related to the process or system of imposing and charging taxes. According to the Respondent, the entire Tax Claim, both in general terms and with regard to each particular claim made by the Claimants, falls within the ambit of this phrase. This would include challenges not only to the substantive law but also to the procedural aspects of the tax proceedings, i.e. the application and enforcement of the substantive law.

212. At the centre of the Tax Claim are measures taken by the Polish tax authorities to enforce the tax liabilities of K under the CIT Law and the VAT Law. In the present arbitration, the Claimants have challenged the legality of the specific decisions issued by Polish tax authorities and the procedures applied by them. The entire dispute in this arbitration is, therefore, concerned with "*matters of taxation*." In this regard, the Respondent argues that the Claimants' reliance on the *Occidental*[106] award is misplaced. In that case, unlike the present dispute, the existence of tax liabilities or their amount was not disputed under international law. The question there revolved around the right of an investor to obtain a tax refund under a contractual arrangement. Had the investor in that case challenged the existence and scope of its tax obligations under Ecuadorian law, the Tribunal's determination of the applicability of the tax exemption in the Ecuador-U.S. BIT may have been different.

213. The Respondent points out that the Claimants' attempt to recast the subject matter of the dispute as "*the legal consequences of the Management Services treatment by the Respondent*"[107] is such a general proposition that it fails to provide any information about the nature of the measures taken. The Respondent argues that the legal consequences that the Claimants refer to can only be "*(i) rejection of the costs*

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[105] CE-588, p. 4.
[106] *Occidental Exploration and Production Company v. Republic of Ecuador*, UNCITRAL, Final Award of 1 July 2004, para. 74 (CE-603).
[107] Claimants' Reply Memorial dated 3 September 2013, paras. 498, 499, 564 and 996.

incurred by the Company as CIT-deductible expenses; (ii) determination of CIT-arrears and late payment interest; (iii) determination of VAT-arrears and late penalty interest, and (iv) determination of an additional tax sanction. All of these are par excellence measures of taxation within the sense of Article VI of the Treaty."[108] As such, the Respondent avers that the central theme of the Claimants' claim remains the tax proceedings. The Claimants' entire damages claim is also built on the assertion that but for the tax measures, K would not have become bankrupt.

214. According to the Respondent, the effect is that Article II(6) of the BIT, on which the Claimants base their claims relating to fair and equitable treatment, full security and protection and non-impairment standards, and Article IX, which establishes the Tribunal's jurisdiction over claims under Article II, do not apply to "*matters of taxation.*"

215. In this regard, the Respondent argues that the Claimants' position, that if the Tribunal has jurisdiction on the basis of any one of the exceptions provided in Article VI(2)(a) to (c) of the Treaty then the Tribunal should also have jurisdiction over all other claims, is flawed because it would render the tax carve out in Article VI(2) of the Treaty devoid of any meaning. The Respondent relies on the decision in *Burlington v. Ecuador,*[109] where the Tribunal found that it lacked jurisdiction over the investors' fair and equitable treatment, full protection and security and arbitrary impairment claims by virtue of the tax exemption in Article X of the Ecuador-U.S. BIT. The Respondent also relies on *EnCana v. Ecuador,*[110] where the tax exemption provision in the treaty was interpreted as a complete bar to all of the investors' claims except the one for expropriation.

216. The Respondent also disagrees with the Claimants' argument that this Tribunal would have jurisdiction to hear a claim based on violation of the fair and equitable standard because Article VI(2) of the BIT recognizes the Tribunal's jurisdiction with respect

[108] Respondent's Rejoinder Memorial dated 20 March 2014, para. 45.
[109] *Burlington Resources Inc. v. Republic of Ecuador*, ICSID Case No. ARB/08/5, Decision on Jurisdiction of 2 June 2010, para. 135 (CE-604).
[110] *EnCana Corporation v. Republic of Ecuador*, LCIA, Award of 3 February 2006 (CE-823 and RLA-016).

to claims under the expropriation provision (Article VII) and in turn Article VII refers to Article II, which includes both the fair and equitable standard and the full protection and security standard.

217. According to the Respondent, Article VII(1) of the BIT only provides guidance to the extent that the legality of any expropriation should be decided in accordance with "*due process of law and the general principles of treatment provided for in Article II(6).*" An expropriation carried out in violation of the fair and equitable standard would be illegal under Article VII. The Respondent argues that the Tribunal must first find that there was an expropriation before it can determine whether that expropriation was legal or illegal under Article II(6). Such a determination would, in any case, only be relevant at the time of quantifying damages – for instance, the Tribunal may award greater damages for an unlawful expropriation as opposed to a lawful expropriation.

218. The Respondent also denies the Claimants' argument that concerted and orchestrated actions were taken by a number of organs of the Respondent all of which targeted K and the transfer of Management Fees. According to the Respondent, the Claimants have argued that the tax nature of the measures was only a cover and that the Respondent's organs abused the tax laws in order to accomplish an internationally wrongful act. The Respondent argues that whether or not the actions of various organs were concerted or orchestrated is irrelevant. Such an argument cannot be used to circumvent the jurisdictional limitation in Article VI(2) of the Treaty. More importantly, the Claimants' theory of concerted action is incorrect as the Claimants have not been able to show any evidence in support of their claim. The Respondent further argues that the following factors confirm that there was no concerted action:

(i) The lack of a common aim or motivation is disproved by the Claimants' own reliance on the system of bonuses obtained by tax officers as motivation for their actions against . The Claimants' reliance presupposes that each of these individuals actually pursued his or her own agenda, motivated solely by greed and the opportunity to earn a greater bonus – not any common aim. Prof.

G Witness Expert Opinion[111] also shows that the tax officers in Opole were not greedy individuals lacking in professional and moral integrity, but simply that they were overzealous and excessively formulistic in their approach.

(ii) The lack of an orchestrator is confirmed by the Claimants' failure to cite any person or body who was pulling the strings or exerting influence on the course of events.

(iii) Finally, the lack of any effect on the Claimants is confirmed by the following facts:

> *(i) the criminal investigation did not lead to presentation of any charges to the Claimants and it has been discontinued in 2011; (ii) the Claimants were able to secure favourable decisions in P , with respect to W , and in W , with respect to W ; (iii) the tax authorities in B and in O never pushed hard for enforcement of the Company's tax arrears, and the tax authorities are one of the most considerable debtors of the bankruptcy estate of the Company; (iv) the Respondent agreed to restructure the Company's tax arrears and forgive some 95 % of the tax debt; (v) on a number of occasions, enforceability of tax decisions was suspended, or (vi) charges for non-material services received by the Company were held to be CIT-deductible expenses, always when proven by the Company.*[112]

219. The Respondent also disputes the Claimants' contention that the present dispute relates to the enforcement or observance of an investment agreement in terms of Article IX(1)(a) and VI(2)(c) of the Treaty. The Respondent argues that the Privatization Agreement was neither an investment agreement as that term is used in the Treaty nor does the present dispute concern the enforcement or observance of its terms. Furthermore, the Respondent avers that the Privatization Agreement provides its own dispute resolution clause, which the Claimants would have had to resort to first.[113]

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[111] Expert Opinion of Prof. G dated 2 August 2013, pp. 17, 29 and 34 (CE-753).
[112] Respondent's Rejoinder dated 20 March 2014, para. 82.
[113] *Ibid*, paras. 136-140.

220. The Respondent contends that the Privatization Agreement is simply a contract for the sale of shares of a state-owned company. It does not impose any requirements on the Respondent, which can be characterized as continuing "observance" or "enforcement" obligations that extend beyond the close of the transaction. It did not entitle the Claimants to any rights beyond the sale of shares. The Privatization Agreement cannot, therefore, be termed as an "investment agreement" for the purposes of the Treaty. In this regard, the Respondent relies on Prof. Vandevelde's treatise on investment agreements[114] where he states that such agreements exclude ordinary commercial contracts. The Respondent also relies on *Joy Mining v. Egypt*, where it was held that:

> *The Tribunal is also mindful that if a distinction is not drawn between ordinary sales contracts, even if complex, and an investment, the result would be that any sales or procurement contract involving a State agency would qualify as an investment. International contracts are today a central feature of international trade and have stimulated far reaching developments in the governing law, among them the United Nations Convention on Contracts for the International Sale of Goods, and significant conceptual contributions. Yet, those contracts are not investment contracts, except in exceptional circumstances, and are to be kept separate and distinct for the sake of a stable legal order. Otherwise, what difference would there be with the many State contracts that are submitted every day to international arbitration in connection with contractual performance, at such bodies as the International Chamber of Commerce and the London Court of International Arbitration?*[115]

221. According to the Respondent, the mere fact that the Privatization Agreement authorized the sale of shares and also operated to effectuate that transfer does not convert a contract for the sale of shares into an investment agreement under the Treaty. Relying on the definition of "investment agreement" in the 2004 U.S. Model BIT, the Respondent argues that such agreements are characterized by a significant investment, their long term horizon and their functional utility to the Host State in terms of natural

[114] Kenneth J. Vendevelde, *U.S. International Investment Agreements*, Oxford University Press (2009), p. 577 (RLA-089).
[115] *Joy Mining Machinery Limited v. Arab Republic of Egypt*, ICSID Case No. ARB/03/11, Award on Jurisdiction of 6 August 2004, para. 58 (RLA-074).

resources, public services or infrastructure projects. The Privatization Agreement does not fulfil these criteria.

222. Even assuming that the Privatization Agreement was an investment agreement, the present dispute relates neither to the application nor interpretation of this agreement as required under Article IX(1)(a), nor does it concern the observance or enforcement of any term of this agreement as required under Article VI(2) of the BIT. The Respondent argues that the Privatization Agreement imposed no continuing contractual obligation on the Respondent such that there could be any case for observing or enforcing any term thereof. Likewise, the present dispute does not concern the Claimants' exercise of any contractual right under the Privatization Agreement.

223. The Respondent contends that to the extent that the Claimants contend that the Respondent's questioning of the Management Services amounts to questioning the proper discharge of the contractual duties of the Claimants under the Privatization Agreement, it is incorrect for the following reasons:

(i) The Respondent does not allege that the Claimants breached the Privatization Agreement. Even if the provision of Management Services could have entailed transfer of know-how as provided in the Privatization Agreement, a failure to provide the Management Services is not a violation of the Privatization Agreement since these services could have been provided by appointment of non-Polish managers to the Management of the Supervisory Board of K .

(ii) The Respondent is not taking the position that no Management Services were provided. Some Management Services were no doubt provided. This was also the position of the tax authorities. This is, however, irrelevant for the present dispute since the Respondent's position is that the tax decisions were correct as a matter of both Polish and international law. The Tribunal is *seised* of the legality of these decisions as a matter of international law, not with a determination of whether the Claimants discharged their obligations under the Privatization Agreement.

(iii) The Claimants' claim is based on a domestic tax law dispute.

(iv) The connection between the Management Fees and the Privatization Agreement was only invented in November 1998, 2 years after the tax inspections had begun and at a time when K was losing the tax battle. This argument was recognized as new and characterized as unconvincing by K own counsel, A A :

> *During the meeting the possible link between the services performed by W and the Privatization agreement (in particular paragraphs 5 and 6) was discussed. In our opinion, referring to the privatisation agreement as to the basis for services rendered by W is unlikely to strengthen N B position in the litigation. The provisions of this agreement cannot be directly connected with consulting and advisory services as the agreement does not oblige S C C and W to perform services for N B .*[116]

(v) If the Claimants' argument were to be upheld, it would allow a person to circumvent the jurisdictional limitations in Article VI(2) of the Treaty simply by raising a point of interpretation of an investment agreement, even if it was secondary and ancillary to the actual issue in the case.

(vi) Finally, neither of the Parties has sought any relief in relation to the Privatization Agreement.

b. <u>Claimants' position</u>

224. The Claimants argue that the present dispute does not relate to "*matters of taxation*" as that phrase is used in Article VI(2) of the Treaty. The Respondent has mistakenly

[116] Letter from A A to W dated 2 November 1999 (RE-154); Respondent's Rejoinder dated 20 March 2014, para. 129.

labelled the Claimants' submissions as a "Tax Claim" and then sought to create an artificial distinction between the "Tax Claim" and the "Criminal Claim."

225. According to the Claimants, the challenge is to "*the legal consequences of the Management Services' treatment by the Respondent leading to the collapse of K .*"[117] That, according to them, is the subject of the dispute. As such, the present dispute is concerned with the legal consequences and cumulative effects of the acts of the Respondent's agents consisting of (i) questioning the Claimants' right to obtain a fair equivalent for the Management Services rendered to K under the Privatization Agreement; and (ii) questioning K right to tax benefits related to the Management Fees under Polish tax law. In this regard the Claimants place reliance on the *Occidental*[118] award where the Tribunal assumed jurisdiction on the basis of the connection between the dispute and the contract between a foreign investor and Ecuador (and not on the basis of the investor invoking any contractual rights as wrongly alleged by the Respondent).

226. While the Claimants admit that they question various substantive laws such as:

> (i) *the introduction on January 1, 1998 into the Polish tax system of the immediate enforceability of the tax decisions upon their issuance;*
> (ii) *the lack of transparency of the Polish transfer pricing rules;*
> (iii) *the lack of transparency of the Polish tax system;*
> (iv) *the retroactive application of the Guidelines;*
> (v) *the introduction of the regulations into the Polish tax system in 2002 which discouraged K from appealing against the tax decisions before the administrative courts…*[119]

According to the Claimants, these issues would, in any case, have to be considered by the Tribunal as relevant elements of the statement of facts, even if they were not challenged as violations of the Treaty.

[117] Claimant's Reply Memorial dated 3 September 2013, para. 498.
[118] *Occidental Exploration and Production Company v. Republic of Ecuador*, para. 74 (CE-603).
[119] Claimants' Reply Memorial dated 3 September 2013, para. 507.

227. According to the Claimants, Article VI(1) of the BIT, imposes an obligation on the Respondent "*to strive to accord fairness and equity in the treatment of investment of and commercial activity conducted by, nationals and companies of the other party*"[120] with respect to its tax policies. The decisions in *Enron*[121] and *Occidental*[122] were cited to argue that this was not a meaningless reference and imposes an obligation on the State similar to the obligation to accord fair and equitable treatment. The Claimants submit that this means that if the dispute involves any of the elements described in Article VI(2)(a) to (c), then it will fall within the purview of the BIT and will be subject to its dispute settlement mechanism.

228. The Claimants further argue that even if the present dispute concerned "*matters of taxation*," all the exceptions in Article VI(2)(a) to (c) of the BIT are applicable. The present dispute relates to (i) transfer pursuant to Article V of the Treaty; and (ii) observance and enforcement of an investment agreement in terms of Article IX(1)(a) of the Treaty as envisaged under Article VI(2)(c) of the Treaty. According to the Claimants, the Privatization Agreement is an investment agreement in terms of Article IX(1)(a) and its claims under the Treaty are related to the observance and enforcement of the Privatization Agreement.

229. The Claimants contend that share purchase agreements such as the Privatization Agreement are investment agreements since they create a long-term economic relationship with a Host State. The Privatization Agreement was entered into between a U.S. company and Poland. This factor itself distinguishes the present dispute from the *Burlington*[123] case, where the Tribunal declined jurisdiction because the relevant contracts were not investment agreements since they were entered into by Burlington's subsidiaries, which were not nationals or companies of the U.S.

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[120] Claimants' Memorial dated 8 May 2012, para. 988 (Article VI(1)). Also see paras. 989 and 990.
[121] *Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic*, ICSID Case No. ARB/01/3, Decision on Jurisdiction of 14 January 2004, para. 65 (CE-605).
[122] *Occidental Exploration and Production Company v. Republic of Ecuador* (CE-603).
[123] *Burlington Resources Inc. v. Republic of Ecuador*, para. 135 (CE-604).

230. In the Claimants' view, the *Joy Mining*[124] case, referred to by the Respondent, is also distinguishable from the present dispute since there the Tribunal was dealing with the distinction between long-term projects, which qualify as an investment under Article 25 of the ICSID Convention, and typical sales contracts, which may be subject to the United Nations Convention on Contracts for the International Sale of Goods. As opposed to this, the Privatization Agreement created a long-term relationship between Poland and the Claimants.

231. The Claimants also argue that the Privatization Agreement constitutes an investment agreement because it imposes significant investment obligations on the Claimants such as investing substantial funds in K ; providing know-how and technology; creating training programs for management and employees; and developing exports. The long-term nature of the investment was recognized in the Privatization Agreement itself; it was not a one-off deal as alleged by the Respondent.

232. According to the Claimants, Article VI(2)(c) of the Treaty refers to the "observance and enforcement" of an investment agreement. This phrase has a broad meaning and is used in an identical manner in Article X of the Ecuador-U.S. BIT. The Spanish equivalent of this phrase, i.e. "*observancia y el cumplimiento,*" suggests a broader scope of this exception than that proposed by the Respondent.[125] The Claimants rely on the Tribunal's decision in *EnCana v. Ecuador*, where even though the Tribunal declined jurisdiction on the basis of Article XIII(c) of the Canada-Ecuador BIT, it observed that

> *…there are significant differences between the BIT applicable in the present case and that which fell to be applied by the tribunal in the Occidental case. The Ecuador-U.S. BIT, Article X, also contains a taxation exception but it is in different terms to Article XII of the Canada-Ecuador BIT; in particular, Article X(2)(c) of the Ecuador-U.S. BIT allows claims relating to taxation provided they are claims with respect to 'the observance and enforcement of terms of an investment Agreement'. Moreover, under Article VI(1) of the*

[124] *Joy Mining Machinery Limited v. Arab Republic of Egypt*, para. 58 (RLA-074).
[125] The Claimants note that a narrow interpretation was proposed in the Canada-Ecuador BIT and the Panama-U.S. BIT, which contain the more restrictive phrase *"cumplimiento y ejecucion,"* or the Argentina-U.S. BIT, which contains the phrase *"la observancia y el cumplimiento imperativo."*

> *Ecuador-U.S. BIT, jurisdiction is conferred on arbitral tribunals in relation to 'investment disputes between a Party and a national or company of the other Party' which arise out of or relate to 'an investment agreement between that Party and such national or company'. In the Occidental case, although the claimant had not invoked any claims of breach of contract or relied on contract-based rights as such (...) the tribunal held that 'because of the relationship of the dispute with the observance and enforcement of the investment contract involved in this case, it has jurisdiction to consider the dispute in connection with the merits insofar as a tax matter covered by Article X may be concerned.*[126]

233. The Claimants, therefore, argue that the present dispute concerns the observance and enforcement of an investment agreement.

234. The Claimants submit that, assuming that the exceptions in Article VI(2)(a) to (c) are applicable to the present dispute, the Tribunal should accept jurisdiction over all of the Claimants' claims, including those based on violation of fair and equitable treatment, full treatment and security, non-impairment standard and free transfer of payments (the "Gateway Theory"). According to the Claimant, the Gateway Theory finds support in the language of Article VI(2) and investment arbitration practice.

235. The Claimants distinguish the case of *Burlington* relied on by the Respondent on the grounds that in that case, the Tribunal expressly recognized that when a claim concerning "*matters of taxation*" relates to the observance or enforcement of an investment agreement, it would fall under the jurisdiction of the Tribunal as a separate claim.[127] According to the Claimants, this decision actually supports the Claimants' position. The Claimants also rely on the award in the *Occidental v. Ecuador*[128] case to the effect that if a BIT claim relates to the observance or enforcement of an investment agreement (Article X(2)(c) of the Ecuador-U.S. BIT), the construction of the taxation carve-out allows the Tribunal to assume jurisdiction over other claims.

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[126] *EnCana Corporation v. Republic of Ecuador*, footnote 119 (CE-823 and RLA-016); Claimants' Reply Memorial, para. 562. The Claimants note that the above peculiarity of the Spanish version of the Ecuador-U.S. BIT was noted by the English appellate court in the *Occidental* case (where the court observed that the Spanish term *"cumplimiento"* more naturally translates as "*performance*" or "*fulfillment*").
[127] *Burlington Resources Inc. v. Republic of Ecuador*, paras. 135, 208, 211, 215, 231, 233 and 248-249 (CE-604).
[128] *Occidental Exploration and Production Company v. Republic of Ecuador*, para. 74 (CE-603).

236. The use of the phrase "i*n particular*" in Article VI(2) of the Treaty clarifies that other provisions of the Treaty, apart from Articles IX and X, shall apply to "*matters of taxation*." The Claimants submit that in cases where tribunals have rejected the Gateway Theory, the taxation carve-out provision has been differently worded from Article VI(2) of the Treaty. For instance, Article XII(1) of the Canada-Ecuador BIT at issue in *EnCana v. Ecuador* states that "*nothing in this Agreement shall apply to taxation measures.*"[129] Similarly, in the *Nations Energy v. Panama* case, Article XI of the Panama-U.S. BIT, which was at issue, states that "*this Treaty shall apply to the taxation matters exclusively with respect to the following...*"[130]

237. The Claimant submits that if this Tribunal finds that the present dispute concerns the observance and enforcement of an investment agreement, then "*the provisions of this Treaty, and in particular Article IX and X, shall apply,*" i.e. all the standards including those of fair and equitable treatment, full protection and security and non-impairment will be applicable, and the Tribunal would have jurisdiction over Claimants' claims if any of these standards was violated.

(2) The Tribunal's analysis

238. The Parties have primarily focussed their arguments on the interpretation of paragraph (2) of Article VI of the Treaty. The Tribunal will, therefore, examine this issue first.

239. Article VI of the BIT provides:

> (1) *With respect to its tax policies, each party should strive to accord fairness and equity in the treatment of investment of, and commercial activity conducted by, nationals and companies of the other party.*
>
> (2) *Nevertheless, the provisions of this Treaty, and in particular Articles IX and X, shall apply to matters of taxation only with respect to the following:*
>
> *a) expropriation pursuant to Article VII;*
> *b) transfers, pursuant to Article V; or*

[129] *EnCana Corporation v. Republic of Ecuador*, para. 108 (CE-823 and RLA-016).
[130] *Nations Energy Inc., Electric Machinery Enterprises Inc. and Jaime Jurado v. Republic of Panama*, ICSID Case No. ARB/06/19, Award of 24 November 2010, para. 457 (CE-829).

> c) *the observance and enforcement of terms of an investment agreement or authorization as referred to in Article IX (1) (a) or (b);*
>
> *to the extent they are not subject to the dispute settlement provisions of a convention for the avoidance of double taxation between the two Parties, or have been raised under such settlement provisions and are not resolved within a reasonable period of time.*

240. In the Tribunal's reading, Article VI(2) provides that in relation to "*matters of taxation*" an investor may only bring claims if they fulfil two conditions:

(i) The claims are based on one of the exceptions stated in the paragraph, i.e. 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

(ii) The 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.

241. The first question the Tribunal has to address is whether the present dispute relates to "*matters of taxation*." The second question is whether the Claimants' claims fulfil condition (i) above. Since these two questions have been raised in the jurisdictional objection under consideration, the Tribunal has addressed these here. The third question – whether the Claimants' claims fulfil condition (ii) above – has been argued in relation to the Respondent's third jurisdictional objection and is, therefore, not addressed in detail here. The Tribunal has accordingly addressed this question in its determination of the Respondent's third jurisdictional objection.

a. Article VI (2) - matters of taxation

242. The Claimants have sought to frame the present dispute as relating to "*the legal consequences of the Management Services treatment by the Respondent leading to the*

collapse of K ."[131] They contend that the former takes their dispute outside the scope of Article VI(2) of the Treaty and that this jurisdictional objection is without merit. The Claimants argue that there is a distinction between "*matters of taxation*" and "*the legal consequences of the Respondent's treatment of Management Services.*" According to the Claimants, the latter relates to the cumulative effects of the Respondent's agents (i) questioning the Claimants' right to obtain fair compensation for the Management Services to K as required under the Privatization Agreement; and (ii) denying K the tax benefits related to the Management Services.

243. Even assuming that the Claimants' submissions are correct, at its core each of their claims relate to the treatment of the costs associated with the Management Services. In the Tribunal's view, all issues in the present dispute stem from it. While the Claimants refer to actions and developments in the criminal proceedings, they did not introduce any expert in relation to these proceedings. The Claimants' experts have not taken the view that the criminal proceedings caused K collapse. The Claimants' damage theory also does not regard the criminal proceedings as contributing to the collapse of K . The Claimants acknowledge that the criminal proceedings were conducted in a fact-finding phase and did not personally involve the Claimants. When charges were eventually brought, those were aimed at and resulted in the detention of two Polish officers of K and not of any U.S. national. In the view of the majority of this Tribunal, the references to actions and developments in the criminal proceedings, do not change the nature of the dispute.

244. The term "*matters of taxation*" is not a defined term in the Treaty. Applying the principles set forth in the Vienna Convention on the Law of Treaties, it must be interpreted "*in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.*"[132] Even if this term were to be narrowly construed, the Tribunal fails to see how disallowing the deductions claimed by an assessee when calculating its tax is not a matter of taxation.

[131] Claimants' Reply Memorial dated 3 September 2013, para. 498.
[132] Paragraph (1) of Article 31 of the Vienna Convention on the Law of the Treaties ("VCLT").

245. Very broadly and generally stated, an assessee declares its gross income and lists its expenses. Its net income is the gross income minus expenses. The net income is subject to tax. The tax authorities have to satisfy themselves that the gross income has been correctly stated – that nothing has been concealed. Once that is done, the tax authorities proceed to examine whether the stated expenses have been incurred, i.e. they are genuine. If the tax authorities are not satisfied that the expenses are genuine, they can call upon the assessee to prove that these were incurred. If the assessee fails to satisfy them, the tax authorities exclude the expenses from consideration. As a result the net income and, consequently, the tax payable increases.

246. The consequences of a tax authority disputing the genuineness of an expense and being dissatisfied by the evidence submitted by the assessee to establish that the expense was incurred would be that the expense would be disallowed, the net income would increase and the assessee would have to pay higher taxes than it originally contemplated. This is what happened here. The tax authorities disputed that the Management Services had been provided. They asked for supporting evidence. They were not satisfied with the record provided to them. The authorities subsequently disallowed the expense. The amount of K net income increased. And so did the tax payable by the K .

247. The legal consequence of the Respondent's treatment of the Management Services was an increase in the amount of K tax. The tax authorities sought to collect the increased amount. The tax authorities had to scrutinise the expenses claimed. They had to determine whether there is evidence to support the claim. These tasks lie at the heart of the tax assessing and collecting function of a revenue authority. In the Tribunal's view, this essentially is what assessment and collection of tax is all about. In an effort to distinguish their claims from "*matters of taxation*," the Claimants have underplayed the significance of their challenge to the Respondent's substantive tax laws. The Claimants admitted that while they were calling certain laws in question, "*these issues would necessarily be subject to the Tribunal's consideration as relevant elements of the statement of facts even if they had not been challenged as being in*

breach of the Polish-U.S. BIT."[133] In fact "*the Claimants submit that all of their claims do not concern 'matters of taxation' and <u>are not subject to Article VI of the Polish-U.S. BIT</u>*"[134] (emphasis supplied).

248. The reason for this may have been that the Claimants wanted to distinguish the case of *Burlington v. Ecuador.*[135] The Tribunal in that case interpreted Article X of the U.S.-Ecuador Treaty. It found that the investor's challenge to a particular Ecuadorian law was within the ordinary meaning of the phrase "*matters of taxation*" and therefore, its claims were limited to the exceptions specified in Article X(2).

249. The Claimants' rely on the decision in *Occidental*[136] to argue that even if at first glance the dispute appears to relate to taxation, on closer inspection the tax itself is not at dispute. The Claimants' reliance in this context is, however, misplaced. In *Occidental*, the Tribunal, while interpreting Article X in the U.S.-Ecuador BIT, which is identical to Article VI of the Poland-U.S. BIT, held that "*because of the relationship of the dispute with the observance and enforcement of the Investment Contract involved in this case, it has jurisdiction to consider the dispute in connection with the merits insofar as a tax matter covered by Article X may be concerned.*"[137] While the *Occidental* Tribunal observed that it had jurisdiction to hear the matter under Article X on other grounds, it ultimately decided to hear the claim on the ground that the dispute fell squarely within one of the exceptions in Article X (i.e. the observance and enforcement of an investment contract) and not on the ground that it did not relate to a matter of taxation.

250. The Tribunal concludes that the present dispute involves "*matters of taxation*" for the purposes of Article VI(2) of the BIT. The Tribunal, however, concludes by majority that its jurisdiction is, therefore, limited to the exceptions listed in Article VI(2)(a)-(c).

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[133] Claimants' Reply Memorial dated 3 September 2013, para. 508.
[134] *Ibid*, para. 509.
[135] *Burlington Resources Inc. v. Republic of Ecuador* (CE-604).
[136] *Occidental Exploration and Production Company v. Republic of Ecuador* (CE-603).
[137] *Ibid*, para. 77.

b. Article VI(2)(a) and (b)

251. In the view of the majority of this Tribunal, since it has determined that the present dispute involves a matter of taxation, it has jurisdiction only over the Claimants' claim for expropriation pursuant to Article VII of the BIT and the Claimants' claim relating to transfers pursuant to Article V of the BIT.

c. Article VI(2)(c)

252. The Claimants further argue that the dispute relates to the observance and enforcement of terms of an investment agreement as referred to in Article IX(1)(a) or (b) of the BIT, and that the Tribunal therefore has jurisdiction under the exception listed in Article VI(2)(c).

253. The Claimants consider that the investment agreement for the purposes of Article VI(2) is the Privatization Agreement. In the Claimants' view, a failure by the Respondent to observe and enforce the terms of the Privatisation Agreement would permit the Claimant to invoke the dispute resolution provisions of the BIT. It is contended that this would also permit the Claimant to bring claims based on the violation of other provisions of the BIT.

254. This line of argument raises two distinct issues. The first is whether the Privatization Agreement constitutes an investment agreement. The second is whether the present dispute relates to the observance or enforcement of the Privatization Agreement.

255. The Respondent has sought to characterize the Privatization Agreement as an ordinary commercial contract for the sale and purchase of shares rather than an investment agreement. The term "*investment*" is defined in Article I of the BIT and includes an investment in "*a company or shares of stock or other interests in a company.*" Through the Privatization Agreement, S agreed to acquire 55% of the shares of K from the Polish State Treasury for US$ 18,782,500; i.e. S agreed to and made an investment in Poland by acquiring "*shares of stock…in a company.*" The Tribunal, therefore, accepts that the Privatization Agreement is an investment agreement for the purposes of Article VI of the BIT.

256. This leads us to examine whether the present dispute relates to the *observance and enforcement* of the Privatization Agreement. The Claimants have argued that (i) they were required to provide Management Services to K under the terms of the Privatization Agreement;[138] and (ii) under the Privatization Agreement they had a legitimate expectation that if such Management Services were provided in good faith, the Claimants would receive fair compensation for such services. In other words, if the Privatization Agreement contained any such requirement or guarantee, then the actions of the tax authorities in relation to the Management Services would constitute a breach of the Privatization Agreement, and hence, the Claimants argue that the dispute would concern the "*observance and enforcement*" of this agreement, which in turn would trigger the exception in Article VI(2)(c) of the BIT.

257. The issue is whether the Respondent breached any obligation under the Privatization Agreement when its agents disallowed the Management Fees deductions claimed by K for calculating its corporate income tax.[139] Even assuming that (i) the Privatization Agreement required the Claimants to provide Management Services to K ,[140] and (ii) the Privatization Agreement guaranteed the Claimants a fair return for the Management Services,[141] the Claimants have failed to refer to any provision of the Privatization Agreement which guarantees that K would be allowed to deduct any such costs for the purpose of calculating its corporate income tax. Indeed, the Privatization Agreement does not contain any such assurance or guarantee.

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[138] In particular, under Article VI, Section 6(1) and Article VII, Section 4(1).

[139] The VAT issue is directly linked to the corporate income tax issue, since if a cost is not deductible for the purpose of calculating CIT, under Polish law, the input tax on it cannot be adjusted for VAT purposes.

[140] The Articles of the Privatization Agreement referred to by the Claimants only relate to the transfer of intellectual property such as trademarks and technology and organizing training programs for employees and not to consulting services like the Management Services.

K own tax advisor, A A , in a letter dated 3 November 1999 stated that "*In our opinion referring to the privatization agreement as to the basis for services rendered by W is unlikely to strengthen N B position in the litigation. The provisions of this agreement cannot be directly connected with consulting and advisory services as the agreement does not oblige S C C and W to perform services for N B . It has to be stated that under paragraph 6 of the agreement the Buyer is obliged only to make available i.e. to transfer to N B the rights or right to use its patents, trademarks, know-how and other intellectual property rights, i.e. there is no relation to consulting and management services provided by W*" (emphasis supplied) (RE-154).

[141] Again, no term of the Privatization Agreement provides such an assurance or guarantee.

258. If the Claimants' argument that the present dispute relates to the observance and enforcement of the Privatization Agreement were to be accepted, then any action by the Respondent that affected K   profits (for instance by increasing the tax payable by it) and therefore, diminished its ability to pay for the Management Services would concern the observance and enforcement of the Privatization Agreement and trigger the exception provided for in Article VI(2)(c) of the BIT. The Tribunal, by majority, sees no reason to interpret the Privatization Agreement in this manner. The majority, is of the view that the present dispute does not concern the observance or enforcement of an investment agreement. Hence it concludes that the exception listed in Article VI(2)(c) is not applicable to the present case.

d. Claimants' argument for an extended scope of Article VI(2)

259. The matter, however, does not end here. The Claimants submit that even if their claims are subject to Article VI(2), the Tribunal's jurisdiction is not restricted to the exceptions specified in Article VI(2). The Claimants raise three arguments in support of this view.

260. The Claimants' first argument – the Gateway Theory – is that because the opening words of Article VI(2) provide that "*the provisions of this BIT and in particular Article IX and X apply*"[142] to "*matters of taxation,*" if the Claimants can demonstrate that their claims fall within any of the exceptions (a) to (c) of Article VI(2), they can also invoke the other provisions of the BIT to support their claims, and not just the ones explicitly listed in Article VI(2). This argument would in effect mean that

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[142] *(1) With respect to its tax policies, each party should strive to accord fairness and equity in the treatment of investment of, and commercial activity conducted by, nationals and companies of the other party.*

(2) Nevertheless, the provisions of this Treaty, and in particular Articles IX and X, shall apply to matters of taxation only with respect to the following:
a) expropriation pursuant to Article VII;
b) transfers, pursuant to Article V; or
c) the observance and enforcement of terms of an investment agreement or authorization as referred to in Article IX (1) (a) or (b);

to the extent they are not subject to the dispute settlement provisions of a convention for the avoidance of double taxation between the two Parties, or have been raised under such settlement provisions and are not resolved within a reasonable period of time.

although "*matters of taxation*," with certain exceptions, are carved out of the BIT by Article VI(2), once an investor can demonstrate that its claim falls within one of the exceptions to the carve-out, for instance, expropriation, it can raise claims based on other violations of the BIT such as fair and equitable treatment or full protection and security. Effectively, if the investor succeeds in showing that he has a claim for expropriation (or a claim based on any of the other exceptions), then he can bring claims based on violations of other provisions of the BIT.

261. In the Tribunal's view, the BIT provides a number of protections to the investor and imposes corresponding mandatory obligations for a Host State. For a breach of any of these the investor can invoke, against the Host State, the dispute resolution mechanism of the BIT. In "*matters of taxation*," however, the dispute resolution mechanism of the BIT can be invoked for the breach of not all but a specified number of protections. The Gateway Theory argument seeks to persuade the Tribunal to hold that if the Claimants can demonstrate a breach of one of the specified protections, then it opens the gate for the Claimants to maintain claims for any or all of the other substantive protections as well.

262. In the view of the majority of this Tribunal, this argument seeks to place on the BIT a construction which would result in Article VI(2) ceasing to be a carve-out provision. It would be transformed into a provision that provides a mere sequential order for the arguments of a claimant. Once a claim is found to fall within any one of the exceptions to Article VI(2) and succeeds, then all other claims even outside the list of exceptions fall within a tribunal's jurisdiction, dependent on the success of the first. The claim within the list of exceptions merely has to be the first. The rest would follow. It is the view of the majority of this Tribunal that such an interpretation would deviate from the plain meaning of the BIT and place upon its words an unnatural and strained construction.

263. The Tribunal, by majority, considers that the meaning of Article VI(2) is plain. It is a carve-out provision. Its purpose is to limit the BIT protections in "*matters of taxation*" to a few specified categories. The BIT, while offering a number of protections to the

investors, limited these to "*matters of taxation*." The language of the BIT makes it clear that in such matters its dispute resolution provisions cannot be invoked by the investor except in the case of a few specified categories.

264. The Gateway Theory would have the Tribunal go around these limits. There is nothing in the language of the BIT, the context in which this language has been used, the objects and purposes of the BIT and the surrounding circumstances, which requires Article VI(2) to be interpreted in this broad manner.

265. Such an interpretation would also be contrary to the ordinary meaning of the words of Article VI(2) of the BIT and repugnant to Article 31 of the VCLT. The Tribunal is not persuaded to take this course.

266. The next argument advanced by the Claimants is that Article VII,[143] which deals with expropriation, contains a reference to Article II(6),[144] which deals inter alia with fair and equitable treatment and full protection and security. The Claimants argue that if

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[143] Article VII reads:

> *1. Investments shall not be expropriated or nationalized either directly or indirectly through measures tantamount to expropriation or nationalization ("expropriation") except for a public purpose, in a nondiscriminatory manner, upon payment of prompt, adequate and effective compensation, and in accordance with due process of law and the general principles of treatment provided for in Article II (6). Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriatory action was taken or became publicly known, whichever is earlier; be paid without delay; include interest at a commercially reasonable rate, such as LIBOR plus an appropriate margin, from the date of expropriation; be fully realizable; be freely transferable; and calculated on the basis of the prevailing market rate of exchange for commercial transactions on the date of expropriation.*
> *2. A national or company of either Party that asserts that all or part of its investment has been expropriated shall have a right to prompt review by the appropriate judicial or administrative authorities of the other Party to determine whether any such expropriation has occurred and, if so, whether such expropriation, and any compensation therefor, conforms to the provisions of this Treaty and to principles of international law.*
> *3. Nationals or companies of either Party whose investments suffer losses in the territory of the other Party owing to war or other armed conflict, revolution, state of national emergency, insurrection, civil disturbance or other similar events shall be accorded nondiscriminatory treatment by such other Party as regards any measures it adopts in relation to such losses.*

[144] Article II(6) reads:

> *Investment shall at all times be accorded fair and equitable treatment, shall enjoy full protection and security and shall in no case be accorded treatment less than that required by international law. Neither Party shall in any way impair by arbitrary and discriminatory measures the management, operation, maintenance, use, enjoyment, acquisition, expansion or disposal of investments. Each Party shall observe any obligation it may have entered into with regard to investments.*

an investor can demonstrate that it has a claim related to "*matters of taxation*" based on the expropriation provision then it can also bring independent claims based on a violation of Article II(6) of the BIT.

267. The Tribunal notes that Article VII of the BIT aims at protecting an investor from its investment being expropriated by the Host State. It further requires that for such an expropriatory measure to be lawful, such measure (i) must be for a "*public purpose,*" (ii) must be taken in a "*non-discriminatory*" manner, (iii) upon "*payment of prompt, adequate and effective compensation,*" and (iv) "*in accordance with due process of law and the general principles of treatment provided for in Article II (6).*" It is the understanding of the majority of this Tribunal that the reference in Article VII to all these criteria, including those of Article II(6), is to lay down a minimum standard to which such expropriatory action must conform. As such if the Tribunal finds that there has been an expropriation, it must be then determine whether such expropriation conformed to the standards described in Article VII, including the requirement that the expropriation be in accordance with the due process of law and meet the fair and equitable standard set out in Article II(6). A failure to observe any one or more of these requirements would make the Host State liable for damages in relation to the expropriation. These requirements, however, only come into play if and when there is a determination that there has been an expropriation and not otherwise. This, in view of the majority of this Tribunal, is the purpose of the reference.

268. The reference to Article II(6) in Article VII, in the view of the majority of this Tribunal, does not mean that the investor can also, for instance, bring a claim for a breach of the fair and equitable treatment protection in respect of a matter of taxation. Such an interpretation would make the Article VI(2) carve-out from the dispute resolution provisions of the BIT meaningless. It is also difficult to see the object and purpose of creating such an express carve-out in Article VI(2), if all these protections could simply be brought in through the back door by such interpretative contrivances. Such a reading of Articles VII and II(6) would render Article VI(2) *otiose*.

269. The majority of this Tribunal, therefore, does not agree with the Claimants' argument regarding the expanded scope of Article VI(2).

e. <u>Claimants' argument regarding Article VI(1)</u>

270. The Claimants' main focus in their argument has been on Article VI(2) of the Treaty. The Claimants maintain that on its stand-alone interpretation, as well as when reading it with other articles of the Treaty, the Claimants are not limited to pursuing their claims for treaty violations only on the exceptions listed in Article VI(2).

271. The Claimants have, however, pleaded facts that can form the basis of an argument that the Respondent violated its obligations (assuming that there are any obligations) under Article VI(1) of the BIT and that, therefore, the Tribunal has jurisdiction to hear this dispute under Article VI(1) of the BIT.

272. Article VI(1) of the BIT has been referred to by the Claimants in:

(1) Claimants' Memorial paragraph 114.[145]

(2) Claimants' Memorial paragraphs 988 to 992; and

(3) Claimants' Memorial paragraph 970.[146]

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[145] When one reads this paragraph it is apparent that the reference here to Article VI(1) of the BIT is a typographical error. Article VI(1) deals with "Taxation." The entire discussion in paragraph 114 is with regard to "Compensation for Expropriation" which is dealt with in Article VII of the BIT. All the "*prerequisites for lawful expropriation*" mentioned in paragraph 114 are listed in Article VII(1) and not Article VI(1) of the BIT. Paragraph 114 of the Claimants' Memorial reads:

> *None of the prerequisites for lawful expropriation which are stipulated in Article VI(1) of the Polish-U.S. BIT were fulfilled by the Respondent:*
>
> > *(i) the Respondent did not provide any public purpose which would justify its conduct - on the contrary, numerous agents of the Respondent confirmed that the collapse of K would be detrimental to the public interest;*
> >
> > *(ii) the Respondent also violated the basic principles of due process of law, including violating the Investor's right to defense and carrying out several arbitral measures throughout the proceedings which amount to a denial of justice;*
> >
> > *(iii) the Respondent also discriminated K by treating it very differently from W and W , in virtually identical circumstances and without the Respondent's authorities providing any justification for that discrimination; and*
> >
> > *(iv) the Respondent did not pay any compensation or offer to pay any compensation to the Claimants for the unlawful expropriation of K .*

[146] Claimants specifically deny that they are challenging the law.

(4) There is no reference to Article VI(1) in the Claimants' Reply Memorial or the Post-Hearing Brief.

273. A summary of the facts considered relevant by the Claimants is provided in paragraph 213 of their Memorial:

> *(i) Polish transfer pricing regulations were not properly adjusted to the needs of a developing economy; (ii) the Polish system offered incentives to tax officials which led to abuses of authority, i.e., the so-called "bounty system"; (iii) the Polish system of administrative courts was based on one-instance jurisdiction which in fact caused infringements of due process of law; (iv) there were legal mechanisms in Poland that strongly discouraged taxpayers from appealing against tax decisions; (v) there were legal mechanisms in Poland that disproportionately compounded the tax arrears established by tax decisions, i.e., the so-called "snowball effect"; (vi) there were legal mechanisms in Poland that could cause a complete loss or significant reduction of a taxpayer's creditworthiness in cases of minor tax arrears; and (vii) the Polish system of tax administration did not provide sufficient protection from incompetence by the tax authorities or from arbitrariness of their decisions.*

274. The Claimants then provide a detailed description of each of these facts.[147] All of these facts relate to the legal framework under which corporate income tax and value added tax was administered and enforced in Poland. The Claimants stated that the purpose in pleading these facts was to give the Tribunal a "*better understanding of the issues*"[148] and to set out "*some of peculiarities of Polish law which contributed to the Respondent's measures which ultimately led to the collapse of K .*"[149]

275. In their pleadings on the merits of their claim, the Claimants argue that some elements of this legal framework violate the provisions of the BIT. For instance, the Claimants submit that:

[147] *See* paras. 215-266 of the Claimants' Memorial dated 8 May 2012.
[148] *Ibid*, para. 213.
[149] *Ibid*, para. 207.

(i) The principles of due process were violated by the retroactive application of the Guidelines relating to transfer pricing, which were issued on 29 April 1996.[150]

(ii) The Respondent's obligation to provide a stable and predictable framework for investment, which is a component of the FET standard, was violated by the retroactive application of the Guidelines and by the introduction of a bounty system in December 1996.[151]

(iii) The Respondent violated its obligation to act transparently, under the Fair and Equitable Treatment standard, by enforcing confusing tax regulations, which did not provide adequate information regarding a taxpayer's obligations relating to transfer pricing.[152]

(iv) The Respondent violated its obligation to provide full protection and security by introducing mechanisms that discouraged taxpayers appealing decisions of tax authorities before administrative courts[153] and by introducing, in January 1998, a system which provided for automatic enforcement of the decisions of tax authorities regardless of the filing of any appeal.[154]

276. Even though the Claimants argue that some elements of the legal framework in Poland violated various protections under the BIT, they do not argue anywhere that either (i) these elements constitute "tax policies" as that term is used in Article VI(1) of the BIT; nor do they argue that (ii) these elements violate the Respondent's obligations under Article VI(1) of the BIT. In fact, the Claimants go so far as to clarify that "*their claims…are not subject to Article VI of the Polish-U.S. BIT*."[155]

277. Paragraph (1) of Article VI of the BIT requires each State Party to strive to accord fairness and equity in the treatment of investment of and commercial activity conducted by nationals of the other State Party. The following paragraph (i.e. Article VI(2)) begins with the word "*Nevertheless.*" It then states that the provisions of the

[150] *Ibid*, para. 1125.
[151] *Ibid*, para. 1185-1191.
[152] *Ibid*, para. 1198.
[153] *Ibid*, para. 1237.
[154] *Ibid*, para. 1241.
[155] Claimants' Reply Memorial dated 3 September 2013, para. 509.

BIT, and in particular Articles IX and X, shall apply to "*matters of taxation*" only with respect to expropriation, transfers and the observance and enforcement of an investment agreement or authorisation. And that too to the extent that they are not subject to the dispute settlement provisions of a double taxation treaty.

278. The ordinary lexical meaning of the word "*Nevertheless*" is "*in spite of that*" or "*notwithstanding.*" This Tribunal is, therefore, by majority, of the view that paragraph (2) applies notwithstanding or in spite of what is stated in paragraph (1). Where the two paragraphs cover the same ground, paragraph (2), therefore, has to be read either as an exception to or as overriding paragraph (1).

279. A different reading would result in the Tribunal assuming jurisdiction in a case of unfair or inequitable conduct by the State in a matter of taxation under Article VI(1) in spite of such jurisdiction being excluded by Article VI(2). That would either make paragraph (2) redundant, or subordinate it to paragraph (1). Such an interpretation would be contrary to the express language of the BIT.

280. This issue has been considered by other ICSID tribunals. The *Nations* Tribunal, when interpreting a similar provision in the U.S.-Panama BIT, held that "*the Claimants' doctrine, pursuant to which Article XI.1 would allow the Arbitral Tribunal to declare itself as competent with respect to a claim based on a possible unfair and inequitable treatment of the State in taxation matters, would leave the exception thus provided for, ineffective.*"[156]

281. The *Occidental* Tribunal, in the context of that case, did not have to address the distinction between "*tax policies*" and "*matters of taxation*" as those terms are used in Article VI(1) and VI(2) of the US-Ecuador BIT. The expression "*tax policies,*" like the expression "*matters of taxation,*" is not defined in the BIT and therefore, must be given its ordinary meaning.

[156] *Nations Energy Inc., Electric Machinery Enterprises Inc. and Jaime Jurado v. Republic of Panama*, para. 478 (CE-829).

282. Had there been no difference between the expressions "*tax policies*" and "*matters of taxation*," the Poland-U.S. BIT would have used identical language in both paragraphs. A different choice of words suggests that the two expressions and hence the two paragraphs were intended to have different meanings.

283. The line between "*matters of taxation*" and "*tax policies*" is not easy to draw. This Tribunal has already noted the view of the *Burlington* Tribunal,[157] that the investor's challenge to a particular Ecuadorian law was within the ordinary meaning of the phrase "*matters of taxation*" and therefore, its claims were limited to the exceptions specified in Article X(2) of the U.S-Ecuador BIT.

284. Taxation has three aspects. Levy of taxes, assessment of taxes and collection of taxes. In the view of this Tribunal, tax policies relate to the general framework under which taxes are levied. A claim that the State, as a matter of policy, has levied a tax in breach of its FET obligations under the BIT would arguably fall under Article VI(1) of the BIT. The claimant in such a case must not only demonstrate that the levy under challenge merely affects it adversely but also that the law levying the tax was the result of a tax policy of the Host State to treat the foreign investor in an unfair or inequitable manner or to deny it the protections of the BIT. "*Matters of taxation*," on the other hand, relate to assessment and collection of taxes (i.e. the implementation of the tax laws) and to claims about a substantive law affecting an investor adversely. It is the view of this Tribunal that tax legislation which is not the product of a tax policy of the Host State to deny BIT protections to investors is a matter of taxation and not tax policy. Article VI(2) and not Article VI(1) of the BIT would, therefore, apply.

285. There is yet another aspect of the matter. Given the language of Article VI(1) of the BIT, a question arises whether it creates such an obligation for the State that in case of the State's failure to observe this obligation, an investor would have the right to commence an investor-State arbitration. In the *Nations*[158] case a similar clause – Article XI – in the U.S.-Panama Treaty was the subject of interpretation. The *Nations*

[157] *Burlington Resources Inc. v. Republic of Ecuador* (CE-604).
[158] *Nations Energy Inc., Electric Machinery Enterprises Inc. and Jaime Jurado v. Republic of Panama* (CE-829).

Tribunal held that Article XI(1) of the U.S-Panama BIT was couched in prescriptive language ("*shall strive to grant*"), which did not impose a mandatory obligation on the State, and the language in Article XI(2) ("*however, this Treaty shall apply to taxation matters exclusively with respect to*"), created an exception to Article XI(1). This meant that paragraph (1) of Article XI of the U.S-Panama BIT was outside the framework of those obligations of the State which could be enforced by investors.

286. The language of Article VI(1) of this Treaty: "*should strive to accord…*" is similar to Article XI(1) of the U.S.-Panama Treaty: "*shall strive to grant.*" Likewise, the language of Article XI(2) of the U.S.-Panama Treaty: "*however, this Treaty shall apply to taxation matters exclusively with respect to…*" is similar to that of Article VI(2): "*Nevertheless the provisions of this Treaty, and in particular Articles IX and X, shall apply to matters of taxation only with respect to…*"

287. It is the view of the majority of this Tribunal that the language of Article VI(1) of the BIT, like that of Article XI(1) of the U.S.-Panama Treaty is prescriptive and directory. When the language of Article VI(1) is contrasted with the language used in Article VI(2), it is clear that it does not impose a mandatory obligation on the State, which can be enforced by invoking the dispute settlement mechanism of the BIT.

288. The Claimants' claims in this arbitration focus on the cumulative effect of the actions of the Respondent's agents, primarily in the form of tax proceedings, which resulted in the disallowance of deductions for the Management Fees paid by K . As already held by the majority of this Tribunal, the Claimants' claims, therefore, fall within the ordinary meaning of the phrase "*matters of taxation*" and, therefore, do not fall under Article VI(1) which relates to tax policies. Even if this was otherwise and they fell under Article VI(1), the conclusion of the majority would remain unchanged as it is of the view that Article VI(1) does not create a mandatory obligation for the State and, therefore, would not give rise to a BIT claim.

289. In conclusion, the Tribunal, by majority, is of the view that:

(i) The present dispute relates to "*matters of taxation*" within the meaning of Article VI(2);

(ii) Only claims arising out of "*maters of taxation*," which relate to expropriation (Article VI(2)(a)), transfers (Article VI(2)(b)) and the violation of an obligation for the observance and enforcement of an investment agreement (Article VI(2)(c)) are covered within the scope of Article VI(2);

(iii) The Claimants' claims relating to expropriation and transfers fall within Article VI(2)(a) and Article VI(2)(b). Their claims do not, however, concern the observance and enforcement of an investment agreement and therefore, do not fall within Article VI(2)(c); and

(iv) Its jurisdiction is, therefore, restricted to claims relating to these exceptions.

C. Jurisdictional objection 3: scope of the Tribunal's jurisdiction given the existence of the DTT

(1) The Parties' positions

a. <u>Respondent's position</u>

290. With respect to the claim based on expropriation, impairment of transfers or observance/enforcement of the Privatization Agreement, the Respondent argues that the Tribunal lacks jurisdiction because the Claimants did not resort to the "*dispute settlement provisions of a convention for the avoidance of double taxation*" before initiating this arbitration as required under Article VI(2) of the BIT.

291. According to the Respondent, Article 22 of the DTT provides a dispute settlement mechanism, of which the Claimants were obliged to avail. Article 22 of the DTT provides that:

> *ARTICLE 22 Mutual Agreement Procedure*
>
> *(1) Where a resident of a Contracting State considers that the actions of one or both of the Contracting States result or will result*

for him in taxation not in accordance with this Convention, he may, notwithstanding the remedies provided by the national laws of those States, present his case to the competent authority of the Contracting State of which he is a resident or citizen.

(2) The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at an appropriate solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation not in accordance with the Convention.

(3) The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention.

(4) The competent authorities of the Contracting States may communicate with each other directly for the purpose of reaching an agreement in the sense of the preceding paragraphs.

(5) In the event that the competent authorities reach such an agreement, taxes shall be imposed on such income in accordance with the agreement. Notwithstanding any procedural rule (including statutes of limitations) applicable under the law of either Contracting State, refund or credit of taxes shall be allowed, as appropriate, by the Contracting States in accordance with such agreement.

292. The Respondent argues that Article 22 of the DTT provides the mechanism for the settlement of tax disputes under the DTT. The reference in Article VI(2) of the Treaty to "*the dispute settlement provisions of a convention for the avoidance of double taxation,*" therefore, must be read as reference to Article 22 of the DTT.

293. The Respondent points out that Article 22 of the DTT corresponds to Article 25 of both the U.S. and U.N. model tax conventions. A leading commentary on Article 25 of the U.N. model convention states that:

[T]axation contrary to the Convention may occur as a result of (i) wrong interpretation or application of the DTC, i.e., of the rules of an international treaty, (ii) of a faulty application of domestic law if DTC law refers to the latter or if domestic law is an element of the

> *circumstances (facts) to which DTC law is applied, or (iii) of incorrect determinations of the facts involved.*[159]

294. The Respondent submits that two of these three bases relate to the application of domestic law to a particular set of facts or allegations that there has been an incorrect determination of facts. According to the Respondent, the central part of the present dispute is the application of income tax laws which is covered under the DTT. As such, the Respondent argues that the assessment and appreciation of facts that underpin a tax proceeding is precisely one of the kind of matters that falls within the ambit of the mutual agreement procedure.

295. The Respondent argues that the repatriation by the Claimants of the benefits of their investment was covered under the DTT. The Claimants structured their operations in such a way that from 8 November 1994 onwards, W earned taxable income from K under two distinct heads:

(i) As Management Fees calculated at 1.25% and then at 1.5% of the monthly sales of K ; and

(ii) As dividends from the company's net profit.

296. The Respondent argues that the Management Fees are covered under Articles 8, 13 or 15 of the DTT. Dividends are covered under Article 11 of the DTT. Both of these payments are different forms of repatriation of funds. In 1994, before W was formed, the Management Services were provided directly by W . After the formation of W , it operated as a pass-through vehicle. It had neither the personnel nor the capacity to provide the Management Services. The Respondent relied on the opinion of its legal expert, Prof. P , that with respect to pass-through companies, international law may disregard them as separate entities.[160] According to the

[159] Klaus Vogel, *Klaus Vogel on Double Taxation Conventions*, Third Ed., Kluwer Law International (1999), p. 1354 **(**RLA-077).
[160] Respondent's Post-Hearing Brief dated 6 June 2014, para. 34.

Respondent, the entire corporate structure involving W was created in order to reap the benefits of the DTT.[161]

297. In the Respondent's view, W was both the beneficial owner of the dividends from K , pursuant to the instrument of the W trust, and the beneficiary of the Management Fees. The tax treatment of the Management Fees directly affected the amount of dividends to which W was entitled. Dividends were to be paid out of the net profits of K , i.e. the gross profits after deduction of CIT. The tax authorities' refusal to allow deduction of the Management Fees for the purposes of calculating CIT reduced the net profits available for distribution of dividends.

298. The Claimants have themselves contended that "*their freedom to transfer was violated by the improper application of the tax law which resulted in K being deprived of the right to calculate, collect and freely transfer the Management Fees to its U.S. contractors. In addition, the Respondent's actions tainted the Management Fees arrangements and, thereby, made them impossible to collect.*"[162] According to the Respondent, the Claimants' argument that their right to transfer funds was violated by the tax measures is precisely the type of taxation matter, which falls within the ambit of the DTT.

299. In this context, the Respondent contends that the Claimants' argument that they were not subject to taxation in Poland and the tax proceedings concerned a dispute between K and the tax authorities as opposed to the Claimants is misplaced since it contradicts their own claim based on Article V of the Treaty – to which the DTT in the Respondent's view clearly applies.

300. As such, according to the Respondent, if the Tribunal found that the exercise of taxation powers by the Respondent in relation to the Management Fees was an internationally wrongful act, and it proceeded to examine how that act affected the

[161] Letter from A A to Mr. B dated 15 September 1999 (RE-242); Respondent's Rejoinder dated 20 March 2014, para. 158.
[162] Claimants' Memorial dated 8 May 2012, para. 1272.

Claimants freedom of transfer under Article V of the Treaty, it would have to apply Article 11 of the DTT. The Tribunal would then have to consider whether the act was justifiable under the DTT. This is precisely the situation contemplated in Article 22(1) of the DTT and triggers the mutual agreement procedure embedded therein.

301. Moreover, according to the Respondent, apart from the Claimants' argument relating to the violation of Article V of the Treaty, which directly invokes the Treaty, the OECD's Commentaries on the Articles of the Model Tax Convention clarify that the dispute settlement procedure is applicable even in the absence of issues involving any double taxation – "*[t]he mutual agreement procedure is also applicable in the absence of any double taxation contrary to the Convention, once the taxation in dispute is in direct contravention of a rule in the Convention.*"[163] Article 22 of the DTT conforms to this since the phrase "*taxation not in accordance with the Convention*" is not qualified in any other manner. The Claimants argue that they do not claim any violation of the DTT and, therefore, the present dispute is not covered by the mutual agreement procedure. The Respondent contends that this argument finds no support in the language of Articles VI(2) or IX(1) of the BIT, neither of which gives the Claimants the right to decide which issues of taxation will be subject to the DTT. A dispute relating to the legality of the refusal to allow tax deductions for the Management Fees has a direct impact on taxable income and is a dispute relating to the alleged actions of a Contracting State that result in taxation not in accordance with the DTT.

302. As to whether the mutual agreement procedure under Article 22(1) of the DTT could be regarded as an effective remedy precluding access to international investment arbitration in accordance with Article VI of the Treaty, the Respondent submits that:

(i) There is no rule of international law which requires a State to consent to the jurisdiction of an investment treaty tribunal for each and every type of investment treaty dispute. As such where a treaty provides that the jurisdiction of an investment treaty tribunal is subject to an investor availing

[163] OECD, *Commentaries on the Articles of the Model Tax Convention* (2010), p. 356 (RLA-108).

the dispute settlement mechanism under a tax treaty, this does not imply that the dispute settlement mechanism must be ineffective.

(ii) At the time the Treaty was entered into, the concept of arbitration without privity had yet to be established and the wave of investment treaty arbitrations had yet to come. At that time, dispute settlement mechanisms under tax treaties were better established and had a longer track record.

(iii) The lack of record of publicly known cases resolved through such a mechanism is a result of such disputes being resolved on an inter-governmental basis and, therefore, not being widely reported. According to the Respondent, the widespread use of mutual agreement procedures and their incorporation in the model tax conventions of both the United Nations and the OECD suggest that there is a global consensus that such procedures are useful.

(iv) Such procedures have been shown to work, most notably in the case of *Feldman v. Mexico,*[164] where the procedure was used before the arbitration commenced and resulted in one of the claims not being pursued before the NAFTA Tribunal.

303. The Respondent further contends that the U.S. tax authorities had jurisdiction in the matter and, therefore, the mutual agreement procedure could have been invoked. The Respondent places particular reliance on the memorandum from A A to S from September 1994.[165] This Memorandum discusses the applicability of the DTT to the Claimants' investment in Poland in the context of W as a pass-through vehicle and the participation exemption under the DTT. It further contemplates the qualification of W holdings in Poland as Controlling Foreign Corporations by the Internal Revenue Service of the U.S. ("IRS"). As such, at the

[164] *Marvin Feldman v. United Mexican States*, ICSID Case No. ARB(AF)/99/1, Award of 16 December 2002 (RLA-067).
[165] RE-242.

relevant time, the Claimants' tax advisors had no doubt that the DTT applied to the W partners, including S .

304. According to the Respondent, the Claimants did not resort to the mutual agreement procedure because

> *…eligible tax residents of the United States – i.e. W L.P. or its partners – would have had to come to the IRS and, most likely, disclose this entire scheme: undocumented consulting services, allegedly performed by friends and relatives, in consideration for hundreds of thousands of US dollars, the Cayman Islands trust and the Cayman Islands company set up to allow investors in W to avoid paying taxes in the United States, and false evidence, fabricated with active participation of a U.S. national, Mr. C H , and submitted to the Polish tax authorities by the Company.*[166]

305. The Respondent argues that the W partners probably chose not to apply to the U.S. authorities under the mutual agreement procedure because these authorities would have had personal jurisdiction over them and their assets and may not have looked leniently upon the tax structures at issue in the present case. According to the Respondent, the failure to resort to the mutual agreement procedure also reflects on the *bona fides* and clean hands of the Claimants. Had the Claimants had clean hands and proper files documenting the Management Services in B , as they claimed, there would have no better authority to understand their position and advocate their position before the Polish tax authorities than the IRS.

306. If the Tribunal is of the view that the tax treatment of the Management Fees by the Polish tax authorities had an impact on the taxation of W Polish revenues in accordance with the DTT, then the Respondent's jurisdictional objection should be upheld.

[166] Respondent's Post-Hearing Brief dated 6 June 2014, para. 57.

b. Claimants' position

307. The Claimants argue that the DTT has no application to the present dispute. In order to interpret the terms of the DTT, it is important to take into account the purpose of the DTT. According to the Claimants it is commonly accepted that the purpose of such treaties is to protect taxpayers against double taxation. Double taxation occurs if all of the following requirements are met:

(i) Taxes are imposed in at least two countries;

(ii) Taxes are imposed on the taxpayer;

(iii) The same economic activity is subject to taxation;

(iv) There is similarity between the tax imposed; and

(v) The taxes are imposed for the same tax periods.

308. In the Claimants' view, in the present case double taxation would only occur if income tax were imposed on K profits for the fiscal years 1994 to 1997 in both Poland and the U.S. Since K was only subject to taxation in Poland, there is no question of double taxation here. Moreover, the Claimants argue that the DTT only applies to direct taxes such as income tax and not indirect taxes such as VAT, which are also at issue here.

309. The Claimants submit that since they were not subject to taxation in Poland and the tax proceedings concerned a dispute between K and the tax authorities, as opposed to the Claimants and the tax authorities, the DTT is not applicable to the Claimants.

310. Even assuming that the DTT were applicable, the Claimants argue that the scope of the mutual agreement procedure only covers violations by a domestic tax provision of a provision of the DTT. In the present case, the Claimants are not claiming any violation of the DTT. The present dispute, therefore, would not be covered by the mutual agreement procedure.

(2) The Tribunal's analysis

311. This issue, like the Respondent's second jurisdictional objection, also revolves around the interpretation of Article VI(2) of the BIT. As stated above, Article VI(2) is a carve-out provision and provides that in relation to "*matters of taxation*" an investor may only bring claims which fulfil two conditions: (i) they are based on one of the exceptions described in the Article, that is claims based on expropriation, transfers or the observance and enforcement of the terms of an investment agreement; and (ii) are not subject to the dispute settlement mechanism in any double taxation treaty between the two States or have been raised under such settlement provisions and are not resolved within a reasonable period of time .

312. Before the Tribunal can adjudicate on such claims that fulfil condition (i) above, the Claimants also have to show that their claims are not hit by condition (ii) above, i.e. they are not subject to the dispute settlement mechanism in any double taxation treaty between the two States or have been raised under such settlement provisions and are not resolved within a reasonable period of time. In this case, such a treaty exists between the U.S. and Poland. It is undisputed that the present dispute has not been raised under the dispute settlement provision of a DTT and hence the second alternative in condition (ii) is not applicable. As such, the Tribunal's analysis will focus on whether the present dispute falls within the scope of the dispute settlement mechanism of the DTT.

313. Article 22 of the DTT allows a resident of one Contracting State to invoke the dispute settlement mechanism if the actions of one or both Contracting States will result in taxation not in accordance with the DTT. The Respondent has correctly pointed out that the central issue in this case relates to the deductibility of costs for the purposes of calculating corporate income tax and the DTT is applicable to income tax. While an issue relating to corporate income tax can certainly be raised under Article 22 of the DTT, the Tribunal has to determine if the present dispute relating to corporate income tax could have been raised under Article 22.

314. To raise a dispute under the DTT, the taxation complained of must be "*not in accordance with this Convention.*" The Claimants, however, have not raised any argument that they are being taxed in contravention of the provisions of the DTT. The Respondent, on the other hand, pointed out that the Management Services are covered under Articles 8, 11, 13 and 15 of DTT. The Tribunal will address the Respondent's points in turn below.

315. Article 8 of the DTT deals with business profits and sub-article (3) provides that in determining the profits of a business, deductions for expenses incurred for the purposes of the business shall be allowed. The Respondent, however, has stated that the present dispute is not whether Management Services were in fact provided, but whether K adequately documented the provision of the Management Services for the purposes of claiming deductions. Article 8(3), while recognizing the right to claim deductions, does not exempt a business from fulfilling the legal requirements for claiming such deductions under domestic law. Accepting the Respondent's own formulation of the dispute, the Tribunal finds that Article 8 has no relevance in the present circumstances.

316. Article 13 of the DDT deals with royalties. In the Tribunal's view, there is no issue of royalties being paid to or by anyone in this case and therefore, Article 13 of the DDT has no application to the present dispute.

317. Article 15 of the DDT relates to personal services, such as the Management Services. Article 15 of the DDT, however, only deals with the taxation of income derived from the provision of such services. The present dispute is not concerned with taxation of the income received from the provision of Management Services; it is concerned with the treatment of the expenses incurred by K in paying for the Management Services. The Tribunal finds that Article 15 of the DDT, therefore, also does not apply to the present dispute. As such, while the Respondent is right that Articles 8 and 15 of the DDT may cover some aspects of the Management Services, these Articles do not cover the present dispute relating to the deductibility of the Management Fees.

318. In the alternative, the Respondent has sought to frame the present dispute as one of repatriation of funds by arguing that the treatment of the Management Fees paid by K directly affected the dividends to which W was entitled. Since the payment of dividends is covered under Article 11 of the DTT, the Respondent argues that the present dispute falls within the scope of the DTT. In this regard, the Respondent relies on the Claimants' contention that their freedom to transfer was violated by the improper application of Polish tax law, resulting in K being deprived of its right to freely transfer the Management Fees outside Poland.

319. The Claimants' claim that their freedom to transfer funds was violated because they could not freely transfer the Management Fees is, however, very different from the taxation of dividends covered under Article 11 of the DDT. Such a claim is not covered under Article 11. While the Respondent submits that the dispute relating to the transfer of funds is exactly the kind of dispute covered under the DTT, it fails to point out any provision other than Article 11 of the DDT, which covers such a dispute. Unless the transfer of funds is covered by a specific provision of the DTT, any limitation on such a transfer will not be in contravention of the provisions of the DTT and therefore, not subject to the dispute settlement mechanism set out in Article 22 of the DDT.

320. In conclusion, the Tribunal is of the view that the dispute raised by the Claimants is not covered under the DTT and is not subject to its dispute settlement clause.

D. Jurisdictional objection 4: scope of the Tribunal's jurisdiction in relation to the criminal proceedings

(1) The Parties' positions

a. <u>Respondent's position</u>

321. The Respondent argues that the Claimants' claims based on developments relating to the criminal proceedings in Poland after the bankruptcy of K, such as the detention of Mr. B and Mr. M in December 2006, cannot give rise to an investment dispute within the meaning of Article IX of the Treaty because they (i)

occurred after the Claimants had already lost their investment; and (ii) relate to measures taken against individuals who do not fall under the definition of investors under the Treaty.

322. In support of its argument that measures taken against individuals who do not fall under the definition of investors under the Treaty cannot give rise to a Treaty claim, the Respondent relies on the decision in *Rompetrol v. Romania.*[167] While in that case the Tribunal concluded that the conduct of criminal proceedings against the employees and managers of an investor could be the subject of a Treaty claim, this conclusion was qualified:

(i) In that case the criminal proceedings took place during the life of the investment. Here the question is whether this Tribunal's jurisdiction extends to acts against local managers after the investment is lost. An investment dispute cannot emerge after the investment is lost.

(ii) The *Rompetrol* Tribunal concluded that the Host State's conduct had to have a sufficient link to the investment or investors to fall under the BIT. In that case the State took invasive measures including arresting the company's directors, thereby depriving it of management, and blocking its shares, thereby affecting investment. In the present case no such measures were adopted. The criminal proceedings prior to 2006 were limited to fact-finding proceedings (i.e. *in rem* proceedings). It was only in 2006 that charges were brought against two individuals. By this time it had been six years since K had fallen into technical bankruptcy. These proceedings could not have had any effect on it.

(iii) Finally, in relation to allegations of criminal misconduct against the managers of the investors in their individual capacity, the *Rompetrol* Tribunal held that

> *[i]f there have been breaches of Mr. Patriciu's or Mr. Stephenson's [two non-Dutch managers of the Dutch claimant] procedural rights in the course of the criminal investigation process, of a kind that could conceivably fall within the scope of 'denial of justice' (or its*

[167] *The Rompetrol Group N.V. v. Romania,* ICSID Case No. ARB/06/3, Award of 6 May 2013 (RLA-097).

> *equivalent, in the case of Mr. Patriciu), then – even if those breaches are duly established – they do not and cannot, in and of themselves, constitute valid BIT claims at the instance of TRG. The rights so breached would be personal rights of the individuals under investigation. For their breach to entail a valid BIT claim would require a separate investigation into their direct or indirect effect on the investments of TRG itself in Romania, and into whether that effect did or did not amount to a failure to respect the protections guaranteed to TRG, as a foreign investor, under the BIT. But that would be an investigation of a qualitatively different kind, applying a potentially different standard, namely that laid down by the relevant provisions of the BIT, properly interpreted and then applied to the facts of the case. The position is no different if (as is indeed alleged by the Claimant in certain respects) the interests of TRG itself became incidentally caught up in steps taken in the criminal investigations against Mr. Patriciu or Mr. Stephenson*.[168]

323. The Respondent further points out that the Expert Report of Dr. Z ,[169] which is the central piece of evidence on which the Claimants rely to establish a causal link between the actions of the Respondent and the insolvency of K , makes no mention of the criminal proceedings. Similarly, Dr. Z supplemental opinion does not, apart from a single conclusion not based on any evidence, refer to the role of the criminal proceedings.[170] The Respondent also points out that Prof. S opinion makes no reference to the criminal proceedings.[171] According to the Claimants' own damage theory and their expert reports, therefore, none of the acts of the Polish criminal authorities before mid-2000 contributed to the collapse of K . In such case, the Respondent submits, this part of the claim would fall outside the jurisdiction of this Tribunal under the *Oil Platforms*[172] doctrine given that even if the facts as alleged were proven, the Tribunal has no jurisdiction unless they would lead to a breach of the Treaty or to any damages.

[168] *Ibid*, para. 166.
[169] Expert Opinion of Prof. Z dated 2 May 2012 (CE-002).
[170] Supplement to the Expert Opinion of Prof. Z dated 19 August 2013 (CE-751).
[171] Expert Opinion of Prof. S dated August 5, 2013, para. 3 (CE-752).
[172] *See* ICJ judgment in Case Concerning Oil Platforms *(Islamic Republic of Iran v. United States of America),* ICJ Report 803, Preliminary Objection dated 12 December 1996, Separate Opinion of Judge Higgins, para. 32, p. 856 (RLA-017).

324. To the extent that the Claimants argue that the criminal proceedings were linked to the conduct of the tax proceedings, these proceedings too would fall within "*matters of taxation*" for the purposes of Article VI(2) of the Treaty according to the Respondent.

325. The Respondent in this respect relies on the *Nations Energy v. Panama*[173] case for the following reasons:

(i) In that case the Tribunal interpreted a provision similar to Article VI(2) of the Treaty and declined to exercise jurisdiction over a claim relating to Panama's refusal to treat certain tax credits as transferable in the context of a bond operation by the Claimants. The Tribunal took the view that the claim related to a matter of taxation.[174]

(ii) The Tribunal also dealt with the Claimants' argument that the impugned acts of the State had consequences beyond mere fiscal measures and that actions of other non-tax organs, such as the judiciary, were also at issue. The Tribunal concluded that the fact that the challenged acts had consequences beyond taxation did not alter the basic nature of the dispute, which related to "*matters of taxation*." According to the Tribunal, it could not decide the Claimants' claim without first determining the propriety of the tax measures.[175]

<u>b. Claimants' position</u>

326. The Claimants argue that the Respondent's jurisdictional objection in relation to the Criminal Claim should be rejected for the following reasons:

> *(a) The K Criminal Proceedings was de facto directed against the Claimants;*
>
> *(b) The K Criminal Proceedings was related to the Claimants' investment in K ;*

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[173] *Nations Energy Inc., Electric Machinery Enterprises Inc. and Jaime Jurado v. Republic of Panama* (CE-829).
[174] *Ibid*, paras. 462-466.
[175] *Ibid*, paras. 459, 462, 465, 632 and 634.

(c) *While indeed there were no acta iure imperii directed against the Claimants, certain adverse acts of the Prosecutor during the K Criminal Proceedings were specifically addressed to the Claimants;*

(d) *The K Criminal Proceedings started before the collapse of K .*[176]

327. While the Claimants do not seriously dispute that, from a strict formal perspective, the criminal proceedings were not conducted personally against the Claimants and the investigation was conducted in a fact-finding phase, they submit that the list of potential suspects in K Criminal Case 5 included the "former managers" of K . In his Decision of Discontinuation of 1 December 2011, the Prosecutor listed the potential suspects in the investigation. These included members of K Supervisory Board such as Mr. R and Mr. M .[177]

328. The Claimants submit that the conduct of the criminal authorities in the K Criminal Proceedings was an integral part of the acts of the Respondent, which violated the Treaty. The tax and criminal proceedings were interrelated. The Respondent's representatives conducting both proceedings relied on each other's statements, particularly in relation to the provision of the Management Services.

329. In this regard, the Claimants rely on the following documents:

(a) *the correspondence between the District Prosecutor in O and the Appellate Prosecutor in W , dated April 5, 2005. The correspondence described instigation in 1997 of the criminal proceedings in respect of the alleged "economically groundless transfer" of K funds abroad which allegedly took place from November 1994 to December 1996. In the correspondence, the Prosecutor alleged that: "(...) W E I P sp. z o.o. started its actions aimed at transferring as much money as possible from the plant in B " (emphasis added). Further, the Prosecutor stated: "The companies from B acquired strategic blocks of shares in another two privatized companies, that is "B T R "" S.A. in*

[176] Claimants' Reply Memorial dated 3 September 2013, para. 601.
[177] CE-385.

B and in W in O W . Also in these companies, the American investor took actions justifying assumption that they were intending to transfer capital from these companies in a similar way";

(b) *Ms. B testimony during the K Criminal Proceedings, dated December 12, 1997, who was an employee of the Tax Inspection Office in B who took part in K tax proceedings. According to the testimony given to the police upon the District Prosecutor in O request: "the purpose of paying for the services rendered by W in favor of N S.A. was only to transfer income in the form of the commission on sale – to the majority shareholder of the block of shares of the inspected company, i.e. S C C in B through the company W in W and W in B - the concealing of the fact of paying the commission on sale in favor of W in W "(emphasis added).*

(c) *The Prosecutor's letter to the General Tax Inspector dated March 7, 1998. In the letter the Prosecutor stated that: "In the presented state of affairs, it should be noted that there is a high risk of economically groundless transfer of capital from Poland to the USA, while the mechanism of this transfer would include not only N in B , but also W in O W and 'B ' T R in B . (...) In relation with the above, considering also that the factual circumstances stated in the course of penal proceedings justify immediate institution of administrative tax inspections (...)" (emphasis added).*

(d) *The Prosecutor's letter to the Director of the Tax Inspection Office, dated November 25, 1998 in which he stated that: "Further arrangements made during the preparatory proceeding allow assumption that despite the fact that the Tax Inspection Office in O stated irregularities at N in the years 1994-1996, in 1997 the company did not stop actions against the law. In particular, this refers to the settlement of intangible services rendered by W E I , which would directly affect abuse in the scope of taxes - income tax and VAT. In relation to the above, I hereby request conducting supplementary inspection at N in B , within the scope identical with the scope of control*

KS-X-3/97, but covering the year 1997" (emphasis added).[178]

330. The Claimants submit that it was upon the request of the Public Prosecutor[179] that the tax inspection in K was initiated on 3 February 1997 till 9 May 1997. The tax inspection was conducted by Mr. I S , who also later carried out the inspection for the fiscal year 1996. Mr. S was then questioned thrice in the K Criminal Proceedings from August to October 1997.[180] According to the Claimants, it was his testimony that led to a series of criminal investigations collectively described as the K Criminal Proceedings. These proceedings seriously affected K day-to-day operations and restricted the Claimants' ability to minimize the losses they incurred due to K collapse. These proceedings also caused the Claimants to suffer moral damages.

331. The Claimants argue that the actions of the Prosecutor during the K Criminal Proceedings amounted to *acta iure imperii*. According to the Claimants, the Respondent is incorrect in submitting that the role of the Claimants in the K Criminal Proceedings was limited to the role of a witness and no coercive measures were adopted against any of them. The Claimants submit that the Respondent has failed to take into account the circumstances of the relationship of Mr. R and Mr. M with the Prosecutor. Mr. R and Mr. M had every reason to fear that coercive measures would be adopted against them as the criminal proceedings were being conducted against K "former managers" and they were members of its Board. In this regard, the Prosecutor's letter of 1 July 2010 indicated that in case the Claimants failed to provide the information being sought he would seek assistance from Interpol and the U.S. law enforcement authorities.[181] This request was repeated through letters dated 10 and 25 August 2010.[182]

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[178] Claimants' Reply Memorial dated 3 September 2013, para. 615.
[179] CE-467.
[180] CE-469, CE-471 and CE-473.
[181] CE-515.
[182] CE-517 and CE-519.

332. The Claimants, therefore, were legitimately afraid of coming to Poland, which is why their legal counsel sought assurances from the Prosecutor, which were given through the Prosecutor's letter dated 16 September 2010.[183]

333. With regard to when the criminal proceedings were initiated, the Claimants submit that their initiation in 1997 (i.e. by launching an investigation, which was conducted in the *in rem* phase) was clearly connected with the initiation of tax proceedings against K , and the later developments in the criminal proceedings do not alter the fact that they were in relation to the alleged illegal transfer of funds abroad and are still pending.

334. The Claimants rely on the decision in the case of *Biwater v. Tanzania* where the Tribunal observed that the cumulative effect of a series of government acts, which include initiating criminal proceedings, could lead to expropriation of an investment.[184]

(2) The Tribunal's analysis

335. This Tribunal has already, albeit by majority, concluded that the present dispute relates to "*matters of taxation*" and therefore, it only has jurisdiction to hear claims based on the exceptions listed in Article VI(2) of the Treaty. In view of this the Tribunal is of the view that it does not have jurisdiction to hear any independent claims based on actions or developments in the criminal proceedings. To the extent that actions or developments in the criminal proceedings, however, relate to and form part of the Claimants' claims based on expropriation or transfers (under Article VI(2)(a) or (b)), the Tribunal will consider them in its findings on the merits.

E. Conclusion on jurisdiction

336. The Tribunal, by majority, is of the view that the present dispute relates to "*matters of taxation*" within the meaning of Article VI(2) of the BIT. The Tribunal's

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183 CE-521.

184 *Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania*, ICSID Case No. ARB/05/22, Award of 24 July 2008 (CE-675).

jurisdiction is, therefore, limited to claims for expropriation, transfers and the violation of an obligation for the observance and enforcement of an investment agreement. The majority of this Tribunal is of the view that the present dispute does not relate to a violation of an obligation for the observance and enforcement of an investment agreement pursuant to Article VI(2)(c) of the BIT. In light of the above analysis, the majority also concludes that it has jurisdiction only to hear claims relating to Article VI(2)(a) and (b). The Tribunal is, however, of the view that the dispute raised by the Claimants is not covered under the DTT and is not subject to its dispute settlement clause.

337. Before turning to the merits of the dispute, however, the Tribunal must determine whether the present dispute falls within the scope of the Additional Facility Rules. This is a dispute between the nationals of an ICSID Contracting State and a State Party which is not an ICSID Contracting State. The Republic of Poland is not an ICSID Contracting State. Mr. V J. R is a national of the United States, which is an ICSID Contracting State. Determining the corporate nationality based on the seat of incorporation, S and A are also nationals of the United States for the purposes of the Additional Facility Rules.

338. There is no dispute that Mr. R and S have made an investment for the purposes of the BIT and hence for the purposes of Articles 4(2) and 2(a) of the Additional Facility Rules. The Tribunal has also found that A has made an investment for the purposes of the BIT and the Additional Facility Rules.

339. The Parties disagree about whether the Republic of Poland complied with its substantive obligations under the BIT in relation to the Claimants' investment in K . The dispute, is therefore of a legal nature, which arises directly out of an investment in accordance with Article 2(a) of the Additional Facility Rules.

340. The Parties have consented in writing to ICSID Additional Facility arbitration. The Respondent's advance consent is contained in Article IX of the BIT, the prerequisites of which have been fulfilled with respect to all three Claimants, and the Claimants' written consents are contained in their Request for Arbitration. Further, approval of

access to the Additional Facility was granted by the ICSID Secretary-General on 3 November 2010. As such the jurisdictional requirements established by the Additional Facility Rules are fulfilled.

341. The Tribunal, therefore, has the jurisdiction to hear claims raised by the Claimants relating to Article VI(2)(a) and (b). In its analysis on the merits, the Tribunal will hence address the Claimants' claims regarding expropriation pursuant to Article VII of the Treaty and the Claimants' claims regarding transfers pursuant to Article V of the BIT.

VI. LIABILITY

A. Applicable law

342. The Claimants submit that based on the subject matter of the dispute, the Tribunal should apply the following rules of law:

(i) The Treaty;

(ii) Customary international law;

(iii) General principles of law recognized by civilized nations; and

(iv) U.S. law as the national law of the State of nationality of the Claimants.

343. The Claimants also ask the Tribunal to refer to the decisions of other courts and tribunals and writings of eminent scholars.

344. The Respondent submits that the Tribunal should primarily refer to the Treaty itself and where the provisions of the Treaty are insufficient to resolve the dispute, reference may be made to customary international law and general principles of international law as submitted by the Claimants. The Respondent also agrees with the Claimants on the persuasive but non-binding authority of decisions of other courts and tribunals and the writings of eminent scholars.

345. Where the Parties primarily differ is on the application of *national* law. The Claimants submit that U.S. law should be applied in determining the standing and status of the Claimants. They further argue that Polish law should be treated as a fact by the Tribunal. The Respondent agrees that U.S. law may be applied in determining the standing and status of the Claimants, i.e. questions relating to the existence of control by Mr. R over S or A or issues of Delaware corporate laws. The Respondent also agrees that international tribunals tend to apply domestic law as fact and does not oppose this approach.

346. The Respondent, however, argues that Polish law must be applied on an equal footing as U.S. law in this arbitration and cannot, in any manner, be treated as subservient to U.S. law. Questions relating to the constitution of W , rules of evidence in the Polish tax proceedings, or the specific CIT or VAT regulations applicable to K must be determined in light of Polish law.

347. The positions taken by the Parties on the applicable law is hence not far apart, and the dispute relates only to the precise role of national law, but there too the difference between the Parties' positions is marginal. The Respondent's position that before an international tribunal questions of domestic law should be treated as questions of fact and both national laws should be applied on an equal footing where required is reasonable. This position, which is set out in the Respondent's Counter-Memorial[185] was not contradicted or opposed by the Claimants' in their Reply Memorial. The Tribunal is of the view that it reflects the settled approach in international arbitration and it will apply U.S. law and Polish law as questions of fact if and when required and treat them on an equal footing.

[185] Respondent's Counter-Memorial dated 8 October 2012, paras. 439-441.

B. Expropriation

(1) The Parties' positions

a. Claimants' position

348. The Claimants submit that their investment in K was indirectly expropriated by the conduct of the Respondent and that none of the requirements for a legal expropriation under Article VII(1) of the Treaty were fulfilled by the Respondent.

349. The indirect expropriation consisted of depriving the Claimants in the year 2000 of the use and expected economic benefits of their investment in K (i.e. as a result of the Respondent's action, in particular the tax proceedings, K lost access to bank financing). Consequently, it could not purchase essential raw material for its production process and was compelled to cease normal operations. The Claimants submit that there was a clear and convincing causal link between the actions of the Respondent and the collapse of K . In this regard, the Claimants place reliance on the Expert Opinion of Prof. Z , who unequivocally states that the tax proceedings, and not any factors attributable to the Claimants or K itself, caused the collapse of K

(i) The standard for expropriation

350. The Claimants submit that the present case is one of indirect and creeping expropriation, where the successive measures of the Host State over a period of time caused the collapse of the investment. According to the Claimants, the present case does not concern the powers of the Respondent relating to taxation, but to its conduct during the tax and criminal proceedings; conduct, which according to the Claimants was not *bona fide*.

351. According to the Claimants, the tax measures in the present case were just one part of a broader matrix of measures, which, when taken together, led to K collapse. In this regard, the nature of the measure and the Host State's intent when applying it are irrelevant for finding a violation of Article VII of the Treaty. A Host State's measures

are "*tantamount to expropriation*" when their effect is "*the effective loss of management, use or control, or a significant depreciation of the value, of the assets of a foreign investor.*"[186] The focus, therefore, must be on the effect of a measure, not the nature of nor intention behind the measure.

352. The Claimants argue that the present case is distinguishable from the *O&L v. Slovakia*[187] case where the company purchased by the investor was already on the verge of bankruptcy at the time of the investment and was already burdened with significant tax arrears. In this case, the conduct of the Respondent constituted an abuse of tax powers since the measures taken were discriminatory, arbitrary and contrary to the due process of law.

353. According to the Claimants, for an expropriation to occur it is not necessary for the investment to be appropriated by the Host State. The Claimants argue that the Respondent has itself conceded that the decisions in *Olguín v. Paraguay*[188] and *Lauder v. Czech Republic,*[189] on which it relied, do not necessarily constitute the leading approach.[190] According to the leading approach, creeping and indirect expropriation consists of measures, which deprive an investor of the benefits of his or her investment but do not necessarily transfer the investment to the Host State. The Claimants rely on *Metalclad v. Mexico*, where the Tribunal observed that

> *expropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the Host State, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the Host State.*[191]

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[186] *Spyridon Roussalis v. Romania,* ICSID Case No. ARB/06/1, Award of 7 December 2011, para. 327 (CE-636).
[187] *O&L v. Slovak Republic*, UNCITRAL, Final Award of 23 April 2012, para. 212 (RLA-010).
[188] *Eudoro Armando Olguín v. Republic of Paraguay*, ICSID Case No. ARB/98/5, Award of 26 July 2001 (RLA-036).
[189] *Ronald S. Lauder v. Czech Republic*, UNCITRAL, Final Award of 3 September 2001 (CE-667).
[190] Respondent's Counter-Memorial dated 8 October 2012, para. 692.
[191] *Metalclad Corporation v. United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award of 30 August 2000, para. 103 (CE-635).

354. The Claimants submit that while the Respondent is correct in asserting that an expropriation requires a permanent loss of benefits to the investors, this is not the same as the investor not remaining in control or losing the management of an investment. Once the investment becomes economically unviable because of the measures taken by the Host State, whether or not the investor still remains in control of the investment is irrelevant. In this regard the Claimants rely on *Burlington v. Ecuador*, where the Tribunal observed that

> *[t]he loss of viability does not necessarily imply a loss of management or control. What matters is the capacity to earn a commercial return. After all, investors make investments to earn a return. If they lose this possibility as a result of a State measure, then they have lost the economic use of their investment.(...) The measure is expropriatory, whether it affects the entire investment or only part of it, as long as the operation of the investment cannot generate a commercial return.*[192]

(ii) K bankruptcy was caused by the Respondent's actions

355. The Claimants rely on Articles 31(1) and 31(2) of the ILC Articles on State Responsibility to argue that a State is obliged to make full reparation for any injury *caused* by its internationally wrongful act. The test for causation is either (i) the natural consequence test; or (ii) foreseeability from the perspective of a reasonable and well-informed third party. International investment tribunals have consistently used these two tests to determine whether the injury to an investor is not too remote (or proximate) from the internationally wrongful act of the Host State. The applicability of both these tests has been confirmed in *CME v. Czech Republic* where the Tribunal stated that "*[c]ausation arises if the damage or disadvantage deriving from the deprivation of the legal safety of the investment is foreseeable and occurs in a normal sequence of events.*"[193] The Claimants also rely on the rulings in the cases

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[192] *Burlington Resources Inc. v. Republic of Ecuador*, ICSID Case No. ARB/08/5, Decision on Liability dated 14 December 2012 paras. 397-398 (CE-758).
[193] *CME Czech Republic B.V. v. Czech Republic*, UNCITRAL, Partial Award of 13 September 2001, para. 527 (RLA-073).

of *S.D. Myers v. Canada*[194] and *Joseph Charles Lemire v. Ukraine.*[195] According to the Claimants, the causation tests are also recognized in Polish law (Article 361 paragraph 1 of the Polish Civil Code states that "*a Party obliged to compensation is responsible only for regular consequences of an act or default leading to damage*") and have been applied by the Polish Supreme Court.[196]

356. The Claimants submit that for an expropriation claim to succeed they have to show that there is an "*uninterrupted and proximate logical chain from the initial cause* [i.e. the tax and criminal proceedings]…*to the final effect* [i.e. to the collapse of K],"[197] whereas the Respondents, if negating the causal link, must show that the final effect was caused not by the wrongful acts of the Respondent but by the actions of the Claimants or third-parties for which no one can be made responsible.

357. To prove the causal link, the Claimants rely heavily on the expert opinion of Prof. Z .[198] According to his expert opinion, K financial standing during the period from 1994 to 1996 was sound. During this period K experienced growth in its scale of operations, as measured by sales volume and revenue. This was a direct result of the increase in vegetable fat consumption in the country and the company's effective marketing strategy. K profitability, EBIDTA-to-sales ratio, return on equity and return on assets were all, on average, higher than the sector benchmarks and, in particular, than its most comparable competitor – Z T K S.A. ("K "). Prof. Z also opined that K leverage strategy during this time was aggressive due to sales growth and extensive capital investment.

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[194] *S.D. Meyers, Inc. v. Canada*, UNCITRAL, Second Partial Award of 21 October 2002, para. 140: "*In its First Partial Award the Tribunal determined that damages may only be awarded to the extent that there is a sufficient causal link between the breach of a specific NAFTA provision and the loss sustained by the investor. Other ways of expressing the same concept might be that the harm must not be too remote, or that the breach of the specific NAFTA provision must be the proximate cause of the harm*" (CE-836).

[195] *Joseph Charles Lemire v. Ukraine*, ICSID Case No. ARB/06/18, Award of 28 March 2011, para. 169: "*The best that the Tribunal can expect Claimant to prove is that through a line of natural sequences it is probable — and not simply possible — that Gala would have been awarded the frequencies under tender. If it can be proven that in the normal cause of events a certain cause will produce a certain effect, it can be safely assumed that a (rebuttable) presumption of causality between both events exists, and that the first is the proximate cause of the other*" (CE-682).

[196] Award of Polish Supreme Court of 19 April 2000, No. V CKN 28/00 (CE-838).

[197] *Joseph Charles Lemire v. Ukraine*, para. 163 (CE-682)

[198] Expert Opinion of Prof. Z dated 2 May 2012 (CE-002).

Its overall debt level, however, remained safe and in line with sector benchmarks. As a result, at the end of 1996, despite unfavourable market conditions, including a rise in the price of raw material and increasing competition which resulted in a decrease in profitability, K generated positive net income and was not only able to finance its purchase of raw material but to continue its investment program.[199]

358. According to Prof. Z , the tax proceedings were the cause of K collapse. In order to evaluate the link between different factors and K collapse, Prof. Z created a Base Model in which he analysed whether the joint impact of all factors, excluding the tax proceedings, relating to K financial and economic standing was sufficient to cause its collapse.[200] Among other factors taken into account in the Base Model were K investment and sales strategies and its management reorganization.

359. In the Base Model, Prof. Z effectively reversed the direct effects of the tax proceedings. The Claimants submit that Prof. Z constructed the Base Model in an extremely conservative manner. Even though the tax proceedings had a multi-faceted impact on K , Prof. Z only reversed those factors such as net cash outflows caused by the tax decisions, tax advisor costs and lost access to preferential loans, which could be quantified with a high degree of accuracy. All other factors were included in the Base Model and no other positive effects of the absence of the tax proceedings were taken into account. As a result, the Base Model is, in Prof. Z view, the worst of many possible worlds without tax proceedings (i.e. a worst case scenario for the company if no tax proceedings had taken place). Prof. Z submits that, for instance, the following potential positive events which in the absence of tax proceedings may have enhanced K positions were excluded:

(i) K had initiated a comprehensive capital improvement program and would have benefited from an expansion in its production capacity making it the lowest cost producer.

[199] *Ibid*, paras. 102 and 104.
[200] *Ibid*, paras. 248-271.

(ii) K suppliers and wholesale clients would have been willing to extend payment terms, which would have a positive impact on K business.

(iii) K would have been able to procure bank financing to continue its rapeseed purchase program.

(iv) The Claimants would have invested more money into K .

360. The final outcome of the Base Model was premised on a comparison of the results achieved in accordance with the presumptions in the Base Model and K actual results, as well as those of K , its main competitor and the sector benchmark.

361. According to Prof. Z , a detailed analysis of macroeconomic data from 1994 to 2000 reveals that changes in these factors, other than the tax proceedings, would have had a positive or neutral impact on K .[201] While the volatility in the price of rapeseed, which was the main raw material required by K , and increasing competition did create risks, these were risks that all companies in the sector were exposed to and were not factors in K bankruptcy.[202] These market conditions began to improve in 2000 and companies, which were in a weaker position than K in the late-1990's, were able to recover.

362. With regard to the impact of the tax proceedings, Prof. Z states that

> *it should be noted that the influence of these proceedings on K financial and economic standing consisted of numerous aspects and was negative in each of them, whereas the strength of that influence can be assessed as substantial. Taking into account the strength of that influence, above all with regard to K relations with banks, it can be reasonably assumed that the tax proceedings caused K bankruptcy.*[203]

363. According to Prof. Z ,

> *excluding a single factor specific to K , i.e. the tax proceedings, would have altered the Company's financial and economic standing*

[201] *Ibid*, para. 164.
[202] *Ibid*, paras. 184-185.
[203] *Ibid*, para. 247.

> *in 1997-1999 to such an extent that it would have been able to obtain financing sufficient in order to assure full raw material supplies for the production process in 2000. Therefore, the presented quantitative analysis indicates, with a probability bordering on certainty that if the tax proceedings had not been carried out, K operating activity would not have collapsed in 2000 (K would not have gone bankrupt).*[204]

364. Prof. Z provides a forecast for K from 2000-2010 on the basis of the Base Model showing that in a no tax proceedings scenario K would not have been expected to go bankrupt:

> *This forecast was made solely for estimating the Claimants' loss. The Base Model itself was sufficient proof that K would not have collapsed in 2000, had there been no tax proceedings. Because in our forecast we conservatively assumed no additional capital injections from its owners, K positive, safe equity level and positive cash in the forecast period were additional, strong evidence that without the tax proceedings K would not have gone bankrupt.*[205]

365. The Claimants submit that in accordance with Resolution No. 8/1999 of the Polish Commission for Banking Supervision if a company reported negative equity, its banks had to make provision amounting to between 50% to 100% of the total loans they had granted to the company.[206] The tax proceedings resulted in K reporting negative equity at the end of 1999,[207] which completely changed the company's negotiating position with banks and resulted in the loss of bank financing.

366. In his Supplemental Opinion, Prof. Z distinguishes between *in abstracto* and *in concreto* relation between reporting negative equity and losing bank financing:

> *According to the Expert Opinion's approach, reporting negative equity alone, i.e., in abstracto, was neither a sine qua non condition, nor a sufficient condition for K bankruptcy, but just an element which definitely increased the probability of losing bank*

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[204] *Ibid*, paras. 270-271.
[205] Supplement to the Expert Opinion of Prof. Z dated 19 August 2013, para. 99 (CE-751)
[206] CE-383, para. 4.2(2).
[207] The key finding of the analysis of the Base Model was that in the absence of the tax proceedings, K would have reported positive equity at the end of 1999. See Expert Opinion of Prof. Z , paras. 249-263.

> *financing. Nevertheless, combined with the banks' assessment of other risks connected with K tax proceedings (e.g., potential bank account seizures) and / or risks connected with criminal proceedings (e.g., the potential detention of K key managers), it definitely could have proved to be a sufficient condition for losing bank financing.*[208]

367. A similar conclusion was reached by Prof. S in his Review Opinion:

> *Even though K experienced financial distress during 1997 to 1999 as shown by its Z score, it did not become bankrupt until the bankruptcy event materialized. The bankruptcy event had been preceded by other events, i.e. the commencement of tax proceedings, tax provisions, the subsequent denial of access to bank credit and denial of preferential loans and the consequent inability of K to carry on its operations to generate cash flow to service its debt. These preceding events were the cascading events that led to the bankruptcy event which triggered K bankruptcy.*[209]

368. According to the Claimants, the link between wrongful acts of the Respondent and K loss of financing is confirmed by correspondence between the Respondent's agents:

> (i) *the letter dated January 20, 1999 from Mr. G M (the Respondent's representative in K Supervisory Board and the Director of the Department of the Finances of the State Treasury in the Ministry of the State Treasury) to Ms. B P (the then Director of the Tax Chamber in O): "I would like to point out the negative consequences caused by the unfavorable for the Company interpretation, of not entirely clear tax regulations, in particular due to the fact that actions of the Company in respect of interpretation of these problems were based on generally accepted principles in western European countries and correctness of performance was confirmed by annual audits of the renowned company – A A Sp. z o.o. An unfavorable decision of the Tax Chamber could cause the bankruptcy of the Company, which entails redundancies, suspension of contracting and purchase of rapeseed, i.e. a threat to the existence of farmers and planters and decrease in income to the state budget from taxes and fees. Such a decision can also have negative*

[208] Supplement to the Expert Opinion of Prof. Z dated 19 August 2013, para. 95 (CE-751).
[209] Prof. S Review Opinion dated 5 August 2013, para. 16; see also paras. 54-55 (CE-752).

repercussions among foreign investors, who attach great importance to the stability and clarity of the legal and tax system"(emphasis added);

(ii) *the letter dated January 9, 2000 from Adam Pęzioł (the then governor of Opole Voivodship) to Mr. Jerzy Buzek (the then Polish Prime Minister): "As it follows from the information obtained from the Mayor of the city of B , problems connected with the repayment of tax liabilities resulted in the suspension of credit lines for the purchase of production material by banks cooperating with the company. In consequence, contracts with farmers were terminated and the financial condition of the company has gravely deteriorated. Possible declaration of bankruptcy of the company will cause the increase of the unemployment rate in the B county which at the moment amounts to over 20%" (emphasis added);*

(iii) *the letter dated January 3, 2001 from Mr. Maciej Stefański (the then Mayor of B) to Mr. Jerzy Buzek (the then Polish Prime Minister): "Recently, the Tax Inspection Office in O , after the inspection carried out at K F ordered the company to pay over PLN 22,000,000. Problems related with the repayment of the amounts due resulted in the suspension of credit lines for the purchase of the production material by the banks cooperating with the enterprise, which in turn limited the activity of the plant to perform processing services on order of other oil processing plants. Thus, contracts with farmers were terminated and the plant is threatened by the prospect of bankruptcy";*

(iv) *the letter dated June 4, 2001 from Ms. Barbara Litak-Zarębska (the then Under-Secretary of State at the Ministry of the State Treasury) to Mr. Jan Rudowski (the then Secretary of the State at the Ministry of Finance); although admittedly Ms. Litak-Zarębska recognized that factors other than the tax proceedings influenced K financial situation, she unequivocally confirmed that the tax issue was the ultimate and decisive reason for cutting off bank financing: "The Tax Inspection Office has declined to recognize the costs incurred for the remuneration of the managing group as tax deductible costs. Decisions of the Tax Inspection Office led to gradual deterioration of the economic and financial situation of the Company and the tax*

> *penalties accrued as the result of the above caused the banks to reject the granting of credit facilities for the purchases.*[210]

369. In the Claimants' view, the banks were also aware of the risks associated with tax proceedings:

> (i) *the assessment of K creditworthiness dated September 14, 1998 prepared by B Ś S.A.: "(...) there is uncertainty with regards to the final outcome of the tax proceedings; assuming pessimistic option for the current and next years (spreading tax arrears into installments) PLN 38 million could be drawn from the company, which could significantly affect the financial liquidity";*
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> (ii) *an opinion of the P S.A.'s analyst with respect to K loan application submitted in 1999: "the loss on activity incurred in 1997 and a substantial influence on its appearance had sanctions imposed on the company by the Tax Inspection Office on account of excluding the expenditures borne on consulting and advisory services from tax deductible costs. Penalty interest as well as provisions on budgetary liabilities were established, jointly amounting to more than PLN 38 million";*
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> (iii) *the Report on the Client dated August 9, 1999, issued in connection with K loan application to P S.A.: "(...) in 1997 the Tax Inspection Office excluded the expenditures borne on consulting and advisory services from tax deductible costs and on this account tax liabilities were established for the years 1995-1996 in the amount of PLN 30 million;*[211]
>
> […]
>
> (i) *the statement of an employee of B Ś S.A. dated August 8, 2005: "At the end of 1998 [correct year 1997], the auditor ordered the creation of a reserve fund of approximately PLN 60 million [correctly circa PLN 38,000,000] for tax liabilities. I think it had to do with the results of the Tax Inspection Office. As a bank, we were forced into a corner. The situation of the company which had been generating profit for years suddenly changed to arrears – I do not remember the reasons for latter. From that*

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[210] Claimant's Reply Memorial dated 3 September 2013, para. 762.

[211] *Ibid*, para. 763.

moment on the process of monitoring the company's restructuring process started; given the amount of the incurred loss, this process turned out to be only theoretical";

(ii) *the statement of an employee of the B B S.A., dated December 17, 2004: "The company's financial situation at that time was tragic. The company was not in a position to act independently because it had no financial fluidity. As far as I know, it was the result of tax arrears, or at least this is what could have been concluded on the basis of financial documents. The tax arrears totaled approximately PLN 50 million. I think it resulted from the Tax Office's failure to consider as tax deductible certain expenses incurred, as I heard, in relation to marketing and advisory services."*[212]

370. The Claimants submit that the loss of working capital loans from banks meant that K was unable to purchase the raw material it needed to continue its production. The company was, therefore, forced to cease normal operations.

371. The Claimants' expert, Prof. Z , also created an Alternative Model, which reveals that even if the tax proceedings had conformed to standards of due process and concluded within a reasonable time, K would still have required a capital injection of at least PLN 15,000,000, to maintain the possibility of obtaining the necessary financing.[213] This Alternative Model confirms that the impact of the tax proceedings was substantial and could not have been easily overcome by K or the Claimants.

(iii) The causal link between the Respondent's actions and K collapse was not broken

K collapse was not attributable to its debt to equity policy

372. The Claimants rely on Prof. Z Supplemental Opinion in which he addresses the assertions of the Respondent's legal experts to the effect that K bankruptcy was caused by its debt-to-equity ratio, i.e. K high leverage policy and lack of equity capitalization made its position so fragile that even a slight worsening of

[212] *Ibid*, para. 764.
[213] Expert Opinion of Prof. Z dated 2 May 2012, para. 279 (CE-002).

conditions in 1999 would have led to K reporting negative equity value and therefore, losing bank financing. The Claimants state in their Reply:

(i) *"We noted that C Le line of reasoning was logically flawed because even if the "fragility argument" was true, it could not justify neither the conclusion that K debt-to-equity policy caused its bankruptcy, nor that the tax authorities' actions did not cause K bankruptcy. One can easily imagine that even with its debt-to-equity policy, K need not have been directly threatened with bankruptcy – as confirmed by numerous examples of highly levered companies operating undisturbed – until the occurrence of an extraordinary factor, such as the tax proceedings in K case. To better illustrate this issue, let us imagine the following situation: if John stood in water up to his chin, but was still able to breathe and counter the waves, and Bill pushed his head down - we would say that the cause of John's drowning was Bill's action and not the high water level".*

(ii) *"Regardless of the above, we examined the soundness of C L "fragility hypothesis". In regards to 1999, we noted that C L analyses were methodologically flawed: C L examined whether in a "no tax proceedings scenario" K equity would have been negative had the market conditions been different than they actually were. Such considerations lead nowhere as in reality without the tax proceedings K equity would have remained positive in 1999, as evidenced by our Base Model, whose correctness has not been disproved by C L ".*

(iii) *"In order to examine whether K bankruptcy in the years 2000 – 2004 was "highly probable", as stated in the Counter Opinion, we performed a comprehensive stress-test. We ran 5,000 simulations in which K Base Model revenue and EBITDA profitability fluctuated randomly according to appropriate standard deviations estimated for actual data reported in 2000 – 2005 by K , the Company's main competitor. It resulted that K default probability was below 5%, where default was defined as equity turning negative in any single year. Furthermore, even had the volatility of the Company's key parameters been twice as high as K (which was practically impossible), K default probability would have been lower than 24%. This led us to conclude that C*

L claim that even in the absence of the tax proceedings K bankruptcy was "highly probable", was "greatly exaggerated".

(iv) *"To support their Counter Opinion's main hypothesis, i.e., that K bankruptcy was caused by excessive leverage and inadequate equity capitalization, C L also claimed that K would not have gone bankrupt, had it been recapitalized with PLN 26.3 M in 1996. From a logical perspective, this argument is undoubtedly as much true as it is useless. Obviously had K had more cash and as a result, e.g., achieved Apple Inc.'s financial standing, it would have been immune to the subject actions of the tax authorities. However, this argument neither proves that the lack of recapitalization caused K bankruptcy, nor does it disprove that the tax proceedings caused it. If additional funds were necessary to counter the tax proceedings' effects, then it is the tax proceedings and not the lack of recapitalization that should be considered the cause of K bankruptcy. Deducing that the lack of recapitalization was the cause of bankruptcy in such a case makes as much sense as claiming that the cause of a shooting victim's death was this person's failure to put on a bullet-proof vest".*

(v) *"Probably despite the Counter-Opinion's Authors' intentions, the "recapitalization argument" proves rather the significance of the tax proceedings' impact than the lack thereof. This is because according to the subject argument, K would have required at least PLN 26.3 M to counter the tax proceedings' effects and this amount is undoubtedly considerable compared to K scale of operations".*

(vi) *"In Subchapter III.5 of this Supplement, we examine C L other allegations towards the Expert Opinion's causality analysis, that is allegations which we consider minor. We concluded that these allegations were also unfounded, either due to C L methodological errors, misinterpretations or incoherence with the source material."*[214]

[214] Claimant's Reply Memorial dated 3 September 2013, paras. 781-786.

K collapse was not attributable to its banks

373. The Claimants argue that the documentary record clearly shows that the banks were not only aware of the risks associated with the tax proceedings but that the loss of bank financing was a normal consequence of the Respondent's wrongful actions.

K collapse was not attributable to any negligent business decisions

374. The Claimants further submit that the Respondent's entire argument in this regard is copied from the indictment against Mr. B and Mr. M and not on any independent evidence. The Claimants point out that Messrs. B and M criminal liability is yet to be established and an indictment carries no legal weight. Furthermore, the Claimants argue that the indictment was based largely on the opinions of Ms. S , one of the chief officers of O tax authorities. In this regard, the Claimants rely on Prof. Z examination of Ms. S claims in relation to K business decisions. In the Claimants' view, Prof. Z has pointed out the numerous instances where Ms. S (i) gave definitive answers to questions she was not competent to address (for instance, the *ex-post facto* evaluation of K business strategy); (ii) failed to differentiate between losses, which result from admissible business risk and which result from negligence or bad faith; (iii) assumed that lack of documentation or lack of direct economic advantage meant that there was negligence or bad faith; and (iv) clearly exhibited an unsubstantiated negative attitude against K management.[215]

375. Further, the Claimants submit that Prof. Z also thoroughly examined K main business strategies from 1994 to 2000 including (i) investments in fixed assets; (ii) management system reorganization; and (iii) aggressive sales strategy and distribution system reorganization, and concluded that they were all within the scope of rational business decisions.[216] Even assuming, however, that some or all of these decisions were negligent or taken in bad faith, in accordance with the Base Model

[215] Expert Review of Prof. Z Concerning the Opinion of Teresa S , pp. 8-9 (CE-538).
[216] Expert Opinion of Prof. Z dated 2 May 2012, paras. 17 and 22-24 (CE-002); and Claimants' Reply Memorial dated 3 September 2013, paras. 813-819.

none of these decisions, jointly or cumulatively, would have brought about the collapse of K , according to the Claimants.

K collapse was not attributable to its bad faith or negligence during the tax proceedings

376. The Claimants submit that they consistently acted in good faith during the tax proceedings and rely on the expert opinion of Prof. G for the correctness of their and K behaviour during these proceedings. Prof. G states:

> (i) *"In my opinion, K tax proceedings were conducted with a bias. The tax authorities breached procedural rules, such as the obligation to reveal the "real truth" and the obligation to carefully verify and assess the probative value of the evidence gathered according to the free evaluation of evidence rule by: making unreasonable requests for evidence and rejecting evidence submitted by K on unreasonable grounds, questioning the tax deductibility of the Management Fees for various irrational reasons, making contradictory and incoherent conclusions, making no efforts to gather evidence favorable to K , disregarding K evidentiary motions, and shifting the burden of proof from themselves to K ".*
>
> (ii) *"The tax authorities also breached substantive law, i.e., they misapplied Article 15 sec. 1 of the Corporate Income Tax Law (the "CIT Law") by denying K the right to treat the Management Fees as tax deductible costs. The tax authorities also misapplied transfer pricing rules, i.e., in K tax proceedings for the fiscal years 1994-1996, the tax authorities completely ignored the procedure for assessing the market price of the Management Services and did not go beyond referring to Article 11 of the CIT Law as the only basis for excluding Management Fees from tax deductible costs. In K tax proceedings regarding the fiscal year of 1997, the tax authorities assessed the price of certain Management Services in violation of the rules specified in Article 11 sec. 3 of the CIT Law. In particular, the tax authorities narrowly defined the subject matter of the price assessment. Additionally, not all physical products of the Management Services were subject to the price assessment".*

(iii) *“Then, I have compared K tax proceedings with the tax proceedings conducted at W . It occurred that the cases were similar in all aspects, whereas the outcome of the cases was totally different. The same as in K case, W benefited from the Management Services provided by W Sp. z o.o. . The tax authorities raised the same allegations with respect to Management Fees both in K and W tax proceedings. However, the W case was finally settled by the tax authority of second instance favorably to W , whereas K tax proceedings lasted for many years and did not end up favorable to K ”.*

(iv) *“I also expressed an opinion on what the result of K tax proceedings would be if the tax authorities obeyed the procedural and substantive tax laws – in my opinion, K tax proceedings would have been settled favorably to K , as it was the case with W ”.*

(v) *“(...) The tax authorities should have acted in line with the law. That means the tax authorities should have obeyed the rule of law, the objective truth principle, the free evaluation of evidence and the burden of proof rule, as well as the obligation to gather evidence ex officio”.*

(vi) *“In particular, during the discovery phase of the proceedings, the tax authorities should have made efforts to reveal the “real truth” by taking an active role in gathering evidence, in particular hearing the foreign consultants who provided the Management Services to K ”.*

(vii) *“First, the tax authorities should have only made reasonable requests to submit additional evidence, e.g., the tax authorities would not request physical proof that the Management Services were provided but instead they would determine their scope by other means of evidence, including witness testimonies, correspondence, hotel and flight reservations. The tax authorities would accept items of evidence submitted by K and reasonably evaluated their probative value instead of rejecting evidence for absurd reasons, e.g., due to the lack of authorship of the reports drafted”.*

(viii) *“Second, if the tax authorities received general as well as partial agreements, they would explain their meaning according to the parties’ intention by other means of* *evidence instead of requesting pointless assignment of reports to particular agreements. They would also not investigate whether a report's title matches the subject matter of a partial agreement. Even if they would still raise the arguments that an agreement was antedated, this should have had no impact on K tax matters".*

(ix) *"Third, the evidence gathered would be evaluated according to the principle of free evaluation of evidence, i.e., with logical consistency and according to the rules of professional experience and common sense. For example, the tax authorities would examine employees' statements submitted by K to determine the facts of the case instead of rejecting them as unreliable due to the employees' alleged loyalty to K ".*

(x) *"Bearing in mind K active role in evidence gathering, the burden of proof should not have been shifted to K . If the tax authorities had some concerns with respect to any facts of the case, further research should have been performed".*

(xi) *"Summing up, the tax authorities would aspire to reveal the "real truth", meaning that they would also gather evidence favorable to K instead of setting traps for K and acting according to the popular communist maxim: 'Show me the man and I'll find you the crime'".*

(xii) *"If the tax proceedings had been conducted according to the above-mentioned rules, the tax authorities would have reconstructed the 'real' facts of the case, as was done in the W case. In particular, similar to the W case, the tax authorities in K tax proceedings would not have had any doubts that the Management Services had actually been provided".*

(xiii) *"If the facts of the case had been reconstructed according to the 'real truth', the application of substantive law would have led to a totally different outcome of the case".*

(xiv) *"In particular, the tax authorities would have noticed that the Management Services were indirectly related to K revenue. As a result, the Management Fees would have been found tax deductible, as it was the case with W ".*

(xv) *"If the tax authorities had any concerns with respect to the market value of the level of the Management Fees, the value of the Management Services should have been assessed according to rules specified in Article 11 of the CIT Law and in the MF Regulation. The outcome of such a price assessment is difficult to predict for me because it would require making calculations and a benchmark based on relevant data that I do not have access to".*

(xvi) *"However, even if it was determined that the Management Fees were not set at the market level, the Management Fees could still be deductible to the extent that they reflected the market price".*

"Summing up, if K tax proceedings had been conducted according to procedural as well as substantive law, the outcome of the tax proceedings would have been totally different. I think that the outcome would have been the same or similar to the case, i.e., the Management Fees would have been found to be tax deductible for CIT purposes. That would have protected K against the multimillion zloty CIT and VAT arrears, including penalty interest and additional VAT liability."[217]

377. The Claimants submit that K itself acted in accordance with Polish tax law and practice. In accordance with Polish tax law, a tax inspection usually commences with the examination of invoices and their comparison with entries in the books of the taxpayer. If these match, then this is sufficient evidence in the Claimants' view to treat expenses as tax deductible. In case any questions arise, the tax inspector can, of course, seek an explanation and where he is not satisfied, he may also seek additional evidence. The Claimants point out that prior to 2001, however, there were no rules or guidelines that required taxpayers to document related party transactions in any particular manner. The obligation to prepare so-called "transfer pricing documentation" was only introduced in the CIT Law on 1 January 2001. Even these rules, so the Claimants argue, did not require the preparation of transfer pricing documentation on an on-going basis. In the early 90s, the case law in Poland was also silent on this issue. The Claimants submit that it was only in the late 90s that case law

[217] Opinion of Prof. G dated 2 August 2013, pp. 76-78 (CE-753); and Claimant's Reply Memorial dated 3 September 2013 paras. 826-842.

on this issue began to emerge and it was only after 2000 that it could be said to be settled. According to the Claimants, the question this raises is – how could K have been expected to anticipate this case law (and the rules), which started to emerge 5 years after the Management Service system was designed?

378. According to the Claimants, even in applying this case law, however, the tax authorities were required to accept the evidence offered by K during the tax proceedings. For instance, K provided invoices relating to the Management Fees paid and maintained books properly. It offered additional documents including reports, tickets and hotel reservations, which in normal circumstances should have been sufficient to prove the genuineness of the Management Services arrangement. K even offered to produce witnesses (such as the consultants and the employees of K) who could explain the scope and significance of the Management Services.

379. The Claimants submit that the tax authorities in the O region, however, went far beyond what a taxpayer was required to maintain in accordance with the law and asked for documents which K was neither obliged to have, nor are usually created in the course of provision of such services. In the Claimants' view, to satisfy these allegedly arbitrary and abusive requirements, K had to prepare "back-up" documentation, including backdated agreements for specific Management Services previously rendered. According to the Claimants, this evidence was rejected by the authorities for irrational reasons. Contrary to the Respondent's arguments, this did not constitute forgery but was the only way K could comply with the requirements being imposed by the tax authorities.

380. The Claimants submit that they did not act in bad faith or negligently in structuring the Management Services. First, the Claimants state that the Management Services were provided. This is the only conclusion that could have been drawn by a person who properly considered the evidence provided by K , including, for instance, the statements of the consultants themselves. The Respondent has itself admitted in its

pleadings that the Management Services were in fact provided.[218] In fact, the Public Prosecutor admitted as much in his Decision on Discontinuation.

381. Second, as per the Claimants, the Management Services were beneficial to K . These services were an integral part of the negotiations of the Privatization Agreement (since such services were not readily available in Poland) and the Claimants' obligation to provide such services was confirmed in the Privatization Agreement. The Claimants relied on the statement of Mr. C H , who stated that the Management Services sought to

> *…provide know-how and experience of western management types* [sic] *consultants with broad management experience.* [....] *The main focus was to provide management of those companies with a strong background and to teach them western management style and techniques. The aim was not only to provide these companies with western business education and know-how, but also to teach them about the practical application of this knowledge; with the emphasis on increasing operating efficiency and profitability in order that the companies could successfully compete in Poland and abroad.*[219]

382. Third, contrary to the Respondent's assertions, the Claimants state that they did not make any profit off of the Management Services. While the Management Fees were intended to cover W cost of providing these services, at the end of the day they did not cover the total costs incurred, as confirmed by A A in its letter of 25 July 1997: "*In both 1994 and 1995, the management fees charged were not enough to fully reimburse the parent for its costs incurred. This resulted in a net loss at the parent and the management company entities. Or to say it another way, the subsidiary companies have been charged less than the services actually cost.*"[220] Even the tax decisions confirmed that 40% of the Management Fees were used for the maintenance of W , while the remaining was transferred to W .[221]

383. Fourth, the Claimants submit that the arrangement of the Management Services from the manner in which the Management Fees were calculated (as a percentage of sales)

[218] Claimants' Post Hearing Brief dated 6 June 2014, para. 26.
[219] Statement of Mr. H , paras. 24-27 (CE-755).
[220] CE-854.
[221] Claimants' Reply Memorial dated 3 September 2013, para. 865.

to the documentation of the services provided was in accordance with Polish law and international practice. According to the Claimants, this was confirmed by the following statements of the Claimants' witnesses:

(i) Mr. R – "*In considering the best method for calculating the remuneration for the Management Services, we took into consideration that many of the consultants would have to provide their services to more than one of our Polish investments, i.e. K , B , etc., at the same time. We consulted with A A and decided to choose a calculation method based on the percentage of the monthly sales of each investment. This methodology was a normal international standard and practice.*"[222]

(ii) Mr. M – "*Recognizing that the manner of charging the companies for services must comply with the Polish legal system as well as sound business and economic principles, S decided to carry out an analysis in order to establish the formula for the provision of the Management Services. Thus, A A was engaged and, following their consultations and advice, it was decided that the method to be used for the calculation of the management fees charged to each Polish company for provisions of the Management Services would be a percentage of the respective company's sales.*"[223]

(iii) Mr. H – "*This method for charging the Management Fees (i.e. the percentage of sales) was a method normally accepted in the U.S. and other developed countries and which had been discussed at length with, and considered acceptable by, A A .*"[224]

The Claimants cannot be blamed for not paying the restructuring fee

384. The Claimants submit that the Respondent's allegations regarding non-payment of the restructuring fee must be viewed in light of K financial standing and market position in 2002 and 2003. At that time, according to the Claimants, lack of bank financing and production breakdowns caused losses in the amounts of PLN 63,862,885.96 in the year 2000, PLN 108,522,721.01 in the year 2001 and PLN

[222] CE-007, para. 42.
[223] CE-008, paras. 41-42.
[224] CE-755, para. 29.

126,922,492.17 in the year 2002. In such circumstances, the Claimants submit that even if the restructuring fee may have been small compared to the total tax debt, one could not reasonably have expected K to throw such money down the drain.

385. The Claimants also argue that, the final decision on K restructuring was issued on 15 May 2013 – less than one month before its bankruptcy on 5 June 2013. Furthermore, the Claimants point out that payment of the restructuring fee was not the only condition for restructuring K debts and the re-payment of some of K outstanding amounts was also required.

Failure to obtain State-aid in the form of a loan

386. According to the Claimants, they cannot be blamed for not obtaining a loan from the Ministry of State Treasury due to the failure to present a coherent plan for K financing. K restructuring plan had to be agreed upon between the entities participating in the restructuring, including the banks and the court supervisor – the success of the plan was not solely dependent on the Claimants. Moreover, the Claimants point out that one of the conditions for financial restructuring was restructuring of K tax debt. In any case, the possibility of State-aid came long after K breakdown, i.e. at the end of 2002.

Withdrawal of K appeal to the Administrative Court in W was necessary for restructuring the Company's tax debt

387. The Claimants submit that the Respondent's argument that withdrawal of the appeal was not a necessary condition for restructuring K tax debts is incorrect. The Act on Restructuring of Public Receivables of 30 August 2002 requires a taxpayer who wants to have all of his tax arrears restructured to have his case resolved or the appeal withdrawn.

388. The Claimants state in K Restructuring Plan for the years 2003 to 2006:

> *Pursuant to the provision of Articles 15 and 16 of the quoted Act of 30 August 2002 on the Restructuring of Some Public Law Receivables from Entrepreneurs, wishing to include the disputable*

> *receivables in the restructuring, K F S.A. Management Board withdrew complaints filed in the Supreme Administrative Court against the decision of the Revenue Office in O concerning corporate income tax for 1996 and 1997. The copies of application filed in the Supreme Administrative Court for the withdrawal of the complaints are attached.*[225]

The Claimant's unwillingness to purchase K after 2000 did not contribute to its collapse

389. The Claimants deny that they were not willing to support K or that Mr. M rejection (on behalf of K I G LLC) of the opportunity to purchase K assets for PLN 107,000,000 shows that the Claimants were not willing to support K . According to the Claimants, the acquisition of the assets of a bankrupt company without any prospect of resuming its operations cannot be considered a reasonable business decision.

390. The Claimants further submit that the price of PLN 107,000,000 had nothing to do with the value that K could have obtained if it continued to operate after 2000.

Failure to accept that the Understanding of 2 June 2003 did not contribute to a failure of K restructuring

391. The Claimants submit that, as allegedly admitted by the Respondent, the Understanding of 2 June 2003 was not unreservedly accepted by all relevant parties and, indeed, the pleading submitted by K representatives to the bankruptcy court on 5 June 2003 (i.e. the day of the declaration of K bankruptcy) demonstrated that the Understanding was still not signed by some of the parties thereto.

(iv) Conduct of the tax proceedings

The tax authorities were biased against K

392. The Claimants submit that the tax authorities were biased and prejudiced against K . According to the Claimants, this is evident from the manner in which the tax

[225] RE-074.

proceedings were conducted. First, the transfer pricing rules were applied retrospectively. As early as April 1996, the Ministry of Finance issued Guidelines on the Manner and Procedure of Income Determination by Way of Estimation ("Guidelines"). These Guidelines were not binding on taxpayers and were for internal instructions only. They introduced four methods for determining the market price of related party transactions; methods, which were later introduced into Article 11 of the CIT Law on 1 January 1997. In the Claimants' view, the Guidelines made it possible for the authorities to apply these new rules without any change in Article 11 itself, which up until 1 January 1997 provided that the tax authorities should determine the price on the basis of average prices applied in the same location on the date of performance of the transaction. The Claimants submit that without legislative approval the tax authorities were able to apply the new rules retrospectively.

393. Second, according to the Claimants the tax authorities set unreasonable standards for providing documentation for the Management Services. For instance, according to the Claimants, the tax authorities insisted on being provided physical proof of the services, not taking into account that intangible services are not associated with physical proof. The Claimants allege that among the unreasonable requests made by the authorities was to identify the author of each work product marked with the letter or logo of W . K provided a list of 19 names, but the authorities wanted that each name be matched to a specific work product.[226] The Claimants refer to Mr. H testimony:

> (i) *The whole of W effort at that time was to be able to provide know-how and experience of western management consultants with broad management experience. At that time, such knowledge was not readily available on the Polish market; which is why the decision was made to engage these individuals. In addition, W organized seminars for K employees. By way of example, there was a four or five-d's Executive Education Department, which was attended by more than 20 top managers from S Polish companies. W provided K (and S*

[226] CE-196, p. 8.

other companies in Poland) with Management Services on a daily basis. It was a time-consuming and extensive development process.[227]

(ii) *The problem with the tax authorities reviewing K back-up information was that they looked at how many volumes of the documentation K provided; they looked for quantity instead of the quality of materials. Due to the nature of the intangible services and expertise provided on a daily basis by W personnel and the Consultants, it was not possible to provide the vast volume of written documentation that the tax authorities seemed to expect.*[228]

394. According to the Claimants, K for its part made its best effort to ensure that the documents submitted reflected the actual course of events and even asked W for help in putting together evidentiary material. The Claimants state that K took action to change the system of documenting the Management Services once the amended Article 11 of the CIT Law came into force on 1 January 1997. Reviewing this documentation, K tax advisors stated that "*[g]enerally, a significant improvement in the quality of documentation supporting the invoices can be observed. We believe that documentation regarding substance of the services rendered to B would be sufficient to justify the level of fees charged in most of third party or even related party relationships*"[229] and confirmed that it was not the method of documenting the Management Services but the prejudice of the tax authorities that led to the Management Fees being disallowed as tax deductible: "*You also have to take into account the historic aspect of charges between W and B and possibly existing prejudice of tax office in this respect the risk exists that – regardless of quality of documentation that may be provided – tax authorities will challenge the deductibility of these costs.*"[230] Ms. Ś statement that "*we suspected almost from the very beginning that these services might have been fictional, and even if performed, their purchase from W was not useful for the Company at all*"[231]

[227] Statement of Mr. H , paras. 24-26 (CE-755).
[228] *Ibid,* para. 33.
[229] CE-855.
[230] *Ibid.*
[231] Witness Statement of Ms. Ś , para. 23; Tr. Day 3, 60:8-20 and 168:1-22.

during the hearing confirms that the tax authorities approach the proceedings was biased.

395. Third, the Claimants submit that the tax and criminal authorities goaded each other on the issue of alleged siphoning of funds through groundless capital transfers from Poland to the U.S. under the guise of the Management Fees. According to the Claimants, it was the Public Prosecutor who, for instance, encouraged that tax authorities inspect the payments made by the Polish Investments to W for Management Fees. In the Claimants' view it was the tax authorities who also leaked such allegations to the press, leading to articles being published on the issue.

396. Fourth, the Claimants argue that the system of awarding tax inspectors bonuses linked to the tax arrears determined irrespective of the final outcome led to abuse, which was only enhanced by the immediate enforceability of tax decisions. According to the Claimants, the larger the tax arrears claimed, the larger the bonuses that were awarded. As a result, substantial bonuses were paid to Ms. M F and Mr. I S , the tax inspectors who conducted the tax proceedings for their findings against K .[232]

Due process was not afforded to K

397. The Claimants submit that the tax authorities refused to consider the evidence provided by K . They refused to accept the statements of K employees, who could have confirmed the utility of the Management Services, by arguing that these employees' views represented their private views, which would be influenced by the employment and loyalty to K .[233] According to the Claimants, they also rejected evidence such as receipts for air travel and accommodation of foreign consultants on the grounds that these did not establish that during the period of performance of the Management Services the persons were in Poland.[234] The tax authorities rejected

[232] Claimant's Reply Memorial dated 3 September 2013, paras. 972-977.
[233] Decision of Tax Chamber in O in appeal against decision No. PDII/730/B/1/99 issued by the Tax Office in B on 14 June 1999, p. 12 (CE-174).
[234] *Ibid*, p. 6.

documents submitted by W on the grounds that they were a third party who had nothing to do with the search for objective truth.[235] They also ignored the Claimants' invitations to examine the relevant documentation located in B . Finally and most importantly, the tax authorities did not examine the consultants who were most familiar with the Management Services and their importance to K despite a motion being filed by A A , on K behalf, on 14 August 1997 before the W Branch of the Supreme Administrative Court.[236] As observed by Prof. G :

> *It is also surprising that neither the tax inspection records nor the tax decision refer to foreign consultants' witness hearing records. This implies that no foreign consultants who provided K with Management Services were summoned as witnesses. The foreign consultants who provided Management Services to K were key witnesses in the tax proceedings as they were the most valuable sources of information about the scope and type of Management Services provided to K . The consultants could provide answers to many questions raised by the tax authorities, in particular, they could describe the nature of the services performed, explain why they were useful for K and why they could not have been performed by K employees.*[237]

398. The Claimants submit that in assessing the Management Services, the tax authorities also relied on expert opinions that were, according to the Claimants, erroneous, defective and were given by persons with no credible knowledge in transfer pricing. The Claimants submit that the result was that the conclusions reached were often ridiculous. For instance, in his first Opinion Prof. S estimated the value of a certain report without examining the items, which had been included in the cost estimate.[238] According to the Claimants, the tax authorities did not bother to look into the working and analysis behind these opinions.

[235] Tr. Day 3, 84:2-4.
[236] CE-869.
[237] Opinion of Prof. G dated 2 August 2013, p. 49 (CE-753).
[238] *Ibid*, p. 86 (CE-753).

K was discriminated against

399. The Claimants also submit that the tax authorities in P , dealing with similar *post facto* documentation supporting the Management Services provided to W , did not find the documentation unreliable and those tax proceedings were finalized in a positive manner for W .[239]

(v) The expropriation of the Claimants' investment was unlawful

400. The Claimants submitted that the Respondent did not fulfil any of the criteria in Article VII of the Treaty for a lawful expropriation. First, the expropriation was not for a public purpose. While the Claimants agree that taxes as a rule are imposed for a public purpose, the present dispute does not concern the legal framework of taxation but the concerted conduct of the tax and criminal authorities. The Claimants argue that the Respondent could not point to any specific public purpose that it was seeking to achieve. However, even if it could, the Claimants state that the expropriation in the present case violated the principle of proportionality which is implied in the concept of public purpose. According to the Claimants, the tax sanctions imposed on K and the initiation of criminal proceedings, which eventually resulted in banks ceasing their financing of K , were not proportional to the alleged purpose of preventing tax evasion.

401. Second, the Claimants submit that the expropriation was discriminatory when compared to the Respondent's treatment of W and W on similar facts and circumstances. W and K cases were comparable since in both cases:

(i) The tax authorities at the first instance relied on the same arguments to disallow deduction of the Management Fees and impose tax arrears;

(ii) The Management Services were provided through W ;

(iii) The Management Fees were calculated using the same methodology;

[239] Claimant's Reply Memorial dated 13 September 2013, para. 907.

(iv) Similar *post facto* documentation for the Management Fees was prepared; and

(v) Similar documentation was produced in evidence.

402. The Claimant submitted that a review of the decisions of the tax authorities at the second instance reveals that in W case the same arguments of the tax authorities were dismissed and the Management Fees held to be tax deductible costs, while in K the same arguments were upheld and the Management Fees disallowed as tax deductible costs.

403. Third, the Claimants argue, the tax proceedings violated the due process of law since the tax authorities allegedly:

(i) Violated the burden of proof principle by questioning the very method of calculating the Management Fees and placing an excessive burden on K to prove a direct link between each and every management service and a specific beneficial result for K ;

(ii) Made unreasonable requests for evidence and refused to consider the evidence provided on irrational grounds;

(iii) Disregarded K evidentiary motions;

(iv) Did not make an effort themselves to gather necessary evidence, which may have provided favourable to K ;

(v) Questioned the deductibility of the Management Fees on unreasonable grounds; and

(vi) Made contradictory and incoherent conclusions.

404. In the Claimants' view, the due process of law was also violated by the Administrative Court in W in the 1996 CIT and VAT proceedings, which despite not recognizing the need to examine foreign consultants in accordance with K motion, concluded that "*if the taxpayer* [i.e., K] *showed that the disputable*

intangible services were actually performed to its benefit, the expenditures on such performance would undoubtedly represent the tax deductible cost."[240]

(vi) Prof. S Opinion is flawed

405. The first major flaw in C L Opinion (whose team was led by Prof. S) according to the Claimants, is in its assessment of the impact of the tax proceedings on K collapse. According to the Claimants, in his first Opinion Prof. S simply ignored the issue entirely, apart from making a single statement that the tax proceedings did not cause the collapse of K . Since it was not possible to ignore the issue entirely without losing credibility, the Claimants submit that in his Supplemental Opinion Prof. S took tax proceedings into account, but stated there were several factors responsible for K negative equity at the end of 1999, of which the tax proceedings was the least significant. According to the Claimants, Prof. S was able to make such a statement by:

(i) Lowering the financial impact of the tax proceedings to only PLN 18.5 million. After the tax proceeding's effects first materialized in 1997, K had to establish provisions amounting to PLN 38.2 million, constituting approximately 8.1% of revenue for that year. K profit on sales for that year only amounted to 7.6% of its revenue. K , therefore, faced the threat of losing its entire operating margin if it started to repay it liabilities including investment loans. Had the tax authorities enforced their decisions, K would have had to pay much more than PLN 18.5 million. According to the Claimants, by ignoring these facts, Prof. S was able to lower the financial impact of the tax proceedings.

(ii) Ignoring the effects of the proceedings, which could not be quantified, such as losing the trust of banks, investors, suppliers, wholesale clients, employees etc. According to the Claimants, these had a major impact on K ability to

[240] CE-231, p. 11; and CE-297, p. 4.

operate from the time the tax arrears were first assessed until K bankruptcy.

406. The second major flaw in C L Opinion, as per the Claimants, is Prof. S assertion that K would have collapsed between 2000 and 2004 even without the tax proceedings. The Claimants submit that not only is this factually and methodologically incorrect, but that simply showing a high probability of collapse between 2000 and 2004 does not absolve the Respondent from liability. It is only if bankruptcy was inevitable at the beginning of this period could the Respondent be absolved from liability. According to the Claimants, Prof. S has not been able to show that that was the case.

407. In the Claimants' view, the third major flaw in C L Opinion relates to the arguments that were put forward to contest the Prof. Z conclusion that without the tax proceedings, K would not have gone bankrupt. These arguments are addressed by the Claimants as follows:

(i) The Claimants point out that the vegetable fats market recovered in 2000 due to K collapse.[241] According to the Claimants, this argument was only raised by Prof. S in his Supplemental Opinion after reading Prof. Z Supplemental Opinion in which he stated that part of the market recovery in 2000 could have been attributed to K collapse. The Claimants states that the purpose of this argument was to undermine K growth forecast after 2000 by showing that it was in fact not tied to market conditions. While K did have a 20% market share before 2000, it continued to operate in 2000 and only gave up around 6.1% of the refined oil market and 9.6% of the margarine market in 2000 – numbers that were too insignificant to result in a significant improvement in competing companies results. According to the Claimants, what is more important and what has been ignored by Prof. S , however, is that the entire market was entering a new growth phase and showed a 6% year on year increase from 1999 to 2000. The vegetable market's recovery was

[241] Claimants' Post-Hearing Brief dated 6 June 2014, para. 156.

confirmed in the market report published by the Polish Ministry of Agriculture and Rural Development.[242] In the Claimants' view, the reasons for the growth included (1) an increase in average vegetable fat consumption per capita in Poland (31% higher than the total increase in the previous two years); (2) a decline in rapeseed production in 1999, which led to higher margins in 2000; and (3) the convergence of the Polish economy with Western Europe and resulting decrease in the cost of debt, which allowed companies to borrow cheaply.

(ii) In the Claimants' view, considering K results for 1999, Prof. Z forecast of K performance in 2000 was too good to be true.[243] The Claimants point out that the entire sector's results improved in 2000 and some companies even reported record-breaking results. No reason was given as to why K would not have taken advantage of this general trend. The Claimants submit that in fact, given K competitive advantages, it was well placed to take benefit from this general trend.[244] In this regard, the Claimants submit that K operating costs in 1999 were burdened with several one-off non-recurring items such as its cooperation with J M , LDS B , W R (to temporarily supplement K margarine production capacities due to increased demand), and purchasing rapeseed above market prices (as a direct result of the tax proceedings), which should not be taken into account when forecasting its future growth.

(iii) According to the Claimants, the argument that had K paid the Management Fees in 1998 and 1999 it would have had to report negative equity in 1999[245] is incorrect. When W stopped charging the Management Fees after 1997 because of the tax proceedings, there is no reason why it would have charged such fees if K positive equity and bank financing depended on it.

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[242] *See* RE-030.
[243] Claimants' Post-Hearing Brief dated 6 June 2014, para. 172.
[244] *Ibid*, paras. 175-182.
[245] *Ibid*, para. 183.

(iv) Since even in the absence of tax proceedings, K would not have met loan covenants with one of its banks, its loans would have been revoked by banks in any case.[246] In the Claimants' view, this argument misconstrues the relationship between banks and companies. Banks do not terminate loans only because companies do not precisely meet contractual covenants – rather they use this to renegotiate terms and increase their margin. In fact, K failed to meet this particular covenant from the very beginning and was still granted the loan.

(v) In order to claim damages, the Claimants have to show that K would not have collapsed in any year between 2000 and 2004.[247] This argument is based on an incorrect reading of the principle of liability. For instance, if K had collapsed in 2000 or 2001, as it did due to the tax proceedings, it would not absolve the Respondent of its liability because "*to claim otherwise would be like claiming that the killer of a 75-year old woman should not be held accountable, because statistically speaking she would have died anyway in the course of the next 4 years.*"

b. Respondent's position

(i) Standard for expropriation

408. The Respondent submits that the taxation measures at issue in the present arbitration were *bona fide* and that this is dispositive of the Claimants' entire expropriation claim. According to the Respondent, the Claimants' main contention is that these measures were not *bona fide* because they were part of a broader pattern of arbitrary and abusive conduct of the Respondent's organs.

409. The Respondent submits that first, the mere fact that simultaneous actions were taken by various State organs all acting within the confines of their jurisdiction and competence does not prove that there was concerted action on the part of various State organs.

[246] *Ibid*, para. 184.
[247] *Ibid*, para. 186.

410. Second, the Respondent argues that bad faith cannot simply be presumed on the part of the State authorities. In the present case no proof of bad faith on the part of the Respondent has been offered.

411. Third, the Respondent submits that the Claimants are wrong when they argue that the intent of a Host State when applying a particular measure is irrelevant when considering whether there has been an expropriation. The Respondent submits that the sole effect doctrine cannot be applied without reservation in the case of alleged *mala fide* tax measures. In the Respondent's view, a tax applied by a Host State in good faith cannot be regarded as a measure of expropriation, regardless of its effect on an investment. In this regard the Respondent relies on the Tribunal's finding in *RosInvestCo UK Ltd. v. Russia* that "*States have a wide latitude in imposing and enforcing taxation laws even if resulting in substantial deprivation without compensation.*"[248] Only a taxation measure applied in bad faith with the intention of depriving an investor of his investment or inflicting undue harm on the investment can be considered an act of expropriation. This was the case in both the *RosInvestCo*[249] and *Quasar de Valores et al.*[250] cases, where the Tribunals found that the intended purpose of the Host State's measures such as removing assets from the control of the company, or seizing and selling its shares, was to expropriate the investment.

412. The Respondent submits that the tax authorities only collected PLN 11 million out of more than PLN 55 million in tax arrears of the company. They were willing to waive off 95% of the debt of the company under the 2002 amnesty.[251] According to the Respondent, this clearly shows that the Respondent's various organs were not acting with the purpose of expropriating any investment.

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[248] *RosInvestCo UK Ltd.v. Russian Federation*, Final Award of 12 September2010, SCC Arbitration V (079/2005), para. 580 (CE-757).
[249] *Ibid*, para. 621.
[250] *Quasar de Valores SICAV S.A., Orgor de Valores SICA V S.A. v. Russian Federation*, para. 128 (RLA-095).
[251] Through a decision dated 23 October 2002, 85% of the company's principal CIT and VAT arrears were cancelled as was 100% of the corresponding tax interest on account of delay in payment. As such of the total amount of PLN 50.7 million in tax arrears, the tax authorities were willing to waive of PLN 47.7 million.

413. The Respondent submits that when considering a claim for expropriation, the Tribunal must consider whether or not the Respondent appropriated the investment. This can be a decisive factor in a finding for or against expropriation. The Respondent relies on *Olguín v. Paraguay* where the Tribunal states that "*For an expropriation to occur, there must be actions that can be considered reasonably appropriate for producing the effect of depriving the affected party of the property it owns, in such a way that whoever performs those actions will acquire, directly or indirectly, control, or at least the fruits of the expropriated property.*"[252] According to the Respondent, similar reasoning was adopted by the Tribunal in *Lauder v. Czech Republic*.[253]

414. The Respondent further argues that expropriation requires permanent deprivation of an investment. Even though K found itself in a state of technical insolvency in 2000, there were several prospects for restructuring the company, including a waiver of its bank debts and public charges and a settlement with its creditors, so the Respondent submits. The Claimants appear to take the position that from mid-2000 onwards the loss to them was permanent. This, however, in the Respondent's view, is belied by the Claimants' own actions and substantial efforts from 2001 to 2003 to resuscitate the company. The Respondent asks if there was no expectation of commercial viability and a permanent deprivation had taken place, why would the Claimants have expended such effort?

415. In this regard, the Respondent submits that a simple lack of access to bank funding does not imply expropriation. According to the Respondent, the Claimants' entire case is premised on the argument that K collapsed in mid-2000 because it was unable to obtain bank financing, which would have allowed it to purchase raw material for production. The Respondent states that the problem with this argument is that external bank funding is only one of the many options that a company has to finance its commercial activities. In fact, the documents produced by the Claimants reveal that in early 2000 the E and S were both discussing various options for

[252] *Eudoro Armando Olguín v. Republic of Paraguay*, para. 84 (RLA-036).
[253] *Ronald S. Lauder v. Czech Republic* (CE-667).

increasing their investment in K , such as issuance of new discounted shares or providing a shareholder's loan.[254] It is, therefore, clear that there were other means available to K to continue its business. The situation in the present case resembles that in the *Nations Energy* case, where the investors also alleged that tax measures led to the bankruptcy of the company because of an inability to raise financing; the Tribunal found that even if the tax authorities had acted unlawfully in disallowing the transfer of tax credits, this did not amount to an expropriation.[255]

416. Finally, the Respondent contests the application of the principle of proportionality as asserted by the Claimants. The Respondent argues that the Claimants' reliance on the *Occidental v. Ecuador*[256] case was misplaced since the facts in that case were different. In *Occidental*, the State took the most drastic action possible by terminating the concession agreement, and it did so even though other less severe alternatives were available to it. In the present dispute, the Respondent submits that the tax liabilities of K arose by operation of law, as did the penalties and late interest payment charges thereon. The Respondent points out that this was not a matter of discretion for the Respondent. The Respondent, however, also argues that the Tribunal's decision in *Occidental* was not correct since as long as the sanction was within the competence of the relevant State organ under domestic law, the State should be allowed to exercise its sovereign power to shape State policy. According to the Respondent, an international investment tribunal is not in a position to make such a policy judgment.

(ii) K insolvency was not caused by the Respondent's actions

417. The Respondent argues that the Claimants have failed to establish a link between a specific international wrongful act of the Respondent and a specific injury as mandated by Articles 31(1), 31(2) and 34 of the ILC Articles on State Responsibility. In this regard, the Respondent submits that the Claimants have referred to a series of

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[254] *See* e-mail from Mr. M to Ms. M dated 7 March 2000 (RE-257); letter from Mr. R to Mr. P dated 9 July 2000 (RE-258); and letter from Mr. R to Mr. P dated 19 July 2000 (RE-259).

[255] *Nations Energy Inc., Electric Machinery Enterprises Inc. and Jaime Jurado v. Republic of Panama*, paras. 673 and 687 (CE-829).

[256] *Occidental Exploration and Production Company v. Republic of Ecuador* (CE-603).

alleged illegal acts - the bias of tax officers, the refusal to examine witnesses, and unreasonable requests for documentation among others. According to the Respondent, the Claimants, however, fail to explain what specific injury was caused by each of these allegedly wrongful acts. For instance, the Respondent points out that the Claimants fail to explain whether some or all of the tax officers were biased and what, if any, was the effect of that. They also fail to explain whether every, or only some, tax decisions rendered against them were tainted with bias. The Claimants' analysis is missing how each of these acts contributed to the collapse of K . Instead, the Claimants adopt a global approach, i.e. that the totality of the measures caused the damage. This position is simply not tenable, which is why the Claimants place such emphasis on allegations of bias. The allegation of bias, however, presupposes a wilful intent at the beginning of the proceedings and this argument of the Claimants has at least four substantial weaknesses according to the Respondent:

(i) It has not been proven through any direct evidence;

(ii) Given the sheer number of tax proceedings and the number of tax officials involved in B and O , the alleged bias would require some form of collective prejudice, which, in the absence of strong proof, cannot simply be presumed;

(iii) It is contradicted by contemporary evidence including the Memoranda of Mr. M dated 23 and 25 July 1997[257] and the notes of A A and other tax counsel of K , which suggest that serious irregularities were discovered in the documentation of the company only incidentally[258] and not as part of a bonus-driven witch hunt; and

(iv) It fails to explain why such bias was not corrected by the higher forums such as the Supreme Administrative Court or the Tax Chamber in W .

[257] Memorandum from Mr. M to Mr. P dated 24 July 1997 (RE-241); Memorandum from Mr. M to Mr. R dated 23 July 1997 (RE-260).
[258] CE-887 and CE-888.

418. The Respondent submits that the Claimants' theory of causality was premised almost entirely on the Expert Opinions of Prof. Z . These Opinions, however, in the Respondent's view, are not credible because Prof. Z failed to show that K became bankrupt because of the tax proceedings; his Opinions show a lack of knowledge and disregard of the actual conditions in which K operated; and his opinions included fundamental contradictions and errors.

419. According to the Respondent, the first critical flaw in Prof. Z Opinions is that they fail to show that the company would not have gone bankrupt in mid-2000 in the absence of the tax proceedings. The Respondent points out that his causality analysis ends on 31 December 1999, whereas the relevant date is mid-2000, i.e. six months later. The first key assumption of the Base Model is that it assumes that all aspects of the company's performance would remain unchanged save the tax proceedings and their effects. Such an assumption fails to take into account the hypothetical Management Fees that K would have paid in 1998 and 1999 and which the Claimants admit it did not pay because of the tax proceedings. C L clearly showed that if such fees were taken into account, the company would have reported a negative equity value at the end of 1999.

420. The Respondent points out that more importantly, however, for the purpose of the Base Model, Prof. Z assumed that nothing would have changed after 1 January 2000; i.e. in the manner in which the company operated, its performance of contracts, its expenditure in core areas, would have all remained the same. The Respondent submits that this fact is of critical importance since the positive book value of K even in the Base Model eroded from PLD 122 million in 1996 to PLN 11 million in 1999. According to the Respondent, Prof. Z fails to explain how this dramatic fall in the company's equity, which started in 1997, would have stopped in 1999 but for the tax measures. Given that the company was burning equity in 1999 at the rate of PLN 6 million per month, it can be assumed that the company's equity would have been significantly below zero by 30 June 2000.

421. In the Respondent's view, this loss in equity was caused by nothing other than the flawed economics of K , including its debt to equity structure, inefficient organization, exorbitant expenditures, flawed rapeseed acquisition policy and bad contracts.

422. According to the Respondent, none of these issues would have been suddenly resolved after 1 January 2000. K did not take any measures in this regard. The Respondent argues that the months after 1 January 2000 should, therefore, have been taken into account in the Base Model and if they had, the company would have continued its downward spiral in 2000 in the absence of the tax proceedings. The Respondent submits that given the low level of equity at the end of 1999, it would have gone into bankruptcy within these six months.

423. A second critical flaw in the Opinion, in the Respondent's view, s is that they are based on two very different versions of K . The Respondent points out that the first K is supposed to replicate the historical performance of the company in the absence of the tax proceedings. This simulation ends on 31 December 1999 and its purpose is to show that in the absence of the tax proceedings, the company would not have collapsed. The Respondent further points out that the second K came into existence after 1 January 2000 for the purposes of quantifying damages. The difference between this K and the first K is the former's ability to generate more revenues (PLN 515 million for the year 2000) at lower costs. The level of correction performed on the cost levels of the company by Prof. Z amounts to over PLN 60 million per year. Prof. Z justifies this on the basis that the performance of the first K was effected by certain one-off non-recurring events in 1999, in the absence of which the cost of sales and administrative expenses of K would have decreased by over PLN 60 million.

424. The Respondent contests this view of the year 1999 as a one-off and argues that it was in fact in line with the way the market had been developing through the 90s – flat consumption, surplus production capacity and fierce competition. In the Respondent's view, disregarding the events that occurred in 1999 and how they affected the

company's revenues contradicts the basic assumption underlying the Base Model, i.e. that all factors other than the tax proceedings were to be included. The result is that Prof. Z analysis, rather than showing that K would not have gone bankrupt in mid-2000 in the absence of the tax proceedings, shows that an entirely different company (the second K) would have performed spectacularly in 2000. Prof. Z fails to explain how the company would have turned its fortunes around in this manner.

425. According to the Respondent, Prof. Z analysis was also plagued by the following inconsistencies and contradictions:

(i) He was unable to identify the main competitors of K with respect to its key products, margarine and oil, and as a result did not include U , the principal competitor of the company, in his analysis;[259]

(ii) He was unable to explain the basic assumptions behind his alternative model and admitted not to have read the documents relating to the tax proceedings;[260]

(iii) He was not aware why K had been recapitalized by its shareholders, even though the information was on record;[261]

(iv) He did not know how the market forecast its future in 1999;

(v) He failed to analyse key loan agreements entered into by the company such as the US$ 22 million BSK loan, which imposed certain obligations on K with respect to its debt-to-equity ratio and which K failed to meet, thereby creating a technical default with a major lender; and

(vi) Several key assumptions made by him were undermined by Mr. R during his cross-examination. For instance, Mr. R was clear that U was

[259] Tr. Day 5, 43:1-8.
[260] *Ibid*, 111:17-18 and 112: 5-6.
[261] *Ibid*, 34:17-19: "*So we exactly don't know what was the objective of the injected capital, injected twice.*"

K main competitor and not K ;[262] Mr. R was clear that there was no expectation on the Polish rapeseed market that it would significantly improve in 2000 or 2001;[263] and Mr. R was clear that Poland was a stabilized shelf-market with no significant growth potential.[264]

426. The Respondent submits that Prof. Z cross-examination revealed the errors in his conclusions, in particular his attempt to show that K bankruptcy was caused by the tax proceedings by reference to the book value of the equity. The Respondent submits that realizing this Prof. Z began to dilute his reasoning with increasingly less believable explanations such as the Base Model only being a model for the worst-case scenario. The Respondent argues that it is not the role of the damages expert to establish the worst-case scenario, but to establish the most probable scenario. Moreover, the Respondent submits that what all the explanations that he put forward have in common is that they are based entirely on speculation and assumptions which are impossible to conclusively confirm or deny and which cannot form the basis of an arbitral award.

(iii) Reasons for K bankruptcy

427. According to the Respondent, the primary reasons for K bankruptcy were (i) an aggressive debt leverage policy resulting in high financial costs for the company; (ii) the inability of the company to generate sufficient cash flows to cover operating and financial costs; (iii) the lack of any restructuring; and (iv) the failure to recapitalize the company. All of these were compounded by unfavourable market conditions.

428. The Respondent submits that between 1994 and 1998, K implemented a capacity extension program. To this end, the Respondent points out that in the Privatization Agreement, the investors committed to a US$ 38.3 million investment program. Mr. R in his letter of September 1994 refers to a US$ 35 million investment program.

[262] Tr. Day 2, 84:4-6: "*U was the major competition, and it was U and ourselves who were battling out for market share.*"
[263] *Ibid*, 94:15-25.
[264] *Ibid*, 41:7-9.

The actual cost of the investment program between 1994 and 1997 was US$ 54 million. Prof. Z states that the company spent over PLN 201 million in investment between 1994 and 1998.[265]

429. The Respondent points out that according to Mr. R , the Claimants expected to be able to finance part of the investment program with a US$ 10 million injection while the remaining amount was expected to be generated from K internal cash flow. The Respondent submits that the company's financial statements, however, show that the gross profit for the year preceding the investment was PLN 14.35 million (approximately US$ 5 million). According to the Respondent, the company could not finance the investment program through internal sources. The Claimants were, so the Respondent submits, faced with three choices: (i) default on their contractual obligations under the Privatization Agreement; (ii) recapitalize the company with equity; or (iii) increase the debt leverage. The company chose the third option and financed the investment program with bank loans carrying an interest of between 15-25% per annum. This imposed a financial burden on the company above and beyond the usual cost of raising external financing each year for the acquisition of rapeseed in July and August. As a result, the company entered a downward spiral of debt financing which by 1999 exceeded any rational debt-to-equity ratio according to the Respondent.

430. The Respondent states that by the time this program was completed in 1998 the market conditions had changed. Most of its competitors had also completed similar programs, while consumption had stagnated. The result was increasing competition and price wars in 1999 and 2000, which, according to the Respondent, resulted in the elimination of K and B from the market. K demise was only accelerated by bad management decisions including the acquisition of rapeseed at above market price.

431. Equally important, in the Respondent's view, was the company's failure to recapitalize. While the Claimants argued that the reason they did not inject further

[265] CE-002, para. 14.

capital into the company was because of the tax proceedings, in actual fact W had already exhausted the equity contributed by its partners and further capital could not be raised because of issues relating to the valuation of the partnership.[266] Moreover, the Respondent states that the market in Poland at the time was not an attractive option for investment.

432. According to the Respondent, the Claimants' own actions contributed to the magnitude of its tax problems. The Claimants' actions (or inaction) resulted in a snowball effect that eventually made the tax problems unmanageable. The Respondent contends that it was possible for K to pay the arrears immediately, thereby capping the interest at a relatively low level and saving its investment incentives. This could have been done as early as the Memorandum from A A in July 1996 alerting Mr. H and Mr. M that the Management Fee scheme was dubious and likely to have tax consequences.[267] The Respondent points out that Mr. M is on record saying that the company felt that it did not owe the taxes and therefore, as a matter of principle, it was decided that funds would not be provided to K to pay taxes, which were not due.[268] Leaving aside whether this view was justified, the Respondent submits that the result was that the company did not take any action to mitigate the effects of the adverse tax decisions and the tax arrears and interest thereon continued to grow until it reached an unmanageable level.

433. Similarly, so the Respondent states, the company did not follow its tax counsel's advice and pay the arrears in 1999 because the amounts were allegedly significant. This, however, ignores the fact that (i) the ability to raise funds on short notice was part of the company's business, i.e. it raised almost US$ 45 million each year for the rapeseed acquisition campaign;[269] and (ii) the company had made a provision for the tax arrears in April 1998. The whole purpose of a provision is that a company reserves the financial means to pay the liability.

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[266] As confirmed by a letter from Mr. R sent in June 1997 before the tax proceedings came to his knowledge (RE-263).
[267] Memorandum from A A to Mr. H dated 7 August 1996 (RE-270).
[268] Tr. Day 2, 179:24-25,180:1-4.
[269] *Ibid,* 42:10-13.

(iv) Conduct of the tax proceedings

434. According to the Respondent, the central issue before this Tribunal is whether the tax proceedings were consistent with international law. In the Respondent's view, this Tribunal has to decide whether it is surprising, shocking, unfair or unjust from an international law perspective that the company lost the tax case. The record of the tax proceedings show that the company was transferring exorbitant fees to a newly established entity – W – in consideration for non-material services for which the company kept no record. According to the Respondent, that the company lost the tax case in these circumstances is hardly surprising.

(v) Insufficient record keeping

435. According to the Respondent, the principal reason the company lost the tax dispute was because its record of the Management Services was deficient. This was recognized as a key issue, by the Supreme Administrative Court in W , in its two judgments of 10 August 2000, with respect to the 1995 proceedings.[270] Where the provision of services was properly documented, such as in the case of the company's expenses on services provided by E Y in 1996, they were allowed as CIT tax deductible.

436. In most instances, so the Respondent argues, the company was unable to provide reliable evidence that the Management Fees were actually paid in return for services rendered. According to the Respondent, the company then attempted to conceal its failure to keep any records by fabricating antedated records. In the Respondent's view, for instance:

> (i) *Most records of the provision of Management Services in 1994 and 1995 in the possession of the Company at the time of the tax inspection were fabricated agreements, cost estimates and cost reports, which described fictitious services and were signed by a person who only became W proxy on 8 December 1995.*

[270] CE-231 and CE-296.

(ii) *Some of the documents were manifestly untrustworthy, e.g. because they attested time-entries of W consultants exceeding 24 hours of work per day.*

(iii) *During the tax inspection regarding the 1997 CIT arrears, the Company was unable to present even copies of the agreements under which the services were allegedly provided by W , not to mention any documents proving that the services were genuinely rendered.*

(iv) *When it finally provided these documents, two months after the original request by the tax inspectors, it turned out that: (a) some of the documents had no reference to the content of the service agreements; (b) other were prepared by Company's employees, sent to S /W and then, after being rubberstamped by W , submitted as evidence of the services allegedly provided by the latter; whereas yet another part of them (c) was already submitted to the tax authorities as evidence of the services allegedly provided in 1996. Moreover, the documents were delivered to the tax authorities in such pristine condition that it gave rise to legitimate doubts as to whether the documents had ever been read. The fact that these documents were created within the Company and rubberstamped by W was actually pointed to the tax inspectors by a former chief of controlling at the Company.*[271]

437. In the Respondent's view, the scarce and fabricated evidence presented by the company contrasted with the exorbitant Management Fees paid. The Respondent points out that the lack of documentation was highlighted by a partner at A A , the company's tax counsel, in a letter of 15 October 1997[272] stating that:

(i) His team "*received virtually no documentation supporting the charges, made to B ;*"

(ii) The support from the company "*is not adding much substantiation in the area where the tax authorities addressed their problems in accepting the charges;*" and

[271] Respondent's Rejoinder dated 20 March 2014, para. 189.
[272] RE-155.

(iii) Given these circumstances, A A help in a court case "*could be very limited.*"

438. The Respondent points out that in 1999, after the Tax Chamber upheld the Tax Office decision relating to the 1995 arrears,[273] A A advised the company not to file an appeal before the Supreme Administrative Court because of the poor documentation provided by the company and the thorough work done by the Tax Office.[274] The company ignored this advice, challenged the decision and lost.

439. According to the Respondent, at the hearing Mr. R was forced to admit that the company did not have the proper documentation:

> *…we got caught between a way, a methodology that we were using, and the Polish laws, and we didn't - - we blew it. We didn't have proportionately what we should have. And then faking documents or backdating documents is obviously the company trying to cover up for not having the documentation. On the other hand, we didn't know about the documentation when we started.*[275]
>
> […]
>
> [Q:] *As an experienced businessman, in other investments have you seen tax authorities from - - do you think there was an obligation by the Polish authorities to go to Boston, or was it your obligation to keep the records in Poland, at the Polish company that made the expenses?*
>
> […]
>
> *A. The documentation should have been in Poland.*[276]

(vi) Unreasonable requests for documentation

440. According to the Respondent, the Claimants laid great emphasis on the tax authorities' alleged unreasonable requests for documentation. The Respondent submits that the objective of the tax authorities was to clarify the facts of the case and to do so they

[273] CE-221
[274] RE-153.
[275] Tr. Day 2, 57:23, 58:5; see also 43:23-25.
[276] *Ibid*, 109:6-11, 110:10.

legitimately exercised their investigatory powers and asked questions relating to the Management Services. The questions asked by the tax authorities were reasonable in the Respondent's view: how were payments allocated to W for specific services? Who were the consultants? Which consultants authored the reports submitted to the tax authorities? What is the proof that the specific services were provided? What was the contractual basis for the provision of these services?[277]

441. The Respondent argues that in accordance with Polish case-law, legal doctrine and the practice of tax authorities, the burden to prove that certain expenses were incurred and can be deducted for the purposes of CIT rests on the taxpayer. Only the taxpayer has the information required to establish whether such a deduction is justified. The Respondent points out that Article 15.1 of the CIT Law requires proof that a service was in fact provided and that there is a link between the cost and the generation of revenue. Only the taxpayer can establish both.

442. According to the Respondent, on the one hand, the Claimants argue that the tax authorities had no legal basis to ask for anything beyond the mere proof of payment of Management Fees. On the other hand, they argue that the tax authorities did not conduct an exhaustive investigation. The Claimants also argue that requests for the identity of consultants and requests for assigning authorship of particular work to individual consultants were unreasonable. The Respondent also points out that the Claimants further emphasize that the tax authorities refused to question the foreign consultants. The Claimants, however, fail to explain how the tax authorities were supposed to question them, if, according to the Claimants interpretation of the law, the tax authorities could not even ask for the identity of the consultants.

443. The Respondent submits that when the Claimants eventually disclosed the identity of some consultants, they provided neither their contact addresses nor specified the scope of the work they had done. According to the Respondent, the record reveals that in 2011 Mr. M was unable to recognize the names of some of the individuals who

[277] Respondent's Rejoinder dated 20 March 2014, para. 197.

had been shown as consultants to the tax authorities.[278] The Claimants also allege that their motions to hear the consultants were disregarded, but only rely on a single motion filed on 14 August 1997. The Respondent asks if the Claimants believed that the statements of foreign consultants were so important, why did they only file a single motion in only one of seven tax proceedings?

444. The Respondent submits that the motion of 14 August 1997 is itself couched in such general language that it is of no use – it does not specify witnesses that should be examined and it does not specify the scope of their testimony. The Respondent submits that when it responded to the Claimants' allegation that the tax authorities disregarded motions to hear five witnesses by showing that these five witnesses were examined, the Claimants changed tack and argued that examination of these five witnesses was insufficient. Had the examination been insufficient, so the Respondent contends, the Claimants could have used their right to ask the witnesses questions to bring out any facts, which were not brought out in the tax authorities' examination. They did not. Instead, the Claimants rely on their subjective feeling of dissatisfaction with the outcome of the tax proceedings to argue that the proceedings constituted an international wrongly act.

445. The Respondent submits that the use of fabricated and antedated documents by the Claimants in the tax proceedings also calls into questions the Claimants' credibility. According to the Respondent, its position in relation to these documents is corroborated by the Memorandum dated 23 July 1997 from Mr. M to Mr. R ,[279] which discloses that:

> *(i) the Claimants were aware that ex post fabrication of documents for purposes of tax proceedings, including backdating, was contrary to the Polish law and that it would inflict complete loss of credibility of the Company in the tax proceedings, (ii) that backdating of the consulting agreement between the Company and W was done contrary to the specific legal advice of the then Polish counsel of W and that as the result of that backdating, that legal counsel withdrew from representing the client (sic!), (iii) that nobody at the*

[278] Letter of Mr. M to Prosecutor J dated 29 April 2011 (RE-267).
[279] Memorandum from Mr. M to Mr. P dated 24 July 1997 (RE-241).

> *Company was able to provide the tax authorities with a good explanation, which services contracts were in force with respect to the alleged Management Services; (iv) that according to A A (the then tax counsel of W), provision of non-material services in the context of cross-border transfers implied the need to provide Polish authorities with detailed evidence of the services provided, (v) that the tax counsel was involved lately in the tax inspection - A A was not in the Company when the tax inspection arrived and its offer for assistance was initially refused, (vi) that the chances of success of the Company in the tax proceedings were described as "very remote" and were believed to hinge on the ability of W to find strong and persuasive evidence of the services provided. The Memorandum also reports a rather disillusioned assessment of the Company's position by an A A partner: "he has never seen such a poor case- he stated that 'everything was done wrong'". This is echoed by the words of S D. M , the author of the Memorandum: "Our options at this point are not very good."*[280]

(vii) Irrelevance of the question whether the Management Services were provided

446. The Respondent argues that the question of whether or not the Management Services were provided is irrelevant to the present dispute. The Respondent's position is not that all of the alleged services were fictitious. The Respondent admits that certain non-material services could have been provided to K . As a matter of fact, the tax authorities themselves recognized this and allowed the expenses related to some services as tax deductible costs.[281] This does not, however, in the eyes of the Respondent, mean that the Management Fees were not primarily used to drain funds from K nor that the tax authorities were incorrect in disallowing them as tax deductible costs.

447. The source documents provided by the Claimants show that the Management Fees were designed to cover operating expenses and activities of W while the excess was transferred to W partners.[282] The Claimants sought to escape their tax

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[280] Respondent's Rejoinder dated 20 March 2014, para. 222.

[281] CE-280 through CE-283; see also Respondent's Rejoinder dated 20 March 2014, para. 226.

[282] W E I I Memorandum dated January 1994 (RE-233); Supplement to W I M dated July 1994 (RE-238); Supplement to W I M dated September 1994 (RE- 239).

obligations in Poland with respect to these fees by designing a tax structure involving W and relying on the provisions of the DTT.[283]

448. The Respondent points out that these Management Fees began to be charged as soon as S purchased shares in K , even prior to the establishment of W and the tax structure for payment of the fees. The general service agreement[284] was antedated in such a manner that it was entered into by a company – W – which did not exist at the time. According to the Respondent:

> *…when the tax inspection began, someone in the Company apparently panicked and presented the tax authorities with the documentation which was made up from A to Z in most dilettante manner, specifying fictitious dates, services, cost estimates and values. The Company continued this chutzpah even in 1999, alleging it had been receiving valuable services that were so intangible they did not even leave a trace of a paper-trail, just to come back after two months with a set of pristine printouts of 'reports' that contained a potpourri of very general presentations, scientific papers of internal documents produced by the marketing and controlling departments of the Company*.[285]

In these circumstances, so the Respondent argues, the reaction of the tax authorities was justified.

449. The Respondent submits that the tax decisions are not final as a matter of Polish law and the Claimants should not be given a second bite at the apple to argue that those decisions were incorrect. However, even if they are given such an opportunity, the Claimants have failed, in the Respondent's view, to show which services were genuine, what their market value was and whether they generated revenue for K . Instead the Claimants only rely on the Decision on Discontinuation and the written communication of Ms. B . With regard to the Decision on Discontinuation, the Respondent argues that

> *[t]he decision of Prosecutor J was issued in 2011, in the context of criminal proceedings, which have different nature,*

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[283] Letter from A A to Mr. B dated 15 September 1994 (RE-242).
[284] CE-112.
[285] Respondent's Rejoinder dated 20 March 2014, para. 229.

subject matter and focus than tax proceedings. The decision on discontinuation of the criminal proceedings was concerned with examination of grounds for criminal responsibility, and not with the prerequisites for CIT-deductibility of specific non-material services. Furthermore, the Prosecutor's view expressed in the decision is not an authoritative statement under Polish law. Rather, it is an opinion expressed by a single-person criminal organ of the state to explain the reasons for his decision. This reasoning does not carry the effects of res judicata under Polish law and does not affect the finality of the tax decisions nor the judgments of the Supreme Administrative Court of 8 August 2000.[286]

450. With regard to Ms. B , the Respondent argues that she

> *…was an experienced specialist in the tax inspection authority in O , until the time when she was engaged by the Company as an employee. In other words, either the Claimants or the Company convinced Ms. B to change sides in the midst of the tax dispute in which she was involved. Effectively, from one day to another she became involved in the tax proceedings on the side of the Company, questioning the acts of her former colleagues. Actually, she was the representative of the Company that removed certain documents from control of the tax inspectors in November 1999.*[287]

The Respondent submits that while the Claimants argue that Ms. B acted to their detriment in the criminal proceedings, in 1999 they employed her in K , offered her a high salary and involved her in representing K before the tax authorities.

(viii) Alleged bias of the tax authorities

451. According to the Respondent, a crucial part of the Claimants' case is that the tax authorities involved in the K proceedings were incompetent and biased. The best place to prove this, in the Respondent's view, would have been through cross-examining the officials involved at the hearing. The cross-examinations of the Polish tax officials – Mr. K , Ms. P and Ms. Ś – by the Claimants clearly showed that these officials were competent and well versed with

[286] *Ibid*, para. 233.
[287] *Ibid*, para. 234.

Polish tax law. The Respondent points out that these officials also explained that the bonus system was a standard component of remuneration of tax officials at the time and was not something extraordinary as argued by the Claimants. In the Respondent's view, the Claimants have failed to establish any causal link between the bonus awarded to particular individuals and the conduct or outcome of the tax proceedings.

452. With regard to the bonus system, the Respondent further submits that:

> (i) *Contrary to what the name 'bonus' may suggest, the bonuses were a standard component of remuneration of tax officials, awarded on a quarterly basis. The record shows bonuses were awarded (but in a reduced amount) also to officials, who for most time were on sick leave, or who had bad results.*
>
> (ii) *Bonuses were awarded also to those tax officials, who were not involved in the inspection at the Company. The comparison of the amounts of bonuses awarded to the officials involved and the officials uninvolved in the inspection of the Company does not show any differences in the level of compensation. The tax officers identified by the Claimants' as alleged predators of bounties related to the tax inspection at the Company, did not usually receive highest bonuses, nor bonuses that would have been significantly higher than the bonuses awarded to their colleagues. As a matter of fact, the differences between bonuses awarded to all inspectors and employees were not significant.*
>
> (iii) *The amounts of the bonuses, in absolute terms, were also far from having corruptive potential. The highest quarterly premiums on the record at that time amounted to PLN 10.000 (i.e. approximately USD 2.500 - 3.000 per 3 months, equals USD 800-1000 per month). However, on most occasions the bonuses varied from PLN 3000 to PLN 8000 per quarter, i.a. PLN 1000 to PLN 2700 per month (USD 300 to USD 900).*
>
> (iv) *There is no clear and direct link between the amount of the bonuses awarded to tax officials and the amounts of tax arrears determined with respect to the Company, or collected from the Company. The Claimants allege that the bonuses of the tax officials were paid from the 20 % of the sums collected from the taxpayer. Since the Company*

eventually paid PLN 12 million in tax arrears, the aggregate sum of all bonuses to all tax officials do not come even close to 20 % of that amount.

(v) *Both the bonus lists and the accompanying orders give insight into the theory and practice of the criteria which were taken into account when awarding bonuses. Effectiveness was rewarded, but so was good quality of work and involvement in complex proceedings. On the other hand, there are also comments indicating 'poor supervision over the inspection and flawed inspection protocol' or 'poor quality of post-inspection materials', as comments justifying lower amount of bonuses. This implies that the tax officials were discouraged from pushing for results at the expense of quality of their work. This was not an "eat-what-you-kill" system.*

(vi) *The tax officials, singled out by the Claimants for their involvement in the tax inspection at the Company, also received commendations for their work related to inspections at other companies at that time.*[288]

453. According to the Respondent, the foregoing record shows that Claimants' argument that the bonus system biased tax officials against the company has no basis in fact. Moreover, it must be taken into account that other countries such as Canada have a similar scheme for remuneration of tax officials.[289]

(ix) Weight of the Supreme Administrative Court's judgments of 10 August 2000

454. The Respondent points out that the decisions of the Supreme Administrative Court of 10 August 2000 relating to the tax proceedings for 1995 were the only decisions which addressed the merits of the Tax Claim and are, therefore, crucial to understanding the tax proceedings. According to the Respondent, the key conclusions of the Court were as follows:

(i) *If…a rule of substantive law makes the possibility of enjoying a tax privilege (tax credit, reduction of taxable base) dependent on the taxpayer proving that certain facts*

[288] *Ibid*, para. 286.
[289] Expert Legal Opinion of Prof. P and Dr. M dated 29 September 2012, paras. 172-181 (REO-001).

have occurred, the burden of proof shall be upon that taxpayer.

(ii) *…the tax authorities properly examined all the events, to which the costs are related, specifically, in a situation where there is no unequivocal evidence that the services were provided.*

(iii) *In the case at hand the tax authorities assessed enforceability for tax purposes not only of the 2 December 1994 agreement but also of the agreements of 27 January, 6 February and 30 May 1995. It should be assumed that in this case the evidence material fully authorized the tax authorities to deem that the agreements signed by the applicant with the company W in W were of ostensible nature and were aimed solely at reducing the income tax amount due to the State Treasury…*

(iv) *…both, the first instance tax authority and the second instance tax authority, generally considered the expenditures on intangible services to be tax deductible costs. In this case these expenditures were questioned due to no evidence to prove the services actually provided.*

(v) *…The tax authorities were specifically thorough when conducting the evidentiary proceedings…*

(vi) *…As regards the applicant's claims that the appellate authority refused to admit as evidence Attachments no. 36 and 50-52 to the pleading of 21 January 1999, one should fully agree with the stance presented by the Tax Chamber in reply to the complaint that the documents referred to by the applicant were submitted to the tax authorities after almost two years had passed from the date when the taxpayer was obliged to submit the same. The submitted studies do not generally bear a signature of the author or a date when they were prepared…*

(vii) *…One cannot accept the party's claim that the tax authorities had entirely disregarded the explanations provided by the party…The majority of claims contained in the complaint is actually a discussion with the assessment of evidence made by the tax authorities. In accordance with Article 191 of the Tax Code, a tax authority assesses on the basis of the collected evidence whether the fact was proved. In the Court's opinion, the tax authorities assessed the*

> *evidence in a complete and logical manner, and their assessment may not be claimed to be arbitrary…*
>
> (viii) *…The presented charge of long-lasting idleness on the part of the tax authorities is not grounded in the facts, since the procedures applicable in this case for both the first instance and the second instance authorities were not violated. It follows from the case files that during the explanatory proceedings the party presented numerous materials. In order to enable the applicant to submit such materials and, next, to have them analysed by the first instance authority, the Tax Office several times extended the proceedings in time…*[290]

455. These two judgments, according to the Respondent, show that the Claimants are essentially re-litigating the tax issues in the present dispute. The Claimants' arguments relating to the interpretation of Article 15 of the CIT Law, the analysis of the evidence by the tax authorities and the alleged delay in the proceedings have all been addressed and decided by the Supreme Administrative Court.

456. The Respondent submits that the Claimants have failed to address, let alone rebut, these findings. The Claimants have not claimed denial of justice with respect to the decisions of the Supreme Administrative Court; rather, they have complained about the irregularities of the tax proceedings without addressing these decisions at all. According to the Respondent, these judgments

> *(i) defeat the Claimants' contention that the record-keeping policy of the Company was in line with the requirements of the contemporary Polish law; (ii) defeat the Claimants' contention that the tax authorities acted in an arbitrary manner or that the process of evidence-taking by the tax authorities were flawed; (iii) defeat the Claimants' views concerning the allocation of the burden of proof with respect to tax-deductible expenditures, and (iv) defeat the allegation of bounty-driven bias, since the alleged incentives (bonuses) did not apply to the judges at the Supreme Administrative Court.*[291]

[290] CE-231, pp. 9-15.
[291] Respondent's Rejoinder dated 20 March 2014, para. 261.

(x) Reliance on decisions in W and W cases

457. The Respondent argues that the Claimants' reliance on the decisions in the W proceedings is not justified since:

(i) According to the Respondent, both cases turned on their own peculiar facts established with reference to the record of each case. The cases involved different agreements, different services, different evidence and different procedural conduct of the taxpayer. These differences can only be appreciated on the basis of the decisions in the W proceedings (since the files were destroyed in 2009). The Claimants have, however, failed to show that the decisions in both cases are comparable.

(ii) The Respondent further submits that to the extent that the same points of law were involved in both proceedings but were decided differently, such differences are justified on the basis of public policy arguments such as (a) the need to afford quasi-judicial autonomy to tax authorities deciding cases; (b) the need to preserve confidentiality of sensitive information related to tax proceedings; and (c) due process and rule of law requirements, in accordance with which the case of each taxpayer should be determined in the basis of the facts of his case rather than those of another taxpayer.

(iii) In the Respondent's view, an investor may not invoke a favourable, but incorrect, decision (in this case the Respondent argues that the decision in the W cases, which was never challenged before the Supreme Administrative Court was incorrect) to overturn an unfavourable decision, the legality of which has already been confirmed by an independent domestic court in a final judgment.

(xi) Probative value of Prof. G Expert Legal Opinion

458. According to the Respondent, the Claimants rely heavily on Prof. G Expert Legal Opinion to establish the alleged impropriety of the tax proceedings. The Respondent argues that the said Opinion suffers from serious defects that undermine

its credibility and value. For instance, Prof. G admitted that his review of the source documents was limited to 106 items listed at the end of his report and that "…*I did not have access to all the documentation from all the years. If I had had to do it, I would not take upon myself the writing of the opinion in such a short time.*"[292] According to the Respondent, such an admission is sufficient to establish the lack of thoroughness of his analysis. Yet despite not reading all the source documents, Prof. G did not shy away from making sweeping conclusions.

459. The Respondent points out that at the hearing, Prof. G admitted that he did not know on what legal basis the Management Fees had been disallowed as CIT-deductible costs; in particular, decisions of the tax authorities. When confronted with the tax inspection office decision for 1994, the decision of the Tax Chamber for 1994 and the decision of the Tax Office of B for 1995, he stated that his conclusion that Article 11 of the CIT Law was the only legal basis for the disallowance might have been based only on the decisions for 1994.[293] Except that he had previously admitted to not having read the decisions for the year 1994.

460. According to the Respondent, Prof. G also admitted[294] to not having read the Supreme Administrative Court's decisions dated 10 August 2002 – the only decisions to consider the merits of the Claimants tax case. While in his Opinion he stated that the tax authorities disregarded K evidentiary motions,[295] during his cross-examination he admitted that this was an assumption he made.[296] Similarly, the Respondent points out that when questioned on the alleged bias of tax officials, Prof. G could not recall the particular officers involved in the proceedings and simply stated that he inferred bias from the content of their decisions.[297] With regard to his conclusions on Polish law, Prof. G admitted that his report did not reflect the position of Polish law but rather the desires of the expert.[298]

[292] Tr. Day 4, 45:10-13.
[293] *Ibid*, 30:20, 41:13.
[294] *Ibid*, 49:12.
[295] CE-753, p. 4.
[296] Tr. Day 4, 45:14-18.
[297] *Ibid*, 50:8-15; 52:13-22; 53: 14 to 54:4.
[298] *Ibid*, 58:23 to 59:1.

461. Finally the following exchange during the hearing raises doubts about his impartiality, according to the Respondent:

> [Q:] …*only a minority of those 106 items* [i.e. the documents Prof. G reviewed in preparation of his expert report] *are expressly referenced to in your expert report, and I wanted to ask you why.*
>
> *A: I saw no reason why the thesis, in my opinion, should be based on other documents. I selected those which seemed to fit the thesis which I posited...*[299]

462. For the foregoing reasons, the Respondent submits that Prof. G opinion does not constitute credible evidence.

(2) The Tribunal's analysis

463. The question before the Tribunal is whether in terms of Article VII of the BIT the Claimants' investment in K was expropriated by the Respondent's conduct in the tax proceedings.

464. Article VII provides as follows:

> *ARTICLE VII Compensation for Expropriation*
>
> *1. Investments shall not be expropriated or nationalized either directly or indirectly through measures tantamount to expropriation or nationalization ("expropriation") except for a public purpose, in a nondiscriminatory manner, upon payment of prompt, adequate and effective compensation, and in accordance with due process of law and the general principles of treatment provided for in Article II (6). Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriatory action was taken or became publicly known, whichever is earlier; be paid without delay; include interest at a commercially reasonable rate, such as LIBOR plus an appropriate margin, from the date of expropriation; be fully realizable; be freely transferable; and calculated on the basis of the prevailing market rate of exchange for commercial transactions on the date of expropriation.*

[299] *Ibid*, 28:2-9.

465. Article VII of the Treaty is in mandatory terms. It provides that investments "*shall not be expropriated or nationalised.*" It covers both expropriation and "*measures tantamount to expropriation.*"

466. It is not the Claimants' case that the Respondent expropriated their property through formal transfer of title or outright physical seizure. The Claimants argue that tax measures and other concerted actions by the Respondent resulted in the Claimants being deprived of their investment.

467. Given the language of Article VII, the Tribunal must first examine whether acts by the Respondent were measures tantamount to expropriation.[300] If its conclusion is in the affirmative, it must then further examine whether the pre-conditions established by Article VII for a lawful expropriation are met. To be lawful in the terms of Article VII, an expropriation must be (i) for a public purpose, (ii) carried out in a non-discriminatory manner, (iii) upon payment of prompt, adequate and effective compensation and (iv) in accordance with due process of law and the general principles of treatment provided for in Article II(6) of the BIT. The examination is, therefore, a two-step process. First, the Tribunal has to examine whether the measures may be characterized as an expropriation. Second, it has to determine whether such expropriation was lawful or not.

a. Existence of an expropriation – bona fide measures

468. Both Parties agree that a *bona fide* exercise of taxation powers does not constitute expropriation. If the Tribunal were to find the measures bona fide it will be dispositive of the issue.

469. While the Claimants admit that *bona fide* tax measures would not constitute expropriation, they argue that the present case does not concern the powers of the Respondent relating to taxation, but to its conduct during the tax and criminal proceedings which, according to the Claimants, was not *bona fide*.

[300] Also sometimes referred to as "*de facto*," "*creeping*" or "*indirect*" expropriation.

470. The Respondent contends that the disputed tax measures were *bona fide* and therefore, cannot constitute expropriation since a State does not expropriate and is not liable to compensate for loss of an investment or the impairment of its value when the loss or impairment results from *bona fide* taxation measures. According to the Respondent it is generally accepted that these are within the police powers of the State.

b. Existence of an expropriation – factors to consider in determining indirect expropriation measures

471. The Claimants rely on the "*sole effects doctrine,*" i.e. that it is only the *effect* of the State's actions that is important in determining an indirect expropriation, and not the intention of the State behind those actions. . The Claimants, however, have rightly conceded that the *sole effects doctrine* cannot be applied in a complete vacuum. In this context, the Claimants themselves rely on the observation of the Tribunal in *RosInvest v. Russia* that

> *…the normal application of domestic tax law in the host State cannot be seen as an expropriatory act. On the other hand, it is generally accepted that the mere fact that measures by a host State are taken in the form of application and enforcement of its tax law does not prevent a tribunal from examining whether this conduct of the host state must be considered, under the applicable BIT or other international treaties on investment protection, as an abuse of tax law to in fact enact expropriation.*[301]

472. In order to determine if certain measures constitute expropriation, what is to be seen is whether, as claimed by the Claimants, there was an "abuse of tax law." The guise of taxation will not save the Host State from liability for actions, based on an abuse of tax laws, if these resulted in the total loss or substantial impairment of the investment tantamount to expropriation. The Tribunal will first examine the Claimants' arguments related to concerted efforts by the Respondent. It will then analyse whether these measures could be considered to be such an abuse of tax law as tantamount to expropriation.

[301] *RosInvest Co UK Ltd. v. Russian Federation*, para. 628 (CE-757).

473. In view of the Parties' pleadings, the Tribunal has to determine whether the measures taken by the Respondent were a *bona fide* and a legitimate exercise of State power. If the answer is in the affirmative, then the measures did not constitute an abuse of tax law and according to the Parties' admitted position, there could not have been any expropriation. The Tribunal will, therefore, first examine the Claimants' arguments related to concerted action by the Respondent amounting to an abuse of tax law, and then analyse whether the tax measures themselves were a bona fide and legitimate exercise of regulatory power.

c. Concerted action

474. The Claimants argue that the tax measures in this case were part of a broader matrix of measures taken by the Respondent, which taken together, deprived the Claimants of their investment. In this regard, the Claimants rely heavily on the inter-linkages between the tax proceedings and the criminal proceedings. In the Tribunal's view, the Claimants' contention that the tax proceedings and the criminal proceedings were interrelated is correct. The tax proceedings were in fact initiated at the request of the Public Prosecutor. Various communications between the tax authorities and criminal authorities and the use of testimony of tax officers in the criminal proceedings affirm this interrelation.

475. At the same time, the Tribunal is mindful that the same set of facts may form the basis of a civil offence and a criminal offence. It is not uncommon for two sets of prosecutions, one on the civil side and the other on the criminal side, to be initiated on the basis of the same facts. That these two sets of proceedings were being conducted simultaneously and that the authorities were communicating with each other does not by itself prove common design or support an argument that there was concerted action to deprive the Claimants of their investment. The Claimants' admission that the criminal proceedings were conducted in a fact-finding phase (and not personally against the Claimants) and the fact that their own experts make no mention of the criminal proceedings as a reason for the cause of K bankruptcy

contradict the Claimants' stance that the criminal proceedings were part of coordinated effort by the Respondent to deprive them of their investment.

476. The Claimants have also not produced any evidence to show that the tax proceedings themselves were part of a concerted effort to deprive the Claimants of their investment. The record in fact supports the opposite conclusion:

(i) Through a letter dated 20 January 1999, a Director from the Department of Finance of the State Treasury wrote to the Director of the Tax Chamber in O requesting a favourable decision in K case since an adverse decision could lead to the bankruptcy of the company.[302]

(ii) In its letter dated 3 November 1999, A A noted that the Tax Chamber's 1995 CIT decision was favourable for K with regard to investment incentives because it was based on new rules introduced in the CIT law. Further, the advisors stated that "*The Tax Chamber decided not to question the incentives even though the wording of the law might suggest that N B lost the right to such incentives (interpretation supporting such a restrictive approach was issued by the Ministry of Finance and published in one of tax magazines).*"[303] A A , therefore, warned that in case an appeal was filed, the Supreme Administrative Court may find the Tax Chamber's decision in relation to the investment incentives contrary to the CIT law.

(iii) On 3 January 2001, the Mayor of B wrote to the Prime Minister of Poland requesting him to take steps to cancel the tax arrears of K .[304]

(iv) Several decisions of the tax authorities were, in fact, overruled and sent for reconsideration.[305]

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302 CE-648.
303 RE-154.
304 CE-669.
305 *See* letter from counsel to K dated 18 August 1999 (RE-156); and letter from A A dated 13 October 1999 (RE-163).

(v) The tax authorities only collected PLN 11 million out of more than PLN 55 million in tax arrears and were in fact willing to waive off up to 95% of the debt through an amnesty scheme.

477. The foregoing record does not support a finding that there was concerted action on the part of the Respondent's agents to deprive the Claimants of their investment. In fact, the record suggests that these were tax proceedings taking their regular course. It is true that a number of the authorities' decisions went against K , but even in those decisions, there were aspects which favoured K ; further, some of these decisions were reversed.

d. Biased, prejudiced and discriminatory conduct; denial of due process

478. The Claimants have also argued that the conduct of the tax authorities was biased, prejudiced and discriminatory and that they were denied due process. For instance, the Claimants argue that the tax authorities applied the transfer pricing rules through non-binding guidelines when those rules had yet to be incorporated in the statute. The Claimants further argue that the guidelines set unreasonable standards for providing documentation, such as asking for physical proof of the Management Services and asking K to identify the author of each work product; and rather than seeking the objective truth, the tax authorities were motivated by a bonus system, which rewarded them for issuing decisions against taxpayers.

479. The Tribunal has carefully reviewed the evidence presented by the Parties and concludes on the record before it that the primary reason that K lost the tax proceedings was not because of the conduct of the tax authorities but because of K insufficient record keeping. The Respondent concedes that its case is not that no Management Services were provided, but that K did not adequately record and document the provision of these Management Services to it for the purposes of claiming deduction of the Management Fees. The Tribunal agrees with the statement by the Supreme Administrative Court in its decision dismissing K appeal: "*In tax proceedings, the principle that the burden of proof rests with the person who derives legal effects from this fact applies. Therefore, the taxpayer should document*

the incurred expenses and demonstrate a causal link between a particular expenditure and the resulting income."[306]

480. The record and documents to prove the fact, quantum and value of the Management Services were or ought to have been in the control and possession of K . It was neither required of nor was it possible for the tax authorities to prove that no Management Services were provided. The burden was on the Claimants to present evidence in the correct form before the tax authorities. That the Claimants did not do so despite being provided an opportunity by the tax authorities is manifest from the following record:

(i) In a memorandum from Mr. M to Mr. R dated 23 July 1997, Mr. M states that not only were documents, such as the main agreement for the provision of Management Services, backdated against the advice of lawyers, but that K tax advisor, A A view was that K had a very weak case given that when A A itself successfully contested a similar matter, the tax authorities sought very detailed documentation.[307]

(ii) In its letter dated 15 October 1997, A A stated that the lack of documentation received from K in support of the payment of the Management Fees suggests that the tax authorities may in fact be correct and that it would be advisable for K to settle the matter.[308]

(iii) In its letter dated 27 October 1997, A A stated that in view of K poor documentation and the thorough work done by the tax authorities, the chances of an appeal succeeding were minimal.[309]

(iv) In its letter dated 30 December 1997, A A stated that the Tax Office in B had agreed to postpone issuing its decision till 31 January 1997 in order

306 RLA-127.
307 RE-241.
308 RE-155.
309 RE-153.

to give K time to provide additional documentation that would support the provision of the Management Services by W ; yet despite there only being one month left, no such documentation had been provided.[310]

(v) In its letter dated 3 November 1999, A A recommended adopting a new approach in the tax proceedings because it believed "*that the change of argumentation is needed as the lack of appropriate documentation denies other ways of presenting the case to the authorities.*"[311]

(vi) During the hearing, Mr. R himself admitted that

> *we got caught between a way, a methodology that we were using, and the Polish laws, and we didn't -- we blew it. We didn't have proportionately what we should have. And then faking documents or backdating documents is obviously the company trying to cover up for not having the documentation. On the other hand, we didn't know about the documentation when we started.*[312]

481. The Claimants' own documents, therefore, instead of establishing their case undermine it. These documents show that K was caught unaware by the tax proceedings. It did not have adequate documentation to support the provision of the Management Services.

482. The extent of K lack of preparation can be seen from the fact that it had not even entered into a formal agreement for the provision of the Management Services. Such a written agreement between K and W was created after-the-fact and backdated to a date when W was yet to be incorporated. The Claimants' expert, Prof. G , suggests in this regard that the backdated agreement was nevertheless valid, testifying that

> *the tax authorities' accusation that the Agreement of December 2, 1994 was antedated and thus invalid – because it was concluded with an entity that had not been yet incorporated – is groundless. This is because concluding contracts which confirm a prior verbal*

[310] RE-190.
[311] RE-154.
[312] Tr. Day 2, 57:23, 58:5; see also 43:23-25.

arrangement between the parties is not a forgery. In fact, this is a standard business practice. The agreement simply became enforceable from the time W was entered into the commercial register.[313]

483. The Tribunal is not surprised by the fact that the tax authorities regarded such a back-dated agreement with suspicion. The Tax Chamber in O observed when upholding the Tax Office's decision for 1994:

> *In tax proceedings, the strength of evidence is mainly given to the documents which reflect the real course of a business transaction. Those documents show clearly that on 2 December 1994 the Appellant* [K] *entered into an agreement for the provision of services with a company* [W] *which did not exist then; therefore, the agreement, as invalid, cannot give rise to any effect in terms of obligations.*[314]

The Tribunal sees no reason to disagree with this conclusion.

484. This Tribunal is not an appeals court sitting in judgment on the decision of the tax authorities. Its task is to ascertain whether the Respondent is liable for actions of the State authorities and reviewing whether these were in breach of the Respondent's obligations under the BIT. For this, convincing evidence has to be produced by the Claimants. That burden has not been discharged here. In view of these facts, the Tribunal is not prepared to hold that the actions of the tax authorities amounted to *an abuse of tax law in violation* of the expropriation provision of the BIT.

485. The Tribunal is also not convinced that the taxation authorities were motivated by a desire to destroy the business of the Claimants in insisting that the Claimants produce convincing evidence of the provision and value of the Management Services or in not accepting the agreement produced by the Claimants.

486. The Tribunal has carefully reviewed the decisions issued during the tax proceedings and the opinions of Prof. G (for the Claimants) and Prof. L and Dr. T (for the Respondent) analysing these decisions. The Tribunal finds these

[313] Expert Opinion of Prof. G dated 2 August 2013, p. 45 (CE-753).
[314] Decision of Tax Chamber in O dated 14 November 1997 (CE-176).

decisions to be reasoned and supported by evidence. In each case, the authorities have examined the evidence submitted by K in support of its arguments and provided detailed reasoning for either accepting that evidence or rejecting it. For instance, the Tax Chamber in O while reviewing the Tax Office's decision for 1996 and documentation submitted by K , observed that

> *…moreover, it should be underlined once again that these documents which allegedly constituted the result of the execution of the agreements which should be owned and used on a current basis by the Appellant* [K], *were submitted after two years of the proceedings pending before the tax authorities. If they were not owned by the Company and moreover, they were used as evidence material within the period of three years, i.e. 1995-1997 modifying only a name or transferring fragments from one study to the other of a different title, in the opinion of this Tax Chamber it means they were drawn up for the purpose of the pending proceedings.*[315]

487. Prof. G admits that the invoices issued by W and presented to the tax authorities by K "*did not relate to a particular written agreement*" and "*did not specify the method for calculating the Management Fees.*" He, however, submits that "*the tax authorities did not take into account that the law did not impose such specific requirements for invoice description. The invoices issued by W for Management Services were in line with the law and did not depart from the contemporaneous market practice at the time.*"[316] In the Tribunal's view, it is not unreasonable for the tax authorities to require invoices to be linked to a particular agreement (especially when the first agreement was entered into with an entity that did not exist at the time) or to specify the manner in which the Management Fees were calculated. This Tribunal is not inclined to hold that these actions were not in the normal course of the functions of the tax authorities to assess and collect such taxes or that these were taken only under the veil of taxation for an unrelated purpose.

488. Similarly, the Tribunal is not persuaded by Prof. G suggestion that the tax authorities only concentrated on gathering evidence unfavourable to K The Tribunal also notes that K was associated with the tax proceedings from the

[315] Decision of Tax Chamber in O dated 28 February 2002 (CE-178).
[316] Expert Opinion of Prof. G dated 2 August 2013, p. 47 (CE-753).

beginning. It was K that received the Management Services. It stands to reason that K was best placed to produce any evidence in its favour.

489. In his Opinion, Prof. G also suggests that K evidentiary motions were rejected and that this constituted a serious breach of procedural law. Yet during his cross-examination, he admitted that this was an assumption he had made.[317] Prof. G Opinion also focused on the tax authorities' abuse of transfer pricing regulations and in particular their misapplication of Article 11 of the CIT law. According to Prof. G the tax authorities "*did not go beyond referring to Article 11 of the CIT Law as the only basis for excluding Management Fees from tax deductible costs.*"[318] An examination of the tax decisions, however, shows that Article 11 of the CIT law was not the only basis of these decisions. The tax authorities relied equally, if not more heavily, on Article 15 of the CIT law.

490. As observed above, this Tribunal is not sitting in appeal on the decisions of the tax authorities in Poland. In this regard, it needs to be emphasized that the tax authorities' decisions relating to CIT and VAT for the year 1995 were upheld by the Supreme Administrative Court through two judgments dated 10 August 2000. These judgments were not the result of denial of justice or abuse of process, nor have the Claimants made any such claim. Apart from these two judgments of the Supreme Administrative Court, however, all other decisions were of lower administrative tribunals or the tax authorities themselves. If these other decisions violated the Claimants' rights, they could have challenged them in Poland through the prescribed judicial hierarchy. They chose not to do so.

491. The Claimants cannot now seek to challenge these decisions in an international arbitration. It is not for this Tribunal to rule on the correctness of those decisions as a matter of Polish law. Its task in the present context is to determine whether the Respondent breached the expropriation provision of the BIT through actions by the State authorities using the tax proceedings as a guise to expropriate or nationalise the

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[317] T. Day 4, 45:14-18.
[318] Expert Opinion of Prof. G dated 2 August 2013, p. 4 (CE-753).

Claimants' investment, or that these measures were tantamount to expropriation or nationalisation. The burden to establish this through convincing evidence was on the Claimants. That burden has not been discharged.

492. If all that a Claimant is required to demonstrate, in order to claim a violation of the BIT's expropriation provision, is an incidental detriment to its business by a taxation measure, then that would amount to a blanket prohibition on the State to adopt or implement any taxation measures which impacts a foreign investor or investment. For instance, a foreign investor may decide not to pay any taxes and as a result incur penalties in the Host State, which then may lead to the collapse of the investor's business. Insofar as these penalties were imposed in the exercise of the ordinary taxation powers of the State, in a *bona fide* manner, such measures cannot be equated to expropriation or to a measure tantamount to expropriation. Bilateral investment treaties are meant to protect foreign investors against actions by a State in breach of the BIT; they are not meant to shield foreign investors from a *bona fide* exercise of the taxation power of the State.

493. The Claimants contend that the bonus system was one of the prime motivations behind the tax inspections and, ultimately, the decisions passed against K at the first instance. According to the Claimants, the bonus system resulted in a bias against taxpayers such as K . The bonus system, however, is not peculiar to Poland. Other countries, such as the United Kingdom and Canada, also implement similar schemes to incentivise tax officials. While the merits of a policy of awarding bonuses to tax officials based on the tax collected by them may be debated, the simple fact that such a policy was in place does not constitute evidence for a conclusion of bias in this particular case. The bonus system was available for the tax officials who conducted the tax inspections and issued decisions at the first instance. The Claimants themselves admit that the bonuses once granted, were non-refundable and "*were not returned by tax officials even if their initial decisions were later reversed or changed in tax appeal proceedings.*"[319] It is clear from this that the process through which decisions of tax

[319] Claimants' Memorial dated 8 May 2012, para. 225.

officials were appealed and reviewed was completely independent of the bonus system. The bonus system did not extend to the Tax Chamber or the Supreme Administrative Court, both of which upheld the decisions of tax officials at the first instance. The existence of the bonus system does not, therefore, of its own establish that there was systemic bias against K which extended throughout the tax hierarchy. The Tribunal is, therefore, not persuaded by the Claimants' argument that the bonus system led to systemic bias against K .

494. To argue that they were discriminated against, the Claimants refer to the Tax Chamber's decisions in the case of W , which, according to them, involved similar issues but were decided in favour of the taxpayer. Even assuming that the proceedings against W involved similar issues, the outcome of any tax proceedings relating to admissibility of expenses depends on the specific documentary evidence presented during those proceedings, the observance of procedural requirements and the conduct of the taxpayer. The evidentiary record before the tax authorities in the W case and on the basis of which they decided the case is not before this Tribunal. In the absence of this record, the Claimants have not been able to show that the same evidence that was presented in K case (i.e. the agreements for providing Management Services, the invoices for the services provided or the final work product) was also before the tax authorities in W case or formed the basis of their decision. In these circumstances, the Tribunal cannot simply assume that K and W cases were comparable and there is, therefore, no basis for treating the two cases differently. The simple fact that different decisions were reached in each case does not prove discrimination.

495. The Tribunal is not persuaded that the tax proceedings initiated against K or the tax decisions issued during these proceedings were arbitrary, biased, discriminatory or contrary to the rule of law. In particular, this Tribunal is not persuaded that the Respondent was using these measures intentionally as a cover to expropriate the Claimants' investment and that these were in effect measures tantamount to expropriation. As such these measures did not constitute an abuse of tax laws. These did not result in the total loss or substantial impairment of the Claimants' investment

in the form of an indirect expropriation. In conclusion, the Tribunal is of the view that the tax proceedings involving K were a *bona fide* and a legitimate exercise of the State's police or regulatory powers in the area of taxation, hence non-compensable. Any incidental or consequential effect on the investment of the Claimants, even of a substantial nature, did not amount to a violation of Article VII of the BIT.

496. The Tribunal is, of the view that in this case there has been no expropriation.

C. Free transfers of funds

(1) The Parties' positions

a. Claimants' position

497. The Claimants submit that the Respondent violated its obligation to ensure the free transfer of funds in accordance with Article V of the Treaty. According to the Claimants, the free transfer of funds may be infringed not only by introducing transfer restrictions (as suggested by the Respondent), but also by taking other measures, which prevent the transfer and effectively imprison the investor's funds in the Host State. Such measures may include increasing the cost of transfer and subjecting them to unreasonable demands or burdens.

498. The Claimants argue that "*[e]ven though there was no formal prohibition on the transfer of the Management Fees to the United States, the Claimants submit that their freedom to transfer was violated by the improper application of the tax law which resulted in K being deprived of the right to calculate, collect and freely transfer the Management Fees to its U.S. contractors.*"[320]

499. According to the Claimants, the Management Fees were so closely connected with the Privatization Agreement that they fall squarely within Article V of the BIT, which protects transfers connected directly with the investment. In this regard, ensuring the

[320] Claimants' Memorial dated 8 May 2012, para. 1272.

free transfer of remuneration of foreign consultants was particularly important since the absence of such protection would make it impossible to attract foreign experts.

500. In response to the Respondent's argument that the only transfer that may have been protected under the BIT was the transfer of Management Fees between W and W , the Claimants submit that the Respondent's actions made it impossible to achieve such a transfer and, in fact, the entire purpose of the actions of the tax and criminal authorities, as revealed by their correspondence, was to prevent such a transfer from taking place. In any case, the Claimants decided to render the Management Services through a special purpose vehicle – W – in order to simplify settlements between the capital groups and make the exercise cost-effective. The Claimants were fully entitled to do so.

501. The Claimants submit that by rejecting the Management Fees as CIT-deductible costs the Respondent effectively imprisoned the investor's funds and prevented K from transferring management fees to the U.S. The tax and criminal authorities have themselves admitted that their acts were aimed at preventing the alleged illegal transfer of Management Fees. They were successful in their efforts. As a result of the tax authorities groundless rejection of the Management Fees as a CIT-deductible costs, the Claimants could not collect and transfer the Management Fees abroad. The Respondent, therefore, infringed its obligation to ensure a free transfer of funds to the Claimants.

b. Respondent's position

502. The Respondent submits that it did not prohibit any transfer of funds regarding the Claimants investments, whether expressly or impliedly, and whether from K to W or from W or W . The tax decisions for each year were issued long after the Management Fees had been collected and transferred to W . The tax decisions, therefore, could not have effectively imprisoned any funds.

503. The tax decisions relate to fiscal years 1994 to 1997 and the first tax decision was issued on 10 July 1997, i.e. half a year through the relevant fiscal year when the

Management Fees were collected by W and transferred to W . Even this decision, however, could not have affected the Claimants' collection and transfer of the Management Fees for the second half of 1997 since, by then, the Claimants had already decided to change the method for calculation of the Management Fees and tie them to the individual services rendered.

504. The Respondent submits that with regard to the fiscal years 1998 and 1999, the Claimants did not collect and transfer any Management Fees but could have done so. The Claimants theory of "imprisonment of funds" also destroyed the entire causation theory developed by Dr. Z . In his Base Model, Dr. Z claimed that even though K equity had been reduced to PLN 11.1 million by December 1999, it would have avoided going bankrupt in 2000. The Claimants' "imprisonment of funds" argument is based on the assumption that in the absence of tax decisions, the Claimants would have been able to transfer Management Fees from K in 1998, 1999 and onwards. Under the terms of the 2 December 1994 agreement, K would have paid W PLN 14.3 million in 1998 and 1999 on account of the Management Fees.

505. The Respondent submits that according to the Claimants' own theory, therefore, had it not been for the tax decisions, the Claimants would have made payments of PLN 14.3 million in Management Fees and pushed K into negative equity by December 1999. Had the Claimants not been dissuaded by the tax decisions, K would have reported a negative equity of PLN 3.2 million in December 1999. According to Prof. Z own rationale, having reported negative equity the company would have gone bankrupt.

(2) The Tribunal's analysis

506. The Claimants argue that that the Respondent violated its obligation to allow the free transfer of funds under Article V of the BIT by effectively imprisoning the Management Fees in Poland as a result of the tax proceedings. The Claimants have not pointed to any measure taken by the Respondent that directly prohibited the transfer of any funds by K .

507. With regard to the Claimants' argument that the tax proceedings themselves prevented the transfer of funds, the Tribunal notes that the tax proceedings were initiated and the decisions issued after the Management Fees had already been paid, collected and – in fact - transferred. Had there been no transfer of these fees by K , there would have been no dispute about the fees being deductible costs.

508. The Tribunal concludes that the tax proceedings, therefore, did not prevent the transfer of funds from 1994 to 1997.

509. The Tribunal recalls that after the first tax decision was issued on 10 July 1997, the Claimants did not collect and transfer any of the Management Fees for the years 1998 and 1999. From the record presented in this arbitration the Tribunal concludes that they were not prevented from doing so by any act of the Respondent. The requirement by the tax authorities that the expenses towards the Management Fees would be admitted as legitimate deductions only if proper supporting documentation was produced cannot be regarded as a clog on the right to free transfer of funds.

510. The Tribunal is, therefore, of the view that the Claimants have failed to make out any claim that the free transfer of funds was prevented by the Respondent.

VII. DAMAGES

511. In view of the above findings on jurisdiction and merits the Claimants have not succeeded in any of their claims. They are consequently not entitled to any damages.

VIII. COSTS

512. The total cost of the arbitration, which includes, *inter alia*, the arbitrators' fees, the expenses of the Tribunal, the Secretariat's fees and expenses and the charges for the use of the facilities of the Centre, amount to US$ 910,014.56.[321] The fees of Prof.

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[321] This amount consists of the arbitration costs at the time of the Award (i.e. US$ 910,214.56), which includes estimated charges of US$ 800.00 for the costs to be incurred in connection with the dispatch of the Award (i.e. costs related to courier services, binding, and photocopying). The ICSID Secretariat will provide the parties with a detailed Financial Statement as soon all invoices are received and the account is final. If there is any balance remaining in the case account, it will be reimbursed to the parties in proportion to the payments that they advanced to ICSID.

F O V amount to US $146,250.00. Prof. V expenses amount to US$ 22,259.35. The fees of Prof. C v W amount to US $208,250.40. Prof. v W expenses amount to US$ 11,432.95. The fees of Mr. M A K amount to US$ 234,140.00. Mr. K expenses amount to US$ 14,095.39. The administrative fees of ICSID amount to US $148,000. Other costs, including court reporters, hearing rooms, meeting facilities and all other ICSID expenses relating to this arbitration proceeding up to the dispatch of the award amount to US $124,786.47.

513. The Claimants submit that they should be reimbursed for their share of costs related to the arbitration proceeding, including all advance payments made in the course of the proceeding and the US$ 25,000.00 lodging fee paid at the time of filing the Request. In addition, in their July 2014 Statement of Costs, the Claimants have claimed the following costs:

(i) US$ 7,036,487.52 on account of all costs borne by the Claimants in connection with the present proceedings. These costs include the following:

(a) Legal fees of the Claimants' counsel and foreign lawyers assisting the Claimants in the present arbitration amounting to US$ 5,915,159.30;

(b) Costs of experts engaged for the purpose of the present arbitration in the amount of US$ 270,041.53;

(c) Out-of-pocket expenses borne in direct connection with the present arbitration in the amount of US$ 258,739.43; and

(d) Legal fees and out of pocket expenses in the amount of US$ 2,086,250.41 incurred by the Claimants in connection with (1) evidence gathering (US$ 336,829.84); (2) protecting themselves from potential criminal charges and defamation caused by K involvement, as an auxiliary prosecutor, in criminal proceedings against Mr. M and Mr. B (US$ 1,214,449.23); and (3) their efforts to ensure that K continued to exist in order to collect material for the present proceedings and to protect the Claimants against potential criminal charges (US$ 534,971.34).

(ii) To the extent that the costs described above in (a), (c) and (d) relate to legal services provided by the Claimants' counsel, they exceed the amount actually paid by the Claimants since the Claimants and their counsel had agreed to a cap on remuneration for legal services. The Claimants are, therefore, not claiming the entirety of these costs insofar as they relate to legal services provided by the Claimants' counsel and are only claiming US$ 6,634,318.44, which is what the Claimants actually paid to their counsel. As a result, the total amount of US$ 7,036,487.52 being claimed is less than the sum of (a), (c) and (d) above.

514. The Respondent has submitted that it should be reimbursed for the costs it incurred in connection with the advance payments to cover the cost of the arbitration. Further, in its July 2014 Statement of Costs, the Respondent claimed additional costs of US$ 2,270,627.00. This amount includes the following costs:

(i) PLN 3,160,030.68 for legal fees and expenses of its counsel;

(ii) PLN 16,566.28, US$ 1,367.62 and EUR 545.00 for costs incurred by the State Treasury Solicitors' Office related to its participation in the proceedings. These amounts include costs incurred on airplane tickets, accommodation and daily allowances of officials;

(iii) PLN 87,157.23 for costs incurred by the Ministry of Finance for translating documents used in the present arbitration;

(iv) PLN 3,685,836.68 for costs incurred by the Ministry of Finance for obtaining the opinions and participation of experts (i.e. Prof. P , Dr. M , Prof. S , Mr. Z , Prof. L and Dr. T);

(v) PLN 6,519.88 and EUR 1,056.00 for costs incurred by the Tax Office in B for participation of fact witnesses Ms. P , Ms. Ś and Mr.

K in the present proceedings. These amounts include the cost of accommodation and airplane tickets; and

(vi) PLN 1,000.00 for costs of international transfers associated with advance payments and PLN 900.00 for international transfers incurred in connection with costs associated with the expert opinions.

The amounts listed in (i) to (vi) above have been converted into US$ at the market rate on the date on which the Statement of Costs was submitted by the Respondent – 14 July 2014 – to arrive at a total figure (excluding the Respondent's share of the arbitration costs) of US$ 2,270,627.00.

515. By letter of 31 December 2014, the Respondent provided further documentation regarding the following costs it incurred in this proceeding:

(i) Costs relating to the preparation of the expert opinions of Prof. P S and Mr. S Z of C L , for two invoices of 17 and 18 July 2014, respectively;

(ii) A further invoice from C L dated 29 September 2014 for the amount of EUR 29,987.50 ; and

(iii) Costs relating to the translation of documents in the amount of PLN 70.05.

The amount listed in (ii) above has been converted into US$ at the market rate on the date on which the Statement of Costs was submitted by the Respondent – 14 July 2014 – to arrive at a figure of US$ 49,899.66. The amount listed in (iii) above has been converted into US$ at the market rate on the date of the Respondent's letter proving further documentation regarding costs – 31 December 2014 – to arrive at a figure of US$ 22.82.

516. The Tribunal understands from the explanations provided by the Respondent in its July 2014 Statement of Costs and its December 2014 letter that the costs related to the invoices referenced in paragraph 515 (i) and (ii) were included in the total amount set forth in the Respondent's July 2014 statement. The Tribunal further understands that

the costs related to the invoice referenced in paragraph 515 (iii) as an additional cost item which was not taken into account in the Respondent's Statement of Costs filed on 14 July 2014.

517. The Parties agree that this Tribunal's power to decide on costs in these proceedings derives from Article 58 of the Arbitration (Additional Facility) Rules and that, in principle, the costs should follow the event and should cover the reasonable legal costs incurred by the winning Party.[322]

518. Where the Parties differ is regarding the Claimants' argument that even if their case fails on the merits, the Respondent should bear all costs arising out of its unjustified and frivolous actions taken in these proceedings including requests to bifurcate the proceedings, to exclude the Claimants' counsel, the Matter of Ms. S , and the decision on the jurisdictional objections, which the Claimants contend were groundlessly raised by the Respondent. The Parties' respective positions in this regard are set out below.

A. Claimants' position

519. At the outset, the Claimants reject the Respondent's reliance on the decisions in *Cementownia v. Turkey*[323] and *Europe Cement v. Turkey*[324] as being unfounded. They point out that the Respondent has failed to present a single piece of evidence to show that the Claimants' claim is based on fraudulent assertions. The Claimants and their counsel submit that the Respondent's allegations in this regard are defamatory.

520. According to the Claimants, while in principle costs should follow the event, the Respondent should bear all costs arising out of its unjustified and frivolous actions taken in these proceedings. The Claimants argue that the Respondent's actions were aimed at delaying these proceedings. These actions significantly increased the cost of

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[322] *See* Respondent's Statement of Costs, pp. 1-2; and Claimant's Statement of Costs, paras. 7-9.
[323] *Cementownia "Nowa Huta" S.A. v. Republic of Turkey*, ICSID Case No. ARB(AF)/06/2, Award of 17 September 2009 (RLA-045).
[324] *Europe Cement Investment & Trade S.A. v. Republic of Turkey*, ICSID Case No. ARB(AF)/07/2, Award of 13 August 2009 (RLA-046).

these proceedings and as a result the Claimants had to bear substantial additional legal fees. The Claimants submit that the Respondent should bear the following costs:

(i) Costs in the amount of US$ 44,801.17 connected with the Respondent's request to bifurcate the proceedings ("Request for Bifurcation"). The Claimants contend that the Respondent's Request for Bifurcation was frivolous and nothing more than a delaying tactic, which was dismissed by the Tribunal. The Respondent's request increased the cost and duration of these proceedings and it should cover these costs.

(ii) Costs in the amount of US$ 14,543.75 connected with the Respondent's request to exclude the Claimants' counsel ("Matter of Dr. J "). This request was also rejected by the Tribunal and therefore, all costs relation to it should be borne by the Respondent (including the legal fees of the Claimants incurred in this regard).

(iii) Costs in the amount of US$ 25,865.00 connected with the Claimants' request to order a hearing to resolve the conflict arising from the Respondent's counsel employing a former employee of the Claimants' counsel ("Matter of Ms. S "). According to the Claimants, the Respondent should bear these costs because (a) the Tribunal found that the Claimants' concerns were legitimate and ordered the Respondent's counsel to establish an ethical screen; (b) this was a further instance where the Respondent's conduct forced the Claimants to engage in proceedings aimed at preserving the integrity of the proceedings; and (c) the Claimants had legitimate concerns regarding Ms. S engagement by the Respondent's counsel.

(iv) Costs in the amount of US$ 6,900.00 in connection with the Respondent's application of 4 June 2014 to admit new evidence, i.e. the Award rendered on 16 May 2014 in the case of *D* *v. Poland*[325] to the record of this case ("Respondent's Application to admit new evidence").

[325] ICSID Case No. ARB(AF)/10/1.

B. Respondent's position

521. The Respondent rejects the Claimants' assertion that, regardless of the outcome of this arbitration, the Respondent should be liable for the costs associated with its requests to bifurcate the proceedings or exclude the Claimants' counsel or the Matter of Ms. S for the following reasons:

> (i) *Firstly, the Respondent notes that the actual costs of these incidental proceedings are to be assessed after the Parties submit their respective statements of costs. The costs of these proceedings will probably be only a small portion of the entire costs related to the matter. Accordingly, there seem to be no good reason to depart from the general rule of "costs-follow- the-event", which looks at the principal outcome of the merits of the case...*
>
> (ii) *Secondly, the outcome of these incidental proceedings should be taken into account. Clearly, the Claimants lost both challenges against the Respondent's counsel. They prevailed with respect to the Respondent's challenge against the Claimants' counsel. However, it should be noted that the cost added by that challenge to the cost of the already pending challenge from the Claimants' against the Respondent's counsel was insignificant. This is reflected both in the record of the Minutes of the First Session of the Tribunal and in the proportion, in which either challenge was discussed by the Tribunal in its Procedural Order No. 2. In its turn, although the Respondent's request for bifurcation of the proceedings was rejected by the Tribunal, this was done based on the Tribunal's assessment of the best way to ensure the efficient conduct of the present case. The Tribunal took the view that some of the jurisdictional objections made by the Respondent can only be decided after an analysis of the merits of the case. Accordingly, there seem to be no reason why the decision on costs related to the decision on bifurcation should not follow the outcome of the merits of the case.*[326]

[326] Respondent's Rejoinder dated 20 March 2014, paras. 513-515.

C. The Tribunal's analysis

522. Both Parties agree that in principle the "*costs should follow the event*" principle should be applied. The Tribunal has ruled that the Claimants' claims have failed. The Tribunal, therefore, awards the Respondent its costs set forth in paragraph 514 (i) through (vi), its additional costs set forth in the 31 December 2014 letter as stated above in paragraph 515, and its share of the arbitration costs set forth at paragraph 512. As a consequence, the Claimants are ordered to pay to the Respondent (i) the Respondent's share of the arbitration costs (i.e. one half of the total arbitration costs) amounting to US$ 455,007.28; (ii) the costs set forth in paragraph 514 (i) through (vi), amounting to US$ 2,270,627.00; and (iii) the costs set forth at paragraph 515 (iii) amounting to US$22.82. Hence, the Claimants are ordered to pay the Respondent a total amount of US$ 2,725,657.10.

523. At the same time the Tribunal awards the Claimants the following costs:

(i) US$ 44,801.17 connected with the Respondent's Request for Bifurcation, since the same was rejected by the Tribunal.

(ii) US$ 14,543.75 connected with the Matter of Dr. J , since the Respondent's request was rejected.

(iii) US$ 25,865.00 connected with the Matter of Ms. S , since the Tribunal found that that the Claimants' concerns were legitimate.

524. The Tribunal, however, rejects the Claimants' request for costs relating to the Respondent's application to admit new evidence, since the Application was allowed.

525. The Parties are entitled to set-off the amounts awarded to each against the amounts owed to the other.

526. The Tribunal is grateful to counsel for both Parties for presenting this complex case with great ability.

IX. AWARD

527. For the reasons set forth above, the Tribunal, by majority, decides as follows:

(1) The present dispute relates to "*matters of taxation*" pursuant to Article VI(2) of the Poland-U.S. BIT.

(2) The present dispute does not relate to the violation of an obligation relating to the observance and enforcement of an investment agreement pursuant to Article VI(2)(c).

(3) Consequently, this Tribunal only has jurisdiction to hear the Claimants' claims based on expropriation (Article VII) and transfers (Article V) pursuant to Article VI(2)(a) and VI(2)(b).

For the reasons set forth above, the Tribunal unanimously decides as follows:

(4) The Claimants' claim relating to expropriation (Article VII) has failed.

(5) The Claimants' claim relating to transfers (Article V) has failed.

(6) Consequently, the Claimants are not entitled to any damages.

(7) The Respondent is awarded its share of the costs of the arbitration and other costs incurred in connection with this proceeding in the amount of US$ 2,725,657.10.

(8) The Claimants are awarded costs of US$ 85,209.92 on account of the applications on which they succeeded.

(9) All other claims are dismissed.

Professor Francisco Orrego Vicuña
Arbitrator

Date: 7 November 2015

(Signed subject to the attached Partial Dissenting Opinion in accordance with Article 52(2) of the ICSID Arbitration (Additional Facility) Rules)

Professor Claus von Wobeser
Arbitrator

Date: 10 November 2015

Mr. Makhdoom Ali Khan
President of the Tribunal

Date: 17 November 2015