Submission to the International Trade Committee Inquiry on UK Investment Policy
Trade Justice Movement, June 2018

Introduction

1. The Trade Justice Movement (TJM) appreciates the opportunity to respond to the International Trade Committee inquiry into UK investment policy. TJM is a UK coalition of nearly seventy civil society organisations with millions of members, calling for trade rules that work for people and planet. Our members include trade unions, aid agencies, environment, social justice and human rights campaigns, Fair Trade organisations and consumer groups.

2. This submission responds to the final two questions of the inquiry and as such will focus on what the right model for post-Brexit investment protections should be, notably ways for the UK government to ensure that investment provisions within trade and investment agreements are compatible with the UK's international commitments on international development, climate change and human rights.

3. A significant number of UK MPs, organizations and activists from a range of constituencies have long understood the huge importance of trade and investment for achieving goals ranging from poverty reduction to climate targets. This constituency includes individuals with significant expertise who are well-placed to contribute to the development of a new UK trade and investment strategy.

What is the effect of the UK's existing bilateral investment treaties (BITs) on investment flows and the UK's ability to regulate in the public interest?

4. The UK plays a significant role in the global investment landscape, it is a leading capital exporting country and has 106 BITs, the fourth highest globally. In common with other BITs, UK treaties offer foreign investors an additional layer of protection – on top of their commercial contracts – in respect of government action and policy that could affect their operations and profitability. These are exclusive rights, unparalleled in international public law, and not available to any other actor, including domestic companies. They impose no enforceable responsibilities on investors regarding their conduct in host countries, whether in terms of the economic contribution of their activities or in terms of their human rights and environmental obligations.

The impact of existing BITs on investment flows

5. The rational for BITs was originally that they would offer additional protection to investors in countries where the investment environment would otherwise be considered too risky. In this way, BITs would help attract investment that would stimulate growth to support the achievement of policy goals. However the evidence suggests that early assessments demonstrating this were flawed and that there is little relationship between signing a treaty and attracting investment.[1] When considering investment in a third country, companies are most likely to look at factors such as the availability and qualifications of labour, the standard

[1] See for example: Aisbett, E. (2009) 'Bilateral Investment Treaties and Foreign Direct Investment: Correlation versus Causation' in Sauvant, K. and L.E. Sachs (eds.) The Effects of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties and Investment Flows (New York: Oxford University Press) ch.15; Poulsen, Lauge N. Skovgaard (2010) 'The Importance of BITs for Foreign Direct Investment and Political Risk Insurance: Revisiting the Evidence' in Sauvant, K. (ed.) Yearbook on International Investment Law and Policy Oxford University Press, Oxford; UNCTAD (2014) World Investment Report 2014: Investing in the SDGs – An Action Plan UNCTAD, Geneva and New York; Yackee, J. W. (2010) 'Do Bilateral Investment Treaties Promote Foreign Direct Investment? Some Hints from Alternative Evidence'", Virginia Journal of International Law (vol.51, no.2), pp.397-434.

of infrastructure, availability of raw materials or size and proximity of target markets. The majority of investment occurs in the absence of any BITs protections (for example between the EU and the US, and the EU and China).[2]

The impact of existing UK BITs on the ability of the UK and host countries to regulate in the public interest

6. UK BITs contain few innovations to ensure that they do not have unintended consequences for policy or to improve their impact on sustainable development. UK treaties contain standard, broad definitions of what constitutes an "investor" or protected "investment", which are critical in allowing companies to bring disputes across a wide range of policy areas. Significantly and in contrast to countries like Germany, the UK does not require companies to have a seat or substantial business interest in the host country before benefiting from its treaty protections. Whilst the OECD has found that countries are increasingly including environmental concerns in investment agreements, the only UK treaty that refers to them is with Mexico.[3]

7. UK BITs typically contain a number of clauses that give significant rights to investors. Some of the most problematic are as follows:

   7.1 Fair and Equitable Treatment (FET) clauses: these require governments to treat investors 'fairly' and not upset their 'legitimate expectations'. They have permitted investors to bring disputes against a wide range of government activities from changes in tariff charges in public utilities to withdrawal of tax exemptions and changes to the regulation of chemicals.

   7.2 Indirect expropriation clauses: such clauses provide for compensation where a regulatory measure is considered to harm, affect or interfere with an investment. This can cover a wide range of government actions and measures, ranging from taxation to environmental regulation.

   7.3 Umbrella clauses: these clauses mean that host states must comply not only with the obligations explicitly agreed to in the treaty, but any other obligations, such as those in contracts with the investor. This potentially elevates contract commitments outside of the BIT process to the level of treaty obligations and makes it difficult for governments to manage the scope and impact of their treaty commitments.

   7.4 Capital control clauses: many BITs contain clauses requiring governments to allow unrestricted movement of payments and capital by investors, with very few exceptions. This can make it difficult for countries to ensure economic stability and manage financial crises.

8. UK BITs also do not require companies to exhaust local remedies before a legal case can be raised to the international level, which is a principle of customary international law.

9. Qualifications to treaty language in UK BITs are minimal. For example, exceptions to the expropriation clause are only allowed for governments to adopt "measures which are necessary to protect national security, public security or public order". Exclusions (generally referred to as 'carve outs') to non-discrimination

[2] There are no existing investment agreements between the EU and China or the EU and the US. Negotiations are ongoing for an agreement with China that might cover investment protection, negotiations on the EU-US Transatlantic Trade and Investment Partnership (TTIP) ceased in late 2016.
[3] Gordon and Pohl (2011)

clauses such as Fair and Equitable Treatment, only cover taxation matters and agreements, and benefits arising from customs unions, free trade areas and similar agreements.

UK BITs allow investors to challenge government policy decisions via costly cases

10. UK BITs contain Investor to State Dispute Settlement (ISDS) clauses which allow investors to challenge governments at private international tribunals if they feel a government has acted in breach of a treaty. The basic premise of ISDS is that governments, and therefore taxpayers, should mitigate the business risk of multinational companies (MNCs) – in effect offering a subsidy for international but not domestic companies.

11. Signing BITs exposes countries to the threat of expensive legal disputes. Average costs for defending a case are US$8 million and large awards are not uncommon. The largest known award was for US$50 billion, against Russia, taken via UK membership of the Energy Charter Treaty, by Yukos Universal Ltd., a company registered in the Isle of Man. UK claims relate to a broad range of investment activities, from mining (Oxus Gold vs. the Republic of Uzbekistan, Churchill Mining vs. Indonesia), and shareholding (The Children's Investment Fund vs. India) to the provision of energy (Standard Chartered Bank vs. Tanzania, Rurelec vs. Bolivia) and water services (Anglia Water vs. Argentina, Biwater Gauff vs. Tanzania).

12. UK companies are among the most active in the world in terms of litigation, responsible for more than 65 cases out of a total of more than 855.[4] Prominent cases include Anglia Water vs. Argentina, which centred on a water concession in Buenos Aires. The company claimed that Argentina breached the terms of its BIT with the UK by forcing renegotiation of the contract, preventing the company from raising tariffs during the country's financial crisis and eventually cancelling the concession. During the case, the Argentine government, together with non-governmental organisations (NGOs), argued that the tribunal should take into account the fact that the concession dealt with water and impacted upon the human right to that resource. The government further argued that its "emergency response" (including freezing tariffs), was necessary in the context of its financial crisis. The tribunal rejected both propositions and specifically stated that states must respect human rights and BITs obligations equally. In 2015, the total award against Argentina was revealed to be US$405 million plus interest, of which Anglia Water was allocated US$21 million.

13. The lack of transparency in the arbitration system makes it impossible to know the exact number of cases being brought under BITs, but the evidence available suggests that it is increasing. For example, the World Bank's International Centre for the Settlement of Investment Disputes (ICSID) (the only centre with a track record of transparency in respect of cases) reports that at the end of 1994 only three investment treaty disputes had been filed; by the end of 2017, the global known total had risen to 855. There are many more cases that are not in the public domain, heard at centres such as the London Court for International Arbitration and the International Chambers of Commerce in Paris, amongst others.

This is already having a significant impact on policy making

14. There have long been indications that the problems outlined above are undermining policy space for important environmental and social legislation. Indeed, foreign investors have already challenged a broad

[4] 855 is the total number of known cases, i.e. cases registered at UNCTAD and ICSID, more cases are taken via for example chambers of commerce where they are not made public. There are 65 UK cases registered at ICSID, there are likely to be more registered at other arbitration centres.

range of government measures and policies using BITs protections, such as emergency laws put in place during a financial crisis, taxation, land use policy, media regulation, energy regulation, currency regulation, licensing rules for telecom and tourism, the withdrawal of solar energy subsidies, hazardous waste legislation, and many more.

15. There is evidence that, even in the absence of a dispute, governments are tailoring their policy and regulatory choices to suit investors because of the threat of BITs. For example, in 2010, Germany agreed to lower environmental requirements of a coal power plant rather than defend a claim by Vattenfall. Canada has also repealed environmental law, in this case a law banning the export of PCBs (a chemical used as a coolant) with effect from January 2015, rather than defend a BIT claim. The high costs of cases are one reason why countries prefer not to defend their decisions in front of an ISDS tribunal, however countries also cite fears of negative implications for diplomatic relations and credit ratings.

There are already a number of precedents to suggest that alternative approaches are available.

16. Developments in the international human rights arena provide a particularly strong context for the review of investment protection policies. The 'Ruggie Process', and resulting UN Guiding Principles on Business and Human Rights (UNGPs), recognise the need for coherence in dealing with business and human rights issues. They specifically note that states and companies should respect and protect human rights and offer affected communities the possibility of redress in cases where those rights are breached. Companies have also recognised their responsibilities with respect to human rights, sustainability and social impact elsewhere, for example in the UN Global Compact.

17. The idea that governments have the right to expect investors to make a contribution to such policy goals is not unheard of even under the current system of investment protection. A limited number of treaties, such as NAFTA (the North American Free Trade Agreement) and the Energy Charter Treaty, use their preambles to explicitly position foreign investment within the overall aim of economic development. In some revealing cases, arbitration panels have used this language to make companies' right to bring disputes under the investment treaties conditional upon their contribution to the host economy. A legal analysis of three specific cases heard under treaties containing such language lead to the opinion that investment must a) be made for the public interest; b) transfer know-how; c) enhance the GDP of the host state; and d) have a positive impact on the host state's development.[5]

18. Overall, this suggests that there is scope for reform to ensure that investment protection is in line with human rights commitments. However, the vast majority of BITs do not contain the kind of language found in the treaties mentioned above. There are also many examples of tribunals who have failed to take this language into account, instead choosing to emphasise the goals of promoting investment and creating conditions favourable for investors. Indeed, BITs contain very little language to support countries in implementing their obligations under human rights instruments. A 2014 OECD survey found that treaty language referring to "human rights" is extremely rare, appearing in less than 1% of the 2,107 treaties in the

[5] See: Garcia-Bolivar, O. E. (2012),'Defining an ICSID Investment: Why Economic Development Should be the Core Element', Available at https://www.iisd.org/itn/2012/04/13/defining-anicsid-investment-why-economic-development-shoul d-be-the-core-element/

sample. All human rights references occurred in the preambles to the treaties; whilst this helps to clarify the context, object and purpose of the treaty for arbitrators, it is not legally binding.[6]

19. Compounding this situation is the fact that, even where obligations contained in international human rights treaties are specifically directed at the activities of corporations, the treaties are only binding on the contracting states, not on the corporations themselves. As a result, human rights concerns can only be raised in BIT arbitral tribunals in a very limited number of circumstances, with nothing to direct tribunals to take into account an investor's record of compliance with human rights instruments when considering the admissibility of a claim.

20. The UK government made a number of commitments under its action plan for implementing the United Nations Guiding Principles on Business and Human Rights (UNGP). The 2013 version of the action plan states that the UK will "ensure that agreements facilitating investment overseas by UK or EU companies incorporate the business responsibility to respect human rights, and do not undermine the host country's ability to […] meet its international human rights obligations." However this language is absent from the updated 2016 action plan, which states only that the UK Government will "Support the EU commitment to consider the possible human rights impacts of free trade agreements, including where these include investment protection provisions, and take appropriate steps including through the incorporation of human rights clauses as appropriate."

21. No action was taken to implement the 2013 commitment and as such UK BITs currently make only scant reference to human rights commitments. This raises the prospect of BITs acting as a barrier to policy change that is intended either to support the UNGPs or to achieve development goals. There is already evidence that UK BITs are impacting upon the policy space of governments. For example, in the more recent of two Standard Chartered Bank cases against Tanzania, the tribunal ordered the parties to recalculate an electricity tariff, increasing costs for end users.[7] These kinds of cases are of particular concern with respect to developing countries as they are more likely to need to introduce new regulations, such as a minimum wage, as their economies develop.

The UK is a global leader in terms of third party funders engaged in the international investment protection regime.

22. The UK is also a hub for the growing industry of Third Party Funding (TPF). 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 and US$10 million and expect a return of two to four times upfront investment. In a case brought against Bolivia, UK-registered firm Rurelec (operating via companies registered in the British Virgin Islands) was awarded compensation of US$31.5 million (plus interest) of which third party funder Burford received US$11 million.[8] Burford also acquired an asset recovery firm to help enforce awards; this will allow the company to purchase uncollected

[6] Gaukrodger, D. and K. Gordon (2012), InvestorState Dispute Settlement: A Scoping Paper for the Investment Policy Community OECD Working Papers on International Investment, 2012/03 Paris
[7] Standard Chartered Bank vs. The United Republic of Tanzania, ICSID Case No. ARB/10/12
[8] See http://www.lse.co.uk/AllNews.asp?code= 78gyppoc&headline=Burford_Nets_USD110_Million_On_ Rurelec_Arbitration_Claim_Investment accessed 31/05/18

judgements and awards, and then pursue them at its own cost and risk.[9] 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 could reduce the possibility of an amicable settlement to cases and undermine the independence of lawyers.

What provisions on investment should the UK seek in future trade and investment agreements?

There is a global trend for reform

23. UNCTAD reported at the end of May 2018 that the number of new investment agreements concluded in 2017 was the lowest since 1983 and that for the first time, the number of effective treaty terminations outpaced the number of new agreements. They also report that since 2012 over 150 countries have taken steps to formulate new agreements whilst others are attempting to modernize existing agreements by issuing interpretations or replacing and consolidating older agreements. Not only does the UK need to develop its own approach to investment under most Brexit scenarios but the majority of UK BITs have also reached their 'anytime termination' phase, meaning that they can be cancelled or renegotiated. The UK therefore has a significant opportunity to rethink how it approaches international investment.

24. The UK should bring its investment policy in line with UK commitments under international human rights, labour, environmental and international development instruments. It should also consider the extent to which taxpayers, particularly those in developing countries, should be required to insure the business risk of international investors and whether investment protection measures need to be included in treaties at all.

25. In 2013, a UK government commissioned report on the costs and benefits to the UK of an investment chapter in the Transatlantic Trade and Investment Partnership (TTIP) found not only that it was highly unlikely to lead to an increase in investment flows but also that it would incentivise claims that would not have been brought under existing UK domestic law. Furthermore, it found that the costs of defending cases under TTIP, as well as any potential awards, could be significantly higher than those of cases brought to domestic courts.[10]

26. The majority of the UK's existing treaties are with capital-importing countries, which means the UK is less exposed to the risk of a case. The UK should be cautious of including investment protection provisions in any future deal with major capital-exporting countries. For example, the US is the single largest source of foreign investment into the UK and home to the most litigious companies under the BITs system, accounting for more than 135 arbitrations; an agreement covering investment protection with the US would expose the UK a significantly increased risk of being sued.

27. A number of countries have already rejected BITs altogether. Brazil, which has long featured in the top ten recipients of foreign direct investment (FDI), has never been party to a BIT.[11] Whilst it signed several

[9] See http://www.burfordcapital.com/wp-content/uploads/ 2015/02/30-1-15_Burford_acquires_asset_recovery_ firm.pdf accessed 31/05/18

[10] Poulsen, Lauge N. Skovgaard, Bonnitcha, J. and Webb Yackee, J. (2013) *Costs and Benefits of an EU-USA Investment Protection Treaty* Department for Business, Innovation and Skills, London, p.26.

[11] For a recent overview of investment flows, see UNCTAD (2017) *World Investment Report 2017: investment and the digital economy* UNCTAD, Geneva and New York.

agreements in the 1990s, these were never ratified by the Brazilian Congress because it found the provisions on indirect expropriation and ISDS were not in line with the country's constitution. Brazil has since developed its own model 'Cooperation and Facilitation Investment Agreement' and the Intra-MERCOSUR Investment Facilitation and Cooperation Protocol (IFCP). Under the IFCP, investors seek redress by taking complaints to national Ombudsmen. As a last resort, a state-to-state dispute settlement process is available. The agreement does not contain an ISDS mechanism. The agreement clarifies the range of investor protections, excluding 'fair and equitable treatment' (replaced by more specific standards like access to justice), protection from 'indirect expropriation and 'full protection and security'. It narrows the definition of investment by excluding short-term, speculative portfolio investments. Protections are explicitly tied to economic activities, rather than broadly defined 'assets'. Finally, the agreement protects governments' right to adopt, maintain and enforce environment, labour or public health legislation, although it stops short of a full carve-out for public interest legislation.

28. In 2010 the South African government concluded a three-year review of its BITs which found that the existing system "open[ed] the door for narrow commercial interests to subject matters of vital national interest to unpredictable international arbitration that may constitute direct challenges to legitimate, constitutional and democratic policy making".[12] It therefore decided to terminate its existing BITs and offer partners the possibility of renegotiation based on a new model. The new model includes a range of innovations: most significantly, it only gives the option for cases to be heard in South African courts, removing the extra layer of international protection for foreign investors. It also limits the scope of expropriation to exclude instances where a government measure has only an indirect adverse impact on an investment or is introduced to protect public welfare objectives.

29. Some countries that have not chosen to cancel their BITs are looking at options for renegotiation. An UNCTAD review of the 18 IIAs concluded in 2013 found that most of the treaties included modifications to include sustainable development-oriented features. Fifteen of the agreements had general exceptions for such issues and referred to them in their preambles, and twelve contained clauses to prevent the parties lowering health, safety or environmental standards in order to attract investment.

30. Similarly, the OECD has found that BITs are increasingly referencing environmental protection, labour rights, anti-corruption measures and corporate social responsibility. Canada, Mexico, the United States and Belgium now routinely use such language in treaties. India also launched a review of its investment treaties in mid-2012, in response to arbitration notices by no less than seventeen investors (including Vodafone), challenging various policy measures and demanding billions of dollars in compensation. As a result, it has developed a new model which limits the scope of agreements, including by narrowing the definition of 'investor' and 'investment' and introducing binding obligations on investors in matters related to corruption, disclosures and taxation. A number of policy measures are exempted from challenge, including taxation, intellectual property rights, state subsidies, government procurement, public health and safety, environmental protection and financial stability.

31. Australia has similarly opted to change its BITs system. Following the instigation of a claim by Philip Morris in response to legislation requiring the plain packaging of cigarettes, its government has said that it will now

[12] See http://www.pmg.org.za/policydocuments/2009/06/25/bilateral-investment-treaty-policy-fra mework-review

only consider the inclusion of ISDS in its treaties "on a case-by-case basis".[13] As a result, there is no ISDS provision in its agreements with Japan and the US and several exceptions to the ISDS provision in its free trade agreement with Korea.

32. Many of the changes outlined above aim at strengthening the position of states and communities vis à vis international investors. International treaties such as the International Labour Organisation (ILO) Conventions, the Maastricht Principles on the Extraterritorial Obligations of states and the Kyoto Protocol, also provide a potentially useful and internationally agreed framework that might better ensure international investment contributes to social and environmental goals. As outlined earlier in this submission, developments in the international human rights arena provide a particularly strong context for the review of investment protection policies.

There are several steps the UK can take to ensure its treaties are fit for purpose

33. The UK should ensure that agreements relating to investment are subordinate to UK and third country obligations under human rights, labour, environmental and international development agreements. It should:
    - 33.1 Require businesses to demonstrate a substantial business interest in the host country in order to benefit from any treaty protections;
    - 33.2 Include binding obligations on investors to undertake due diligence;
    - 33.3 Include binding obligations on investors to adhere to the international human rights and environmental instruments to which the UK is a signatory;
    - 33.4 Include binding obligations on investors to comply with the national laws of the host country;
    - 33.5 Hold companies legally liable, in home states, for (complicity in) human rights violations, environmental destruction and corrupt practices;
    - 33.6 Include legally binding mechanisms of redress for communities who have been negatively impacted upon by the activities of investors.

34. The UK should promote alternative arrangements for investment protections. These could include:
    - 34.1 Provisions within investment contracts, which allow host countries to agree terms on a case-by-case basis, for example reflecting the level of investment in question rather than offering broad protections to all investors;
    - 34.2 Requiring companies to begin by seeking redress through host country judicial systems;
    - 34.3 Political risk insurance, available through private banks, a World Bank's Multilateral Investment Guarantee Agency (MIGA) and many governments;
    - 34.4 State-to-state dispute resolution;
    - 34.5 Establishing a dispute prevention policy and offering mediation.

35. Ensuring business retains the responsibility for the risks it incurs will help to reduce the number of risky projects that are set in train. If the UK does opt to include investment protection in agreements, they should at minimum:
    - 35.1 Omit the problematic clauses outlined above, such as umbrella clauses;

[13] Joint Standing Committee on Treaties, Parliament of the Commonwealth of Australia (2014) p 14 and Tienhaara, K and Ranald, P (2011) Australia's Rejection of Investor-State Dispute Settlement: Four Potential Contributing Factors available at http://www.iisd.org/itn/2011/07/12/australiasrejection-of-investor-state-dispute-settlement-four-potentialcontributing-factors/

35.2 Include clauses that limit the scope of a treaty (for example by excluding certain types of investment);

35.3 Set explicit exceptions for certain areas of public policy and

35.4 Exclude ISDS provisions. UK provisions on investments should also prohibit third party funding.

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