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## Investment Recommendations for RCEP

This Policy Brief offers a concise overview of the some of the most important issues in RCEP investment negotiations, namely the risk of foreign investors treaty-shopping (and to control it), the treatment of tax matters under investment treaties, and the limits of general exceptions clauses modeled on the GATT.

### Why is the RCEP investment chapter important? Assessing the Exposure of Asian States to Investment Claims

Asian states are not immune any longer to investor-state arbitration. Investment treaties have teeth as demonstrated by recent trends in growing claims under ISDS provisions. This makes any commitment under the RCEP investment chapter a potential candidate for foreign investor to file an investment claim.

The first-ever case brought against an Asian state was the one involving a Hong Kong claimant against Sri Lanka in 1987. Some Asian states have not yet experienced investment litigation, including New Zealand, Brunei Darussalam, Nepal, Afghanistan, Vanuatu, Tonga, Hong Kong China, Japan, Taiwan, or Singapore.

However, since 1987 a growing number of states (36 in total) have been challenged by international arbitration. More importantly, if only an average of four claims a year were initiated from the early 2000s to 2010, there was a sharp increase in 2011. In 2011, more than ten disputes were initiated. It is expected that 2016 will be another rich year, with eight disputes already as of May 2016.

It is of course risky to predict the future but litigation requires instruments, knowledge of these instruments and a significant volume of foreign direct investment (FDI). All three parameters are now satisfied in most Asian states.

- Most Asian states have entered into investment treaties over the last few years and are expanding their networks of International Investment Agreements (IIAs). All these new agreements are the instruments which, soon, will likely lead to more litigation.
- Equally important has been the growth of knowledge of the treaties that relate to private practice and legal education on investment matters. There is no wide study and measure of such knowledge, but it seems to be a trend in many Asian-based law firms to develop an “arbitration” department and for many universities to establish programs on investment regulation. These developments will nurture the capacity of investors who will rely on expert legal advice to bring claims before arbitration against Asian states.
- The regular increase of foreign investment into Asian economies is also important. By definition, there were fewer disputes in the early 2000s in Asia because the volume of FDI was lower. It is because FDI is increasing that the likelihood of having to face claims is becoming more significant.

These three parameters have to be combined to understand the prospects for litigation against Asian states. They actually reveal a great potential which hitherto has been ignored or marginalized. However, investor-state arbitration is developing fast in Asia, and one can predict a more intense practice in the coming years. In this connection, careful attention should be paid by negotiators to the following issues.

#### *Read further:*

Julien Chaisse 'The Shifting Tectonics of International Investment Law-- Structure and Dynamics of Rules and Arbitration on Foreign Investment in the Asia-Pacific Region' (2015) 47(3) *George Washington International Law Review* 563-638



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<https://cuhk.academia.edu/JulienChaisse>

Julien Chaisse 'Assessing the Exposure of Asian States to Investment Claims' (2013) 6(2) *Contemporary Asia Arbitration Journal* 187-225 also at <https://cuhk.academia.edu/JulienChaisse>

### **The practice of structuring (and restructuring) of investments to gain access to investment agreements**

There is no official definition of treaty shopping. Also, as a matter of law, treaty shopping is not, in principle, prohibited under international investment law, as the precise purpose of IIAs is to encourage investment.

In light of the corporate practice, one can formulate a definition describing treaty shopping as the process of routing an investment so as to gain access to an IIA where one did not previously exist or to gain access to more favorable IIA protection. In addition, treaty shopping can further be narrowed by introducing a temporal element and by focusing the definition on restructuring by the transfer of shares or otherwise at the time when the investment is already under some threat, such as in the case of revocation of a license or termination of a contract. In essence, treaty shopping refers to the practice of structuring (and restructuring) investments to gain access to international jurisdiction.

There are eight investment awards that have openly dealt with the issue of treaty shopping. It is a perfectly legitimate goal—and no abuse of an investment protection treaty regime—for an investor to seek to protect itself from the general risk of future disputes with a host State;<sup>1</sup> but the same is not the case in relation to pre-existing disputes between the specific investor and the State.<sup>2</sup>

There is no abuse of rights in restructuring an investment to obtain bilateral investment treaty (BIT) protection. However, for pre-existing disputes

to restructure investments only in order to gain jurisdiction under a BIT would, in the words of Phoenix Action, be an “abusive manipulation of the system”).<sup>3</sup> Also, compared to the more than three hundred awards rendered so far by international tribunals, quantitative analysis shows that treaty shopping is not a significant practice which currently distorts the essence of investment treaties and investment arbitration.

However, just because past awards have not openly discussed the issue of treaty shopping, the practice may increase as indicated by the recent attempts of Philip Morris against Australia. The investment regime is now better known to lawyers and combined with the expansion of foreign investment throughout the world, one can reasonably hypothesize an increase in treaty shopping.

This risk is tangible in light of the great variety of investment treaties and the different approaches chosen to determine the scope of some substantive rights. The absence of a multilateral agreement on investment further feeds the risk of treaty shopping.

While the risk of treaty shopping is increasingly high, some legal solutions include narrower definitions of investor and investment and/or stricter regimes on the admission and legality of the foreign investment. These solutions can also be combined to a clause on the denial of benefits (which remain largely untested before international tribunals). The Contracting Parties to a BIT are free to define their consent to jurisdiction in terms that are broad or narrow; once that consent is defined, tribunals should give effect to it, unless doing so would allow the ICSID Convention to be used for purposes for which it clearly was not intended.<sup>4</sup>

#### Read further:

Julien Chaisse 'The Issue of Treaty Shopping in International Law of Foreign Investment-- Structuring (and restructuring) of investments to gain access to investment agreements' (2015) 11(2) *Hastings Business Law Review* 225-306 also at <https://cuhk.academia.edu/JulienChaisse>

1. Phoenix Action v. Czech Republic notes that investments can be structured 'upstream' to avail themselves of international protection as confirmed in *Tokios Tokeles*. *Phoenix Action, Ltd.*, ICSID Case No. ARB/06/5, Award, ¶ 94.

2. *Tidewater Inc. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/10/5, Decision on Jurisdiction, ¶ 184 (Feb. 8, 2013).

3. *Venezuela Holdings B.V.*, ICSID Case No. ARB/07/27, Decision on Jurisdiction, ¶¶ 198, 205.

4. *Tokios Tokeles*, ICSID Case No. ARB/02/18, Decision on Jurisdiction, ¶ 39-40, 20 ICSID Rev. 205.



## Treatment of tax matters under investment treaties

Many would think that tax treaty law and the international investment treaties occupy two different worlds and two separate legal regimes. It is not the case; they largely overlap which suggests that RCEP negotiators should pay close attention to the treatment of tax in the RCEP investment chapter.

Some investment agreements exclude tax matters from its scope of application without any reservation. For example, Article 5(2) of the Argentina/New Zealand BIT (1999) provides as follows: “The provisions of this Agreement shall not apply to matters of taxation in the area of either Contracting Party. Such matters shall be governed by the domestic laws of each Contracting Party and the terms of any agreement relating to taxation concluded between the Contracting Parties.” Many other investment treaties exclude the application of NT, MFN, FET and other treaty standards from treatments resulting from ‘any matter’ related to taxation.

These restrictions appear often straightforward given the broad and sometimes ambiguous terms of these arrangements. The new phenomenon of investment arbitration has brought about a number of decisions from different arbitral fora in the tax sector, contributing to the formation of a jurisprudence that is elucidating the meaning of key provisions and contributing to the emergence of global economic regulation of tax matters. Importantly, fifteen disputes have resulted in significant compensation being paid by host states for breaching investment treaty commitments by imposing tax measures. The details of these fifteen disputes show that there a number of provisions which have proven decisive to justify the claims of the taxpayers, namely, protection against expropriation, FET, FPS, non-discrimination, the umbrella clause, and PR.

An arbitration tribunal in an international investment case does not sit as a court of appeal to the local tax court or administrative body that decides tax cases in that state. Whether a certain tax is applicable under the laws of a state is a matter for the courts and administrative bodies of that state, not for the

arbitration tribunal. The arbitration tribunal decides whether the state breached any international obligations as set out in the IIA, in general international law or, perhaps, in the contract between the state and the investor. In other words, it is not the role of the arbitration tribunal to interpret and apply the tax laws of a state to an investor. But the way a state applies its tax laws, even if applied correctly under that state’s law, may very well constitute a breach of the obligations of that state under international law. As such, the matter can be both a question for a local tax court (to be decided solely on the tax laws of that state) and for an arbitration tribunal (to be decided on international investment law).

### Read further:

Julien Chaisse ‘International Investment Law and Taxation: From Coexistence to Cooperation’, World Economic Forum (WEF) E15 Task force on Investment Policy, 24 pages. Available for free online at

<http://e15initiative.org/publications/international-investment-law-taxation-coexistence-cooperation/>

Julien Chaisse and Michael Lang ‘China and Hong Kong-- An International Tax Perspective (Hong Kong: Wolters Kluwer, 2014) 337 p (Book only).

## Preserving public policies from investors claims: Use and Abuse of general exceptions clause

In the WTO context, Article XX has served as a last resort stopgap measure, not as a proactive environmental or health policy instrument. This type of clause puts the burden of proof on the party accused of violating non-discrimination principles, and success with using the Article in the GATT has not been high. While agreements that fit Article XX into one of the enumerated settings has not been hard, meeting the “good faith” clause of the chapeau has not been easy. It seems to have caught many arbitrary and disguised restrictions on trade.

In the practice of the WTO law, GATT Article XX plays a tremendous role in WTO litigation to balance free trade requirements and other public policy goals, such as health, which is a source of inspiration for international investment treaties, but does not seem to be the ideal tool to ensure, for instance, that tobacco controls do not violate investment treaty commitments.



Recent investment treaties increasingly adopt GATT Article XX-like general exceptions which does not seem a good public policy option for RCEP.

This type of incorporation means that the investment treaty simply uses the wording of WTO law and even makes explicit reference to this model. Some IIAs incorporate Art. XX, GATT or Art. XIV, General Agreement on Trade in Services (GATS), *mutatis mutandis*. Some others incorporate both, which shows a very inconsistent treaty practice. As an example, the New Zealand-Malaysia Free Trade Agreement was signed in Kuala Lumpur on October 26, 2009.<sup>5</sup> Chapter 10 is covers investment and chapter 17 is covers exceptions. Chapter 17 and its Article 17.1 are about General Exceptions.

Some other investment treaties do not cite the WTO model but employ a wording so close that the inspiration is obvious. As an example, see the Singapore-Jordan Bilateral Investment Treaty (BIT) that was concluded on April 29, 2004 and came into force on August 22, 2005.<sup>6</sup> On the same day, respectively, the Singapore-Jordan Free Trade Agreement was also concluded and entered into force.<sup>7</sup>

In fact, a “general exceptions” clause similar to GATT Article XX is not a panacea and does not help to better balance investment protection and health protection. Such a clause appears in most cases as either unsuited for the investment law regime (with respect to the national treatment standard) or unnecessary due to the congruence with investment protection standards (fair and equitable treatment and full protection and security).

<sup>5</sup> New Zealand-Malaysia Free Trade Agreement, Oct. 26, 2009 [2010] NZTS 09, available at [http://www.parliament.nz/NR/rdonlyres/EF72A49B-246D-4775-88EB-1606723EC005/209843/DBHOH\\_PAP\\_22632\\_NewZealandTreatySeriesMalaysiaNewZ.pdf](http://www.parliament.nz/NR/rdonlyres/EF72A49B-246D-4775-88EB-1606723EC005/209843/DBHOH_PAP_22632_NewZealandTreatySeriesMalaysiaNewZ.pdf).

<sup>6</sup> Bilateral Investment Treaty Between the Government of Hashemite Kingdom of Jordan and the Government of the Republic of Singapore, Jordan-Sing., May 16, 2004, [http://www.worldtradelaw.net/fta/agreements/JorSing\\_BilInvTreaty.pdf](http://www.worldtradelaw.net/fta/agreements/JorSing_BilInvTreaty.pdf) [hereinafter BIT Jordan-Sing.]

<sup>7</sup> The SJFTA and the BIT form part of a broader Framework on Closer Economic Partnership between Singapore and Jordan, which also includes a Technical Support Agreement signed in October 2003 and a Memorandum of Understanding in Cultural and Tourism Cooperation signed during the Official Visit of then Prime Minister Goh Chok Tong to Jordan in February 2004.

#### Read further:

Julien Chaisse 'Exploring the Confines of International Investment and Domestic Health Protections-- General exceptions clause as a forced perspective' (2013) 39(2/3) American Journal of Law & Medicine 332-361 also at <https://cuhk.academia.edu/JulienChaisse>

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Julien Chaisse 'Exploring the Confines of International Investment and Domestic Health Protections-- General exceptions clause as a forced perspective' (2013) 39(2/3) American Journal of Law & Medicine 332-361

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Julien Chaisse and Puneeth Nagaraj 'Changing Lanes-- Trade, investment and intellectual property rights' (2014) 36(1) Hastings International and Comparative Law Review 223-270

Julien Chaisse and Michael Lang 'China and Hong Kong-- An International Tax Perspective (Hong Kong: Wolters Kluwer, 2014) 337 p.

Julien Chaisse 'The Issue of Treaty Shopping in International Law of Foreign Investment-- Structuring (and restructuring) of investments to gain access to investment agreements' (2015) 11(2) Hastings Business Law Review 225-306

Julien Chaisse 'The Shifting Tectonics of International Investment Law-- Structure and Dynamics of Rules and Arbitration on Foreign Investment in the Asia-Pacific Region' (2015) 47(3) George Washington International Law Review 563-638

Julien Chaisse 'International Investment Law and Taxation: From Coexistence to Cooperation' (2016) World Economic Forum (WEF) E15 Task force on Investment Policy, 24 pages

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