



## Investment treaties and taxation

9 October 2020

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## Agenda

### I. Investment treaties in general

- i. Raison d'être
- ii. Sources of international investment law
- iii. Investment arbitration

### II. Scope of bilateral investment treaties

- i. Personal scope
- ii. Objective scope

### III. Substantive provisions

- i. Full Protection and Security / Fair and Equitable Treatment
- ii. National Treatment / Most Favored-Nation
- iii. Expropriation
- iv. Umbrella Clause

### IV. Cases

- i. Corn Products International v Mexico
- ii. 9REN Holding v Spain

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## Raison d'être

**AGREEMENT**  
**BETWEEN THE GOVERNMENT OF THE REPUBLIC OF FRANCE**  
**AND THE GOVERNMENT OF THE UNITED MEXICAN STATES**  
**ON THE RECIPROCAL PROMOTION AND PROTECTION**  
**OF INVESTMENTS**

The Government of the Republic of France and the Government of the United Mexican States hereinafter referred to as the Contracting Parties,

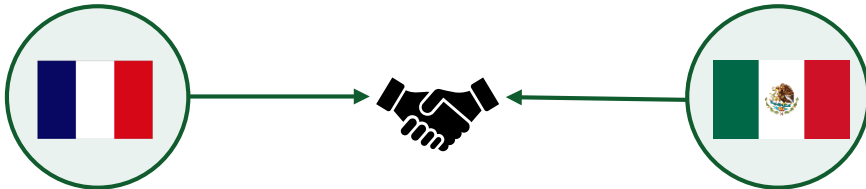
Desiring to strengthen the economic cooperation between both States and to create favourable conditions for French investments in Mexico and Mexican investments in France,

Convinced that the promotion and protection of these investments would succeed in stimulating transfers of capital and technology between the two countries in the interest of their economic development,

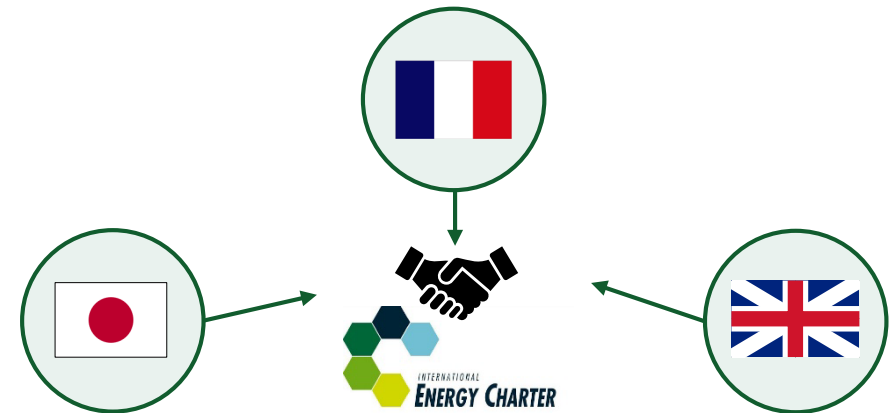
*Extract preamble, BIT France – Mexico*

## Sources of international investment law

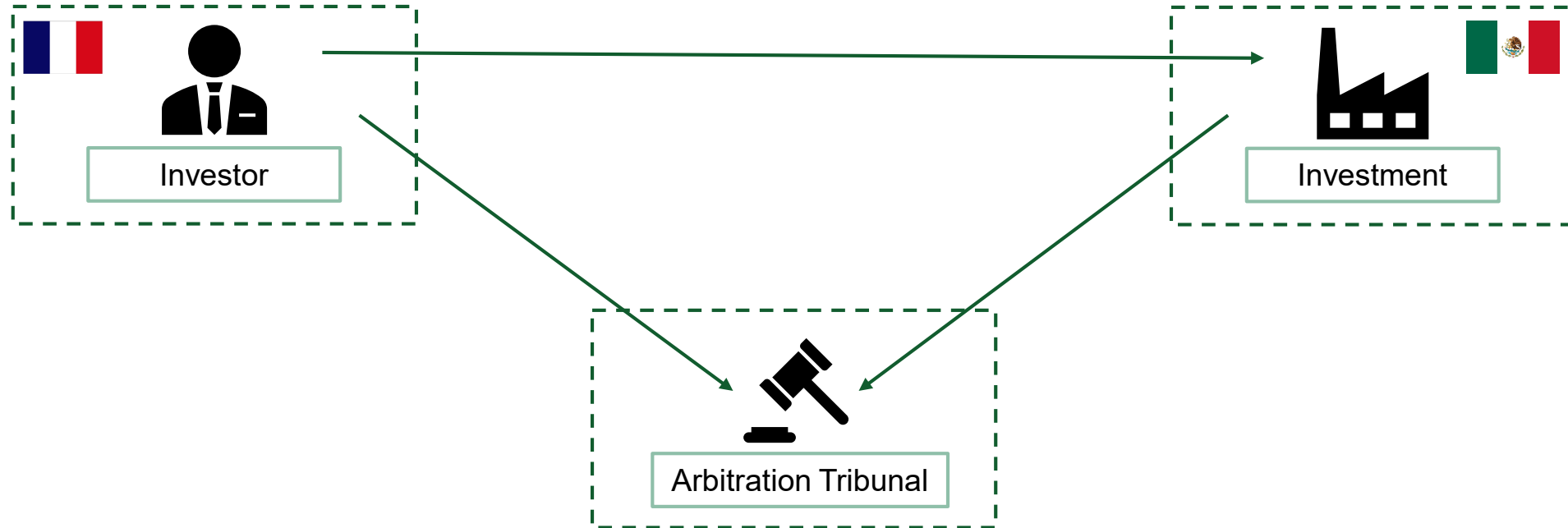
### Bilateral investment treaties



### Multilateral investment treaties



## Investment arbitration



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## Personal scope

### Personal scope: Nationality of the investor

- (7) "Investor" means:
- (a) with respect to a Contracting Party:
    - (i) a natural person having the citizenship or nationality of or who is permanently residing in that Contracting Party in accordance with its applicable law;
    - (ii) a company or other organization organized in accordance with the law applicable in that Contracting Party;<sup>6</sup>
  - (b) with respect to a "third state", a natural person, company or other organization which fulfils, mutatis mutandis, the conditions specified in subparagraph (a) for a Contracting Party.

*Extract art. 1 Energy Charter Treaty*

## Personal scope

→ Nationality is determined according to the laws of the state whose nationality is claimed

### Individuals

- Nationals of the host state: generally excluded according to art. 25(2)(a) ICSID
- Dual citizenship: generally entitled to investment treaty protection unless otherwise stated

### Legal entities

- Different criteria for definition of nationality:
  - place of incorporation
  - seat of business
  - place of real economic activity
- Piercing of the corporate veil if controlled/owned by foreign nationals in certain treaties (denied in *Tokios Tokelés v Ukraine*)
- Denial of benefits clauses in certain treaties

## Objective scope

### Objective scope: Meaning of investment

- (6) "Investment" means every kind of asset, owned or controlled directly or indirectly by an Investor and includes:<sup>5</sup>
- (a) tangible and intangible, and movable and immovable, property, and any property rights such as leases, mortgages, liens, and pledges;
  - (b) a company or business enterprise, or shares, stock, or other forms of equity participation in a company or business enterprise, and bonds and other debt of a company or business enterprise;
  - (c) claims to money and claims to performance pursuant to contract having an economic value and associated with an Investment;
  - (d) Intellectual Property;
  - (e) Returns;
  - (f) any right conferred by law or contract or by virtue of any licences and permits granted pursuant to law to undertake any Economic Activity in the Energy Sector.

*Extract art. 1 Energy Charter Treaty*

## Objective scope

### Salini test

- Development of definition of an investment by arbitration tribunal in *Salini v Marocco* (however, the meaning of the Salini test is controversial)
- Definition of an investment according to the Salini test:
  - Certain duration
  - Assumption of a risk
  - Regular collection of profits and returns
  - Not inconsiderable own contribution by the investor
  - Contribution to the development of the host country

### Examples

- Projects confirmed as investments:
  - Construction projects
  - Purchase of financial instruments
  - Loans
  - Participation in companies
  - Mining operations
  - Agricultural operations
- Projects denied as investments:
  - Bank guarantees
  - Options
  - Ordinary one-off commercial contracts

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## Overview

Full Protection and Security /  
Fair and Equitable Treatment

National Treatment /  
Most Favored-Nation

Expropriation

Umbrella clause

## Full Protection and Security / Fair and Equitable Treatment

### Definition and scope

- Commitment to fair and equitable treatment and full security and protection for investors and their investments
- Flexible, vague standards, whose normative content is expanded in case law
- Protection under FPS, e.g.:
  - Protection against physical violence and harassment
  - Legal protection (controversial)
- Protection under FET, e.g.:
  - Stability and protection of the investor's legitimate expectations
  - Transparency

### Intersection with taxation

Breach of treaty e.g. affirmed:

- Inconsistent practice in reimbursing VAT after change of a tax law without clarification on its new meaning (*Occidental Exploration and Production v Ecuador*)
- Intensive controls by tax authorities (*Rompetrol v Romania*)

## National Treatment / Most Favored-Nation

### Definition and scope

- Foreign investors/investments should not be treated less favorable as domestic investors or investors from a third state  
→ Establishing a level playing field
- Conditions:
  - Treatment of the foreign investor by the host state
  - Foreign and domestic/third state investor in like circumstances
  - Less favorable treatment accorded to foreign investor than to domestic/third state investor
  - No justification of less favorable treatment
- WTO jurisprudence is not necessarily relevant for the interpretation of the investment treaty (e.g. NAFTA: “in like circumstances” ≠ GATT: “like goods” (see *Methanex v United States*))

### Intersection with taxation

- BITs (e.g. French Model BIT) often contain tax carve-outs regarding the NT / MFN provision
- Tax treaties contain non-discrimination provisions with a similar rationale
- Potential of conflict between tax treaties and NT / MFN, e.g.:
  - Entitlement to equal treatment as resident taxpayers?
  - Entitlement to tax treaties concluded with third countries?
- E.g. an excise tax that only affects foreign producers who are in competition with domestic producers, was regarded as discriminatory (*Corn Products v Mexico*)

# Expropriation

## Definition and scope

- Most severe action of a state towards a foreign investor
- Covers direct and indirect expropriations
  - Direct = formal deprivation of property right
  - Indirect = deprivation of possibility of utilizing the investment in a meaningful way
- An expropriation might be lawful if it
  - Serves a public purpose,
  - is not discriminatory,
  - follows a due process, and
  - is compensated.

## Intersection with taxation

- Determination of threshold for expropriation is difficult, especially for taxes, which by their nature interfere with the investor's property → only in exceptional cases taxation can be understood as expropriation
  - No expropriation: partial denial of VAT refunds (*EnCana v Ecuador*) and 20% excise tax (*Corn Products v Mexico*)
  - Expropriation: taxation combined with other measures led in their entirety to expropriation in Yukos cases (inter alia *RosInvestCo UK v Russia*)
- Some treaties contain tax carve-out clauses for expropriations

## Umbrella clause

### Definition and scope

- Covers other disputes related to investments (not only treaty violations)
- Additional protection, covering agreements between the host state and the investor, as obligations arising from such agreements become enforceable
- Several unsettled questions regarding the scope and conditions, e.g.:
  - Only governmental acts or commercial acts as well covered?
  - Contractual obligations as well as unilateral obligations included?
  - Obligations covered which are entered by states or also by entities under state control?

### Intersection with taxation

- Umbrella clauses can e.g. cover arrangements on future taxation, such as tax stabilization agreements
- Clause was e.g. successfully invoked regarding a tax stabilization agreement, when a merger was recharacterized as sham transaction (*Duke Energy International v Peru*)
- Possible conflicts with BEPS obligations?

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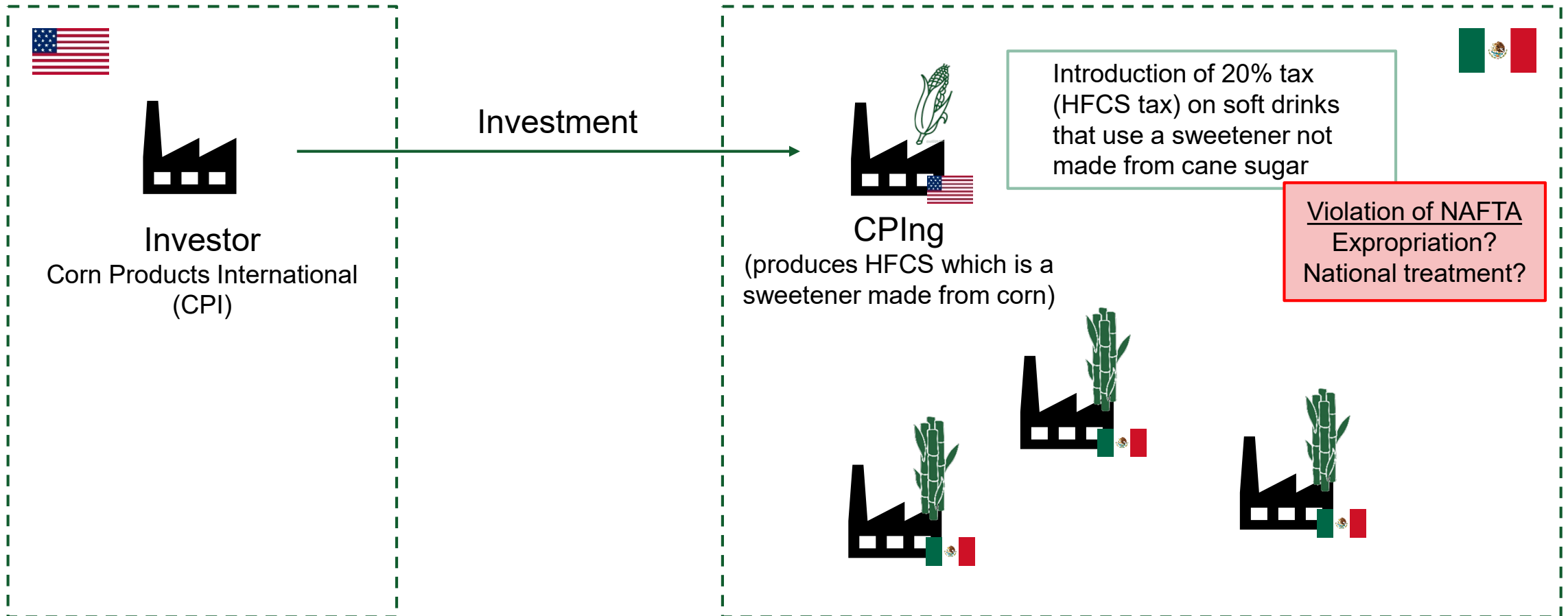
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# Corn Products International v Mexico (ICSID Case No. ARB(AF)/04/01)\*



\*Simplified facts of the case

## Corn Products International v Mexico (ICSID Case No. ARB(AF)/04/01)

### Article 1110: Expropriation and Compensation

1. No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment ("expropriation"), except:

- (a) for a public purpose;
- (b) on a non-discriminatory basis;
- (c) in accordance with due process of law and Article 1105(1); and
- (d) on payment of compensation in accordance with paragraphs 2 through 6.

*Extract NAFTA*

## Corn Products International v Mexico (ICSID Case No. ARB(AF)/04/01)

### Article 1102: National Treatment

1. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.
2. Each Party shall accord to investments of investors of another Party treatment no less favorable than that it accords, in like circumstances, to investments of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

*Extract NAFTA*

## Corn Products International v Mexico (ICSID Case No. ARB(AF)/04/01)

### Tribunal decision on expropriation

- In this case “no physical taking of property or forcible transfer of title”
- An expropriation requires in such situations that “the taking must be a substantially complete deprivation of the economic use”
- CPI was exposed to a certain loss due to the HFCS tax, however they maintained control and also, they themselves held that no long-term effects were expected from the HFCS tax
- CPI failed to show that the HFCS amounted to expropriation

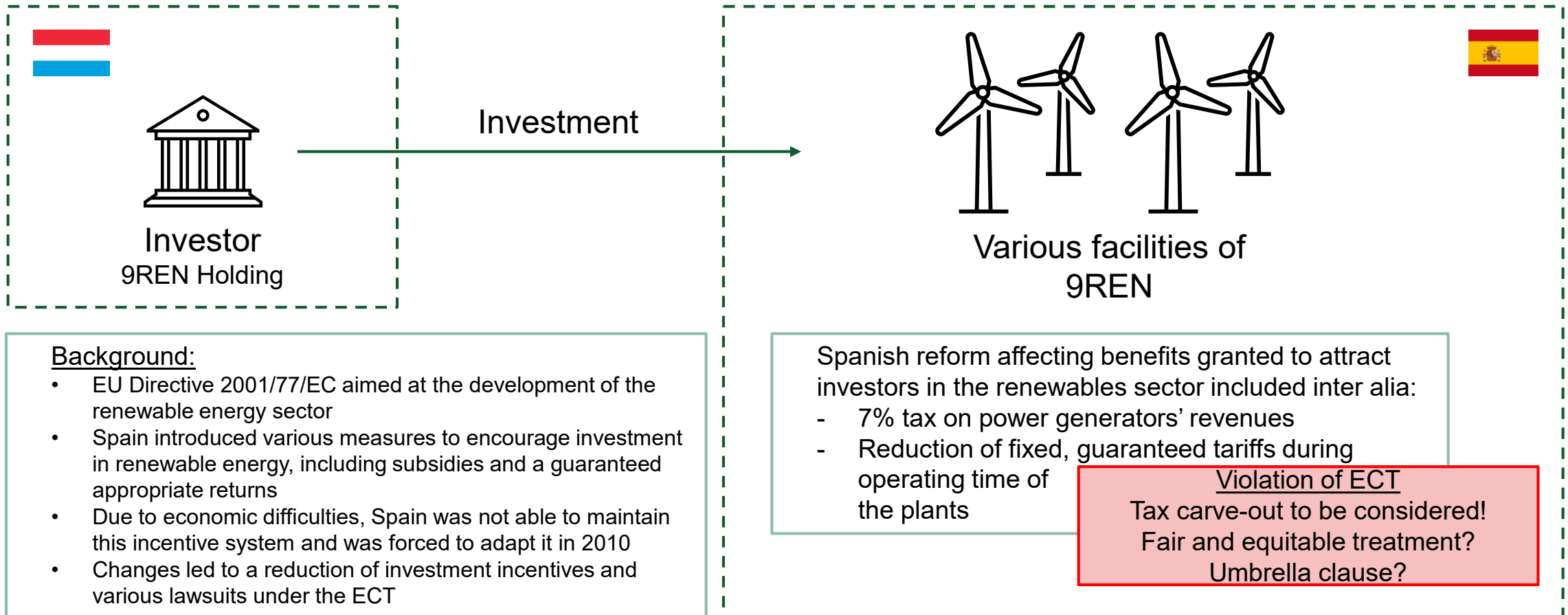


### Tribunal decision on national treatment

- HFCS tax was treatment accorded by Mexico to CPI as the effect of which targeted HFCS producers and not soft drink bottlers
- Domestic cane sugar and foreign corn sugar (=HFCS) producers were in like circumstances as they operated in the same business and their products (cane sugar and HFCS) were in direct competition as sweeteners for soft drinks
- Only foreign owned companies produced HFCS, cane sugar producers were mainly Mexican
- Tax on the soft drinks led to less favorable treatment of foreign suppliers



## 9REN Holding v Spain (ICSID Case No. ARB/15/15)\*



\*Simplified facts of the case

## 9REN Holding v Spain (ICSID Case No. ARB/15/15)

### ARTICLE 21

### TAXATION

- (1) Except as otherwise provided in this Article, nothing in this Treaty shall create rights or impose obligations with respect to Taxation Measures of the Contracting Parties. In the event of any inconsistency between this Article and any other provision of the Treaty, this Article shall prevail to the extent of the inconsistency.

*Extract ECT*

## 9REN Holding v Spain (ICSID Case No. ARB/15/15)

### Tribunal decision on the tax carve-out regarding the TVPEE

- Article 21 contains general exclusion for taxation matters:
  - FET (article 10(1)) would fall outside the tribunal's jurisdiction for taxation measures
  - But illegal expropriation (article 13) could nevertheless be examined
- TVPEE = 7% tax on all revenues received from generation of electricity
- 9REN holds the view that TVPEE does not constitute a tax, but simply reduces the set tariffs and thereby the incentives for investors
- Does TVPEE qualify as a tax within the meaning of article 21 ECT?
  - Levy established by law → TVPEE is law duly enacted
  - That imposes obligations on a defined class of persons, → imposed on producers who sell electricity
  - Generates revenues going to the State and → proceeds flowed to the State's treasury
  - These revenues are used for public purposes → reduction of tariff deficit
- Tribunal qualified TVPEE as a tax and thus this levy could not be tested with the FET standard



## 9REN Holding v Spain (ICSID Case No. ARB/15/15)

### ARTICLE 10

#### PROMOTION, PROTECTION AND TREATMENT OF INVESTMENTS<sup>19</sup>

- (1) Each Contracting Party shall, in accordance with the provisions of this Treaty, encourage and create stable, equitable, favourable and transparent conditions for Investors of other Contracting Parties to make Investments in its Area. Such conditions shall include a commitment to accord at all times to Investments of Investors of other Contracting Parties fair and equitable treatment. Such Investments shall also enjoy the most constant protection and security and no Contracting Party shall in any way impair by unreasonable or discriminatory measures their management, maintenance, use, enjoyment or disposal. In no case shall such Investments be accorded treatment less favourable than that required by international law, including treaty obligations.<sup>20</sup> Each Contracting Party shall observe any obligations it has entered into with an Investor or an Investment of an Investor of any other Contracting Party.<sup>21</sup>

Umbrella clause

*Extract ECT*

## 9REN Holding v Spain (ICSID Case No. ARB/15/15)

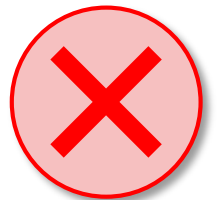
### Tribunal decision on the violation of fair and equitable treatment

- Balancing of the state's regulatory autonomy against international obligations
- Enforceable legitimate expectations can arise from rules which are not specifically addressed, but which aim to attract investments and on which the investor has relied on
  - 9REN's legitimate expectations on tariff stability were frustrated, given the clear and specific representation of benefits
- Further factors relevant for violation of FET:
  - Financial vulnerability due to up-front capital costs and long term blocking
  - Spain benefitting from rising prices while risk of falling prices borne by investors



### Tribunal decision on applicability of the umbrella clause

- Obligation of Spain to pay the investors the guaranteed tariffs was claimed by 9REN as “any obligation” under the umbrella clause
- According to the tribunal only bilateral obligations such as contracts are protected, but not legislation or regulations as in the current case



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