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ISDS: The Brexit Lawsuits the UK Should Be Worried About

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It is widely acknowledged that the departure of the UK from the EU, commonly referred to as Brexit, gives rise to multiple legal problems, some of which are bound to lead to actions. While there is a widespread coverage of public law related litigation, there is less knowledge of potential private actions, including those taking place in arbitration. On the assumption that Brexit will have severe negative consequences on a number of industries, it is worthwhile exploring the potential of private actions, specifically through investment treaty arbitration to offer redress to those affected. For the sake of brevity, this post is not addressing the 'cakeist' scenario that everything will change yet remain the same after the UK's departure from the EU. While Brexit continues to be shrouded in ambiguity, there is more clarity now than there was in 2017, or 2016, as to what Brexit might entail. We certainly know the exit will not entail a continuation of the UK's membership in the European Single Market. You will have noticed that while a grand debate is being held around border controls and the Custom's Union, the Single Market is a much less prominent topic of discussion. Everyone seems to assume that Brexit means (at least) no participation in the Single Market.

As we are graduating, however, from projecting Brexit scenarios to mapping the consequences of concrete government choices, we are moving to a situation where affected businesses have stopped trying to manage the situation and get ready to call their lawyers to explore avenues of legal redress for what are now understood to be inevitable losses. Still, what can legal advice achieve on the individual level, when litigation has failed to stop the Brexit process altogether, or at least to guide it towards less radical paths? The government itself has revealed that its concern lies with ISDS. Liam Fox (the UK's Int. Trade Secretary), when asked in 2017 if the government could face dispute settlement cases from companies whose investments are damaged by Brexit, said that the government was preparing for any eventuality:

> "But again, the sort of market access that we would hope to reach would mean that they [ISDS cases] were not necessary."

What we now know in 2018 is that the sort of market access that the government will reach for UK's most significant industry means precisely that those suffering losses will try and use ISDS to seek compensation. And this industry is financial services. How could a financial firm based in London, lucky to benefit from the protection of a treaty between its home country and the UK, use all this? Brexit will most likely result in London becoming a much different business proposition. London can no longer be the gateway to European finance, as it is projected to lose its place in the

Single Market, as well as it can no longer guarantee access to one of the world's biggest consumer markets. One could argue that leaving the Single Market, losing the financial passport, is an abrupt, wholesale upending of the entire regulatory background of an investment, rendering such investment practically worthless.

As I argue in my recently published paper in the ICSID Review, foreign-owned financials could seek legal redress, arguing that the changes brought about by Brexit (from the point of exit onwards) will violate legitimate expectations protected by Bilateral Investment Treaties (BIT) the UK has signed with their country of origin. Considering the historical importance and magnitude of the UK's departure, however, what is it that entitles lawyers to use ISDS as a potential spanner in the Brexit works? The answer is contained in a single word. That word is Spain.

The reason why Spain is central to the relation of investor claims with Brexit is the fact that this South European country is the closest example of a western, developed economy which has faced an avalanche of ISDS claims due to a significant change in regulatory conditions. In the Spanish case, the change involved a reworking of the regulatory framework for clean energy generation. The cases generated by the reaction of investors are of particular importance to our understanding of the role investment treaty violations can play in the context of Britain disentangling itself from the EU.

In these Spanish cases investors claim that, amongst other violations, Spain did not afford them fair and equitable treatment as required to by its treaty obligations. The Energy Charter Treaty (ECT), under which these claims are brought, demands that states shall encourage investment, create "stable conditions", and ensure "fair and equitable treatment" (FET) of investors. Investments "shall also enjoy the most constant protection and security" while "unreasonable or discriminatory measures" are strictly forbidden. In the first of the cases to conclude, Charanne and Construction Investments v. Spain, a Dutch solar energy investor argued that the FET standard demands the maintenance of a stable and predictable legal framework for investments. Spain, they claimed, had frustrated their legitimate expectations through wholesale changes to the regulation of solar energy generation. Spain countered that legislative changes introduced in the energy sector were an expression of its sovereign right to regulate. Meeting the FET standard under its treaty obligations, in its view, did not mean freezing a legal framework in place, as would happen under a stabilization clause (an explicit commitment to maintain regulatory environments for the duration of the investment).

In Charanne, the Tribunal agreed that, in the absence of specific commitments adopted by Spain, the threshold for a finding of FET violation was not reached. Specific commitments could have found expression in an express stabilization clause or by means of a declaration by Spain addressed to the investors, but this had not taken place. It is well established that the host State is entitled to maintain a reasonable degree of regulatory flexibility to respond to changing circumstances in the public interest. Consequently, the requirement of fairness must not be understood as the immutability of the legal framework. So far so good, but there is a catch. A state is deemed to be allowed to regulate so long as it does not fundamentally and abruptly alter the whole regulatory environment causing major losses to the investor. Spain won its first challenge, but celebrations did not last long.

The second important decision on these Spanish claims, Eiser Infrastructure Limited and Energía Solar Luxembourg S.à r.l. v. Kingdom of Spain, resulted in a win for the investor and goes to the core of what the protection of legitimate expectations is about. In this case, brought by a British energy company, the Tribunal underlined that treaties protect investors from a fundamental regulatory change – total and unreasonable – in a manner that does not take into account the circumstances of existing investments made in reliance on the prior regime. Fundamentally, the Tribunal recognized that the regulatory power of the state has a limit that is established by the commitments assumed under investment treaties, one that cannot be ignored. Spain eliminated a favourable regulatory regime previously extended to the investors to encourage their investment in its territory and replaced it with an unprecedentedly different regulatory approach, based on wholly different premises. This new system was profoundly unfair and inequitable as applied to the claimant's existing operation, stripping them of virtually all of the value of their investment. The investor won a payout of 128 million Euros (plus interest).

Could someone actually win such a case against Britain? I conclude that in the field of financial services, if a foreign-owned bank from a jurisdiction that has a BIT with the UK (containing FET protection and recourse to ISDS) were to sue the UK after a no-deal or a hard exit from the EU has taken place, they could win if they satisfy the following criteria. First, they must have been established in the UK to carry out predominately European operations, using the financial passporting arrangements as a gateway to Europe. Second, they must have been established in the City of London after being attracted here due to the strength of government, local authority, and foreign direct investment-promoting institutions, which invited them specifically to take advantage of the UK's European links (before a referendum on an EU membership was aired as a viable policy aim). Third, the loss due to Brexit must be catastrophic, leading to the negation of almost the totality of their investment. Fourth, the Tribunal must be convinced that a State act (for instance, the Withdrawal Bill coming into force) has radically changed the conditions under which the investment was made to the detriment of the investor.

Brexit has just become a lot less boring if you are an investment treaty arbitrator.

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