Kluwer Arbitration Blog

Brussels Court Sets Aside Investment Treaty Award for Wrongfully Finding Poland Breached its FET Obligation through Denial of Justice

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On 18 February 2022, the Brussels court of first instance set aside an UNCITRAL award regarding a claim brought against the Republic of Poland under the US-Poland bilateral investment treaty (**US-Poland BIT**). This is the first time we see a Belgian court set aside an investment treaty award. The court decided that the arbitral tribunal violated Belgian international public policy in finding that Poland failed to guarantee a fair and equitable treatment (**FET**) to an investor because the Polish Supreme Court denied justice through its arbitrary and discriminatory decision.

1. **Factual background**

In 2006, a US investor, Manchester Securities Corp. (**MSC**), acquired bonds issued by a Polish real estate developer to finance residential building projects in Krakow. The bonds were secured by mortgages. The developer also contracted other secured loans with Polish state banks. When the developer failed to meet its repayment obligations in 2007, all outstanding amounts became immediately due. Before the real estate developer went bankrupt in 2009, the regional tribunal of Krakow had already ordered it to a pay MSC the outstanding debt. However, trouble started for MSC when it tried to enforce this judgment by enforcing the mortgages.

Ultimately, in 2012, the Polish Supreme Court awarded a challenge of the validity of MSC's mortgage brought by purchasers of one property. The Supreme Court held that MSC's mortgage conflicts with the principle of "social co-existence" and that MSC – being aware of the economic risks of the real estate project – behaved dishonestly and should not be allowed to benefit from its mortgage entitlements.

In response, MSC brought a claim to invalidate the mortgage on another property held by a Polish bank involved in the real estate project. Although MSC relied on the same arguments as upheld in the 2012 Supreme Court decision, MSC's claim was found inadmissible.

In the same period, MSC tried to enforce its mortgage rights on two specific apartments in this same property. The Polish Supreme Court decided in 2012 that the enforcement for the first apartment violated the principles of social co-existence, but it decided for the other apartment in 2014 that MSC's enforcement claim did not violate these principles.

In short, the Polish Supreme Court decisions on the validity and enforcement of the mortgages on various properties of the real estate project have led to very different conclusions.

In 2015, MSC brought arbitration proceedings against Poland under the US-Poland BIT. On 7 December 2018, the arbitral tribunal decided that MSC was denied justice by the Polish Supreme Court and that Poland had breached the FET clause and must pay damages of +/- EUR 10,000,000 and interest. As the seat of the arbitration proceedings was Brussels, Poland brought set aside proceedings in the Brussels first instance court in March 2019.

2. **Set aside proceedings before the Brussels court**

After extensive written submissions, three merit hearings were scheduled in January 2022, suggesting that the first instance court considered the case to be a complex one.

2.1 Set aside was not excluded

The parties did not exclude set aside proceedings, even though article 1718 of the Belgian Judicial Code foresees this possibility for arbitrations with a seat in Belgium between parties who have no connection with Belgium (as is the case for MSC and Poland), even for awards that are contrary to Belgian international public policy (*see*, C. Verbruggen, article 1718, in *Arbitration in Belgium*, N. Bassiri and M. Draye, Kluwer, 2016, p. 492, § 19. The fact that an award is contrary to international public policy will however be a ground for objecting to the enforcement of the award in Belgium).

2.2 The court's power to assess the arbitral tribunal's finding of denial of justice

The court only examined Poland's argument that the arbitral tribunal acted as an appeal court to the Polish Supreme Court, which is contrary to Belgian international public policy and which, under article 1717, §3, b), ii) of the Judicial Code, constitutes a ground for setting aside an award.

First, the court confirms that only the international public policy and not Belgium's internal public policy rules can serve as set aside ground. The court then acknowledges the different definitions for international public policy, including the definition developed by the Belgian Supreme Court (Cass., 15 March 1968, *Pas.*, 1968, I, p. 884) and the definition set out in the International Law Association report of 2002 (ILA, Committee on international commercial arbitration, Final Report on public policy as a bar to enforcement of international arbitral awards, New Delhi, 2002, Recommendation 1, (d)).

Next, after having described the decision of the arbitral tribunal, the court explains that (i) international arbitration proceedings may not serve as appeal proceedings to reverse decisions of domestic judiciary courts; (ii) the bar for showing denial of justice is high and requires the proof of a generalised breakdown of an entire national judicial system; and (iii) proof of a factual or legal error by an individual judge is not sufficient to show denial of justice, which at its core contains bad faith rather than a judiciary mistake.

Then the court explains that the prohibition to deny justice as a principle of international law forms part of Belgium's international public policy and that this is illustrated by the recognition of fundamental due process rights in article 6 of the European Convention on Human Rights.

The court goes on to clarify that, whilst the Belgian Supreme Court held that article 1717, § 3, b), ii) of the Judicial Code does not require that the set aside judge re-examines the dispute with regard to public policy rules, it does require the judge to verify whether the award is contrary to public policy (Cass., 28 November 2014, Pas., 2014, I, n° 736). The set aside judge must control the application by the arbitrator of the public policy laws (B. Hanotiau and O. Caprasse, "L'annulation des sentences arbitrales", *J.T.*, 2004, p. 419, § 41). The restrictive interpretation of set aside grounds under the *favor arbitrandum* principle, does not prevent the effective control of the effect of an award on international public policy. This means that there needs to be a causation between the violation of the international public policy rule and the result of the award. The court concludes that it may therefore verify whether the arbitral tribunal could reasonably consider that there was a denial of justice by the Polish courts.

2.3 The investment treaty award violates Belgian international public order

The court notes that the arbitral tribunal found the Polish Supreme Court's position was arbitrary and discriminatory because it had reached different decisions in related proceedings, but it did not establish a structural breakdown of the Polish judiciary system or fraudulent behaviour or bad faith by the Polish Supreme Court. Further, the fact that the Polish Supreme Court had reached these different decisions should not have allowed the arbitral tribunal to make findings of discrimination by the Polish court system, which has no binding precedents. Also, by examining the Polish Supreme Court's interpretation of the principles of social co-existence, the arbitral tribunal had exceeded its marginal appreciation powers. As a consequence, the arbitral tribunal in reality acted as an appeal judge to the Polish Supreme Court. As the imperfect or erroneous nature of one single judicial decision is insufficient to demonstrate the failure of an entire judicial system, the arbitral tribunal was wrong to consider that the Polish Supreme Court had denied justice by adopting a discriminatory attitude towards MSC. Hence, the court finds that the arbitral award breaches the Belgian international public policy and it sets aside the award.

3. **Original reasoning**

The court's decision that denial of justice requires proof of a deeper court system dysfunction than one single court decision, appears uncontroversial, as is the principle that international arbitration is not an appeal instance to domestic judicial decisions.

More original is the court's reasoning that the arbitral tribunal's finding of denial of justice by the Polish courts breaches Belgium's international public policy:

- The definition of the Belgian international public policy refers to the interests of Belgium as jurisdiction of the set aside court (*see* ILA report, Recommendations 1, (c), 2(a)), whereas the court projects these interests on the Polish State. This could imply that, for example, an arbitral tribunal's finding of fraud or corruption in an investment protection case, can be questioned on matters such as standard of proof or on due process rights in later set aside proceedings, to the

extent these would be viewed as "transnational public policy" rules (*see* ILA report, Recommendation 2, (b) and 3(b)).

- International public policy rules in relation to due process concern procedural guarantees and remedies against unfair proceedings. In this case, the court inverted this principle and found that the award breached Belgian international public policy because the arbitral tribunal wrongfully considered that the Polish proceedings were unfair. The issue in this case is indeed not "did the arbitral tribunal fail to guarantee due process" but rather "did the arbitral tribunal properly verify whether the Polish courts guaranteed due process".

Some commentators questioned if the court did not exceed the limits of its competence by assessing if the decision of the Polish Supreme Court constituted a denial of justice. Presumably, the court foresaw this concern and expressly set out the extent of its competence with reference to guidance of the Belgian Supreme Court (*see* above). It might be debated whether the court correctly applied this guidance and did not do more than merely verifying if the arbitral award is not in violation with public policy.

Others have queried the tension between Belgium's obligation (i) as EU Member State to recognise judgments of other Member States as part of the principle of mutual trust and (ii) as Contracting State under the New York Convention to recognise and enforce arbitral awards. However, it seems that both obligations require Belgium to apply the same test: recognise and enforce the judgment or arbitral award, unless that is manifestly contrary to public policy in Belgium (*see A*rticle 45 *juncto* 46 of the Brussels Recast Regulation and Article V.2(b) of the New York Convention).

MSC has announced that it bring an appeal in the Belgian Supreme Court, so further updates are to be expected.

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