A Response To The Critics Of “Profiting From Injustice”

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Pia Eberhardt (Corporate Europe Observatory)

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By Pia Eberhardt, Corporate Europe Observatory, and Cecilia Olivet, Transnational Institute

At the end of November, Corporate Europe Observatory and the Transnational Institute published Profiting from Injustice, a report that looks at the role of law firms, arbitrators and third-party funders in investment treaty arbitration. In it, we argued that the arbitration industry has fuelled an investor-state dispute boom over the past two decades, promoting new cases and investor-friendly rulings, and lobbying against reform. We also argued that the current investment arbitration regime is neither fair nor independent, but biased towards the interests of investors.

Some arbitrators and investment lawyers have rejected these allegations, claiming that the investment arbitration system is not pro-investor biased. They told the Vancouver Sun that “states win a significant number of cases” and have as much influence over the composition of the panel of arbitrators deciding the cases as the claimant. Due to the “staggering costs of launching a lawsuit”, investors have “a fair amount of money at risk”. Overall, they claimed, the system has “built up a fair amount of credibility”, facilitating “businesses operating abroad and help poor countries attract job-creating investment”.

This blog aims to respond to these points.

Is the investment arbitration system fair? Statistics on the known outcomes of investor-state claims could be interpreted that way. According to UNCTAD, around 40% of cases were decided in the state’s favour and 30% in favour of the investor. The rest were settled.

But these statistics are not the full story. First, investment arbitration is non-reciprocal. Investors cannot be sued, for example, when they violate human rights. They might not win every case, but only states can lose in the sense that only states have to pay compensation. How can anyone call such a system “fair” and deny that it is “pro-investor”? Frankly, that is a mystery to us.

Second, it is likely that many of the settled cases – 30% of known decisions – involve payments or other concessions for the investor. Germany, for example, settled the first dispute with Swedish energy company Vattenfall by agreeing to water down environmental standards imposed on one of Vattenfall’s coal-fired power plants. Paper maker Abitibi-Bowater’s case against Canada was settled when Canada paid US$130 million. When settlements contain something for the investor, the above statistics look very pro-investor.

Third, it is commonly held that the threats of claims against governments have become even more important and occur more frequently than actual claims. There is evidence that proposed and even adopted laws on public health and environmental protection have been abandoned or watered down because of the threat of corporate claims for damages. It is also likely that countries are currently postponing and/or weakening anti-smoking legislation because of the Philip Morris claims against Australia and Uruguay. Even if the tobacco company loses, these cases could have a chilling effect on anti-smoking laws across the world.

This underlines how investor-state arbitration provides investors with VIP treatment. They have the exclusive right to threaten and initiate claims at international tribunals that regularly order governments to pay large sums in compensation. This gives them a privileged position in policy-making and in the allocation of public funds which are used to pay compensation for laws that may benefit a wide range of constituencies. Domestic investors do not have this privilege, let alone citizens and communities. It is difficult to understand how such a system can be presented as "fair" and not "pro-investor".

It is also important to recognise that investment arbitration is not just about the final awards. Research by Gus van Harten reveals that arbitral tribunals tend to resolve contested legal issues in investment treaty law with expansive interpretations. These enhance "the compensatory promise of the system for claimants and, in turn, the risk of liability for respondent states", he writes, adding: "If the system is meant to provide an impartial and independent adjudicative process based on principles of rationality, fairness, and neutrality, then the interpretation and application of the law should reflect a degree of evenness between claimants and respondent states in the resolution of contentious legal issues arising from ambiguous treaty texts." But van Harten's evidence suggests that arbitrators in fact tend to favour the claimant.

A similar observation was recently made by Singaporean attorney general Sundaresh Menon who noted that it is "in the interest of the entrepreneurial arbitrator to rule expansively on his own jurisdiction and then in favour of the investor on the merits because this increases the prospect of future claims and is thereby business-generating."

Finally, our report questions the alleged neutrality of many of those whom we called "an elite of 15 investment arbitrators". Some have explicitly stated "they do not normally see themselves as guardians of the public interest". Some sit or have sat on corporate boards, including in companies which have filed investor-state disputes. Some have worked or are working for law firms which encourage investors to claim against states and which also advise on picking the most investor-friendly treaties for their claims as well as on structuring their investments accordingly. Others have spoken out against investment treaty revisions which might allow governments greater freedom in policy making. One arbitrator has his own lobby firm advising corporations on how to avoid or counteract government regulations. Yet these elite arbitrators have decided the majority of all known investment-treaty disputes, weighing public interest against the interests of profit (see chapter 4 in our report). These close links with business, combined with their belief in a system we consider to be biased in favour of corporations, in our view, raise questions about the neutrality of international investment arbitration.

How does a possible pro-investor bias on the side of prominent investment arbitrators fit with the fact that states appoint one of the three members of an arbitration panel and ideally agree with the investor on the third? That is indeed an interesting question that merits further research. One aspect to bear in mind is that the choice of arbitrators for states hiring external counsel is likely to depend on the names put forward by their counsel, meaning that "undue importance is placed on arbitrator relationships with law firms" (as research by Queen Mary University and White & Case found for the claimant party).

According to one prominent investment lawyer who responded to our report, the staggering costs of launching a lawsuit mitigate against frivolous actions, with the investor putting “a fair amount of money at risk”.

No doubt the legal costs of investment arbitration are high, including for the claimant. But two trends reduce or even remove the financial risk of an expensive claim, making investment disputes more attractive for investors. First, contingency fee arrangements are becoming more and more common in investment arbitration. Second, third-party funders are also increasingly common, financing (parts of the) costs of investment disputes in the hope of sharing in the spoils if a payout is awarded.

While there is usually little incentive for funders to fund weak cases, bubbles in the legal claims market might incite exactly that. Mick Smith from litigation funder Calunius Capital has indicated that is the case: “The perception that you need strong merits is wrong – there’s a price for everything”. Eventually, frivolous, high-risk claims could inflate the value of funders’ portfolios. As the Burford Group, another litigation funder, noted: “If we shy away from risk for fear of loss, as some litigation investors do, we will not maximise the potential performance of this portfolio”.

So, what about the claim that investment treaties “help poor countries attract job-creating investment”? The evidence is ambiguous. While some econometric studies find that investment treaties do attract investment, others find no effect at all. Qualitative research suggests that the treaties are not a decisive factor in whether investors go abroad. Investment lawyers who think otherwise might want to read Lauge Poulsson’s review of the existing research.

Governments are also beginning to realise that the promise of foreign investment is not being fulfilled. During this year’s WTO Public Forum a South African government official said: “We do not receive significant inflows of FDI from many partners with whom we have BITs, and at the same time, we continue to receive investment from jurisdictions with which we have no BITs. In short, BITs are not decisive in attracting investment.” The official also underlined the severe risks that the investment arbitration system entails for government policy in times of major socio-economic and ecological challenges.

So, the alleged “fair amount of credibility” of the investment arbitration system appears to be very much in the eye of the beholder. It might be credible for investment lawyers whose livelihoods depend on it. But more and more governments appear to be looking for a way out.