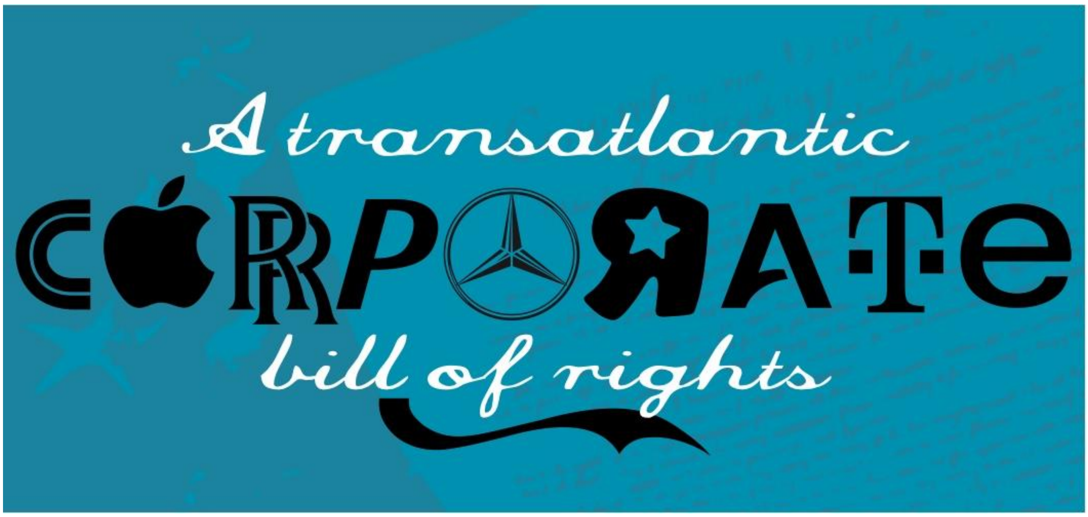
Investor-State Dispute Settlement: the corporate dash for power



When the French president, François Hollande visited Washington in early February 2014, his message on the trans-Atlantic trade deal (TTIP) was clear: "We have everything to win by going fast. Otherwise we know that there will be an accumulation of fear, of threats, of convulsions." (*Financial Times*, 16 Feb, 2014) That same week, the *Financial Times,* like the UK government a firm supporter of TTIP, echoed these sentiments in advice to the chief trade negotiators of the US and the EU: 'What then should Mr Froman, Mr De Gucht and their respective political leaders do to advance the agenda? One thing they can do is to accelerate the pace of discussions.' (*FT* 17 Feb 2014) This encouragement from the French president and the FT came in the wake of President Obama's failed attempt to fast-track the trans-Pacific trade deal through the US congress.

Why the rush to get this deal signed as quickly as possible? Because social organisations and citizen groups in both the US and Europe are waking up to just how bad these deals are for everyone in society except the corporate elite and their investment lawyers. As the former US trade negotiator told the *New York Times*, if people knew what was in the deal, it 'would raise such opposition that it could make the deal impossible to sign'. Hence Hollande's justified concern about an accumulation of fear, threats and convulsions.

Treaties like TTIP pose a threat to government regulation, the public sector, the environment, and health but one feature above all has attracted a lot of public concern. This is the Investor-State Dispute Settlement (ISDS) contained in this and other similar treaties.

ISDS is an attack on democracy, state regulation and the established justice system

What has captured the attention of many people is the power that international trade treaties give to corporations and to a small elite of unelected and unaccountable corporate lawyers. If a corporation thinks that a decision or a regulation made by any government that is a signatory to the treaty could have a negative effect on existing or anticipated profits, it can sue the government in a tribunal established by the treaty and normally made up of three investment lawyers. The process is incredibly expensive, can last for years, is secret, and the decision can not be appealed against. The democratically elected government, the parliament of the country, as well as the country's own courts and legal system can be overruled and ignored. And it's a one-way system – corporations can sue governments but not the other way round.

Treaties and investment law are complex and governments try to keep these matters secret. It's usually some event that captures the headlines and brings home to people what is at stake. For the Australians it was when the tobacco giant, Philip Morris, sued the Australian government which had passed a law requiring plain packaging of cigarettes. For the Germans, it was in 2012 when the Swedish energy giant, Vattenfall, launched a lawsuit seeking $4.6 billion for lost profits when the German government decided to phase out nuclear energy after the Fukushima nuclear disaster. For the Canadians it was when the US energy company, Lone Pine Resources, demanded $250 million in compensation from Canada when the provincial government of Quebec, with broad popular support, introduced a moratorium on fracking until a proper environmental study had been carried out.

Damages awarded in international investment cases can be very high – the highest known damage awarded in an ICSID case was $1.77 billion to the US oil company Occidental Petroleum in a case against Ecuador. Such fines can be a real problem, especially if the country is poor. In addition to the fines, there's the legal costs of fighting the lawsuit. The cost to a country of fighting an investor challenge is on average $8 million and rises to over $30 million in some cases. At the end of 2010, 60 per cent of known ISDS cases involved developing countries. For instance, the Philippines government had to spend $58 million to defend two cases against the German airport operator Fraport. Argentina has been sued more than 40 times as a result of the economic reform programmes implemented after its economic crisis in 2001. By the end of 2008, awards against the country had reached a total of $1.15 billion.

But it isn't just the financial aspect that's a problem. In many cases, governments withdraw or amend regulations to avoid costly litigation. For instance, already in 2009, Vattenfall had sued the German government for $2 billion when the government imposed certain environmental restrictions on one of its coal-fired power plants. The government's response was to water down its environmental regulations. The threat of an investment dispute is often enough to force governments to submit to corporate demands. Arbitration lawyers also encourage their clients to use the threat of investment disputes as a way to scare governments into submission. According to the German law firm, Luther, one of the firms involved in securing a settlement for Swedish energy giant Vattenfall against Germany: 'A settlement, which you should always aim for, is easier to reach under the shadow of a looming investment treaty claim'. Five years after NAFTA's investor-to-state provisions came into force, a former Canadian government official told a journalist: "I've seen the letters from the New York and DC law firms coming up to the Canadian government on virtually every new environmental regulation and proposition in the last five years. They involved dry-cleaning chemicals, pharmaceuticals, pesticides, patent law. Virtually all of the new initiatives were targeted and most of them never saw the light of day"

This power of corporations to threaten elected governments, ignore existing legal systems and exert such influence on domestic legislation is meeting with increasing opposition from civil society in both Europe and the US. But there has been very little scrutiny of the supra-national legal system that the treaties create and which gives corporations such power. This is the tribunal system in which governments have to defend themselves against corporate claims. In November 2012 the Trans-National Institute in Amsterdam and the online Corporate European Observatory published a report on this tribunal system which shows it to be a corrupt, elitist, biased and anti-democratic system. Most of the material in what follows is based on the findings of that report.

How the tribunal system operates

The tribunals deciding these cases are comprised of three private sector attorneys who act as arbitrators. These arbitrators are unaccountable to any electorate. Their hearings are secret and their decisions are final. Treaties normally determine which forum investors may use for dispute settlement. The World Bank's International Center for the Settlement of Investment Disputes (ICSID) is the most frequently chosen forum. Each side in the dispute selects an arbitrator. The third member of the tribunal is agreed by both parties or is selected by ICSID. Each side to the dispute then selects legal counsel from well-established investment law firms to argue their case. Only investors can bring legal claims to a tribunal.

Legal claims are always against governments and concern actions by governments which, in the view of the investor, are contrary to the freedoms granted investors in an agreed treaty. In practice, this involves a claim by investors that some government decision or regulation could either now or in future have a negative impact on company profits. For instance, during the financial crisis, Argentina imposed a freeze on people's energy and water bills. It was sued by the international utility companies and was forced to pay hundreds of millions of dollars in compensation to these companies because it allegedly breached the terms of its trade treaty.

The treaties concerned are Bilateral Investment Treaties (BITs). These treaties lay down the conditions for private investment by nationals and companies of one state in another state and there are many such treaties. The US, for instance, has over forty such bilateral investment treaties with other countries. However, in recent decades, these investment treaties have been increasingly shaped by the politics of neoliberalism which has dramatically increased corporate rights and limited government rights to regulate and own public provision of goods and services. Investor-state disputes in recent decades have involved especially consumer health and safety policies, environmental and land-use laws, government procurement decisions, regulatory permits, financial regulations and other public interest polices that investors allege are interfering with the freedoms granted investors in trade treaties. Since major corporations today tend to have subsidiaries in a large number of countries, when making a legal challenge they can choose whichever treaty is the most likely to give them the result they want. For instance, Philip Morris is a US-based corporation but when it challenged Australia's right to regulate cigarette packaging, it based its claim on the investment treaty Australia had agreed with Hong Kong. US firm Baker McKenzie advises its US clients to structure investments in China through intermediary companies in the Netherlands – because there is no US-China investment treaty, but there is a Dutch one.

Investors lawyers – the legal mafia

For investment lawyers, investor-state disputes are a very lucrative business. The TNI/CEO report argues that the alleged fairness and independence of investment arbitration is an illusion. The law and the consequential disputes are largely shaped by law firms, arbitrators and, more recently, a phalanx of speculators who make a lot of money from the disputes.

In 2011 alone there were 450 known investor-state cases, the majority of which were filed by corporations from industrialised countries against countries from the Global South. Over the past two decades, these arbitration tribunals have granted huge sums in compensation to corporations. Canada is the sixth most sued country in the world and currently faces over $5 billion worth of investor claims. The legal costs of defending against such claims is also immense. This lucrative investment arbitration industry is dominated by a small and tight-knit group of law firms and elite arbitrators based mostly in the US and Europe. Of the 450 known cases in 2011, three top law firms – Freshfields (UK), White & Case (US) and King & Spalding (US) – claim to have been involved in 130. Leading the field is the UK-based firm, Freshfields Bruckhaus Deringer. It was involved in 71 such cases in 2011, earning a gross revenue of $1.8 billion (($2.7 million per partner). It claims altogether to have acted in more than 165 investor-state disputes. White & Case was involved in 33 cases that same year, earning $1.3 billion. The firm Hogan Lovells earned $1.7 billion in 2011 representing the British firm Churchill in a dispute with Indonesia involving mining rights.

Just 15 arbitrators, nearly all from Europe, the US or Canada, have decided 55 per cent of all known investment-treaty disputes. This small group of lawyers, referred to by some as an 'inner mafia', sit on the same arbitration panels and act as both arbitrators and counsels. These elite law firms charge as much as $1,000 per hour, per lawyer – with whole teams handling cases. According to figures from the International Centre for the Settlement of Investor Disputes (ICSID), arbitrators also charge very high fees, earning a $3,000 daily fee plus travel and living allowances.

Not only do these tribunals operate behind closed doors, there are no meaningful conflict-of-interest rules with respect to arbitrators' relationships with, or investments in, the corporations whose cases they are deciding.

Small wonder then that these elite law firms are major backers of ISDS clauses in investment treaties. They also engage in their own form of ambulance-chasing, advising potential clients whenever they spot an opportunity for a profitable lawsuit. When Hungary introduced a tax on profitable companies to reduce its public debt in 2011, law firm K&L Gates suggested some "attractive" arbitration options. When Swedish energy giant Vattenfall announced arbitration against Germany's phaseout of nuclear power, UK firm Herbert Smith Freehills analysed how investors "might seek redress in the UK should a similar decision be made here". When India allowed a generic drug producer to sell a cheaper version of a patented cancer drug in 2012, White & Case pointed out that patent-holding drug multinationals "may be able to seek relief under applicable bilateral investment treaties".

Corporate bias of arbitration panels

Evidence shows that many of the arbitrators enjoy close links with the corporate world and share a corporate viewpoint in relation to the importance of protecting investors' profits. Given the one-sided nature of the system, where only investors can sue and only states are sued, a pro-business outlook would be a strategic choice for an ambitious investment lawyer keen to make a lucrative living. A study of arbitrator behaviour in these investment tribunals published in 2012 found that arbitrators tend to favour investors over states.

It's to potential corporate clients that law firms advertise their services, and it's as advisers to business that they hope to earn their millions. Freshfields offers its potential clients: 'We've handled deals, disputes and investigations in some of the world's most challenging legal environments, and can help you assess and mitigate sovereign and legal risks for your operations and investments.' These elite firms dominate the market. Even poorer countries are forced into paying their exorbitant fees because they find that their local law firms are no match for these for this club of experienced players.

These specialised arbitration lawyers have another advantage. They know the 'judges'. In fact the arbitrators come from the same firms. Freshfields has 25 of its lawyers listed on arbitration panels. These top lawyers sometimes act as counsel and sometimes as arbitrators. K&L Gates claims that 'A number of our lawyers regularly sit as institutionally appointed or party-nominated arbitrators. This experience of acting as arbitrator can prove invaluable when it comes to acting as counsel for a party and in deciding what methods and strategies are most likely to be effective with the arbitral tribunal.' Within this elitist club, lawyers know each other. K&L Gates can present a better case because it knows 'the particular likes/dislikes' of the tribunal arbitrators.

These law firms and the arbitrators they sponsor lobby strongly against any changes to the ISDS system. Charles Brower is an arbitrator with the US firm, White and Case, and has served as arbitrator in 33 investment treaty disputes: 'My proposition is that any proposal that alters any of the fundamental elements of international arbitration constitutes an unacceptable assault on the very institution'. This is a view shared by most of the legal and corporate elite.

The TNI/CEO report concluded that:
'Yet rather than acting as fair and neutral intermediaries, it has become clear that the arbitration industry has a vested interest in perpetuating an investment regime that prioritises the rights of investors at the expense of democratically elected national governments and sovereign states. They have built a multimillion-dollar, self-serving industry, dominated by a narrow exclusive elite of law firms and lawyers whose interconnectedness and multiple financial interests raise serious concerns about their commitment to deliver fair and independent judgements.'

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