Investment protection falls victim to Brexit - Analysis of the EU-UK Trade and Cooperation Agreement

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Introduction

On 1 January 2021, the Trade and Cooperation Agreement concluded between the EU and the UK (the TCA) entered into force. The TCA marks the end of a controversial Brexit process and sets out the framework for trading relations going forward.

While intra-EU investors are starting to get used to the radical shift in EU investment law following the plurilateral treaty to terminate existing intra-EU bilateral investment treaties (BITs) (read more here), the relationship between the UK and the EU and, in particular, clarity on the protections to be afforded to investors, was much anticipated. In this article we look at the investment protection provisions in the TCA, as well as the fate of the UK's BITs with EU Member States.

The TCA regulates the new post-Brexit relationship between the EU and the UK and includes provisions on investment protection. However, despite the parties' stated "commitment to establish a favourable climate for the development of trade and investment," the TCA provides only limited protections to foreign investors. This gives rise to considerable uncertainty and potential risks for those UK investors operating in the EU, and EU investors operating in the UK. Even though no official estimates exist, it is likely that thousands of businesses – from the likes of Scandinavian renewable energy companies or German car manufacturers operating in the UK, to UK financial services providers that operate across Europe – could be left with little or no international investment protection, and no recourse to well-established, international dispute resolution mechanisms.

The TCA

The TCA provides for preferential trading arrangements across a range of sectors, as well as for cooperation on matters such as intellectual property, public procurement, aviation and road transport, energy, fisheries, social security, and judicial cooperation in criminal matters. The 1,246-page document was negotiated in ten months, significantly more quickly than the seven years required to negotiate the Comprehensive Economic and Trade Agreement between the EU and Canada (the CETA).

Provisions applicable to foreign investment are set out under Part Two (Trade, Transport, Fisheries and Other Arrangements), Heading One (Trade), Title II (Services and Investment, known as SERVIN). These provisions differ considerably from provisions commonly found in other free trade agreements and BITs. Below we summarise the key

aspects of the TCA which underscore its narrow scope, the limited substantive protections it provides to foreign investors, and the lack of an effective investor-state dispute resolution mechanism. In no small measure, the TCA conforms with the EU's desire to move away from investment arbitration in favour of some other forum in which disputes should be resolved, be that national courts or some supranational investment court. Meanwhile, the TCA is silent on the UK's BITs with EU Member States, and the future of these agreements remains in the balance.

Investment protection under the TCA

In terms of investment protection, the TCA is narrower in scope than many trade agreements and BITs in a number of respects.

(a) Qualifying investors and investments

The definition of investor under the TCA is narrow. The TCA defines an "Investor of a Party" as a natural or legal person of one party that seeks to establish, is establishing or has established an enterprise in the territory of the other party. The TCA also requires all investors to engage in substantive business operations, and that UK investors operating in EU Member States also have an effective and continuous link with that state. This effectively excludes shell companies and non-operating or inactive subsidiaries from protection. (Article SERVIN 1.2(j) and (k))

The TCA also excludes a range of sectors from protection, including air transportation and related services, maritime and inland waterway transportation, and audio-visual services. The TCA also does not apply to measures relating to public procurement and government subsidies or grants, including government-supported loans, guarantees and insurance from its application. (Articles SERVIN 1.1.5 to 1.1.7)

Further, the TCA also allows parties to deny benefits to an investor on the grounds of maintaining international peace and security, as well as ensuring human rights protection. (Article SERVIN 1.3)

(b) The right to regulate

The TCA expressly recognises the parties' right to regulate. Article SERVIN 1.1.2., which is broadly drafted, allows the parties to regulate to achieve legitimate policy objectives which include the protection of public health, safety, the environment and climate change, social or consumer protection, privacy and data protection, but also social services, public education, public morals, or the promotion and protection of cultural diversity. As a result, the UK and EU have particularly wide powers to regulate, which, coupled with the lack of substantive standards of protection, potentially limits the protections commonly afforded to foreign investors.

(c) Limited substantive protections

Unlike other international agreements, the TCA provides only limited substantive standards of protections to foreign investors.

- **The TCA imposes a national treatment obligation on the parties**. This means that both the UK and the EU must accord investors of the other party treatment no less favourable than that accorded to its own investors and enterprises. The national treatment obligation is one of the most common standards of investment protection that, according to UNCTAD, is available in an estimated 85% of all BITs. (SERVIN Article 2.3)
- **The TCA imposes a most favoured nation treatment obligation on the parties**. The TCA requires both the UK and the EU to accord investors of the other party treatment no less favourable than it accords to investors of third countries, with respect to (i) their establishment in the UK or EU's territory, and (ii) their operation in that territory. This provision, known as a most favoured nation (MFN) clause, also excludes international agreements relating to taxation, and measures in respect of recognition of authorisation, licensing and certification of economic activities from the scope of MFN treatment. Importantly, the TCA expressly provides that investor-state dispute settlement procedures provided in other international agreements are not covered under this provision. As such, investors cannot seek to rely on the MFN clause to import a more favourable dispute resolution provision from another BIT. (SERVIN Article 2.4)
- **The TCA prohibits the parties from imposing limitations on market access**. In particular, the parties cannot limit in any way the number of enterprises that may carry out a specific economic activity, the total value of transactions or assets, operations or output, the participation of foreign capital, or the total number of natural persons that may be employed in a particular sector or by a particular enterprise. The parties are equally prevented from restricting or requiring specific types of legal entity or joint venture through which an investor may perform an economic activity. This

is a novel substantive standard of protection that is rarely found in older BITs and free trade agreements, but that has been included in more recent instruments including CETA and the 2018 Agreement between the United States of America, the United Mexican States, and Canada (the USMCA) that replaced NAFTA. (SERVIN Article 2.2) ***

In short, the standards of protection accorded to investors under the TCA are substantially fewer than those found in other free trade agreements and BITs. For example, the TCA does not provide any explicit protections against expropriation, any measures guaranteeing fair and equitable treatment, full protection and security, or other common protections such as an umbrella clause. As a result, investors would have to rely on customary international law principles to seek recourse, say, in the event of an expropriation.

(d) The TCA lacks any investor-state dispute resolution mechanism

The most striking and very deliberate omission from the TCA is the lack of any dispute settlement mechanism that would allow the investor to claim relief against a state. The TCA expressly prohibits investors from invoking the TCA before the national courts of the UK or of any EU Member State (Article COMPROV 16), and there is no provision granting the investor access to international arbitration.

Instead, Part Six (Dispute Settlement and Horizontal Provisions), Title I (Dispute Settlement) provides for an inter-state mechanism (similar to that which exists in the WTO regime) for avoiding and settling disputes concerning the interpretation and application of the TCA between the UK and the EU. As a result, the investor has no direct relief for any eventual breaches of the TCA by the UK or the EU. Moreover, the TCA is silent on any steps that an investor may need to take in order to escalate the dispute to the inter-state level.

As such, EU investors operating in the UK and vice versa, who want to seek relief for breaches of standards of protection or other discriminatory measures taken against them, are limited to:

- relying on the new inter-state mechanism that has been established under the TCA and seeking support of their government to submit a dispute on their behalf. Clearly, this option may have limited practical outcome for the investor as it was the desire of states to remove themselves as intermediaries from investment disputes that led to the development of the ISDS system in the first place;
- seeking protection under one of the 11 BITs still in place between the UK and EU Member States;
- asserting protection under the Energy Charter Treaty (the ECT), which would be available only in the narrow category of disputes that relate to energy-related investments;
- relying on any express investment agreement with the state that provides for arbitration; and
- taking active steps to secure international law protection by restructuring the investment.

UK BITs with EU Member States

In addition to the TCA, there are BITs in place between the UK and 11 EU Member States: Bulgaria (1995), the Czech Republic (1990), Croatia (1997), Estonia (1994), Hungary (1987), Latvia (1994), Lithuania (1993), Malta (1986), Romania (1995), Slovakia (1990) and Slovenia (1996). The UK's BIT with Poland (1987) was terminated by Poland in 2019. However, due to a 15-year long sunset clause, it remains in effect for all investments made while it was still in force, until 22 November 2035.

Importantly, the TCA does not terminate any of these BITs. In fact, it expressly provides that it applies "without prejudice to any earlier bilateral agreement" between the UK and EU Member States and that the parties "reaffirm their obligations to implement any such Agreement" (Article FINPROV 2). What is more, the TCA acknowledges the possibility that the UK and different EU Member States may "conclude other bilateral agreements between them" in the future and states that such agreements will constitute supporting agreements to the TCA, thus forming "an integral part of the overall bilateral relations" and the overall framework (Article COMPROV 2). As a result, given the TCA's limited substantive protections and lack of any effective mechanism that would allow the investors to seek relief, investors might be considerably better off by relying, where applicable, on one of the existing BITs between the UK and EU Member States.

In this context, it is important to note that since the 2018 case in *Achmea v Slovakia*, the European Commission has taken the view that BITs between EU Member States are incompatible with EU law. On 15 January 2019, the UK along with other EU Member States issued a declaration "On the Legal Consequences of the Judgment of the Court of Justice in Achmea and on Investment Protection in the European Union" agreeing to terminate all existing intra-EU BITs. Following this, on 5 May 2010, 23 Member States signed the agreement for the termination of intra-EU bilateral

investment treaties (the Termination Agreement), which effectively terminated the existing intra-EU BITs between them, and removed any legal effect of sunset clauses.

Importantly, four EU Member States (Austria, Finland, Ireland and Sweden) and the UK did not sign the Termination Agreement. As a result, despite the UK's initial commitment to terminate its BITs with other EU Member States, all 11 BITs between the UK and the signatories of the Termination Agreement remain in force. However, there is a risk that some, or all, of those Member States might decide to unilaterally terminate the BIT, in a similar manner to Poland. Any move to restructure investments to gain the benefit of the UK's BITs ought therefore to be done at the earliest opportunity.

Options available to investors

The landscape for investment protection between the UK and the EU is changing rapidly. Regrettably, the TCA offers little comfort to investors in terms of investment protection and resolution of disputes. Further, while 11 BITs between the UK and EU Member States remain in force, the future of those treaties is uncertain.

Investors are advised to monitor developments closely and, where appropriate, take active steps now to protect their investment. In particular, investors might consider:

- seeking legal advice to understand whether their investment is protected under international law;
- restructuring their investment to obtain access to one of the 11 BITs between the UK and EU Member States (restructuring a business to obtain protection under that BIT for future disputes is a fairly common and legitimate practice); and
- securing express guarantees as to investment protection and access to international arbitration in any new investment agreements entered into by UK investors in the EU or vice versa.

Please get in touch if you would like further information.

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