

# Profiting from injustice

## How law firms, arbitrators and financiers are fuelling an investment arbitration boom



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### Executive summary

The last two decades have witnessed the silent rise of a powerful international investment regime that has ensnared hundreds of countries and put corporate profit before human rights and the environment.

International investment treaties are agreements made between states that determine the rights of investors in each other's territories. They are used by powerful companies to sue governments if policy changes – even ones to protect public health or the environment – are deemed to affect their profits. By the end of 2011, over 3,000 international investment treaties had been signed, leading to a surge in legal claims at international arbitration tribunals. The costs of these legal actions weigh on governments in the form of large legal bills, weakening of social and environmental regulation and increased tax burdens for people, often in countries with critical social and economic needs.

Yet while these financial and social costs have started to become ever more visible, one sector has remained largely obscured from public view and that is the legal industry that has profited from this litigation boom. This report seeks to address that by examining the key players in the investment arbitration industry for the first time. It seeks to shine a light on law firms, arbitrators and litigation funders that have profited handsomely from lawsuits against governments.

The report shows that the arbitration industry is far from a passive beneficiary of international investment law. They are rather highly active players, many with strong personal and commercial ties to multinational companies and prominent roles in academia who vigorously defend the international investment regime. They not only seek every opportunity to sue governments, but also have campaigned forcefully and successfully against any reforms to the international investment regime.

The international investment arbitration system was justified and put in place by Western governments with the argument that a fair and neutral dispute settlement system was needed to protect their corporations' investments from perceived bias and corruption within national courts. Investment arbitrators were to be the guardians and guarantors of this regime.

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.

As a result, the arbitration industry shares responsibility for an international investment regime that is neither fair, nor independent, but deeply flawed and business-biased.

**Key findings:**

1. **The number of investment arbitration cases, as well as the sum of money involved, has surged in the last two decades** from 38 cases in 1996 (registered at ICSID, the World Bank's body for administering such disputes) to 450 known investor-state cases in 2011. The amount of money involved has also expanded dramatically. In 2009/2010, 151 investment arbitration cases involved corporations demanding at least US\$100 million from states.
2. **The boom in arbitration has created bonanza profits for investment lawyers paid for by taxpayers.** Legal and arbitration costs average over US\$8 million per investor-state dispute, exceeding US\$30 million in some cases. Elite law firms charge as much as US\$1,000 per hour, per lawyer – with whole teams handling cases. Arbitrators also earn hefty salaries, amounting up to almost US\$1 million in one reported case. These costs are paid by taxpayers, including in countries where people do not even have access to basic services. For example, the Philippine government spent US\$58 million defending two cases against German airport operator Fraport; money that could have paid the salaries of 12,500 teachers for one year or vaccinated 3.8 million children against diseases such as TB, diphtheria, tetanus and polio.
3. **The international investment arbitration industry is dominated by a small and tight-knit Northern hemisphere-based community of law firms and elite arbitrators.**
  - a) Three top law firms – Freshfields (UK), White & Case (US) and King & Spalding (US) – claim to have been involved in 130 investment treaty cases in 2011 alone.
  - b) Just 15 arbitrators, nearly all from Europe, the US or Canada, have decided 55% 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, act as both arbitrators and counsels and even call on each other as witnesses in arbitration cases. This has led to growing concerns, including within the broader legal community, over conflicts of interest.
4. **Arbitrators tend to defend private investor rights above public interest, revealing an inherent pro-corporate bias.** Several prominent arbitrators have been members of the board of major multinational corporations, including those which have filed cases against developing nations. Nearly all share businesses' belief in the paramount importance of protecting private profits. In many cases concerning public interest decisions, such as measures taken by Argentina in the context of its economic crisis, arbitrators have failed to consider anything but corporations' claims of lost profits in their rulings. Many arbitrators vocally rejected a proposal by International Court of Justice Judge Bruno Simma to give greater consideration to international environmental and human rights law in investment arbitration.
5. **Law firms with specialised arbitration departments seek out every opportunity to sue countries – encouraging lawsuits against governments in crisis,** most recently Greece and Libya, and promoting use of multiple investment treaties to secure the best advantages for corporations. They encourage corporations to use lawsuit threats as a political weapon in order to weaken or prevent laws on public health or environmental protection. Investment lawyers have become the new international 'ambulance chasers', in a similar way to lawyers who chase hospital wagons to the emergency room in search for legal clients.
6. **Investment lawyers, including elite arbitrators, have aggressively promoted investment arbitration as a necessary condition for the attraction of foreign investment, despite evidence to the contrary.** Risks to states of acceding to investor-state arbitration are downplayed or dismissed.
7. **Investment lawyers have encouraged governments to sign investment treaties using language that maximises possibilities for litigation. They have then used these vaguely worded treaty provisions to increase the number of cases.** Statistical study based on 140 investment-treaty cases shows that arbitrators consistently adopt an expansive (claimant-friendly) interpretation of various clauses, such as the concept of investment. Meanwhile arbitration lawyers have taken a restrictive approach in international law when it comes to human and social rights.

- 8. Arbitration law firms as well as elite arbitrators have used positions of influence to actively lobby against any reforms to the international investment regime, notably in the US and the EU.** Their actions, backed by corporations, succeeded in preventing changes that would enhance government's policy space to regulate in the US investment treaties that had been proposed by US President Barack Obama when he came to office. Several arbitrators have also loudly denounced nations that have questioned the international investment regime.
- 9. There is a revolving door between investment lawyers and government policy-makers that bolsters an unjust investment regime.** Several prominent investment lawyers were chief negotiators of investment treaties (or free trade agreements with investment protection chapters) and defended their governments in investor-state disputes. Others are actively sought as advisers and opinion-makers by government and influence legislation.
- 10. Investment lawyers have a firm grip on academic discourse on investment law and arbitration,** producing a large part of the academic writings on the subject, controlling on average 74% of editorial boards of the key journals on investment law, and frequently failing to disclose the way they personally benefit from the system. This raises concerns over academic balance and independence.
- 11. The investment arbitration system is becoming increasingly integrated with the speculative financial world,** with investment funds helping fund investor-state disputes in exchange for a share in any granted award or settlement. This is likely to further fuel the boom in arbitrations, increase costs for cash-strapped governments, and raises concerns of potential conflicts of interest because of a dense web of personal relationships that link financiers to arbitrators, lawyers and investors. Firms such as Juridica (UK), Burford (US) and Omni Bridgeway (NL) have already become an established part of international investment arbitration, in the absence of any regulation of their activities. This financialisation of investment arbitration has even extended to proposals to sell on packages of lawsuits to third parties, in the vein of the disastrous credit default swaps behind the global financial crisis.

Some countries have started to realise the injustices and inconsistencies of international investment arbitration and have initiated a retreat from the system. In spring 2011, the Australian government announced that it would no longer include investor-state dispute settlement provisions in its trade agreements. Bolivia, Ecuador and Venezuela have terminated several investment treaties and have withdrawn from ICSID. Argentina, which has been swamped with investor-claims related to emergency legislation in the context of its 2001-2002 economic crisis, refuses to pay arbitration awards. South Africa is engaged in a thorough overhaul of its investment policy to better align it with development considerations and has just announced that it will neither enter into new investment agreements nor renew old ones due to expire.

The backlash has not gone unnoticed by members of the investment arbitration industry. Some insiders are ready to confront the challenges with proposals for moderate reform, such as greater transparency. But these proposals do not address the inherent flaws and corporate bias of the investment arbitration system. We believe only systemic reform, based around principles that consider human rights and the environment as more important than corporate profits, can deliver necessary change. This must start with the termination of existing investment agreements and a moratorium on signing new ones.

Nevertheless even within the existing system, there are some steps that can be taken to help to roll back the power of the arbitration industry. This report calls for a switch to independent, transparent adjudicative bodies, where arbitrators' independence and impartiality is secured; the introduction of tough regulations to guard against conflicts of interest; a cap on legal costs; and greater transparency regarding government lobbying by the industry.

These steps will not by themselves transform the investor-state arbitration system. Without governments turning away from investment arbitration, the system will remain skewed in favour of big business and the highly lucrative arbitration industry.