Trade and Brexit briefing 3

UK protections for international investors – not fit for purpose

The post-Brexit case for reform

- As the UK takes back competence for trade and investment following the EU referendum, it has a unique opportunity to ensure its investment protection provisions support social and environmental goals.
- Investment protection provisions are contained in Bilateral Investment Treaties (BITs) and Free Trade Agreements (FTAs) both of which are binding agreements between two or more countries. They offer protections to international investors that are not available to domestic companies or citizens.
- These agreements often contain an Investor-to-State Dispute Settlement (ISDS) mechanism which allows investors to sue governments in international tribunals if they believe a policy undermines the profitability of their investment.
- Cases can cost millions, sometimes billions of dollars. There is growing evidence that the fear of facing a case deters governments from taking legitimate policy decisions in relation to important sectors such as health and energy.
- The UK is a key player in the global investment protection regime: it has the fourth largest number of BITs globally, UK companies have initiated more than 50 cases and the UK is a hub for law firms and third party funders that take the cases. Yet UK agreements are out of date: they have not kept pace with global reform trends, nor have they been updated to bring them in line with human rights and environmental commitments. As the UK gears up to negotiating a raft of new trade and investment agreements, it is crucial to ensure a 21st-century approach.

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Gold-plated protections with no responsibilities

Investment protection provisions in BITs and FTAs offer foreign investors an extra layer of protection – in addition to commercial contracts and domestic law, and beyond that available to domestic companies or citizens – in respect of government action and policy that could affect their operations and profitability. In effect, they provide state-funded protection for private international investment, allowing investors to offset risk at the expense of taxpayers. Yet these provisions impose no enforceable responsibilities on investors regarding their impact in host countries, whether in terms of their economic contribution or their human rights and environmental obligations.

Investors can sue governments in private international courts

One of the most worrying provisions of these treaties is the ability of foreign investors to sue governments for financial compensation. The number of cases globally has grown significantly in recent years, from just three by 1995 to 767 by 2017. UK-based investors initiated more than 50 of these cases.

Cases initiated by UK companies relate to a broad range of investment activities, from mining to the provision of energy and water services. Costs associated with these cases are extremely high: Tanzania has suggested, in relation to a case brought against it by Standard Chartered Bank, that the legal costs alone will exceed US$8 million. In 2014 Yukos Universal (registered for tax purposes in the Isle of Man) was awarded US$50 billion against Russia. Under the Treaty of Canterbury the UK was ordered to pay €8 million to Eurotunnel for costs incurred in preventing migrants from entering the UK.

In an EU public consultation, ninety-seven percent of the 150,000 responses opposed the inclusion of ISDS in the proposed EU-US trade deal, TTIP.

Policy making undermined

> **"[Investment Agreements] may make it difficult for countries to achieve essential public policy objectives, including their development goals and the maintenance of environmental, human rights and labour standards"**
>
> Veniano Qualo, Acting Head of International Trade, Commonwealth Secretariat

There is growing evidence that fear of such cases deters countries from introducing policies in the public interest. This is particularly problematic for Southern countries because they have a greater need to introduce policies to support their development objectives. More than three-quarters of the UK's 106 BITs are with Southern countries, exposing them to challenges they can ill-afford.

> **"As a practitioner, I can tell you that there are states who are now seeking advice from counsel in advance of promulgating particular policies in order to know whether or not there is a risk of an investor-state claim"**
>
> Toby Landau, QC, Essex Chambers

'Innovative finance' driving the cases

Third party funding (TPF) is an agreement by which a bank, hedge fund or insurance company agrees to pay the costs of a case in exchange for a share of any compensation awarded to their client. Funders generally invest between US$3 million and US$10 million and expect a return of two to four times the upfront investment. Since 2009, the use of TPF has grown significantly and the UK is a hub for many major specialist funders. Claims are increasingly being packaged and traded as investment opportunities. The system lacks checks and balances and there are concerns that it reduces the likelihood of an amicable settlement to cases and undermines the independence of lawyers.

UK system out of date

There are a number of reasons why these treaties deter countries from taking policy decisions. For example, clauses in UK BITs are vaguely worded, allowing broad interpretation of their meaning. This is critical in allowing companies to challenge a wide range of government policy decisions. The majority of UK treaties also make no reference to environmental or human rights commitments. In particular treaties do not reflect the UK action plan under the UN Guiding Principles on Business and Human Rights. For this reason, arbitrators working on cases prioritise investor protections and rarely take into account social and environmental considerations.

Governments across the world, including South Africa, Brazil, India and Indonesia have taken steps to address the issues highlighted above. Some have chosen to replace flawed investment treaties with alternative investment strategies. UK treaties have not kept pace with this global trend for reform and the UK currently has no plans to modernise its system. Most of the UK's existing BITs have reached their 'anytime termination phase', and therefore could be cancelled, according to the terms of the treaties.

Lack of parliamentary scrutiny

Despite the significant protections offered to companies and the fact that existing treaties expose policy making in the UK and partner countries to significant challenge, UK politicians have very little opportunity to scrutinise deals. Only once a deal has been signed is it put before the Houses of Parliament. If within 21 days no motion is passed against it, the deal is ratified. There is no limit on the number of times the government can put a deal before the House.

Time to modernise UK investment protection

The UK is a global leader in the investment protection landscape. Following the EU referendum and as the country gears up for new international trade and investment negotiations, there is an opportunity to show global leadership by ensuring that UK investment law supports social and environmental goals. It is crucial that the UK's policies are up-to-date, do not threaten partner countries' policy making and are in line with the UK's international commitments on human rights, development and the environment.

What are we calling for?

- **A fundamental rethink of the protections offered by the UK to international investors;**
- **Better public and parliamentary scrutiny of proposed deals;**
- **Investment protections to be formally aligned with UK commitments on human rights, the environment and international development.**

Contacts

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