

Kluwer Arbitration Blog

International Financial Services and Small States: Conference Report

Patricia Backhausen, Constantin von Hirsch (Wilmer Cutler Pickering Hale and Dorr LLP) · Sunday, February 26th, 2017 · WilmerHale

A conference titled ‘International Financial Services and Small States’ was held at Wilmer Cutler Pickering Hale and Dorr’s London office on 30-31 January 2017, jointly organised by the firm’s International Arbitration Practice Group and the Centre for Small States, Queen Mary University of London. The conference followed on from the ‘Integration and International Dispute Resolution in Small States’ conference in May 2016.

The conference took the form of a keynote address, three discussion panels and a reflection panel. One of the panels, chaired by Gary Born, focused on the use of international arbitration in financial matters and its relevance for Small State International Financial Centres (SS IFCs).

The two forms of tax dispute resolution

Carlos Ramos-Mrosovsky (Freshfields Bruckhaus Deringer) considered the two different forms of resolving tax disputes: negotiation between the states themselves pursuant to a tax treaty (the most widespread form), and arbitration pursuant to investment treaties. In view of the taxpayer’s lack of involvement in and control over the state-to-state negotiation procedure, Mr Ramos-Mrosovsky explained that, if possible, it was preferable for an individual to lodge a claim under a BIT. However, this was a big ‘if’, as there are a number of difficulties associated with bringing a tax claim under a BIT.

The first hurdle is establishing that a tax claim is arbitrable under the terms of the BIT: when compared to typical BIT clauses, tax disputes do not obviously fit within the scope of investment arbitrations – indeed many BITs explicitly exclude tax matters (e.g. the Hong Kong-New Zealand BIT), subject to certain exceptions, such as in the context of expropriation.

The second hurdle is proving that the measure really is a tax. The definition of what constitutes a tax matter will depend on whether domestic or international law is applied, and Mr Ramos-Mrosovsky highlighted how arbitral tribunals had reached differing conclusions on this point (in *Occidental Petroleum v. Ecuador* a domestic law definition was applied, whereas an international law definition was applied in *Burlington Resources v. Ecuador*).

The third hurdle is demonstrating that the tax dispute is admissible under the BIT. To qualify for the protection of the BIT, the individual must show that the tax in question is illegitimate. As a starting point, there is a basic presumption of validity in favour of legislative measures adopted by

a state, which has a sovereign right to impose such tax measures as it deems appropriate (*El Paso Energy v. Argentina*, at 290, 295). However, a measure might trigger the protection of the BIT if it was not a bona fide tax, but was rather an action “taken only under the guise of taxation, but [that] in reality aims to achieve an entirely unrelated purpose” (*Yukos award*, at 1407). Similarly, a tax might trigger the protection of the BIT if it was discriminatory (*Burlington Resources v. Ecuador*), or “extraordinary, punitive in amount or arbitrary in its incidence” (*En Cana v. Ecuador*, at 177) such that issues of indirect expropriation arise.

Arbitration in the financial sector

Claudia T Salomon (Latham & Watkins LLP) then discussed the extent to which arbitration has been adopted by the financial sector, a topical issue in the light of the November 2016 ICC Report on ‘Financial Institutions and International Arbitration’.

Ms Salomon, who co-authored the ICC Report, emphasised that it was unhelpful to speak of the financial ‘sector’ as a distinct sector: the suitability and popularity of arbitration varied greatly across the various branches of finance (derivatives, securities, M&A, project finance etc.), which were therefore best considered independently of each other as standalone sub-sectors. It was wrong, then, to speak of a general aversion to arbitration in the financial sector.

For especially complex and highly technical disputes (e.g. M&A, project finance), the possibility of choosing a panel with the required level of expertise was highlighted as a very attractive feature of arbitration, and financial institutions were particularly open to using arbitration for such disputes. The ease of enforcement was another important consideration, especially as financial institutions increasingly look towards emerging markets for growth. Confidentiality was a factor for certain transactions, though in general the desire for precedent prevailed.

However, finality was seen as a double-edged sword: financial institutions often preferred litigation precisely because it afforded the possibility of an appeal. Ms Salomon saw this as a potential opportunity for SS IFCs to differentiate themselves from other jurisdictions by incorporating the possibility of appealing an award into their arbitration procedure. Another perceived advantage of litigation was that litigation allows for a more expeditious disposal of straightforward proceedings such as simple debt actions. Ms Salomon again saw no reason why similar procedures could not be incorporated into arbitration legislation.

Financial dispute resolution and SS IFCs

Francoise Hendy (FRANHENDY Attorneys), however, showed little enthusiasm for the idea of SS IFCs embracing tax arbitration. In her view, the current system of tax dispute resolution worked well and she saw little need for change.

Ms Hendy also warned of the importance for SS IFCs of fostering good relationships with larger states and considered that treaty-based negotiation was more conducive to this, as well as allowing for more creative and flexible solutions, and at considerably less expense. Negotiation also obviated the need for creating a whole infrastructure for financial arbitration from scratch, something that presented particular difficulties for SS IFCs given their constraints on human capital.

The last point led chair Gary Born to question whether financial arbitration ought rather to be considered as a form of financial service itself that formed part of the overall “palette of offerings”

of financial services provided by SS IFCs. Mr Born pointed to the examples of Hong Kong, Switzerland and Singapore as evidence of the close link between dispute resolution services and financial services.

However, Ms Hendy maintained that there was little point in SS IFCs going to the trouble of creating the necessary infrastructure. Addressing Mr Born's point that the availability of dispute resolution services might make an SS IFC's overall financial services package more attractive, Ms Hendy acknowledged that it was important not to fall behind the competition in this regard, but argued that it was not important to do more than the competition. Only where an SS IFC wanted to differentiate itself by carving out a niche for itself as a jurisdiction renowned for financial arbitrations might it make sense to invest in an arbitration infrastructure.

The special status of SS IFCs

The discussion between Ms Hendy and Mr Born fed into one of the main themes of the conference, namely the special status of SS IFCs on the global stage.

Professor Christopher Bruner (Washington and Lee University), in his keynote address, outlined how certain small states had succeeded in establishing themselves as dominant centres for international finance. Their lack of natural resources and human capital had created a reliance on international financial services as a way of participating in the global economy.

The discussion of the impetus on small states to create and support IFCs led to a wider panel discussion of how the global economy, in turn, benefited from SS IFCs by virtue of the tax neutrality, flexibility, simplicity and creditor friendliness that they afforded. Geoff Cook (Jersey Finance) and Richard Hay (Stikeman Elliott LLP) outlined the important role played by SS IFCs in funding the investment-gap in Africa by acting as intermediaries between investors and emerging markets. Professor Richard Murphy (City University London), however, was far more critical of the role of SS IFCs in the global economy, in particular because of their status as what he termed "secrecy jurisdictions": jurisdictions which enabled tax avoidance and money laundering without any accountability.

The criticised lack of transparency surrounding SS IFCs – in particular, the general unavailability of information regarding the beneficial ownership of companies – gave rise to problems of perception. SS IFCs were generally characterised in the media as being parasitic, entrenching poverty in developing countries and facilitating tax evasion and money laundering. The panel agreed in attributing this in large part to the role of NGOs and other "false prophets" in publishing damning information based on misleading data. The panelists agreed that commissioning research of their own would allow SS IFCs to challenge the established narrative with evidence-based arguments that highlighted the positive role that SS IFCs played,

Tax reform and closing remarks

The legal architecture of the international tax reform agenda, as set out in the work plans of the OECD Global Forum on Transparency and Exchange of Information, the [OECD Base Erosion and Profit Shifting](#) (BEPS) and the EU Good Tax Governance Initiative, was another focus for discussion.

Reflecting on the conference Susie Allegre (Doughty Street Chambers) emphasised the opportunity for SS IFCs to pioneer a business and human rights framework while Professor Petra Butler (Co-

Director, Centre for Small States) reminded the participants of the lack of human capacity which limited what reforms small states could implement.

The conference programme containing a full list of all the speakers can be found [here](#).


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The graphic features a dark background with white text and a circular icon. The icon depicts a group of stylized human figures, with one figure in the center being magnified by a magnifying glass. The background is accented with horizontal lines in blue and green.

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