Investment Arbitration in a Post-Brexit World

Some eighteen months have now passed since the United Kingdom ('UK') voted to leave the European Union ('EU'). Speculation on the impact of this decision on investment arbitration falls, broadly speaking, into two main camps. The first sees the Brexit decision as the generator of a potential increase in investment arbitration claims against the UK. The second sees Brexit as having the opposite effect. Unshackled by EU Rules, the UK would become a more attractive place for investment arbitration or a hotspot for restructuring. As with many things Brexit-related, whilst there may be an element of truth in many of these arguments, at present there is very little certainty in any of them.

The biggest difficulty, from the investor's perspective, is that the type of Brexit that will occur is still not settled. There is significant concern that the UK was careering towards a hard Brexit, implying that the UK will leave the Internal Market[1] and, likely, the Customs Union[2]. Such a scenario would have the biggest impact on investments in the UK and is therefore the one that should be of most concern to investors.

In December 2017, the parties agreed to move on to Phase II of the Brexit talks and to the transition phase and future relationship. As part of this deal, the UK has agreed that even in the event of a failure by the UK and the EU 27 to reach a satisfactory trade agreement on their future relationship, the UK will maintain full alignment with the rules of the Internal Market and the Customs Union which, *now or in the future*, support the all-island economy of Ireland and protect the Good Friday peace agreement.[3] Could this be seen as a sign that a hard Brexit might now become less likely? Or at the very least as regards certain aspects of the Northern Irish economy?

1 The Internal Market refers to the EU as one territory without any internal borders or other regulatory obstacles to the free movement of goods and services.
See online at: https://ec.europa.eu/growth/single-market_en
2 The EU Customs Union refers to a country grouping where members apply the same tariffs to goods imported into their territory from the rest of the world, and apply no tariffs internally among members.
See online at: https://europa.eu/european-union/topics/customs_en
3 See further the text of this Agreement at:
https://ec.europa.eu/commission/sites/beta-political/files/joint_report.pdf

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The type of Brexit that will occur is still not settled

In reality, a potential shift towards a softer Brexit is still unclear and the political signs as to what level of regulatory alignment there may or may not be between the UK and the EU 27 remains to be determined. What is clear is that the closer the regulatory alignment between the parties, the softer Brexit. A Brexit that closely mirrors the Customs Union and the Internal Market will have considerably less disruptive impact on investments in the UK. Less divergence from EU law will require less regulatory changes by the UK government, thus ensuring regulatory continuity and more certainty for investors.

So what does all this potentially mean for investment arbitration? The UK currently has 94 Bilateral Investment Treaties ('BITs') in force, of which 12 are with EU countries. UK BITs generally contain strong protections for covered investors, particularly as compared to recent investment treaties signed by other countries. When the UK leaves the EU, these treaties will continue in force. However, given the international trade reality that the EU is both the world's leading host and source of foreign direct investment, the decision to leave the EU will not be without investment consequences.

Testing the Scope of Legitimate Expectations: a proliferation of hard Brexit claims?

In the case of a hard Brexit, a number of distinct areas are potential sources of claims against the UK, which might not be covered (or covered completely) by the UK's regulatory alignment commitment regarding Northern Ireland. First, goods: the introduction of customs duties, quantitative restrictions or WTO tariffs on goods exported to the EU will (almost) inevitably lead to an increase in operating costs and a decline in profits for foreign investors established in the UK, particularly those involved in manufacturing and selling.

The case of Nissan is a good example of how issues of investment arbitration and goods might play out. Nissan was assured, in writing, by the UK government that its competitiveness would not be damaged by the UK pulling out of the EU. On the basis of these assurances, Nissan apparently decided to maintain its plan to invest and open a manufacturing plant in Sunderland. Nissan did not seek monetary compensation to offset the impact of Brexit but, according to Nissan's Vice President in Europe, instead sought '*compensatory measures, tax measures, infrastructure measures or competiveness measures*'. However, Nissan has now suggested that if the UK fails to agree a trade deal with Europe and moves to WTO tariffs, this could have an impact on the Sunderland plant, which currently produces 500,000 cars per year. Arguably, if Nissan has been told by the UK government that it would continue to have tariff free access to the Single Market and Nissan proceeded with the investment on that basis, then any terms of UK withdrawal from the EU that render this assurance void of content, might breach Nissan's legitimate expectations as guaranteed at the time of making the investment.

Second, services: in relation to financial services, foreign-owned banks operating out of the City of London that lose their financial passporting rights in the EU financial services market –which allow UK investors to sell financial services in the EU without further authorization in EU countries–, may be inclined to seek damages in respect of the breach of legitimate expectations that the UK would be part of that market.

The loss of EU subsidies and attractive loans offered by the European Investment Bank ('EIB'), which invested a little less than EUR 7 billion in the UK in 2016, is another issue. Once the UK leaves the EU, it becomes a third country for the EIB. Lending volume will drop and presumably have to occur at less favourable rates. Could the UK government be found liable for effectively depriving investors in long-term projects –established in the UK before Brexit was even envisaged– of funds that, but

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for the Brexit decision, they could have had access to and upon which their investments depend?

Similarly, aviation industry businesses established in the UK on the basis that they had a legitimate expectation that the UK would remain part of the aviation Single Market providing access to EU flight paths are also an at-risk group. It appears that if no deal is done between the UK and the EU on access to the aviation market by March 2018, being one year prior to the Brexit 'D-day' of 29 March 2019, then flights dependent on that access will not be able to be sold from March 2018 onwards. Airline investors' legitimate expectations to be a part of the Internal Market will therefore arguably be breached even before the UK officially leaves the EU.

Potential successful claims or hot air?

There are a multitude of other potential 'claim-generating' avenues, but for an investor to bring a successful treaty claim there must, of course, be a particular measure that is attributable to the UK that specifically affects an investment in the UK. While the referendum itself is arguably not likely to be considered a measure attributable to the UK for purposes of state responsibility, the specific regulatory measures that will be required in order to implement Brexit may be considered an impermissible regime change or fundamental regulatory shift subject to liability under international law. On the other hand, arbitral tribunals could consider such changes to be a permissible non-discriminatory measure of general application.

The paradigm of Brexit therefore has the potential to test the limits of what an investor's legitimate expectation as to protection from fundamental regulatory shifts means under international law. Whilst the paradigm may be new, investment arbitration law has already seen many cases where states have been sued on the basis of significant regulatory change. Results have varied so far. Some tribunals have been willing to find against states when in their view the regulatory change has fundamentally affected investments, such as in *Enron Corporation Ponderosa Assets, L.P. v. Argentine Republic* (ICSID Case ARB/01/3, award of 22 May 2007), in which the arbitral tribunal found against Argentina in relation to measures it took to overhaul the gas sector in the wake of its 2001 financial crisis. Similarly, in *Eiser Infrastructure Ltd* et al. *v. Kingdom of Spain* (ICSID Case ARB/13/36, award of 4 May 2017), which concerned changes to Spain's renewable energy subsidies as a result of its financial crisis, the arbitral tribunal found that the regulatory changes enacted constituted a '*total and unreasonable change*' to the legal framework upon which Eiser's investment depended and therefore breached the investor's legitimate expectations. Regulatory regimes could not be radically altered as applied to existing investments in ways that deprive investors —who invested in reliance on those regimes— of their investment's value.

However, in *Charanne B.V.* et al. *v. Kingdom of Spain* (SCC Case 062/2012, final award of 21 January 2016), the arbitral tribunal found that an investor's

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hope that a Spanish regulation would remain in its current state did not create legitimate expectations in the absence of a particular commitment given by the host state. Changes to domestic legislation were permitted and should therefore have been taken into account by the investor. In *Total S.A. v. Argentine Republic* (ICSID Case ARB/04/1, decision on liability of 27 December 2010), another Tribunal concluded that states have the responsibility to '*amend their legislation in order to adapt it to change and the emerging needs and requests of their people in the normal exercise of their prerogatives and duties*.' The decisions on both sides of this argument could be equally applicable to post-Brexit disputes.

A further consideration is whether the mere threat of bringing claims will suffice for investors in the UK to negotiate a better deal from the UK government. Given the considerable pressure bearing down on the UK's reputation as an open and international trading centre, how would the UK withstand the pressure of 5, 10 or 20 significant Brexit-related investment arbitrations being launched? The risk is that every one of these arbitrations could be an opportunity for further damage to the UK's reputation. Why then would a foreign investor not consider itself more likely to get some sort of special one-off 'Nissan Deal' from the government by initiating investment arbitration proceedings? And for those who fail to be granted a 'Nissan' assurance, is there subsequent potential for suing the UK for non-transparent and discriminatory treatment, precisely because they did not receive such assurances?

Post-Brexit Hotspot?

Others suggest that free from the obligations of EU law, the UK may become a prime hotspot for investment claims. Companies could thus restructure their investments via the UK so as to potentially benefit from the protections provided for by UK BITs. In this way, the fact that the UK will be a third country, and therefore no longer subject to the European Commission's current concerns relating to intra-EU BITs, gives the UK a significant advantage, or so the argument goes. A Spanish company that has invested in Sweden might therefore consider structuring its investment to flow through a UK subsidiary in order to gain the benefit of a UK-Sweden BIT, in the absence of any permissible intra-EU BIT between Sweden and Spain.

However, investors should bear in mind that the Court of Justice of the European Union ('CJEU') has in the past, long prior to Brexit, already required Member States to end their extra-EU BITs where they have been found to be incompatible with the EU treaties; in particular the provisions on the free movement of capital. This type of reasoning by the CJEU may imply that the role of EU law in any '*intra turned extra-EU*' UK BIT is still up for debate, particularly if the CJEU were asked about such BITs by the EU Member State involved. Moreover, it now appears all but inevitable that the UK will be subject to the jurisdiction of the CJEU during the likely two-year transition phase. There are also mixed messages as to the role which EU law will play after the transition phase. As recently as 5 October 2017, the President of the UK Supreme Court, Lady Hale, called on the UK parliament to give as much clarity as possible to judges as regards how far they should take into account judgments from the CJEU in the future. All of this suggests that, whilst issues of compatibility with EU law pertaining to intra-EU BITs will be removed from the post-Brexit world, there may yet be other Brexit-related EU law issues to address.

The decision to leave the EU will not be without investment consequences

Conclusion

Eighteen months after the vote that changed the landscape of the UK and the EU forever, the future for investment arbitration in the UK remains uncertain. For as long as a soft Brexit remains an option, investors can breathe a potential sigh of relief. However, given that a hard or *hardish* Brexit is not off the table, practitioners and investors would do well to remain on high alert. Changes to the form and content of Brexit will shape the evolution of investment law in the UK in the near future and a considerable impact on UK investments cannot, at this stage, be ruled out.