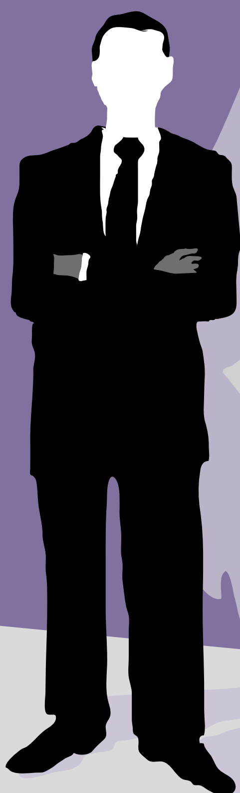
Profiting from Crisis

How corporations and lawyers are scavenging profits from Europe's crisis countries



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Executive summary

Profiting from Crisis is a story about how corporations, backed by lawyers, are using international investment agreements to scavenge for profits by suing governments from Europe's crisis countries. It shows how the global investment regime thrives on economic crises, but is very uneven in who it benefits. While speculators making risky investments are protected, ordinary people have no such protection and – through harsh austerity policies – are being stripped of basic social rights.

For a long time, European countries were left unscathed by the rising global wave of investor-state disputes which had tended to target developing countries. In the wake of the global financial crisis, however, corporations and investment lawyers have turned their eyes to potential pickings in Europe. An investment regime, concocted in secretive European board rooms, and that gives corporations powerful rights to sue governments, has finally come home to roost.

The report first explores the history of investor-state lawsuits as a result of economic crises across the world from Mexico in 1994 to Argentina in 2001. As crises struck these nations scrabbled desperately to protect their rapidly sinking economies; the measures they took have since come under systematic attack from corporations. Countries have been sued for measures to revive a domestic financial system or the freezing of public services' tariffs to keep them affordable for their people. Some measures, such as sovereign debt restructuring (renegotiating terms with creditors) are even required as part of debt deals, yet have been similarly challenged by investment lawsuits.

The legal bases of these lawsuits are the over 3,000 international investment treaties in existence to date. They contain far-reaching protections of private property enshrined in catch-all clauses such as "fair and equitable treatment" and "protection from indirect expropriation". The trouble is that these clauses have been interpreted so broadly that they gave a carte blanche to corporations to sue states for any regulations that could be deemed to affect current or future profits. Moreover, investment treaties grant corporations rights to protection, without giving equivalent rights to states to protect their own citizens.

Profiting from Crisis looks closely at how corporate investors have responded to the measures taken by Spain, Greece and Cyprus to protect their economies in the wake of the European debt crisis. In Greece, Poštová Bank from Slovakia bought Greek debt after the bond value had already been downgraded, and was then offered a very generous debt restructuring package, yet sought to extract an even better deal by suing Greece using the Bilateral Investment Treaty (BIT) between Slovakia and Greece. In Cyprus, a Greek-listed private equity-style investor, Marfin Investment Group, which was involved in a series of questionable lending practices, is seeking €823 million in compensation for their lost investments after Cyprus had to nationalise the Laiki Bank as part of an EU debt restructuring agreement. In Spain, 22 companies (at the time of writing), mainly private equity funds, have sued at international tribunals for cuts in subsidies for renewable energy. While the cuts in subsidies have been rightly criticised by environmentalists, only large foreign investors have the ability to sue, and it is egregious that if they win it will be the already suffering Spanish public who will have to pay to enrich private equity funds.

Profiting from Crisis reveals how:

- The public bailout of banks that led to the European debt crisis could be repeated with a second public bailout, this time of speculative investors. Corporate investors have claimed in arbitration disputes more than 700 million euros from Spain; more than one billion euros from Cyprus and undisclosed amounts from Greece. This bill, plus the exorbitant lawyers' fees for processing the cases, will be paid for out of the public purse at a time when austerity measures have led to severe cuts in social spending and increasing deprivation for vulnerable communities. In 2013, while Spain spends millions on defending itself in lawsuits, it cut health expenditure by 22 per cent and education spending by 18 per cent.
- Many of the investment lawsuits under way against European crisis countries are being launched by speculative investors. They were not long-term investors but those which invested as the crisis first emerged and were therefore fully cognisant of the risks. Yet rather than paying the costs of risky investments, investment agreements have given them an escape clause and are being used to extract further wealth from crisis countries. Poštová Bank, for example, bought bonds in early 2010 at the same

time that Standard & Poor's categorised Greece's debt as "junk". In Spain, out of 22 companies involved in lawsuits, 12 invested after 2008 when the first restrictions to feed-in tariffs for solar energy were introduced; eight more continued to invest in the country despite the 'threats' to their investments.

- The investors involved in lawsuits have profited considerably despite the 'threat' to their investments by the crisis countries. Poštová Bank reported a net profit of 67.5 million euros in 2012; renewable energy investor Abengoa SA reported a 17% increase in revenues to 5.23 billion euros in the first nine months of 2013. It has been a very different story for the citizens of the countries being sued. Greeks, for example, are on average almost 40% poorer than they were in 2008 and there has been a drastic rise in homelessness. One in three children (around 600,000) are now living under the poverty line.

- Corporate investors have been supported and encouraged by highly paid investment lawyers who continuously and actively identify litigation possibilities. In a few cases, arbitration firms suing cash-strapped countries were also advising the very same companies when they made the risky investments in the first place. UK-based law firm Allen & Overy, now counsel to investors in five out of seven known claims (at the time of writing) against Spain relating to subsidy cuts in the energy sector, advised some of these investors in their original acquisition of the power plants. The corporate lawyers' marketing has paid off with a boom in cases and healthy profits and income for these elite firms. UK-based Herbert Smith Freehills, hired to represent Spain in at least two cases, for example, is retained at a fee of 300 euros an hour and could earn up to 1.6 million euros for the cases.

- Investment lawyers and corporations are using the threat of legal cases to try to change policies or prevent regulation that threaten profits. In an October 2011 client briefing paper, US-based law firm K&L Gates, for example, recommended investors should use the threat of investment arbitration as a "bargaining tool" in debt restructuring negotiations with governments. Similarly, UK-based firm Clyde & Co suggested using the "potential adverse publicity" of an investment claim as "leverage in the event of a dispute with a foreign government".

- The European Commission (EC) has played a complicit and duplicitous role, effectively abetting this wave of corporate lawsuits battering crisis-hit countries. Some of the lawsuits have arisen due to debt and banking restructuring measures that were required as part of EU rescue packages. Moreover, while the EC has been critical of BITs (Bilateral Investment Treaties) between EU member states (known as intra-EU BITs), they continue to actively promote the use of investor-state arbitration mechanisms worldwide, most prominently in the current negotiations for the controversial EU-US trade agreement (TTIP). Defending corporate protection while denying social protection is a disturbing indictment of current priorities in European trade and economic policies.

- The investment arbitration regime provides VIP treatment to foreign investors and privatises justice. Foreign investors are granted greater rights than domestic firms, individuals or communities, even when these are just as affected by the measures that led to the dispute. The cases are judged by a tribunal of three private, for-profit lawyers who get to decide on policies that affect the welfare of millions of people. Some of them have ignored international legal principles that allow for states to violate their international obligations when it is necessary to protect the interests of their citizens, especially in crisis situations.

The deepening crisis in the European periphery has attracted more and more circling vultures, scavenging for profits. In 2012, New York-based Greylock Capital argued that buying Greek bonds was "the trade of the year". At the time, investors were paying 19 to 25 cents for bonds for every dollar worth of bonds.

In April 2013, US-based law firm Skadden which represents Cyprus Popular Bank (Laiki) in a looming multibillion-euro investment treaty dispute against Greece praised the "increasing appeal and novel use of Bilateral Investment Treaties". The firm noted, "the appeal of BIT tribunals, coupled with the economic uncertainty of recent times, has triggered an increased use of BITs to resolve disputes in ways that previously had not been encountered by arbitral tribunals, and we expect this trend to continue." The experience of Argentina, which faced 55 investor lawsuits in the aftermath of its crisis in 2001, shows that claims keep coming some time after a crisis. The cases listed in this report are almost certainly just the beginning of a new wave of investor-state lawsuits against European countries.

These investor-state disputes are part of a broader pattern that has become deeply evident since the economic crisis broke; one where corporations are protected from risky investments while citizens are told that cuts are inevitable; where corporate losses are socialised and taxpayers pay the bill; where corporations have recourse to justice while citizens' human rights are sidelined.

The European and American public were understandably angry about bailout of the banks. It is time now to turn a spotlight on the bailout of investors and call for a radical rewrite of today's global investment regime.

As a first step, we believe EU governments should seek to terminate existing investment agreements. In particular, European citizens and concerned politicians should demand the exclusion of investor-state dispute mechanisms from new trade agreements currently under negotiation, such as the proposed EU-US trade deal. A total of 75,000 cross-registered companies with subsidiaries in both the EU and the US could launch investor-state attacks under the proposed transatlantic agreement. Europe's experience of corporate speculators profiting from crisis should be a salutary warning that corporations' rights need to be curtailed and peoples' rights put first.

Chapter 1
Introduction:
protecting speculators, endangering democracy

The European Union is currently negotiating international trade and investment agreements with countries such as the United States, Canada and China which grant ample rights to corporations. The proposals to include "investment protection" in these agreements would empower multinational companies investing in Europe to directly sue EU governments in private international tribunals – whenever they find that regulations in the area of public health, environmental or social protection interfere with their profits. EU companies investing elsewhere would have the same privilege abroad.

People in Europe are already bearing the brunt of corporate irresponsibility – from the speculation that triggered the financial meltdown, to the public paying for the resulting bank bailouts – in the context of the economic crisis. The fact that the European Commission is willing to grant corporations even more tools to rein in democracy and raid public treasuries has already sparked controversy and resistance – particularly in the context of the EU-US trade deal currently being negotiated, the Transatlantic Trade and Investment Partnership (TTIP).

Ongoing investor attacks against public health and environmental protection policies have been at the heart of the concern. For example, tobacco giant Philip Morris is suing Uruguay and Australia over anti-smoking legislation; energy company Vattenfall is suing Germany because the country decided to phaseout nuclear energy; and oil and gas firm Lone Pine is challenging Canada over a moratorium on dangerous drilling techniques ('fracking') in the Canadian province of Quebec.

Another threat has been less discussed, however: how corporations are using the sweeping investor rights in trade and investment agreements to sue countries in economic crisis. Argentina, for example, has been sued more than 40 times by foreign investors as a result of the reforms implemented after its economic crisis in 2001. It has been ordered to pay around US$980 million in compensation – on top of millions of dollars in legal costs it paid to defend the investor disputes.

And now, investor-state lawsuits are starting to hit crisis-struck countries in the Eurozone. Belgium, Spain, Greece and Cyprus are all battling multimillion dollar demands at international arbitration tribunals. The cases are a result of policy decisions taken in times of crisis. But they have largely escaped public attention. And they do not seem to prevent the EU from wanting to enshrine the same excessive corporate rights on which they are based in even more trade agreements.

This report attempts to shed light on the investor-state lawsuits that have been filed against EU countries in the context of the economic crisis. It reveals a class of speculative investors which have first gambled with the financial hardship of countries and are now suing them because their expected profits did not materialise. The report also exposes how international law firms which make money with investor-state disputes are using the economic meltdown to expand their business, seeking out every opportunity to sue countries.

The report hopes to contribute to the ongoing debate about the EU's future policy towards foreign investors.

Chapter 2
Never let a good crisis go to waste

In the last two decades, there have been repeated major economic meltdowns across the world: Mexico (1994), South East Asia (1997), Czech Republic (1997), Russia (1998), Ecuador (1999), Brazil (1999), Turkey (2001), Argentina (2001), and United States/Europe (2008 and beyond). Some were deeper than others, but the crises had one thing in common: governments had to intervene and were expected to alleviate the hardship of their people. They adopted a number of emergency measures ranging from sovereign debt restructuring – i.e. negotiating repayment terms with creditors – and currency devaluation, to the freezing of prices for public services.

Economic crises trigger investor-state lawsuits

These types of urgent government measures to take control of an economy in meltdown have been challenged by foreign investors under international investment agreements. These treaties give sweeping powers to foreign investors, including the peculiar privilege to directly file lawsuits at international arbitration tribunals, without necessarily even going through local courts. Companies can claim compensation for actions by host governments that they feel have damaged their investments, either directly through expropriation, for example, or indirectly through regulations in the area of public health, environmental or social protection. 'Investment' is understood in such broad terms that corporations can claim not just for the money invested, but for future anticipated earnings as well.

The claims are decided by a tribunal of usually three private lawyers, the arbitrators. They tend to be hired from a small club of people with a financial stake in the system: unlike judges, they have no flat salary but earn more the more investor claims they rule on.[1] And they have been found to make expansive, investor-friendly interpretations of the vaguely worded clauses in investment treaties, paving the way for more business to come their way in the future.[2]

There are currently more than 3,000 international investment agreements in existence, the vast majority, Bilateral Investment Treaties (BITs) between two countries. EU member states alone have signed around 150 such BITs between themselves (intra-EU BITs), most of them signed between 'old' and 'new' member states before the latter joined the EU. Other investment agreements include broader free trade deals with investment chapters such as the North American Free Trade Agreement (NAFTA) between Canada, Mexico and the United States, and multilateral agreements such as the Energy Charter Treaty which regulates investments in the energy sector.

Investors have argued that governments' responses to economic collapse have violated the corporate rights enshrined in these investment treaties. Argentina, for example, has been sued more than 40 times as a result of the reforms implemented after its economic crisis in 2001 (see Box 2 on page 12). It is a prime example of how a country in crisis can find itself battling dozens of lawsuits from disgruntled investors, even when the measures taken by the government could be considered necessary and aimed at easing people's hardship.

> When I wake up at night and think about arbitration, it never ceases to amaze me that sovereign states have agreed to investment arbitration at all... Three private individuals are entrusted with the power to review, without any restriction or appeal procedure, all actions of the government, all decisions of the courts, and all laws and regulations emanating from parliament.

Juan Fernández-Armesto, arbitrator from Spain[3]

Box 1

What you need to know about investment treaties & arbitration[4]

- States have signed more than **3,000** international investment treaties.
- These treaties give **sweeping powers** to foreign investors, including the power to directly file **lawsuits at international tribunals**, without necessarily going through local courts.
- Emblematic ongoing cases include Swedish energy giant **Vattenfall** challenging Germany's exit from nuclear power, tobacco company **Philip Morris** suing Uruguay and Australia over health warnings on cigarette packs and energy company **Lone Pine** suing Canada over a fracking moratorium in the Canadian province of Quebec.
- The claims are decided by a tribunal of private lawyers, the **arbitrators**, who have a financial stake in the system and a number of conflicts of interest.
- Globally, **514** investor-state disputes were known of at the end of 2012.
- Around **42%** of the known concluded investor-state cases were decided in favour of the state, **31%** in favour of the investor and **27%** of the cases were settled (many of the latter likely to involve payments to or other concessions for the investor).
- The highest damages to date, **US$2.3 billion**, were awarded to US oil company Occidental Petroleum against Ecuador.

Argentina is not the only country that had to fight investors in foreign tribunals in the midst of a major crisis. Mexico was sued under NAFTA as a result of the government's emergency measures taken during its financial crisis. US insurance company Fireman's Fund claimed that, when the 1997 peso crisis struck, Mexico had bailed out domestic investors, but not foreign ones. While the arbitration tribunal indeed found a "clear case of discriminatory treatment" it did not have jurisdiction on this issue because NAFTA limits investor-state arbitration in the finance sector to claims of expropriation. As the tribunal did not consider Mexico's actions expropriation, Fireman's Fund lost the case. Nonetheless, the tribunal ordered Mexico to pay its own legal costs and half the administrative costs of the tribunal.[5]

The beginning of the current global economic crisis in 2008 spurred speculation that, as in the case of Argentina and Mexico, investors would resort to the protection of investment agreements and that the number of treaty claims against European countries would rise.

> The 2001 Argentine financial crisis triggered a wave of international litigation against that state. If current trends continue, there is no reason to expect any different on existing state responses to the Global Financial Crisis.
>
> Anne van Aaken (University St. Gallen) & Jürgen Kurtz (Melbourne Law School)[6]

These predictions are starting to materialise. Crisis-hit countries in the Eurozone are being hit by investor-state lawsuits. Belgium,[7] Spain (see chapter 4), Greece and Cyprus (see chapter 3) are all battling multimillion dollar demands at international arbitration tribunals. The measures these lawsuits attack are a result of decisions taken in order to deal with a crisis.

Box 2

Argentina: the world's most sued country under international investment treaties

No country in the world has been sued more often under international investment treaties than Argentina. Fifty-five investor-state lawsuits against the country are known about. Two thirds have their roots in the measures taken by Argentina during its 2001-2002 economic crisis.[8]

In the 1990s, Argentina's Menem government privatised all public and financial services as well as pensions. At the same time, dozens of Bilateral Investment Treaties (BITs) with far-reaching protections for foreign investors – for example, those corporations with a new stake in the privatised services – were signed. A deadly combination.

In 2001, Argentina's economy was thrown into chaos. Suffering from recession, the country could not devalue its currency because, at the time, the Argentinean peso was pegged to the dollar. To sustain the exchange rate and the economy, Argentina borrowed more and more money, piling up an unsustainable debt burden. Public spending was cut as unemployment and poverty rates soared. There was hyperinflation and prices for basic services such as electricity and water had increased enormously due to the privatisations.

After months of protests, a new government passed an Emergency Law to cut loose from the dollar and devaluate the currency to boost exports. Argentina also defaulted on its debt and froze public services' tariffs to keep them affordable for its people.

These measures helped Argentina to recover but hurt the profits of foreign corporations investing in the country, which then proceeded to sue. Over 40 foreign investor lawsuits from companies like CMS Energy (US), Suez and Vivendi (France), Anglian Water (UK) and Aguas de Barcelona (Spain) demanded multimillion compensation packages for revenue losses from reversed privations and the freezing of prices for basic services.

An important ongoing investor-state lawsuit is known as 'Abaclat and others vs Argentina' in which 60,000 sovereign bond holders are suing Argentina for over US$1 billion. The reason: after the 2001 financial crisis Argentina defaulted on its debt and these bondholders did not accept the reduction of value of the bonds. They claim that Argentina "expropriated" their investment (i.e. seized their property and/or reduced the value of their investment) and did not treat them in a "fair and equitable" manner. But can bondholders be considered legitimate investors when they have no real economic project in Argentina? The Argentinian government has argued they cannot. But, two of the three arbitrators sitting in the Abaclat arbitration panel decided that bond instruments qualify as investments and have agreed to hear the mass claim. There is no final decision yet, but Argentina has already spent at least US$12.4 million in legal fees for its defence.

Number of known investment treaty lawsuits against Argentina **55**

Number of known cases emerging from the 2001 economic crisis **41**

(75% of all cases against Argentina)

Status of crisis cases (as of January 2014):

- Arbitration tribunal that first decided on the case ruled in favour of the investor:[9] **15 cases**[10]
- Tribunal ruled in favour of Argentina:[11] **3 cases**[12]
- Settlement:[13] **10 cases**
- Cases discontinued: **3 cases**
- Cases still ongoing: **10 cases**
- Argentina has so far been ordered by arbitration tribunals to pay around **US$980 million** in compensation.[14] In October 2013, Argentina agreed to pay **US$677 million** to various foreign companies.[15]
- Argentina has spent at least **US$12.4 million** in legal fees for its defence in just one case (Abaclat).[16]

Governments' emergency measures become the target of foreign investors

International investment agreements contain a number of rights for foreign investors that can be used against states fighting financial crises and economic collapse (see Table 1 on page 14). Academics have argued that these rights also act as straitjackets, potentially leading to "regulatory freeze" as governments seek to preempt claims on the basis of investment treaties "by shying away from regulations that may provide fertile grounds for a challenge".[17] Here are some of the measures taken to protect a country's population and economy during a financial crisis that could be severely undermined:

- **Favouring national over foreign investors:** Economists have argued that "the ability to treat domestic and foreign creditors differently is a necessary policy option for governments in a financial crisis".[18] Discriminatory policies might be needed to preserve national industries, revive a domestic financial system or ensure fulfilment of wage and pension commitments. During the banking crisis in Europe, for example, countries such as Germany, the UK, and Ireland to some extent implemented financial stabilisation programmes that benefited some financial institutions but not others. In 2008, Ireland, for example, issued state guarantees for Irish-owned banks (later extended to include some foreign owned banks). During the Argentinian financial crisis, domestic bondholders got a better deal than foreign bondholders. Domestic creditors operate in the national economy and therefore have a direct impact on jobs and livelihoods. It is in the interest of a government in crisis that these companies keep fuelling the economy.[19] But investment treaties could constrain a government's decision to favour national over foreign investors.[20]

- **Sovereign debt restructuring:** Debt restructuring is a common tool in countries' economic crisis mitigation toolbox. When a state can no longer pay its debts, it negotiates with its creditors to either reduce the value of its debt or lower the interest rates it has to pay. However, investment protection rules can undermine governments' capacity to negotiate and manoeuvre to resolve their debt problems. The United Nations Conference on Trade and Development (UNCTAD) has warned: "It is important to ensure that [international investment agreements] do not prevent debtor nations from negotiating debt restructuring in a manner that facilitates economic recovery and development".[21] Similar arguments have been put forward by academics.[22]

> A de-facto regime may be arising whereby international investment agreements can serve as a way for disgruntled investors to circumvent debt restructuring.
>
> Kevin P. Gallagher, Boston University[23]

- **Capital controls:** Academics and international organisations have recognised that capital controls are legitimate policy tools to prevent and mitigate financial crises.[24] But according to UNCTAD, international investment treaties could jeopardise the decision of governments to impose capital controls.[25] Likewise, the International Monetary Fund (IMF) has acknowledged that investment treaties could conflict with its own recommendation that governments might consider deploying capital controls in order to mitigate the risks of financial crises.[26]

> Countries should be cautious about entering into bilateral investment treaties... that may severely constrain their ability to reregulate capital flows.
>
> United Nations Conference on Trade and Development (UNCTAD)[27]

Emergency situations do not prevent investors from suing

Customary international law allows for states to violate their international obligations when it is necessary to protect the interests of their people (the necessity defence). In these situations, the state should not be the one to justify itself. Rather, the investor would have to prove that the state violated international law and that alternative measures to protect the interests of the country's population without affecting investor rights were feasible. But arbitration tribunals – usually three for-profit lawyers who

TABLE 1

How investment treaties undermine policy space to deal with financial crises

Common rules in investment agreements	What does it mean?	Examples
National treatment	Foreign investors have to be treated at least as favourably as domestic investors. Any measure by a government that favours domestic actors, thereby discriminating against the foreign investor, can lead to investor-state challenges.	If a government bails out a national bank but not a foreign one, the foreign one can sue arguing that the principle of national treatment has been violated. If a government subsidises domestic businesses during a crisis period, foreign companies can demand similar support or else initiate a lawsuit over discrimination.
Fair and equitable treatment	Foreign investors are granted the right to a stable and predictable business environment that does not frustrate an investor's expected profits. Any measure taken that changes 'the rules of the game' – such as increasing taxes, freezing tariffs, reducing subsidies, banning capital outflows – can lead to investor-state disputes.	If a government freezes prices for public services to ease people's hardship during a crisis, it can be sued for breaching the legitimate expectations of certain profits by foreign companies. If a government restructures its debt, bondholders can also argue that their legitimate expectations for a financial return on lending money have been destroyed.
Protection against expropriation	If governments expropriate investors, they have to pay compensation – otherwise they can be sued. 'Expropriation' not only refers to the outright seizure of property (direct expropriation), but also to actions which have reduced the value of an investment, including through regulatory measures (indirect expropriation).	Sovereign debt restructuring could be seen as an indirect expropriation because it reduces the value of the asset, i.e. the sovereign bonds which represent government debt owned by the investor. Financial re-regulatory measures such as financial transaction taxes on banks to recoup the costs of bailouts could also be seen as indirect expropriation.
Ban on capital controls	Governments must not restrict the investors' free transfer of any type of capital, including equities, securities, loans and derivatives. Any restriction that limits transfer payments in and out of a country can lead to investor-state lawsuits.	If a government implements taxes on inflows/outflows, limits the ability of foreigners to borrow domestically, imposes exchange controls or mandatory approvals for capital transactions, or if it prohibits the inflow/outflow of capital, investors can file a lawsuit.

hear the case in private – tend to see investment law as a self-contained legal regime where general principles of international law such as the necessity defence become an exception, forcing the state to demonstrate its right to intervene to protect its people.[28]

On top of that, very few investment agreements contain explicit emergency clauses which free governments from their obligations towards investors in situations such as a financial crisis.[29] And even when states have enshrined such narrow safeguards in a treaty, investors have been successful in bypassing them.

One way to bypass emergency clauses is for investors to resort to a principle included in all investment treaties known as "most favoured nation". With this principle, governments agree to grant foreign investors from all countries with which they have signed investment treaties the same favourable treatment. If a state has signed another investment treaty without an emergency clause, an investor can 'import' the more investor-friendly conditions from this other treaty and claim that the emergency clause does not apply. This was the strategy followed by US-based energy company CMS in its case against Argentina.[30]

Finally, in cases where investors have argued that the state's actions were neither covered by the necessity defence nor an emergency clause, arbitration tribunals have set very high thresholds of proof, making it almost impossible for governments to use the exemptions.

The Argentina-US investment treaty, for example, which was invoked by investors in at least 13 disputes resulting from the Argentinian crisis, includes an "emergency clause" (Art XI). In most disputes Argentina referred to the clause, arguing that actions taken during the crisis could not be challenged by investors. Yet in only two cases (LG&E vs Argentina and Continental Casualty vs Argentina) the arbitration tribunal accepted that the government's measures had to be taken to combat the crisis (at least during the months when it was at its peak). In other cases, the tribunal rejected Argentina's defence – even though the circumstances were similar.

Arbitrators side with investors

These inconsistencies in the rulings show that it is very difficult for a country to know whether it can safely endorse certain policies in a situation of severe economic crisis – or whether it will be condemned to pay millions of dollars in compensation in an investment dispute later. It is up to a tribunal of – usually three – private lawyers, the arbitrators, to decide.

So far, most arbitration tribunals have rejected the "economic and financial crisis" line of defence by states such as Argentina, failing to acknowledge the implications for public well-being.[31] Referring to the disputes against Argentina brought by services corporations, Nobel Prize winner Joseph Stiglitz has noted: "It is not clear whether the arbitrators have the ability to judge the full societal consequences of what would have happened had, say, all utility contracts been honored [in Argentina]."[32]

The warning of arbitrator Georges Abi-Saab in the ongoing Abaclat case against Argentina in which bondholders attacked debt restructuring (see Box 2 on page 12) demonstrates the tendency for those sitting on these tribunals to put private profit over the public interest. Abi-Saab lambasted the other two arbitrators in the case, Pierre Tercier and Albert Jan van den Berg, arguing that they ignored its social, economic and political implications. He warned that the case questions "in an acute manner... the workability of future sovereign debt restructuring". In his opinion, arbitration tribunals should not intervene in sovereign debt disputes because holding sovereign debt is not real economic activity that would fall under the protection of an investment treaty. He also indicated that the judgment of his arbitrator colleagues was biased, "driven in part by controversial policy considerations" and that they had "uncritically" followed the arguments of the investor, while paying "hardly... any attention" to Argentina's defence.[33]

The two arbitrators that allowed the case to continue, on the other hand, maintained that "policy reasons are for states to take into account when negotiating BITs... not for the tribunal to take into account in order to repair an inappropriately negotiated or drafted BIT."[34]

Winston Churchill once said: "Never let a good crisis go to waste." Investors and investment lawyers have followed that advice. Argentina was one of the first victims; European countries in crisis are next.

“ Winston Churchill once said: "Never let a good crisis go to waste". Investors and investment lawyers have followed that advice. ”

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8 All statistics presented in the section are based on known investment-treaty cases including different rules (UNCITRAL, ICSID, etc). The data was collected by the authors combining a search in different databases: ICSID, United Nations Conference on Trade and Development (UNCTAD) and Investment Treaty Arbitration (ITA).

9 In many of the cases where the tribunal that first arbitrated the dispute produced an award, Argentina contested the award. In some instances the award was later annulled and/or the legal battle continues. This count only takes into consideration the decision of the first tribunal that was formed for the case.

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11 In some cases where the tribunal that first arbitrated the dispute produced an award, the investor contested the award. This count only takes into consideration the decision of the first tribunal that was formed for the case.

12 Daimler Financial Services AG (ICSID ARB/05/1), Wintershall Aktiengesellschaft (ICSID ARB/04/14) and Metalpar S.A. and BuenAire S.A. (ICSID ARB/03/05).

13 The terms of settlement are usually not disclosed, but in the majority of cases, the state has agreed to pay the company or has given other concessions. Settlements can be counted as wins for the investors. The settled cases include: Impregilo vs Argentina (ICSID ARB/08/14); Compañía General de Electricidad vs Argentina (ICSID ARB/05/2); RGA Reinsurance Company vs Argentina (ICSID ARB/04/20); France Telecom vs Argentina (ICSID ARB/04/18); Telefónica vs Argentina (ICSID ARB/03/20); Suez; Soc. Gral. de Aguas de Barcelona vs Argentina (ICSID ARB/03/18); Pan American Energy LLC; BP Argentina Exploration Co. vs Argentina (ICSID ARB/03/13); Pioneer Natural Resources vs Argentina (ICSID ARB/03/12); Camuzzi Int. S.A. vs Argentina (ICSID ARB/03/07); Bank of Nova Scotia vs Argentina (UNCITRAL).

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Chapter 3

Greece and Cyprus: falling into the debt trap

Investment and hedge funds are known for speculating on the sovereign debt of countries facing an economic crisis. As we have already seen, Argentina, as well as Congo, Liberia and Zambia have been on the sharp end of this practice. But increasingly, European countries in financial trouble are being targeted.

So what is the investors' strategy? Buy debt cheap, in the form of sovereign bonds of government debt discounted because of a crisis. Then refuse to negotiate a reduction in the value of the bond (commonly known as a 'holdout') when the country concerned attempts to restructure its debt to ease the financial burden. These bondholders then demand to be paid in full, ensuring big profits since they bought the bonds at knock-down prices. If governments refuse to pay, the bondholders cry foul and attempt to enforce payment by seizing assets abroad or by suing at international arbitration tribunals. These types of investors have been rightly named 'vulture funds'.

Greece, facing one of the worst crises in its history, attracted the circling vultures. It began with a public budget deficit that raised fears Greece would default on its sovereign debt repayments. As a result, between 2011 and 2012, Greek bonds were being sold at an average of 50% of face value.[1] It is estimated that speculative funds bought around €50 billion in Greek debt.[2]

> The Greek crisis is "certainly a great chance to make money".
>
> Robert Marquardt, founder of Signet, a fund of hedge funds[3]

The Troika – the European Commission, the European Central Bank (ECB) and the International Monetary Fund (IMF) – intervened to inject money into the Greek economy. In return, they demanded a harsh austerity package and the restructuring of the Greek debt.[4]

The austerity measures hit the Greek people hard, particularly the most vulnerable sectors of society. In the same vein, bondholders of Greek debt – mainly big European banks, insurers and asset managers – similarly might have been expected to bear the brunt of debt restructuring measures.

The people of Greece were left to suffer austerity measures that would set them back a decade and condemn them to hardship and unemployment. In contrast foreign bondholders remained safe, their money protected by the 39 Bilateral Investment Treaties (BITs) that the Greek government had ratified.[5]

These international agreements protect investors from losses from risky investments. Foreign investors can challenge via international arbitration tribunals any government measures that threaten their profits, even when the investor was speculating on debt. Furthermore, investors can sue a government, even when the measures that lead to the lawsuit were imposed from outside, as in this case by the Troika.

Greece and Cyprus, two countries fighting deep economic crises, are both being sued by foreign investors who are claiming a breach of BITs. In the case of Greece, two foreign bondholders (Poštová Bank from Slovakia and its Cypriot shareholder, Istro Kapital) challenged the terms of the debt restructuring at an international arbitration tribunal. In the case of Cyprus, a Greek private equity investor (Marfin Investment Group) is claiming loss of profits as a result of the restructuring of Cyprus' main banks. These, it should be made clear, were not national government decisions. Debt and bank restructuring were measures imposed by the Troika on Greece and Cyprus as part of the bailout packages.

Rescuing Greece? Debt restructuring as a condition for bailout

In December 2009, Greek sovereign debt reached 113% of GDP, nearly double the Eurozone limit of 60%.[6] Who was responsible for the high levels of public indebtedness? There are at least three culprits: i) the Greek government, for years of over-spending including high military expenditure[7] and the huge cost of the Athens Olympic Games in 2004;[8] ii) big investment banks such as Goldman Sachs that helped to hide the debt for years[9]; and iii) other European countries, especially Germany who failed to intervene in the continuous and increasing lending to Greece of its own banks.[10]

> Irresponsible borrowers can't exist without irresponsible lenders. Germany's banks were Greece's enablers. Thanks partly to lax regulation, German banks built up precarious exposures to Europe's peripheral countries in the years before the crisis.

Bloomberg editors[11]

Rating agencies responded by downgrading Greek debt. However, analysts have pointed out that, at the time, "there was no significant sign of financial distress in the Greek banking system".[12] The Greek government tried to keep the markets calm by assuring that there was no chance of a debt default,[13] but despite this there was substantial capital flight[14] and what analysts such as Marica Frangakis, from the Nicos Poulantzas Institute in Athens, considered a "massive speculative attack on Greek government bonds".[15]

Greece received two bailout packages from the Troika totalling 240 billion euros, conditioned on a massive privatization plan affecting pensions, education, healthcare, natural resources, public companies, and a restructuring of Greece's debt.[16]

Greek debt restructuring: a sweet deal for big banks

No one doubted that Greece had to restructure its debt by reducing the face value of its bonds (a 'haircut'). While some economists suggested a sustainable restructuring,[17] or debt rescheduling that spread the burden among creditors more evenly,[18] these suggestions were ignored and in 2012, the government approved the Greek Bondholders Act. The new legislation, imposed by the Troika, did force investors to accept a haircut but favoured the bigger, foreign bondholders.

> The reality is that private creditors got a very sweet deal while most actual and future losses have been transferred to the official creditors... Greece's public debt will be almost entirely socialised.

Nouriel Roubini, New York University[19]

Bondholders seem to have got a sweet deal and emerged largely unaffected. While the price of the new bonds was below their nominal value, it was well above the market value at the time. Some analysts have stated that Greece granted "very generous treatment of holdout creditors"[20] and that "Greece's private creditors are the lucky ones".[21]

Not only did big banks receive a good price for the bonds, but 49% of the bailout money (financial assistance given to Greece by the Troika) then went back to pay banks holding Greek bonds.[22]

Speculating on a bankrupt country

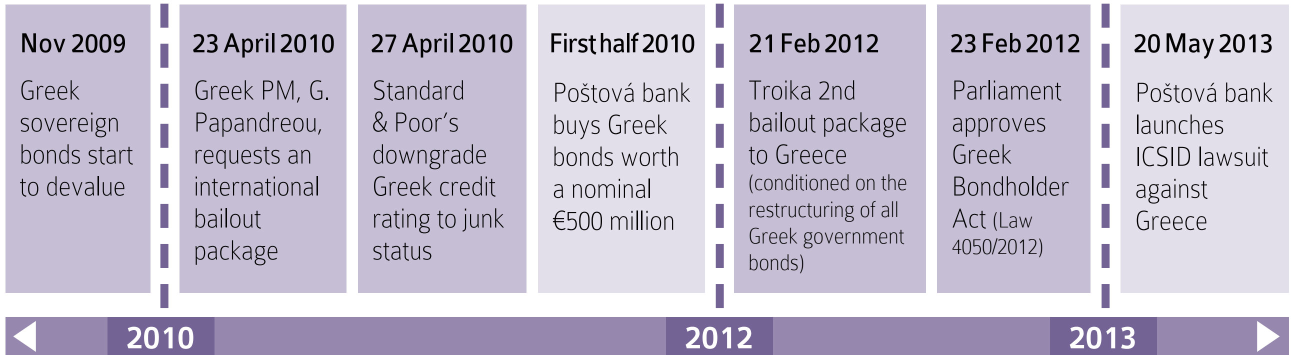
Despite the fact that the Greek debt restructuring was very favourable to creditors, some speculators wanted even more favourable treatment, and set out to gain from the 'haircut'.

Poštová Bank is a Slovakian institution that, lured by the possibilities of high returns, bought Greek sovereign debt bonds in early 2010, after credit agencies were warning of the risk of default and the bonds value had already been downgraded.[23,24] In fact, it seems Poštová Bank bought the Greek bonds at a moment when others were trying to get rid of them.[25]

The risks of such investment were clear at that time. By the second quarter of 2009 the rating of bonds started to decline.[26] In April 2010, rating agency Standard & Poor's categorised Greece's debt as "junk".[27] But Poštová Bank saw an opportunity to make money out of the crisis.

Figure 1

Greece Timeline



Two years later, the bank, despite having made a risky investment, refused to restructure Greece's debt. It now claims to have lost millions due to the forced Greek debt restructuring. It has launched an international arbitration case claiming Greece breached the state's obligations under the BITs, including those regarding expropriation and fair and equitable treatment.[28]

> Who would have thought in 1961 that a BIT signed to bring investment funds into the country, would allow vulture funds to pick at Greece's fiscal corpse in 2012?
>
> Ioannis Glinavos, Lecturer in Law, University of Reading[29]

Poštová Bank is one of a small minority of speculative investors who rejected the Greek deal with the expectation of using foreign courts or international arbitration tribunals to recover the full amount of the bond. In May 2013, the Poštová Bank from Slovakia and its Cypriot shareholder, Istro Kapital, sued the Greek Government at an international investment tribunal under the auspices of the World Bank, the International Centre for Settlement of Investment Disputes (ICSID).[30]

The banks are using BITs between Slovakia and Greece and between Cyprus and Greece in order to pursue the case.[31] It is worth noticing that the investment treaties are between European Union member states, adding an extra bitterness to the situation since the European Commission has repeatedly questioned the validity of these BITs.[32]

The bottom line is that even if Poštová made some losses on their investment, that was a clear risk they took when they decided to buy bonds from a country in deep crisis. Speculative investments carry risks, and investors should not be able to pass on the losses when their risk-taking goes wrong. Indeed, despite their limited losses, Poštová Bank keeps yielding high profits.[33]

Meanwhile, the people of Greece (who will be the ones paying if Poštová wins the lawsuit) are suffering from the harsh austerity measures imposed upon them. In 2013, statistics show that Greeks are on average almost 40%

Table 2

Case Summary

Who is suing Greece?	Tribunal	Demand for	Arbitrators	Counsel to investors	Counsel to Greece
Poštová bank (Slovakia) and Istrokapital (Cyprus)	ICSID (Case No. ARB/13/8) **Treaty** Bilateral investment treaties Slovakia-Greece and Cyprus-Greece	Unknown	Eduardo Zuleta (Colombia) President John Townsend (U.S.) appointed by the investor Brigitte Stern (French) appointed by the State	Debevoise & Plimpton Havel, Holásek & Partners	Cleary Gottlieb Steen & Hamilton

Box 3

Greece: the vultures that won

For some vulture funds, the gamble to buy debt cheap and use legal means (in this case national courts rather than international tribunals) to get paid in full has already worked.

Dart Management and Elliot Associates are among the investment funds that 'held out' and appear to have made hefty profits. In May 2012, Dart together with other few investors that rejected the haircut, threatened to sue the Greek government, in, for example, US courts, if they failed to make the €436 million bond payment that was due.

The creditors that decided to hold out and did not accept the debt restructuring deal, retained roughly €6.4bn of Greek bonds[34] and were ready to fight for their share. Afraid of a legal battle and without an elected government in place, Greece paid off the vulture funds, who made a hefty profit.[35] Some 90% of the 436 million euro bond payment made by Greece in May 2012 went to Dart Management.[36]

There could be more such cases in the future. After the haircut and bond swap of 2012, Greek bonds were categorised as junk. However, hedge funds still believed they could make money out of Greece. In 2012, New York-based Greylock Capital said Greek bonds were "the trade of the year", paying 19 to 25 cents for every dollar worth of bonds.[37] Other banks such as Morgan Stanley agreed.[38] Just recently investment firm Japonica Partners attempted to buy €3 billion in debt bonds,[39] claiming it was a great investment.[40]

These type of funds have been categorised as "risk-happy investors", but as we see with Dart Management, it seems they are not necessarily willing to take the hit when the expected profits do not materialise.

poorer than they were in 2008.[41] The austerity programmes imposed by the government have resulted in overall unemployment of 27% and youth unemployment of 60%;[42] the suicide rate has doubled from when the crisis started,[43] there is a drastic rise in homelessness, and one in three children are living below the poverty line.[44] The general picture is one of massive reductions in conditions and living standards for large parts of the Greek population including lower wages for the ones who are lucky enough to still be employed. Greece is today one of the poorest countries in the EU.

Cyprus crisis: knock-on effect from Greek debt restructuring

One of the key victims of the Greek debt deal was the Cypriot financial system. The Cypriot economy had been inflated for years based on an unsustainable financial system whose assets were eight times the country's GDP. One of those assets was in fact Greek sovereign debt. In particular, the Laiki Bank and the Bank of Cyprus had bought large amounts of Greek bonds, the majority of which was lost after Greece's debt restructuring process.

When in April 2013 a bailout loan and programme for Cyprus was adopted, one of the conditions imposed by the Troika was to dismantle Laiki Bank. The Cypriot Government took an 84% stake in Laiki and appointed a new board.[45] The main investor affected by these measures was Marfin Investment Group (MIG). Marfin is a Greek-listed private equity-style investor, which had acquired most shares of Laiki bank in 2006.[46]

It is worth noting that it was after Marfin became a relevant shareholder in Laiki that it started an important expansion of its operations outside Cyprus, including buying Greek bonds, increasing its vulnerability to external shocks.[47] Furthermore, after the Cyprus government took over Laiki, the new board discovered a series of questionable lending practices, cases of conflict of interest, and an unsustainable financial situation.[48]

But bearing some responsibility in the creation of a financial crisis in Cyprus was no deterrent for Marfin to sue the Cyprus government for loss of profits. In January 2013, they filed a notice of dispute under the Greece-Cyprus BIT seeking to restore the bank's private ownership or, if this fails, to get at least €823 million in compensation for their lost investment.[49] Twenty other smaller Greek shareholders of Laiki are joining Marfin in its claim. The 20 Greek businessmen are thought to be seeking around 229 million euros.[50]

Figure 2
Knock on effect of Greek crisis in Cyprus

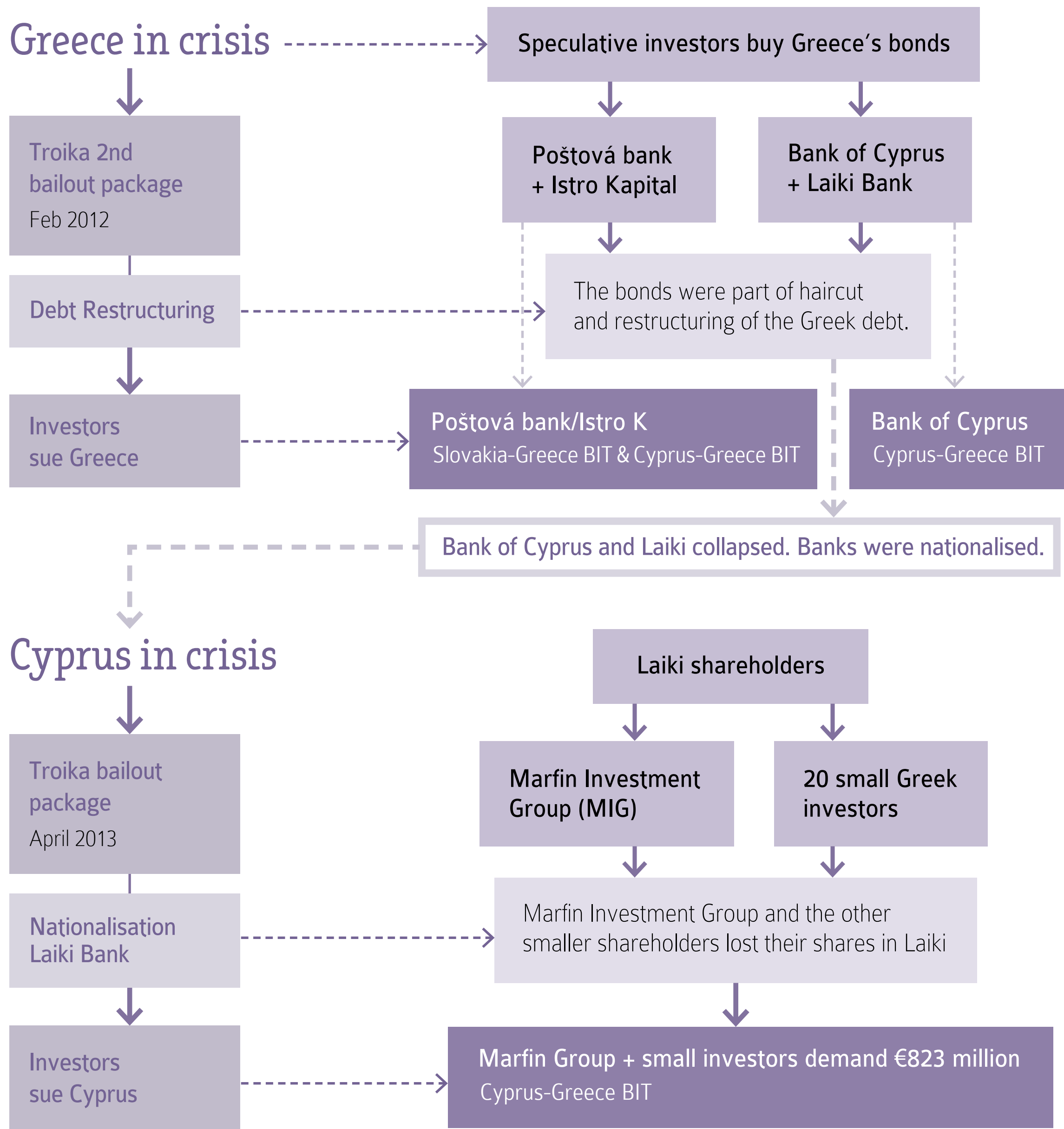


Table 3
Case Summary

Who is suing Cyprus?	Tribunal	Demand for	Arbitrators	Counsel to investors	Counsel to Cyprus
Marfin Investment Group (MIG) and 20 Greek investors	ICSID (Case No. ARB/13/27) **Date** September 27, 2013 **Treaty** Cyprus-Greece bilateral investment treaty	€823 million + €229 million	Daniel M. Price (U.S.) appointed by the investor David A.O. Edward (British) appointed by the State President still unknown	In-house counsel Freshfields Bruckhaus Deringer Jan Paulsson	Skadden, Arps, Slate, Meagher & Flom Andreas Neocleous & Co

Current claims: only the tip of the iceberg

Up to now there have been only two cases based on investment treaties officially filed against Greece and Cyprus (Poštová Bank vs. Greece, Marfin Investment Group vs Cyprus). However, the Argentinean experience shows that lawsuits can keep coming sometime after the crisis. The fact that Greece has 39 BITs in force[51] and Cyprus 20 BITs,[52] opens the door for many more lawsuits to come.

Greece could even expect a mass claim from bondholders.[53] Cyprus could also face other lawsuits. The agreement with the Troika included substantial losses for deposits of more than 100.000 euros at Laiki.[54] The Laiki Bank is estimated to hold around 20 billion euros in deposits from Russian nationals, which raises the possibility of further claims by investors. (However, as neither Russia nor Cyprus have ratified their 1997 BIT, investors would have to use a different treaty to bring their claims.)[55]

Speculative banks: socialise the losses, privatise the profits

Litigation from creditors and vulture funds against Argentina has shown how vulnerable countries taking sovereign decisions to deal with a profound debt crisis are. As the IMF recently admitted, "litigation against Argentina could have pervasive implications for future sovereign debt restructurings by increasing leverage of holdout creditors".[56] In other words, future sovereign debt bondholders may demand better terms for themselves or refuse to renegotiate debt payments entirely, knowing they can resort to litigation to recover their money.

Even more troubling, the cases of Greece and Cyprus show governments being sued by speculative investors for decisions they have not taken freely but under the rule of the Troika. Even if the decisions had not been imposed upon them, however, it is the prerogative of any state to adopt, in times of crisis, measures they could not foresee in advance, regardless of whether they are discriminatory towards foreign investors.

Furthermore, the investors who are suing today were aiming to make quick profits when they bought Greek sovereign bonds below face value. They were well aware that the country was in deep financial crisis. They gambled and, in some cases, they lost. But instead of accepting that in business, promises of high returns do not always materialise, they are able to make use of an extra layer of protection only afforded to foreign investors via BITs. Today, they are suing the very same countries for millions of euros at whose expense they were expecting to make big profits in the first place.

The cases against Greece and Cyprus seem even more unfair when we take into consideration that it is European companies, using investment treaties signed between European member states (intra-EU BITs), who are suing. Intra-EU BITs throw overboard the idea of the European Union with equal legal footing for all its members. The fact that BITs between European member states exist means that some European investors have greater rights than others. It also means that the European Court of Justice, the institution created to ensure that EU law interpretation is applied equally across all EU member states, is bypassed and instead three private individuals rule on intra-european disputes on an ad-hoc basis.

These cases present clear examples of investors trying to make sure that losses are socialised, as profits remain privatised. International investment agreements are the perfect tool to assure that they are able to get their way.

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Chapter 4

Spain's solar dream becomes a legal nightmare

The cases against Greece and Cyprus clearly show how investment treaties limit states' capacity to tackle economic crises. Spain, another country experiencing its worst economic downturn in decades, is also the target of several investment lawsuits at international tribunals. This case shows how governments that implement unpopular austerity measures in a financial crisis not only receive angry responses from the people but could also face angry investors. But while the general population have little recourse, powerful international investors have the resources and legal avenues to sue.

Not long ago, Spain had a thriving economy and the country had become a global leader in solar energy, a model to follow in the sector. By 2008, Spain was hosting half of the world's new solar energy installations by wattage.[1] Companies from all over Europe and the US were flocking to Spain. The country was on the way towards achieving the European Union target of generating 20% of energy consumption from renewable sources by 2020.

All this changed when the economic crisis hit in 2008, and the Spanish government reversed the generous subsidies originally granted to renewable energy investors. These had offered companies rates for renewable energy that were higher than the market price, with big returns guaranteed for the entire lifetime of the installations. The Spanish government blamed the high costs it faced on the fact that the renewable energy market grew well beyond expectations and created a massive electricity tariff deficit.[2] The tariff deficit is the difference between the regulated power prices that consumers pay for electricity and the cost that electricity companies pay to energy generators, including renewable energy producers. Electricity companies sell to consumers at a loss and they carry that tariff deficit in their balance sheets. However, the Spanish government was ultimately liable for it and electricity companies expect to be reimbursed by the state.

The government maintained that the subsidies were unsustainable in the crisis situation. It branded the cuts as regulatory austerity measures.

Even though Spain was facing real difficulties in light of the worsening economic situation, the decision to cut renewable energy subsidies has been harshly criticised. The changes in policy were attacked by foreign investors who moved to demand compensation for their losses, both at national courts as well as international tribunals. But civil society organisations in Spain have also condemned the government for curbing the subsidies to an industry that is seen as a real alternative to dirty energy and as a way of mitigating climate change.[3] Organisations such as SomEnergia, a cooperative working on solar energy, and the environmentalists Ecologistas en Acción defended the high levels of investment in renewable energy.[4]

Among those who believe in the need to move to greener sources of energy, there is little doubt that states like Spain need to subsidise the transition from fossil fuels to renewable energy. However, it is highly questionable that foreign investors, especially those who entered the market after the crisis started, and were in full knowledge of the possibilities of the government's cuts to subsidies, should be allowed to sue a government in crisis at international tribunals for loss of future profits. State support should go to local and national renewable energy initiatives and not to international investment funds seeking to ensure big profits and risk-free business protected by investment agreements.

Furthermore, this is not a level playing field: the small and medium Spanish enterprises that also invested in solar do not have recourse to international arbitration. International investment treaties (either Bilateral Investment Treaties, Free Trade Agreements with investment protection chapters or multilateral agreements such as the Energy Charter Treaty) are discriminatory as they only protect foreign investors but not national ones.

In the end, if these companies prevail it is the people of Spain who, once again, will foot the bill.

A solar bubble

In March 2007 the European Union members agreed to increase support to renewable energies, setting a goal of acquiring 20% of energy needs from renewable sources by 2020.[5] Along with many other EU governments, Spain's Zapatero administration responded by pouring resources into the wind and solar energy industry.

The renewable sector, particularly solar photovoltaic (PV) and solar thermal (generating electricity from the sun rays and solar heating of water respectively), boomed in Spain with the Renewable Energy Plan 2005-2010, which established "incentives for renewable energy electricity production through subsidies in the form of feed-in tariffs",[6] guaranteed for 25 years above market rates. The price paid for feeding solar power into the national electrical grid was ten times higher than the price paid earlier to non-renewable energy suppliers.[7] They were amongst the most generous in Europe and worldwide. As a consequence Spain became a very attractive country for investors, both national and foreign, in the photovoltaic sector.

> We are a world power in this field, we are capable of exporting our technology and competing across five continents and we are today at the forefront of the renewable-energy industry.
>
> Jose Luis Zapatero, Spain's Prime Minister[8]

In 2007 and 2008 Spain became one of the biggest state subsidisers of renewable-energy in the world.[9] The fixed-price system created what some called a speculative "bubble" in photovoltaic power driven by unsustainable subsidies.[10,11]

Solar subsidies slashed as the crisis hits

By the time the real estate bubble burst and the banks started to fold in 2008, Spain's government had accumulated a considerable debt with the electricity companies. This debt, which today amounts to around 29 billion Euros (equivalent to almost 3% of GDP),[12] is, according to the government, the outcome of the 'tariff deficit'.[13] This was added to the mounting costs of an administration dealing with a growing and worrying fiscal deficit and public debt. With the crisis, Spanish sovereign debt went from 40% of GDP in 2007 to more than 100% of GDP in the first six months of 2013.[14]

The Spanish government argued that cutting subsidies to the renewable energy sector was a necessary measure in order to reduce the massive electric tariff deficit, and therefore meet the requests of the European Union to make stringent cuts to the public budget.[15,16] Eurostat, the statistical information unit of the EU, had threatened the Spanish government with including the tariff deficit in the calculation of the overall government deficit.[17] This would have put Spain under much more pressure in terms of reaching the specified targets for deficit reduction under the EU budget rules.

> The cuts in subsidies for alternative energy technologies were necessary to eliminate the accumulated 28 billion euro ($37.4 billion) tariff deficit in the electricity system.
>
> José Manuel Soria, Spain's Industry Minister[18]

Between 2008 and 2013, the Spanish government adopted several legislative decrees that increasingly cut all the subsidies to the renewable energy sector that had been granted in 2007.

In 2008 they redefined the concept of feed-in tariffs. In 2010, the government approved two key reforms that substantially reduced the guarantees and subsidies for solar generation.[19] In 2011, the Spanish Industry, Energy and Tourism Minister, José Manuel Soria, appealed to the "need to contribute from all sectors to reduce the public deficit" when he introduced a moratorium in the subsidies for new solar plants.[20] Following continuous pressure from Brussels, and succumbing to the lobbying by the big energy companies, between October 2011 and February 2013, the government approved a series of new measures that restricted even further the concessions made to the renewable energy sector.[21]

> As the euro crisis overwhelmed Spain's finances, reform of the renewable-energy bonanza became inevitable.
>
> *The Economist*[22]

Ending the solar dream: a boom in investors' lawsuits

As a result of the slashing of solar subsidies, 22 companies – mainly private equity funds that came into the market after the crisis had started – have sued Spain at international tribunals in seven different cases (at the time of writing, see table 3).

All lawsuits are based on the Energy Charter Treaty (ECT), a multilateral agreement that provides protections to investors in the energy sector. The investors' rights contained in this treaty are similar to those found in bilateral investment treaties (BITs). It also allows companies to sue governments at international arbitration tribunals.

TABLE 3

Investor-State cases against Spain relating to renewable energy subsidies

Case	Court/ Rules	Date of lawsuit	Treaty	Law firm representing the investor	Law firm representing the State	Arbitrators	Claim for	Sector
15 PV investors[23]	UNCITRAL rules (United Nations Commission on International Trade Law)	Nov 2011	Energy Charter Treaty	Allen & Overy	Herbert Smith Freehills	Gabrielle Kaufman-Kohler (chair) Charles N. Brower (investor nominee) Bernardo Sepulveda-Amor (State's nominee)	600 million euros	solar PV
Charanne and Construction Investments	Stockholm Chamber of Commerce (SCC)	May 2012	Energy Charter Treaty	Bird & Bird Shearman & Sterling	Herbert Smith Freehills	Alexis Mourre (chair) Guido Tawil (investor nominee) Claus von Wobeser (State's nominee)	17 million euros	solar PV
Isolux Infrastructure Netherlands	Stockholm Chamber of Commerce (SCC)	2013	Energy Charter Treaty	Bird & Bird	N/A	N/A	N/A	solar PV
Abengoa / CSP Equity Investment	International Court in The Hague/Stockholm Chamber of Commerce (SCC) rules	June 2013	Energy Charter Treaty	Allen & Overy	N/A	Brigitte Stern (investor nominee) Others unknown	60 million euros per year until the dispute is resolved[24]	solar thermal
RREEF	ICSID – International Centre for Settlement of Disputes (Case No. ARB/13/30)	22 Nov 2013	Energy Charter Treaty	Allen & Overy	N/A	N/A	N/A	solar thermal
Antin	ICSID – International Centre for Settlement of Disputes (Case No. ARB/13/31)	22 Nov 2013	Energy Charter Treaty	Allen & Overy	N/A	N/A	N/A	solar thermal
Eiser Infrastructure	ICSID – International Centre for Settlement of Disputes (Case No. ARB/13/36)	23 Dec 2013	Energy Charter Treaty	Allen & Overy	N/A	N/A	N/A	Solar Thermal

All investors suing are based in Western Europe (Denmark, France, Germany, Luxembourg, Netherlands, Norway, UK, Italy, and Belgium; for details of all the investors suing see Annex 1 on page 32-33). In five out of seven cases, the law firm Allen & Overy is representing the investor.

More than half of these companies only started investing after 2009 and continued increasing their portfolios throughout 2010 and 2011 (see Annex 1).[25] So by the time that the majority of these foreign investors came in, Spain was in full blown crisis mode and the restrictions in solar subsidies had already begun.[26]

> It was clear from the beginning – from the early days of Spain's prolonged fiscal crisis – that the country's solar sector would take a hit of some sort.
>
> *Forbes Magazine*[27]

The sun into gold? Speculating with solar energy

The majority of photovoltaic (PV) plants were installed in 2007-2008 (see figure 3). By August 2007, Spain surpassed 85% of its 2010 goal for PV power.

Until 2009, most solar operators were national companies that built the parks (large-scale solar installations) and later sold them in auctions. Then flocks of foreign investors – particularly private equity firms[28] and wealth and asset management funds – lured by high margins of return bought whole portfolios of these already-installed solar plants. The amount of investment is not usually disclosed, but the modus operandi of these firms is usually to stay in business for five to seven years, after which they disinvest to reap the profits.[29]

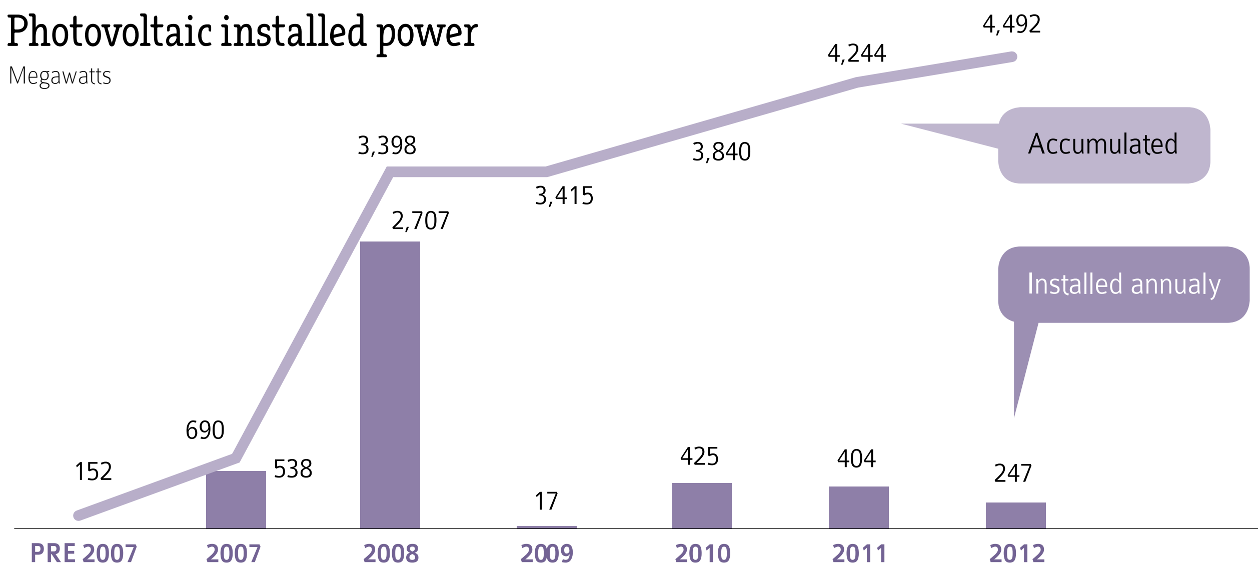
> The funds prefer large parks with proven technology and quality that do not give surprises, with rates of return of 12% or 13%.
>
> Delphine Barredo, Director of *Capital & Corporate* magazine, specialised in private equity firms.[30]

Private equity investors and investment fund managers are interested in businesses that yields high returns, not in ethical investment. It just happened that in Spain that business was renewable energy. Ian Simm, Chief Executive of Impax Asset Management, one of the funds suing Spain puts it clearly: "We don't have an ethical mandate per se... We're trying to make money for investors in this area [energy, water, food and waste]. We are often attractive for ethical investors, because what we do fits their objectives, but we also manage funds for investors who would say they are agnostic on ethical investing, at best! They're attracted by exposure to a high growth area... They ought to be able to make good, if not better, returns in the long term from this area than from anything else."[31]

Figure 3

Photovoltaic installed power

Megawatts



Source: El Pais, 3 May 2013[32]

Most foreign investors suing today at international tribunals claim that their expectations of profits have been undermined by the changes in government policy. However, the reality is that when they decided to invest in Spain, they were already well aware of the deepening crisis, the rise of Spain's sovereign debt and the decision of the government to cut subsidies to the renewable energy sector. Therefore, if they had indeed expected to get those superior returns for their investment, they have no one else to blame but themselves for being blinded to reality at the time.

The first, and much publicised, case was filed by 15 photovoltaic investors (see table 3 and Annex 1 for details) in November 2011.[33] It is reported that these investors manage more than 30 billion dollars and more than 70 pension funds and other institutional and private investments and own nearly a third of the installed solar power in Spain.[34] They are demanding 600 million euros in compensation.[35]

White Owl Capital AG, one of the 15 PV investors suing, is one of Germany's leading fund and asset managers in the field of renewable energy. White Owl started investing in Spain in 2009 and by 2012 it had built or acquired 20 solar plants.[36] Yet despite the fact that the company claims massive loss of profits for the cuts in subsidies, they continued investing in six power plants that opened during 2011.[37]

KGAL GmbH, another of the 15PV investors suing, seems to have made at least three large investments in Spanish solar energy between July and November 2011. Thus they were still buying assets whilst actually preparing their November 2011 lawsuit. Despite their suit, in 2013 KGAL's Managing Director reported good returns: "The amount of sunlight exceeded our expectations, and the excellent technical performance of our plants ensures good results for our investors... Although the era of government payment for feed-in is ending, investing in renewable energies still makes sense."[38]

The second claim was filed in 2012 by companies Charanne and Construction Investments. These investment funds are registered in the Netherlands and Luxembourg respectively, but in reality they are owned by Spanish businessmen Luis Delso and José Gomis. Both men consistently appear in rankings of the biggest fortunes in Spain.[39] As Spaniards, they need a foreign registered vehicle to be able to sue. Charanne is what is called a 'mailbox company'.[40] The Netherlands is famous for hosting companies that have no employees and are only incorporated in the country for tax purposes and to make use of the extensive network of Dutch BITs.[41] Charanne and Construction Investments are suing for 17 million euros under an arbitration tribunal operating under the rules of the Stockholm Chamber of Commerce (SCC).[42] These two initial claims together amount to 617 million euros, which would equal paying 90,000 people unemployment benefits for 4 months in Spain.

Another claim by Isolux Infrastructure Netherlands was presented in 2013. This is also a mailbox company which was only registered in the Netherlands in June 2012. It partly belongs to the same businessmen Luis Delso and José Gomis that own Charanne and Construction Investments.

During 2013, four more lawsuits emerged by four different investment funds. In one way or another, all these investors claim that the government changes in legislation breached their legitimate expectations and constitute an expropriation of their investment. However, an analysis of who these companies are and when they invested in Spain reveals that they could have expected serious cuts in the subsidies and their investments are likely to have been speculative in nature.

Investment funds RREEF (owned by Deutsche Bank) and Antin (owned by BNP Paribas), for example, only acquired solar-thermal power plants in 2011.[43] By then the government had already made significant cuts to subsidies and the precarious situation in Spain was well-known. They are both suing at the International Centre for Settlement of Investment Disputes (ICSID), the arbitration tribunal of the World Bank.

CSP Equity Investment, a subsidiary of Spanish multinational Abengoa registered in Luxembourg is another investor claiming that the expectations of profitability from its Spanish plants has been reduced, constituting an "expropriation of its investment".[44] The company has invested in six thermo-solar plants and its claim for compensation could run into billions.[45] Despite the claims of loss of profits due to the cuts, it was reported in 2013 that "Abengoa's concentrating solar power (CSP) business has shown remarkable success in recent months". [46] The first nine months of 2013, Abengoa reported a 17% increase in revenues.[47]

Eiser is one of the few funds suing that invested before the crisis hit Spain. Their first investment was in 2007. However, they continue investing despite the cuts. Indeed, in 2011 the UK equity fund helped to capitalise a new solar thermal plant in Spain. But, despite being fully aware of the risks involved, on 23 December 2013 they launched the

latest of lawsuits against the Spanish government for the new regulations imposed on the thermo solar sector (at the time of writing; at least one more investor claim was brought later, by Masdar Solar & Wind).

News reports indicate that investment funds from the US, Japan, and United Arab Emirates also intend to claim under the ECT for their losses as a result of the new energy reforms in Spain.[48] This means Spain could be facing even more lawsuits.

Impoverished Spaniards footing the bill

In order to meet European Union targets for fiscal deficits, the Spanish government imposed an extensive austerity programme that has worsened the already dire economic and social situation. In 2013, Spain cut health expenditure by 22 per cent and education by 18 per cent.[49] One in four children lives below the poverty line.[50] The unemployment rate is around 26% (6 million people). Hundreds of thousands of families have been evicted since 2008, leading to an epidemic of suicides.[51] Obviously, the government is in serious need of every eurocent available. And yet it may be forced to pay hundreds of millions of euros to speculators as a consequence of the investment treaties it has signed.

The costs for the government as a result of these lawsuits could run into millions. Even if companies win, the government, in many cases, will still have to pay the law firms hired to represent them in the different lawsuits. Herbert Smith Freehills was hired to represent Spain in at least two cases. The company was retained at a fee of 300 euros an hour and a cap on costs of 1.6 million euros.[52]

> Abengoa's allegations of government expropriation is music to the law firms ears. They have just received the best advance Christmas present possible.
>
> Spanish newspaper *La Informacion* reporting on the Abengoa lawsuit[53]

Furthermore, for every big investment fund that claims compensation at international tribunals, there are many very small national PV investors who lost their life savings[54,55] but cannot access the same level of protection. National investors cannot make claims at international tribunals. But, even if they could, the costs are so high that they would be almost impossible for small enterprises to afford.

Support renewable champions, not corporate profiteers

Investment in community-led renewable energy rather than market mechanisms (such as carbon credits) is a clear path to building sustainable carbon-free societies and mitigating climate change.

No doubt consecutive Spanish administrations made mistakes. First, in the way the government constructed the feed-in tariff for the renewable energy sector. And then, in the way they targeted the solar energy sector when making the cuts. But it is the local solar investors, and in general all Spaniards, that will pay the price while foreign investors have an extra-legal route.

Investors, including many of the speculative ones currently suing Spain, claim that they invested relying on the fact that the government would continue to apply the same pre-crisis subsidies. The real story however is that a majority of them moved in when it was already clear that subsidies would be cut. Today, these corporate profiteers – as with the vulture funds in the cases against Greece and Cyprus – are attempting to maintain their excessive profits at the expense of scarce public resources.

Investors seem outraged that they are being forced to absorb the cuts;[56] they complain that the government changed the "rules of the game" and dishonoured what they had been "promised". However, this is what people in Spain are also asked to endure in the context of the crisis. They were also promised jobs, health, education and unemployment as well as pension benefits. The government is cutting those. Their legitimate expectations have, therefore, also being breached. They, however, have no recourse to million euro lawsuits.

The question we need to ask ourselves is not only whether the decision of the government to cut renewable energy subsidies was regrettable or not, but also whether foreign speculative investors should be allowed to claim billions in compensation for austerity measures implemented in the midst of a financial crisis, under pressure from Brussels. A bill that ultimately will be paid by the same citizens that are already enduring incredible hardship of a kind that the shareholders of the renewable energy companies suing the country could not imagine.

ANNEX 1

Companies suing Spain at international arbitration tribunals

Case	Company suing Spain	Where is the investor registered?	Type of investor	Other investors involved?	When did it invest in solar energy in Spain?
PV Investors (UNCITRAL)	Ampere Equity Fund	Netherlands	Private equity fund	Triodos Bank, Dutch pension funds APG and PGGM, Delta Lloyd Bank and Rabobank	2009, 2010
	NIBC Infrastructure Partners	Benelux	Infrastructure Investment fund	Benelux based pension funds and financial institutions	2010
	European Energy	Denmark	Developer of renewable energy farms	-	2007, 2008, 2010, 2012
	Foresight Group	UK/Italy/US	Infrastructure and private equity investment	UK and international private and high net-worth individuals, family offices, pension funds and other institutional investors	2009, 2010
	Element Power	US/UK	Renewable energy developer	Owned by Private equity firm Hudson Clean Energy Partners	2008, 2009
	Eoxis Energy	UK	Renewable energy developer	Owned by private equity Platina	2009, 2010-2011
	Green Power Partners	Denmark	Private equity fund	Proark group (a Danish private investment firm) and AP Pension, PensionDanmark and PBU (three Danish pension providers)	2009
	GWM-Lux Energia Solar	Luxembourg	Wealth management company	Greentech Energy Systems	2010
	HgCapital	UK/Germany	Private equity investment fund	Private and public pension funds, endowments, insurance companies and fund of funds	2008, 2009, 2010
	Hudson Clean Energy	US/UK	Private equity firm	Invested through Element Power	2008, 2009, 2010
	Scan Energy	Denmark	Independent power producer that focuses on renewable energy sources in Europe.	Since 2012, a subsidiary of wealth management company Kaiser wetter Invest GmbH	2008
	Impax Asset Management	UK	Asset Management firm	Institutional and high net worth investors globally	2007-08
	KGAL GmbH & Co KG	Germany	Investment company	Owned by Commerzbank, BayernLB, HASPA Finanzholding and Sal. Oppenheim	2008, 2010, 2011
	AES Solar	US/France/Italy	Owners and operators of utility-scale, solar PV power plants	Owned by AES Corporation and private equity firm Riverstone Holdings	2008, 2009
	White Owl	Germany	Asset manager company		2009, 2010, 2011

Case	Company suing Spain	Where is the investor registered?	Type of investor	Other investors involved?	When did it invest in solar energy in Spain?
Case Charanne (SCC)	Charanne	Netherlands	Investment vehicle owned by Spanish investor	Spanish businessmen Luis Delso and José Gomis	2009, 2010
	Construction Investments	Luxembourg	Investment vehicle owned by Spanish investor	Spanish businessmen Luis Delso and José Gomis	2007, 2008, 2009, 2010
Case CSP Equity Investment (SCC)	CSP Equity Investment/ Abengoa	Luxembourg	Equity investment fund	Owned by Abengoa (Spanish company)	2009, 2010
Case RREEF (ICSID)	RREEF Infrastructure (G.P.) Limited	UK	Private equity fund	Deutsche Bank	2011
Case Antin (ICSID)	Antin Infrastructure Partners	France	Private equity fund	BNP Paribas	2011
Case Eiser Infrastructure (ICSID)	Eiser Infrastructure Partners	UK	Private equity firm	Insurance companies, pension funds and other financial institutions in Europe and Japan	2007, 2011
Case Isolux (SCC)	Isolux Infrastructure Netherlands	Netherlands	Investment vehicle owned by Spanish investors	Isolux Corsan Concesiones and Infra-PSP Canada (Canadian pension fund)	2012

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Chapter 5

Legal sharks circling crisis countries

The debt crisis in Greece grabbed the attention of the world in 2011. With an enormous budget deficit, violent protests and public spending cuts that devastated the lives of ordinary people, the country appeared to be on the brink of collapse. Without massive restructuring to reduce the debt, Greece's survival was under threat.

Several international law firms were also watching Greece – but their concern was not to save its people from social disaster or prevent economic collapse in Europe. On the contrary, in the midst of the debt crisis lawyers saw an opportunity to tout for business, urging multinational corporations to pursue investment arbitration to defend their profits in Greece.

> What do international arbitration institutions have in common with Domino's Pizza, public transport operators, pawnbrokers, discount supermarkets, property auctioneers, and opposition politicians? Answer: all have profited from the global economic downturn.

Global Arbitration Review journal, November 2010[1]

The German law firm Luther, for example, told its clients that where states were unwilling to pay up, it was possible to sue on the basis of international investment treaties. Luther suggested that "Greece's grubby financial behaviour" provided a solid basis for seeking compensation for disgruntled investors; compensation that would ultimately be paid by Greek taxpayers.[2]

Analysing one of the pending disputes against Argentina (Abaclat, see Box 2 on page 15) in an October 2011 client briefing paper, US-based law firm K&L Gates wrote that investment treaty arbitration could "recover damages for investment losses from nations defaulting on their sovereign debts." It continued: "Given the current financial crises worldwide, this should provide hope for investors who have suffered losses at the hands of sovereign restructuring of their debt instruments." The firm identified Greece as a country where investors should check which investment treaties "may protect their investment".[3]

US law firm Milbank, the Dutch firm De Brauw and UK-based Linklaters all took a similar line,[4] preparing the ground for billion dollar claims against a cash-strapped country struggling to restore its economy. While the profits per partner climbed to up to US$2.5 million in 2011 (at Milbank), Greece lowered the monthly minimum wage for workers under 25 to €510 (US$660).[5]

In March 2012, after long negotiations between the EU and the banks, funds, and insurers owed money by Greece, most creditors accepted an easing of repayment terms. But soon after, several law firms announced that they would seek millions in damages on behalf of lenders refusing to accept the debt swap.[6] In May 2013, the first investor lawsuit challenging the debt swap was filed against Greece, while more claims are looming (see chapter 3).

> The legal sharks have already started circling the fall-out from the Greek sovereign debt restructuring.

Patrick Heneghan & Markus Perkams of law firm Skadden, in May 2012[7]

Investment lawyers fuel the arbitration goldrush

The Greek debt crisis case stands out as just one example in a highly lucrative investment arbitration business. As the number of international investment disputes against states has exploded over the past two decades, legal arbitration has become a money-making machine on its own right. As arbitration lawyer Nicolas Ulmer from Swiss law firm Budin & Partners explained: "Arbitration institutions vie for their market share of disputes, legislatures pass arbitration-friendly measures to attract this business, various conferences and workshops are held year round, a class of essentially full-time arbitrators has developed and a highly specialised 'international arbitration bar' pursues large cases avidly. A veritable 'arbitration industry' has arisen."[8]

Box 4

Investment arbitration is big business for big law

- Legal costs for investor-state disputes average over **US$8 million**, exceeding **US$30 million** in some cases.[9]
- Insiders estimate that **more than 80%** of the legal costs end up in the pockets of the parties' lawyers, the counsel.[10]
- The tabs racked up by elite law firms can be **US$ 1,000** per hour, per lawyer – with whole teams handling cases.[11]
- The lawyers who sit on the tribunals that ultimately decide the cases, the arbitrators, also earn handsome fees: at the most frequently used tribunal for investor-state claims, International Center for Settlement of Investment Disputes (ICSID), arbitrators make **US$ 3,000** a day.[12]

In this "new Eldorado",[13] lawyers have multiple roles – and wield enormous power.[14] As counsel, they represent the parties in the multi-million-dollar disputes. But they also sit as arbitrators, deciding the cases. They advise governments on the drafting of investment treaties, the legal base of the disputes. They advise companies on how to structure investments to get access to the most investor-friendly arbitration routes – for example, by channelling an investment through a subsidiary in a country with many international investment treaties. And they have mounted fierce lobbying campaigns to counter attempts by governments to reduce their legal exposure to predatory corporate legal action, by reforming investment treaties.

Turning international investment arbitration into a lucrative business has provided a great incentive for smart lawyers to sustain and expand the system in order to maximise profits. Keeping corporate clients constantly informed about the opportunities for litigation is the bread and butter of an investment arbitration lawyer. Not every company follows their advice, but the marketing of some law firms is nevertheless a driving force in the recent boom in international investment arbitration.

> Lawyers live on disputes. They create monsters like the current investment arbitration regime and hype it to produce work for themselves – as lawyers and arbitrators. I truly believe that the investment arbitration system wouldn't exist the way it does today if it wasn't for the lawyers.
>
> Nathalie Bernasconi-Osterwalder, International Institute on Sustainable Development (IISD)[15]

Fuelling lawsuits in economic crises

Encouraging claims against countries fighting a major economic crisis is one way to expand the business of specialised arbitration firms. Ever since the global economic meltdown in 2008, panel debates amongst lawyers about the role of "arbitration in times of crisis" have mushroomed around the globe.[16] Law firms have published numerous 'client alerts' analysing bank bailouts, subsidy cuts, debt swaps and other measures that countries have taken to deal with the crisis, suggesting their clients could challenge these policies on the basis of international investment treaties (see Box 5 on page 38). As UK-based law firm Clyde & Co wrote in such a briefing: "The value of bilateral investment treaty ("BIT") protection should not be underestimated in today's turbulent economic times."[17]

> The value of bilateral investment treaty ("BIT") protection should not be underestimated in today's turbulent economic times.
>
> Law firm Clyde & Co

In an October 2011 newsletter, lawyers at US-based law firm Milbank outlined the "potential for claims" against economic-crisis-related measures that "do significant damage to international investors". They wrote, "Debt repayment defaults are an obvious threat." They continued: "Less obvious threats include the impairment of investments as the direct consequence of austerity measures, significant exchange rate interference by a state, as well as increased taxation."[18]

Box 5

Investment arbitration lawyers' hit list of economic crisis measures

Greek debt swap: US law firm K&L Gates, Dutch firm De Brauw, UK-based Linklaters and the German firm Luther are just some of many law firms that provided their clients with analyses on how they could use international investment treaties to defend their profits in the context of the Greek debt restructuring imposed by the European Commission, the European Central Bank and the International Monetary Fund, the so called Troika (see chapter 3).[19]

Restructuring of the banking sector in Cyprus: When the country was granted bailout money from the Troika on the condition of restructuring Cyprus's biggest banks (see chapter 3), law firms such as DLA Piper, Debevoise & Plimpton and Morgan Lewis (all US-based) offered advice on the "potential recourse for lost investments", suggesting that "large depositors in Cyprus's two largest banks may consider international arbitration."[20]

Capital controls: Law firms have argued that restrictions on the flow of money as imposed by the Cypriot government to avert financial collapse might violate provisions in international investment treaties. They suggest that clients should "seek legal advice… to determine whether there are sufficient grounds to bring a claim under a BIT."[21] Firms like Sidley Austin (US) and Herbert Smith Freehills (UK/AUS) prepared their clients for the imposition of capital controls if Greece were to exit the Eurozone. In such a scenario, investment treaties "could provide substantial leverage for foreign investors… but could also help companies protect the value of their investments in Europe after such measures are imposed."[22]

Subsidy cuts: Lawyers of the US-based firm Milbank have warned clients that "austerity measures can directly impair investments by cutting expected funding for investment projects". Mentioning specifically the cuts in solar energy subsidies by EU governments, they argued that "investors will likely be protected against austerity measures if they can prove a reasonable investment-backed expectation in the status quo for a significant additional period of time."[23] When investors sued Spain over subsidy cuts in the solar sector (see chapter 4) law firms such as Dentons "set out practical tips for companies investing in the energy sector and facing similar issues".[24]

Bank bail-outs: Investment lawyers have also argued that legislation initially proposed to protect only domestic banks from collapse such as in Ireland and Iceland, would violate non-discriminatory guarantees found in international investment treaties. Therefore, they argued, "foreign investors should consider them a possible source for bringing a claim."[25]

Exchange rate interventions: When Switzerland set a value ceiling for the Swiss franc against the euro to tackle the huge speculative capital inflows to the country following the eurocrisis, Milbank lawyers called these measures "extreme" as they would "have a significant impact on Swiss franc-denominated lenders – and parties who recently structured their investments through Switzerland". As further exchange rate interventions were to be expected in the context of the eurocrisis, the lawyers argued, "investors should carefully consider their legal options in response to such action."[26]

It looks like the marketing has paid off for the legal industry. In an April 2013 memorandum for their clients, US-based law firm Skadden praised the "increasing appeal and novel use of Bilateral Investment Treaties", discussing the "innovative application of BITs by businesses", including in cases related to the global financial crisis. The firm wrote: "The appeal of BIT tribunals, coupled with the economic uncertainty of recent times, has triggered an increased use of BITs to resolve disputes in ways that previously had not been encountered by arbitral tribunals, and we expect this trend to continue."[27]

Scaring governments into submission

In the context of the economic crisis, arbitration lawyers have also encouraged their clients to use the threat of potential investment disputes as a way to scare governments into submission. Analysing one of the pending disputes against Argentina in an October 2011 client briefing paper, US-based law firm K&L Gates, for example, recommended investors should use the threat of investment arbitration as a "bargaining tool" in debt restructuring negotiations with governments.[28] UK-based firm Clyde & Co suggested using the "potential adverse publicity" of an investment claim as "leverage in the event of a dispute with a foreign government."[29]

> In considering whether to bring a claim... investors should bear in mind that around 30 to 40 per cent of investment disputes typically settle before a final award is issued. Commencing a claim can create leverage to help the investor reach a satisfactory result.

Global law firm Dentons' 'practical tip' for investors affected by Spain's solar subsidies cuts[30]

In the world of investment arbitration, these "pre-emptive strikes" seem to be on the rise, with disputes no longer used as a shield against illegitimate action by states, but a political weapon in a wider war of attrition against governments.[31] There is evidence that proposed and even already-adopted laws on public health and environmental protection have been abandoned or watered down because of the threat of huge damage claims.[32] Considering big finance's ongoing "lawfare" against financial reforms in national courts,[33] it is perfectly possible that effective restructuring in the financial sector is currently impeded across the world by looming investor-state disputes.

> Could the threat of legal challenges by creditors of sovereign debt be an impediment to the debt's swift and effective restructuring?

Law firm DLA Piper[34]

A BIT of protection in times of crisis

Lawyers also advise their clients on what they euphemistically call "corporate structuring for investor protection" – to be able to access the most beneficial fora and countries for multinational corporations to sue via in order to get the best results. In a paper entitled "Managing Eurozone risk through BIT planning" from May 2012, law firm Clyde & Co explained: "If no BIT exists with the state of the immediate investor or ultimate parent, it may be possible to rely on a BIT in force with the state of an intermediary company in the corporate structure." The firm added: "Having BIT protection over the lifespan of an investment is critical in today's changing world."[35]

The importance of such "treaty planning" (BIT-friendly investment structuring) is clear in the case of the investor-state claims filed against Spain over its cuts in the solar energy sector (see chapter 4). Spanish conglomerate Abengoa used a Luxembourg-registered subsidiary to sue its own government under the Energy Charter Treaty (ECT). As global law firm Dentons correctly explained to its corporate clients, "had Abengoa directly held its shares in the plants, it would not have been able to bring a claim under the ECT." One of the firm's practical tips for investors therefore is: "Before making an energy-related investment, investors should try to access protections arising under the ECT and/or BITs to which the host State is a signatory. This may require routing the investment through an entity registered in another signatory State."[36] According to law firm Freshfields more and more "sophisticated investors" follow this kind of advice.[37]

> We remain in a golden age of BIT arbitration, and sophisticated investors now factor BIT protection into their investment structures.

Constantine Partasides of law firm Freshfields[38]

Law firms profiting twice

Specialised arbitration firms were also advising the very same investors now suing cash-strapped countries when they made their risky investments in the first place. Law firm Allen & Overy, for example – now counsel to investors in five out of seven claims against Spain (at the time of writing) relating to subsidy cuts in the energy sector

Table 4

Big law firms busy with investor-state cases against Greece, Cyprus & Spain

Law firm	Role in claims against Greece, Cyprus & Spain	Total number of investment treaty claims in 2012/13[39]	Gross revenue in 2012 (US$)[40]	What you should know about the firm
Freshfields Bruckhaus Deringer (UK)	Counsel to Marfin Investment Group & others in case against Cyprus (with ex-Freshfields Jan Paulsson)	**47** (plus 53 in an advisory stage)	**1,935,500,000**	By far the most dominant investment arbitration firm in the past decade.
Cleary Gottlieb Steen & Hamilton (US)	Defending Greece against Poštová banka & Istrokapital	**20**	**1,131,000,000**	Represented Telecom Italia in a claim against Bolivia. Reacting to Telecom Italia's faulty service and low investment, Bolivia re-nationalised the telecoms firm Entel. Bolivia paid US$100 million to settle the case.[41]
Shearman & Sterling (US)	Counsel to Charanne & Construction Investments in case against Spain (with Bird & Bird)	**20**	**752,000,000**	Elite arbitrator Emmanuel Gaillard is the figurehead of the firm, attracting vast amounts of work as counsel. One of the industry's intellectual lions, he constantly intervenes in political and academic debates about investment law and arbitration.[42]
Allen & Overy (UK)	Counsel to investors in 5 out of 7 known claims against Spain (at the time of writing) relating to subsidy cuts in the energy sector	**17**	**1,885,500,000**	Won a US$ 60 million (plus interest) award for Deutsche Bank in an oil derivatives claim against Sri Lanka. Following public outcry and allegations over corruption in the hedging deals between a state-owned petroleum corporation and several banks, the country's supreme court had ordered to hold payments to the banks.[43]
Debevoise & Plimpton (US)	Counsel to Poštová banka + Istrokapital in case against Greece (with Czech law firm Havel, Holásek & Partners)	**15**	**675,500,000**	Together with Covington & Burling, Debevoise won the largest known ICSID award, US$2.3 billion, for US-based Occidental Petroleum against Ecuador, for the termination of an oil production site in the Amazon. Oxy has been accused of human rights violations and environmental destruction.[44]
Skadden Arps Slate Meagher & Flom (US)	Counsel to Cyprus in claim launched by Marfin & others (with Cyprus law firm Andreas Neocleous & Co)	**12**	**2,210,000,000**	A major player in the legal fight over the disputed Dabhol power project in India, advising energy giant Enron. When authorities cancelled a contract because of too high electricity prices, India was covered in lawsuits which reportedly led to multimillion awards and settlements.[45]
Herbert Smith Freehills (UK/AUS)	Counsel to Spain in 2 of the 7 known cases (at the time of writing) relating to cuts in solar energy subsidies (Charanne & AES Solar and others)	**4**	**1,280,000,000**	Sued Bolivia on behalf of subsidiary of US company Bechtel after protesters had successfully reclaimed their water system in the now famous 2000 Cochabamba water revolt, following a 50% price hike for water after privatisation. Bechtel ultimately withdrew the case when Bolivia absolved it from any potential liability.[46]
Bird & Bird (UK)	Counsel to Charanne and Construction Investments in case against Spain (with Shearman & Sterling)	**3**	**386,000,000**	A relative newcomer to investor-state disputes that handled its first treaty arbitration in 2012.[47]

(see chapter 4) – advised some of these investors in their original acquisition of the power plants in Spain.[48] Herbert Smith Freehills, the firm which is now defending the Spanish government at hourly rates of 300 euros in two investor-state lawsuits launched against the country, advised RREEF Infrastructure and Antin Infrastructure when they first acquired equity interests in two solar thermal power plants in Spain.[49] Both investors filed investment disputes against Spain in November 2013. The law firms profit twice: when they advise on the speculative investment in the first place and then as counsel in investor-state disputes when the risks do not pay off.

> Debt woes, broken contracts and soured business deals may cost global investors billions in losses and create seemingly never-ending headaches for policy makers. But there is a set of specialists profiting from such geopolitical problems: arbitration lawyers.

New York Times, August 2013

Lobbying to kill investment treaty reform

Whenever policy-makers set out to better balance public and private interests within international investment treaties, law firms and investment arbitrators together with industry associations have mounted fierce lobbying campaigns to counter reform. This is not surprising: the more investment treaties and trade agreements with investor-state dispute settlement provisions exist, the more far-reaching investor rights they contain, the more business for these lawyers.

To influence the debate in the EU, law firms like Hogan Lovells and Herbert Smith Freehills have invited the European Commission, EU member state officials and members of the European Parliament to "informal but informed" roundtable discussions and webinars with their clients – including several who have sued countries under existing investment treaties such as Deutsche Bank, Shell and energy giant GDF Suez. Their message: there is a need for high standards of investor protection and in particular investor-state arbitration.[50]

Investment lawyers have also been keen to retain the investment treaties that EU countries have signed amongst themselves – which now form the legal basis of the crisis-related investor state disputes against Greece and Cyprus (see chapter 3). Elite arbitrator Emmanuel Gaillard of Shearman & Sterling, for example, warned of the "disastrous economic consequences" if these so called intra-EU BITs were abolished, as had been proposed.[51] He discreetly forgot to mention that he makes a living from these treaties: Gaillard himself sat as arbitrator in several intra-EU BIT cases.[52] No wonder he and his colleagues want to keep the legal base for this business intact.

Propping up an unjust system

Specialised arbitration lawyers are far from passive beneficiaries of international investment law. Rather, they are active players who not only seek every opportunity to sue governments, but have also campaigned successfully against any reforms to the international investment regime, including in the EU. Sometimes, they have been at the root of investor-state claims filed against countries in crisis, telling investors how to structure their investments so that they could later file an investor-state dispute. Investment arbitration lawyers also encourage corporations to use lawsuit threats as a political weapon in order to weaken or prevent effective restructuring in the financial sector.

> When there is money to be made, someone somewhere will always consider options, regardless of the damage such action may cause to the country concerned and its prospects for recovery.

Ioannis Glinavos, Lecturer, University of Reading[53]

Profit-seeking investment arbitration law firms will continue to play these multiple roles, propping up an already unjust investment arbitration system. Every new trade and investment agreement which allows for investor-state arbitration will open multiple opportunities for them to do so.

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Chapter 6
Conclusion:
ending corporations' VIP treatment

Europe is still haunted by its worst economic crisis in decades, one that started as a banking meltdown in Wall Street and turned into a crisis of public debt when EU member states bailed out their banks with billions of euros. This has locked many economies into a downward spiral and been used as an excuse for harsh austerity policies which have had devastating social consequences: people now have to work harder and longer for less pay; many have lost their jobs; pensions, unemployment benefits and other social protections have been slashed; public services are being privatised.

This report has shed light on a largely unknown, but powerful legal system that could make matters even worse for people in Europe: international investment treaties. These treaties give sweeping powers to foreign investors, including the privilege to sue governments in international private tribunals for measures that they took to combat economic meltdowns. One example that should ring warning bells for Europe is Argentina, which has been sued more than 40 times as a result of the reforms implemented after its crisis in 2001. In the context of the euro-crisis, European countries are now starting to suffer the same lawsuits, too.

Investment treaties: corporate power unbound

The investor-state lawsuits against Greece, Cyprus and Spain unveiled in this report show that:

- The investment treaty regime is increasingly being used as a legal escape route by speculative, risk-taking investors. They first gamble for quick profits with risky investments in cheap sovereign debt (as in the case of Greece) or soon-to-be-abandoned subsidy schemes (as in Spain). When things go wrong, they use the excessive protections in investment treaties to sue for millions of euros in compensation.

- If the investors win their compensation claims, public treasuries will be raided for millions of euros, socialising private losses and making it even more difficult for crisis-hit countries to find the funds to alleviate the hardship of their people.

- Investment treaties provide VIP treatment to foreign investors by granting them greater property protection rights than are enshrined in national constitutions and providing them with a legal system that is exclusively available to them but not domestic firms, individuals or communities (as in the case of Spain where local cooperatives, for example, also lost out when the government phased out solar energy subsidies).

- Those suing European countries in crisis are European companies. They are protected by a dense web of an estimated 190 bilateral investment treaties signed between European member states (so called intra-EU BITs) and the Energy Charter Treaty which protects investments in the energy sector.

- Wealthy law firms with specialised arbitration departments seek out every opportunity to sue countries, encouraging their multinational clients to file lawsuits against governments in crisis. They also encourage corporations to use lawsuit threats as a political weapon in order to weaken or prevent financial regulation, debt restructuring and other measures to combat economic crisis.

In many parts of the world, these lawsuit threats have already had a chilling effect on regulation, when governments have shied away from much needed reforms for fear of multi-million euro legal disputes. In Canada, for example, the government has abandoned legislation ranging from bans on dangerous fuel additives to anti-smoking laws following actual and threatened investor-lawsuits under the North American Free Trade Agreement (NAFTA).[1]

In Europe, existing and new investment treaties also act like a straight-jacket on governments that may be too afraid of litigation to enact much needed reforms, for example in the financial sector, as well as action to boost economies and protect people from corporate wrongdoing. Particularly in times of crisis, the results could be disastrous.

Wanted: a root-and-branch review of the investment regime

At a time when the world has seen the enormous social costs of excessive corporate control over economic and legal systems and of short-sighted deregulation of capital, calls for re-regulation and corporate accountability are increasing. But investment agreements dramatically curtail the regulatory space that governments require to rein in corporate power. What is needed is a root-and-branch review of the investment regime.

Just as EU governments have agreed to an international investment system that currently benefits corporations at the expense of the public interest, these same governments have the power to reverse course. Given the costs and dangers evident from existing investment treaties, EU governments should seek to terminate them (including the intra-EU BITs). And they should not expand the dangerous corporate rights via new trade and investment deals. This includes the proposed EU-US agreement, the nearly-concluded trade deal between the EU and Canada and similar agreements which the EU is currently negotiating with countries such as China, Malaysia, Thailand and Morocco.

> Agreements that restrict a country's ability to revise its regulatory regime... obviously have to be altered, in light of what has been learned about deficiencies in this crisis.

UN-appointed Stiglitz Commission on reforms of the international financial system[2]

Enshrining excessive investor rights in more agreements would give corporations even more powerful weapons to fight regulation. The proposed EU-US trade deal, the Transatlantic Trade and Investment Partnership (TTIP), for example, would cover more than half of all foreign direct investment in the whole EU – much of it from highly litigious Wall Street companies. A total of 75,000 cross-registered companies with subsidiaries in both the EU and the US could launch investor-state attacks under the proposed transatlantic deal.[3] This danger is even more present given that EU and US businesses know very well how to work the system, having already launched the majority (64%) of all investor-state disputes known globally.[4] The notoriously litigious US law firms may already getting their knives out to join them in fighting regulations they dislike on both sides of the Atlantic.

> The possibility of legal action is a consequence of decades of foreign direct investment liberalisation coming back to haunt us.... If there is a wider message to draw from this discussion, it could be that policy-makers need to think harder when balancing the need for investment with policy freedom in the long run.

Ioannis Glinavos, Lecturer in Law, University of Reading[5]

People in Europe must not let this happen. With the growing awareness about the risks of the investor-state dispute settlement provisions in the proposed transatlantic trade deal, there is a unique opportunity to tell politicians to axe these investment treaties that grant extreme corporate privileges once and for all. We must declare an end to a system that has enshrined ever increasing rights and privileges for corporations without corresponding responsibilities. The moral and political challenge is instead to work on democratic mechanisms for communities to address corporate impunity when violations of human and environmental rights occur.

References chapter 6

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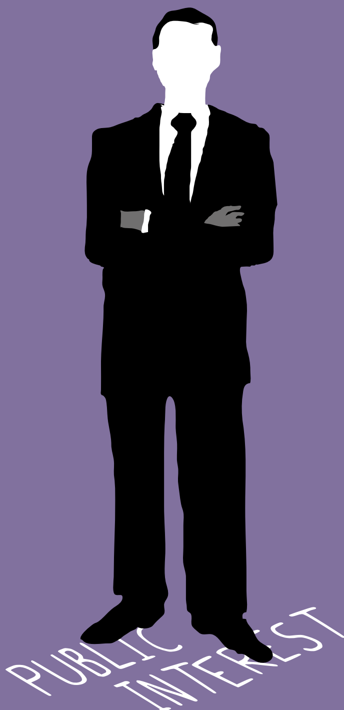

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