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# Shaping future UK trade policy: Investment Protection Provisions

Policy Briefing

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# Introduction

**As the UK adopts its own independent trade policy for the first time in nearly 50 years, the government will need to make a number of policy decisions to shape the kind of agreements it wants to have with partner countries. This briefing note gives an overview of investment protection provisions – one of the key areas where policy will need to be developed – and sets out the options available to the UK.**

# About Investment Protection Provisions

Investment protection provisions are primarily found in Bilateral Investment Treaties (BITs) and in a small number of Free Trade Agreements (FTAs). When originally signed, the intention of these provisions was to provide investors with legal certainty when investing overseas: they offer a range of broadly-defined protections, including those of fair and equitable treatment, protection from expropriation (including indirect expropriation), and to national and most favoured nation treatment.

These rights are enforceable through Investor to State Dispute Settlement (ISDS) mechanisms which allow investors to seek compensation from governments for measures that they consider to have negatively impacted on the profitability of their investment, using ad-hoc arbitration tribunals. The UK currently has 96 of its own BITs, mostly signed in the 1980s and 1990s, and is party to four EU agreements that contain ISDS provisions.[1]

In recent years questions have increasingly been raised regarding the appropriateness of ISDS as a tool to protect international investment. This has been prompted by:

- The kinds of government measures that have been challenged under ISDS, including: raising water quality standards, the introduction of a sugar tax, a ban on a toxic fuel additive and the introduction of plain packaging on cigarette packets.[2]
- The significant awards that have been made to investors, generally in the hundreds of millions of dollars.[3]
- The high legal costs, averaging US$8 million, faced by governments even when they are successful in defending a claim.[4]
- Evidence that governments are being deterred from introducing new policies because they are concerned that it will trigger an ISDS claim.[5]
- The lack of obligations on investors, for example to comply with human rights or environmental standards in the host country, as a condition of accessing treaty protections.

The following outlines a number of concerns that we believe provide a strong case for rethinking the system.

## 1. ISDS could hamper efforts to tackle climate change and address the loss of biodiversity

There is widespread consensus that preventing extreme climate change and reversing the global loss of biodiversity are among the most urgent issues of our time and that addressing them will require significant changes to government policy. ISDS mechanisms could allow investors to sue for compensation if these changes negatively affect the profitability of their investments, potentially impeding the development of policy in this area:

- Half of all ISDS cases registered at the World Bank by the end of 2015 related to oil, mining, gas, electric power or other energy forms, all of which have climate and environmental impacts.
- Overwhelmingly, the findings of the tribunals hearing ISDS cases support the proposition that companies should be compensated if their 'legitimate expectations' of a 'stable business environment' are undermined, whether or not environmental concerns are at stake.
- Very few UK BITs contain any provisions to exempt environmental or climate provisions from their provisions.[6]

Cases brought on the basis of environmental policy changes include: Vattenfall vs Germany, where the company challenged the introduction of higher water quality standards; Lone Pine vs Canada in response to a moratorium on fracking under the St.Lawrence river; Bilcon vs Canada for the denial of a mining permit; TransCanada threatened the US with a $15 billion case when President Obama denied a permit for an oil pipeline.[7]

## 2. ISDS has not kept pace with developments in international human rights law

Human rights are fundamental rights and therefore merit the most rigorous standard of protection. The past twenty-five years have seen significant developments in human rights protections, including the recognition of economic, social, cultural, civil and political rights. BITs have not kept pace with these developments. Instead, they create a special class of rights for investors which are extensive and benefit from powerful enforcement mechanisms with no means for balancing them against fundamental human rights and no equivalent mechanism to protect human rights.[8]

BITs themselves generally contain no language on human rights, which means that there can be no certainty that human rights will be protected in an agreement or taken into account should a dispute arise and tribunals rarely consider human rights arguments because they are not required to do so. This creates a situation of significant inequality: the rights of individuals are formally proclaimed in a manner similar to the rights of international investors but cannot be enforced in an equivalent manner. For example, when local residents in Peru sued Renco in the United States over alleged environmental harm, including high levels of lead, copper, zinc and sulfur dioxide pollution, the company responded by using ISDS to claim against Peru.[9]

## 3. ISDS can undermine the rule of law

There are a number of ways in which BITs can undermine the rule of law in host countries. Many BITs, including those to which the UK is a party, do not require companies to exhaust domestic remedies before they can access ISDS mechanisms. This bypasses domestic legal systems and creates a parallel system. This is problematic because:

- A process that effectively requires taxpayers to insure the business risk of international investors does nothing to raise governance standards for society as a whole and instead removes some of the incentives for host countries to strengthen domestic governance and judicial systems;
- It eliminates opportunities for domestic judges and administrative agencies to consider and address the substantive problems faced by investors and to develop corresponding domestic law and expertise;
- It can create incentives for governments to favour the concerns of foreign investors over other constituencies because ISDS offers significant amounts of protection to foreign investors only;
- National treatment provisions in fact often duplicate existing domestic laws, many of which already offer international investors the same treatment as domestic investors. This offers the potential for investors to have 'two bites of the cherry' when bringing a case;[10]
- Most Favoured Nation clauses mean that companies can access the benefits of treaties to which their own home state is not a signatory by looking at the full range of deals that the host country has signed and picking the one that offers them the best terms;
- The ISDS system has no established system of case law or precedent, which means the potential outcomes of a case and the amount of an award are often unpredictable and inconsistent.[11]

## 4. ISDS creates special protections accessible only to a particular group of actors

ISDS is only accessible to international investors, there is no equivalent provision made for domestic investors. Whilst compensation is provided for in UK law, compensation orders are rare and the amounts available are generally much lower. In 2008-10 there was an attempt to adjust the law of administrative redress to expand liability for misfeasance in public office in line with EU law and liability under the ECHR. The attempt failed, which means that UK citizens only have extremely limited possibilities to sue public entities for damages.[12] This stops far short of the provisions that are made in BITs, which provide for broadly defined rights, including to 'fair and equitable treatment' and for investors' 'legitimate expectations to be met'. There is therefore a significant imbalance between domestic and international companies.

A further barrier to access for small and medium-sized companies is that the ISDS process is very costly, cases can take several years and the outcomes are uncertain. This puts the system out of reach of the majority of investors who lack the resources to bring a case: whilst the UK is a significant source of cases, relatively few UK companies have made use of the system: the 69 UK cases registered by 2018 were brought by 61 companies – a very small proportion of the UK's total outward investment flows – and only 16 cases have resulted in awards for these companies.[13]

## 5. ISDS now goes far beyond protection against arbitrary deprivation of property

The right to compensation for 'indirect expropriation' has meant that investors have been able to claim not just for the uncompensated seizure of physical assets but also for issues such as the perceived infringement of intellectual property rights , the limiting of tariffs in public utilities and increased environmental standards.

Investors have been compensated not only for actual losses suffered but often also for a loss of anticipated future profits; this can increase significantly the amount of compensation awarded. For example, in the case of Al-Kharafi and Sons vs Libya, US$935 million in compensation was awarded, of which US$900 million was for lost profits. The investor had only invested US$5 million at the time of bringing the case and sought US$2 billion in compensation to cover an 83 year land lease.[14]

BITs generally offer no guidance to tribunals as to how an award is to be calculated and, although some tribunals have applied the full reparation principle of customary international law, there are significant variations in the methods of calculation used and disagreement regarding the factors that should be taken into account.[15]

## 6. There is no direct relationship between signing an investment treaty and increased investment.

When BITs were first developed, the promise was that they would bring additional investment. A number of studies have been undertaken to assess whether they have delivered on this promise. The overall conclusions are that:

- There is no clear evidence that they bring additional investment.[16]
- Investors tend to prioritise other factors before they look at whether a country has an investment treaty including the skill level of the labour force, quality of infrastructure and proximity of target markets.[17]
- Some of the biggest investment destinations in the world do not have investment treaties: Brazil is among the world's top five investment destinations and has no investment treaties that contain ISDS and there are no investment treaties between the EU and the US, despite significant investment flows.[18]

## 7. A number of countries are changing their approach to ISDS

A number of countries are rethinking their approach to investment protection and promotion:

- Countries including South Africa and Ecuador have cancelled their BITs outright.
- A number of other countries, including India, Morocco and Nigeria have undertaken a significant overhaul of their investment protection models, introducing innovations such as limitations on investor rights, increased investor responsibilities and requiring that investors be liable in domestic law for their activities overseas.
- Brazil has introduced an alternative model called a 'Cooperation and Facilitation Investment Agreement' which introduces a number of innovations, including: the exclusion of an ISDS mechanism, instead establishing a national ombudsman to whom investors can appeal; clarifying the range of investor protections, for example by replacing 'fair and equitable treatment' with more specific standards like access to justice and excluding indirect expropriation. The agreement also narrows the definition of which investments are covered, excluding short term speculative portfolio investments.
- The EU has introduced a new 'Investment Court System' (ICS) into some of its trade agreements and its proposal for a Multilateral Investment Court, is currently under discussion at the UN. ICS is problematic because it leaves investment protections largely unchanged, but it does

introduce procedural reforms including the creation of a permanent tribunal with government appointed arbitrators, an appeal tribunal, and the obligation to disclose third party funding.[19]

## 8. A number of alternative protections are already available to international investors

There are a number of alternative ways that investors can seek to protect their investments overseas:

### **i.** Investors can help to avoid problems arising in the first place by taking a number of steps, such as:

- Undertaking due diligence before an investment is considered;
- Undertaking impact assessments that engage with local communities;
- Consider designing investment to ensure strong backward linkages into local or national economies, for example by exploring the possibility of a joint venture;

### **ii.** Non-legal mechanisms may prove to be the best way to avoid disputes:

- Disputes can be addressed in the initial stages via mediation;
- Investors may be able to develop good relationships with local actors, such as other businesses or civil society, who could support efforts to address issues that arise;

### **iii.** Investors can use market-based products to protect their investments:

- Commercial political risk insurance is available through a number of private banks, or for investments in developing countries through the World Bank's Multilateral Investment Guarantee Agency;

### **iv.** There are a number of alternative legal mechanisms:

- Investors should seek to exhaust domestic remedies before looking to international instruments;
- In cases of the most egregious behaviour, disputes can be dealt with under human rights instruments;

### **v.** State-to-state dispute settlement may also be available.

## 9. ISDS may allow companies to bring challenges to measures taken in response to Covid-19

The Covid-19 pandemic could lead to an increase in ISDS cases. A number of law firms have already promoted the possibility of cases,[20] on the grounds that investors may challenge governments for introducing measures designed to protect public health, regulate the economy or support particular industries in response to the pandemic.

Since ISDS cases allow investors to sue for loss of profits resulting from government policy, and changes in the investment conditions, it is possible that Covid-related policies would bethe basis of disputes. For instance, Covid has led to various restrictions on economic activity, resulting from lockdown policies. This could very easily impact the profitability of an investment.[21]

There are also concerns that this could have an impact on devolved areas and local governments, which are often responsible for implementing lockdown policies. Variation between regional policies could be construed as a breach of Fair and Equitable Treatment, which can in turn form the basis of an ISDS claim. For example, if Scotland has stricter lockdown regulations than England, a US investor with more operations in Scotland could claim that this amounts to unequal treatment. In such instances, the claim would still be brought against the UK government, since the UK is party to the treaty, but any financial settlement may involve the Scottish government.[22]

# Achieving change: Parliamentary opportunities

**New trade agreements:** the Government has begun trade negotiations with the US, Australia, New Zealand and Japan, and announced its intention to join the Trans-Pacific Partnership (CPTPP). Other trade negotiations with new partners are also likely. Many of these agreements could contain ISDS – it is already included in the CPTPP. Parliament may have the opportunity to debate some of these deals, subject to the significant constraints of the Constitutional Reform and Governance Act (CRAG) process.[23] If so, these debates may offer the opportunity to raise concerns about ISDS although Parliament only has the power to vote on the whole deal, not on specific aspects of it.

**Rollover agreements:** agreements to which the UK is currently party through EU membership are being 'rolled over' by the Government. Some of these, such as the agreement with Canada, include ISDS provisions. These will also be approved through the CRAG processes with the same opportunity to raise concerns as are outlined above.

**The Trade Bill** is currently making its way through Parliament. Although the focus of the Bill is on rollover agreements, no agreement covering new agreements has been proposed, this may therefore be the only opportunity to table amendments on ISDS, and amendments have been tabled at various stages of the passage of the Bill.

# Conclusion

**As the UK regains full responsibility for its trade and investment policy post-Brexit, it must seriously consider its approach to international investment protection. Existing agreements have not kept pace with developments in human rights and environmental protections, create a parallel legal system and offer significant benefits to investors with no corresponding obligations. Their vague wording has allowed for broad interpretation by tribunals without any requirement to follow case law, making the system unpredictable. There is little evidence to support the proposition that BITs lead to increased investment in partner countries. Finally, there is a serious possibility that countries are challenged for measures taken to protect their populations during the Covid-19 pandemic. Given the range of alternative options that are available and the continuing rejection of ISDS by countries around the world, the UK must use this opportunity to rethink its approach.**

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