UK-Based Businesses Investing Abroad May Benefit from Brexit

This memo provides practical guidance on the potential benefits of the UK's decision to leave the EU in the area of UK-based foreign direct investment. In particular, it considers the benefits to UK-based investors of the UK's ability, outside of the EU, to conclude its own investment protection treaties, thereby potentially avoiding the problems and controversies generated by the EU's increasing legislative activity in the area of foreign direct investment.

The Structure of Foreign Investment

Over the last two decades, there has been a surge in foreign direct investment on a global scale. In order to attract foreign investors, capital importing countries have taken various measures. In particular, many of these countries have sought to reassure foreign investors and tried to reduce the risks of state interference (i.e. expropriation of assets, alleging non-compliance with permits, or other forms of unfair, inequitable, discriminatory or arbitrary treatment of foreign investors) by entering into international treaties. The most common form of international treaty in this area is that of the Bilateral Investment Treaty ("**BIT**"). However, investment protection may also be included in specific chapters of Multilateral Treaties, such as the Energy Charter Treaty ("**ECT**"), the North American Free Trade Agreement ("**NAFTA**") or the Association of Southeast Asian Nations ("**ASEAN**"). There are more than 3,000[1] investment treaties in force today and the UK is party to more than 100 of them.[2]

The majority of treaties contain dispute resolution provisions which, typically, allow investors to refer disputes under the investment treaty, relating to alleged unfair treatment by the host state, to international arbitration. Most commonly, investors select the International Centre for the Settlement of Investment Disputes ("**ICSID**"), a self-contained and independent system which provides for enforcement in contracting states and derives its authority from its status as an institution of the World Bank. Other common choices are the Stockholm Chamber of Commerce, the International Court of Arbitration or an *ad hoc* arbitration under the United Nations Commission on International Trade Law ("**UNCITRAL**") Arbitration Rules.

So far, there have been some 700 publicly known investment treaty cases and the number is rising every year. In these cases, the most frequent investors were located within the US, the UK and the Netherlands,

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[1] http://www.oecd.org/investment/internationalinvestmentagreements/50291678.pdf

[2] http://investmentpolicyhub.unctad.org/IIA/CountryBits/221

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whereas common respondent states have included Argentina, Venezuela, Spain, Russia, the Czech Republic and Ukraine.[3]

EU Reforms of the Investor-State Regime

With the Lisbon Treaty entering into force, the EU has assumed exclusive competence over foreign direct investment pursuant to Article 207 of the Treaty on the Functioning of the European Union ("**TFEU**"). This allows only the EU to conclude investment protection treaties directly, whereas before, investment protection treaties were concluded only bilaterally by individual Member States. A side effect of this exclusive competence has been the slow destruction of intra-EU BITs (i.e. BITs between Member States), as the European Commission has put increasing pressure on the Member States to terminate these BITs on the basis that they allegedly create discrimination between investors from different Member States, posing indirect obstacles to the free movement of capital, and are therefore incompatible with EU law.[4] This "pressure" has manifested itself in several court proceedings, commenced by the European Commission against five Member States (Austria, the Netherlands, Romania, Slovakia and Sweden).[5] The approach taken by the European Commission has proved to be controversial, as investors in general and some historically capital exporting States are in favour of maintaining the intra-EU BITs.

Another effect of the EU's exclusive competence in this area has been a proposed change to the dispute settlement mechanism contained in future investment treaties. After a public consultation in 2014 and subsequent debate with other stakeholders, the European Commission argued for a new Investment Court System ("**ICS**") that would consist of one Investment Tribunal and one Appeals Tribunal, whose judgments would be made by judges pre-selected by the State Parties. Ultimately, the ICS would replace the current dispute resolution mechanism of international arbitration.[6]

The proposal has attracted strong criticism from a number of leading experts in the field of investment treaty arbitration, including from the former chairman of the ICC International Court of Arbitration, John Beechey CBE,[7] former president of the International Court of Justice Stephen M. Schwebel and Professor Rudolf Dolzer, a frequent arbitrator and the co-author of the "Principles of International Investment Law".[8] The criticisms centre on the significant risks of a pro-state bias within the ICS as, contrary to the position in international arbitration, investors would have no part in the appointment of the judges or in the composition of the three-member arbitral panels.[9]

Benefits of Brexit

It is difficult to predict the impact of Brexit and the terms of UK's ultimate "divorce settlement" with the EU. However, it is certain that the UK will regain competence to enter into free trade agreements and investment protection treaties. If no radical political shift occurs, the UK will not be part of the problematic

3 http://investmentpolicyhub.unctad.org/Upload/ISDS%20Issues%20Note%202016.pdf

4 https://www.iisd.org/itn/2009/02/10/eu-member-states-reject-the-call-to-terminate-intra-eu-bilateral-investment-treaties/

5 http://europa.eu/rapid/press-release_IP-15-5198_en.htm

6 https://ec.europa.eu/commission/2014-2019/malmstrom/blog/proposing-investment-court-system_en

7 https://www.youtube.com/watch?v=ewMYp-iACy0 (Mr. Beechey speaks at 3:38 – 24:04.)

8 http://isdsblog.com/wp-content/uploads/sites/2/2016/05/THEPROPOSALSOFTHEEUROPEANCOMMISSION.pdf

9 http://www.oecd.org/daf/inv/investment-policy/2016-conference-investment-treaties.htm (The reference is to Mr. Dolzer's speech at the conference, unfortunately no audio record is available.)

and controversial policies arising out of the EU's exclusive competence in this area. Various benefits follow from this.

First, the EU is currently negotiating various investment protection treaties and free trade agreements, including investment protection chapters with the US, Japan and China, while a similar agreement with Canada ("**CETA**") is scheduled to be concluded this autumn. However, due to a growing resistance against free trade agreements in Europe, the negotiations have proven to be lengthy and difficult, and may continue to be so. Post-Brexit UK, on the other hand, as a single state with a single set of interests, may find itself, despite its somewhat diminished bargaining power, in a better position with regard to the negotiation of similar treaties. The UK has, for example, already entered into preliminary discussions with China regarding a potential multi-billion pound free trade agreement,[10] started talks with India about an eventual bilateral free trade agreement, and plans to focus on negotiating trade and investment treaties with the USA, Canada, Japan and South Korea.

Second, by choosing not to enter into the treaties negotiated by the European Commission containing the problematic ICS clauses, post-Brexit UK could enter into treaties with the traditional ISDS mechanism based on international arbitration. This has the dual benefit of being both a proven, tested system and one that avoids the risk of state bias in the appointment process through permitting investors to select an arbitrator.

Third, by not having to terminate the UK BITs in place with other EU countries (the intra-EU BITs), post-Brexit UK could provide its nationals investing in some of the EU countries with extra protection against state interference, as opposed to relying solely on EU law for that form of protection.

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[10] http://www.bbc.co.uk/news/business-36877573