EIGHTH ANNUAL JURIS INVESTMENT TREATY ARBITRATION CONFERENCE

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KEYNOTE SPEECH

BY GEORGE KAHALE, III

MR. LAIRD: Welcome back, everyone. My name is Ian Laird. I didn't introduce myself earlier. I'm from Crowell & Moring and one of the co-chairs of this event.

One of the highlights of our annual conference is having noted and eminent keynote speakers to come to and give their views about current issues in investor-State investment arbitration, and today is a continuation of that pattern.

We have today one of most senior people in our field, George Kahale from Curtis, Mallet-Prevost, Colt & Mosle. George has been a chairman of that firm since 2008. He's been lead counsel on numerous international investment arbitrations, some of the largest arbitrations that have occurred in our field. Curtis, Mallet, as you know, represents many States, and that's their primary and sole representation.

George himself really has marked, and I have to give great credit to Curtis, Mallet; really George has been at the forefront of growing his law firm and becoming one of the leading firms in our field, and it's really a pleasure to have him here today to give us the benefit of his views and his experience.

So, I'd like to ask Mr. Kahale, please come to the stand, and we look forward to your thoughts.

(Applause.)

MR. KAHALE: Thank you, Ian.

First, let me say that I feel very honored and privileged to be here today. I want to thank all the organizers for inviting me, despite knowing the views that I'd be likely to express. As some of you may know, I have a slightly different perspective on investor-State arbitration, having spent most of my career as an international corporate lawyer, but it's true that I've had the distinct privilege over the last decade or so of intensive involvement in this rapidly expanding field, and unfortunately I have to tell you that I don't like much of what I see.

Since I've written and spoken about this in various fora, I often get the question of why I like biting the hand that feeds me. The answer isn't simply that I can always can go back to drafting contracts instead of briefs; it is that the system that we're celebrating here today is seriously flawed, and in my view it needs a complete overhaul, even though we all know that isn't going to happen any time soon. I'm not going to catalogue today for you all of the troubling aspects of investor-State arbitration. I've just selected my Top Ten for your consideration.

First, we should understand how we got into this mess, and that's thanks to about 3,000 investment treaties. I realize many of you think those are the greatest invention since sliced

bread, but the story of the creation and proliferation of those weapons of legal destruction hardly inspires confidence in the legal system that they have spawned. It was both disturbing and refreshing a few years ago to read what the former Attorney General of Pakistan had to say about his country's BITs. According to one article, he admitted that, in the past, BITs were signed, and I'm quoting now, "without any negotiation or consideration of the consequences," that most were signed because a dignitary was visiting a foreign country or vice versa, and the two governments, "couldn't think of any other document to sign"; and that, and again another quote, "a BIT provides a good photo opportunity." I'm afraid that what he was describing may be closer to the rule than the exception.

Now, this wouldn't be so troubling if we were talking about agreements or a system that could be easily dismantled and rebuilt, but when you have a network of over 3,000 treaties with durations of generations and multitudes of third-party beneficiaries, the fix isn't so simple.

These third-party beneficiaries and their lawyers have taken full advantage of the mistakes of governments, constantly developing new theories to push the boundaries of State responsibility, to the point where some practitioners show

practically no hesitation in transforming virtually any governmental act, gesture or statement into an FET claim, and where one bad treaty provides through the magic wands of MFN and treaty shopping, protections never imagined for virtually an entire world of investors.

Years ago, my tax partners introduced me to the concept of a Dutch sandwich. They explained how silly it was for Company A to invest in Country B without a tax treaty, paying high withholding and capital gains taxes, when all it had to do was form a Dutch company and take advantage of the vast network of Dutch tax treaties.

Well, the investment law version of the Dutch sandwich works the same way: If you don't have a BIT, form a Dutch company and use a Dutch treaty. For good measure, make sure you can think of a good business reason for doing that in case someone thinks that you're abusing the treaty system. That's the new Dutch sandwich.

Second on my Top Ten list, we're now adjusting to the reality that an entirely new body of international law is being developed by arbitral tribunals constituted under these thousands of investment treaties. Normally development of the law is a

good thing. The question we have to ask is exactly who is it that's doing the developing?

We've all heard about the club of international arbitrators, a club without a formal membership or formal membership requirements. Now, don't get me wrong: I'm not applying for admission and have already declined membership, but I do think we need to examine where the club members are coming from. Are they trained in international law, or do they come more from a background of private commercial arbitration, where important issues of public international law are rarely implicated, precedents of any kind are rarely created, and a premium is often placed on resolution of the controversy, whether legally correct or incorrect, so that the business people can get on with their business? In that environment, arbitrators are actually encouraged to trade points as if they are bargaining in a Turkish bazaar, acting more like party representatives negotiating a settlement than arbitrators deciding a momentous legal controversy.

In investor-State arbitration, the damage done when this approach is followed is incalculable. Legally bankrupt decisions are cited in subsequent cases involving the same issues in the hope that a new legal principle will emerge, and

suddenly a theory that couldn't be taken seriously in any classroom is hailed in conferences like this and imbued with a certain legitimacy.

So, what can we expect from a system where tribunals are not appointed for their training in international law, where many are part-time with other interests not necessarily consistent with their functions as arbitrators, and where arbitrators are dependent upon the interested parties or the appointing authorities for additional appointments? What we can expect is exactly what we have, and, in my view, that's not a satisfactory state of affairs.

Now, as I've made clear in the past, this is not to say that there aren't many arbitrators who are extremely competent and professional; quite a few are and would be deserving of positions in any real international legal system, but I'm simply pointing out the obvious, which is that the system that works reasonably well in the context of private commercial arbitration is unsuitable to today's investor-State arbitration.

Number 3 on my list is the predominance of substantive concepts that are susceptible to abuse. The two most glaring examples are MFN and FET.

I'm not going to delve into the endless debate about the scope of these concepts. My point here is more basic. With respect to FET, I think most of us intuitively sense that the drafters of these 3,000 treaties had little or no idea that FET meant anything other than the minimum standard of treatment under customary international law. Even the United States, Canada, and Mexico were taken aback by the expansive interpretations of some tribunals, which is why they entered into the NAFTA interpretation of FET.

As for MFN, I'm less interested in the technical argument regarding the scope of MFN clauses than I am in the entire concept. Quite simply, MFN, in all of its forms, is a dangerous provision to be avoided by treaty drafters whenever possible. As a corporate lawyer, I always try to avoid MFN-type clauses in contracts because of the difficulty in applying them. The same is true with BITs.

Should an investor from one country benefit from more favorable treaty provisions granted to investors from another when the latter were granted in exchange for benefits conferred outside of the treaty, such as foreign aid, military or diplomatic support, or guaranteed investment levels that the first treaty partner did not confer? The entire concept is unworkable, and

States would be well advised to eliminate it from their treaties. Unfortunately, as I said before, given the duration of these treaties and the tails on them, that's easier said than done.

Number 4 on my list is the drive for speed and finality that again has its roots in private commercial arbitration, where a premium is placed on the quick resolution of disputes rather than the proper administration of justice. For an example, see the CMS Annulment Claim. There, the original tribunal held that the essential security interest provision of the Argentine-U.S. Treaty was no more than an incorporation of the state-of-necessity defense under the ILC Articles on State Responsibility. The Annulment Committee disagreed in the strongest of terms, finding "manifest errors" in the original decision that "could have had a decisive impact on the operative part of the award." But the Annulment Committee nevertheless felt that it couldn't annul the award because it exercised jurisdiction under what it thought was a "narrow and limited mandate conferred by Article 52 of the ICSID Convention."

Now, my question is: How is Argentina supposed to feel when it loses a case that the Annulment Committee says was a product of manifest errors of law?

Fifth is the phenomenon of the mega case. A generation ago, a 50 or $100 million case was a real eye-opener. Not anymore. In my view, it's unacceptable to take a cavalier approach to the application of legal principles with claims that exceed the GDP of many nations. You simply cannot approach such a case with the same rules, the same attitudes, the same system used to deal with a small demurrage claim under a charter party.

Up until relatively recently, this was only a warning not to be taken seriously, perhaps because even in flagrant examples of tribunal adventurism, damage awards tended to be more or less under control. The Occidental versus Ecuador Case showed that we had better take this seriously. There, the tribunal awarded $1.8 billion plus interest, not an insignificant sum for a country like Ecuador. What is interesting about that case is not only that it involved a strong dissent arguing that the majority's reasoning could not be followed from Point A to Point B, but also that the tribunal found it appropriate to reduce compensation by 25 percent. Now, I'm not against the reduction, but I'm scratching my head as to how it was that the arbitrators arrived at that figure. If my calculations are correct, it amounts to

about $600 million, which itself would have been one of the largest awards in history.

Did the arbitrators just throw darts? Did they sit around negotiating percentages, how about 30 or maybe 40? No, that's too high, let's make it 25.

Let's not forget also what the reduction was for. The whole case arose because Ecuador terminated the agreement for violation of the prohibition against assignment. Occidental, the claimant, argued that it was not in breach because it remained the legal owner in the contract vis-à-vis the State, and it had only transferred the equitable interest. Occidental actually lost on that issue. I can only assume that Ecuador was and remains puzzled as to how it is that it can win the underlying issue giving rise to the case and still lose the largest award in ICSID history.

Can you imagine what the U.S. Congress would have done if a multi-billion dollar award had been rendered against the United States for exercising its right to terminate an oil lease for breach of its terms? The Occidental Case, as you probably know, is still before an ICSID annulment committee.

If you want another even more recent mega-case head-scratcher, take a look at the majority's decision on

jurisdiction and the merits last September in the ConocoPhillips Case against Venezuela, which also came with a dissent from one of the world's most distinguished international lawyers, and then look at the letter published by Venezuela requesting a hearing on one aspect of that decision--and, yes, that is my letter--and judge for yourselves whether you can follow the majority's reasoning from Point A to Point B.

By now you've probably also heard that Venezuela's Motion for Reconsideration was denied, again with a dissent by Professor Abi-Saab, who concluded that no self-respecting tribunal could pass over the evidence presented by Venezuela. He went on to refer to, and I'm quoting, "a legal comedy of errors on the theater of the absurd, not to say travesty of justice, that makes mockery not only of ICSID arbitration, but of the very idea of adjudication." Venezuela immediately challenged the majority for lack of the requisite impartiality under the ICSID Convention, and that challenge is now pending.

The point of all this is that the system cannot withstand mistakes at this level. It may be that some of you think these are not mistakes, but I can assure you that there is a very large segment of the international community, including States, international law scholars, and even students trying to make

heads or tails out of these decisions that believe otherwise. And if that's the case, as it undoubtedly is, it calls into question the legitimacy of the entire system.

Number 6 on my Top Ten list is the high bar for disqualification. I know that many consider arbitrator challenges to be nothing more than a nuisance, a ploy to delay a case, but the fact is that many challenges are serious and many that don't succeed fail because the rules of the game are stacked against the challenging party.

We have to acknowledge that conduct wholly unacceptable for a federal judge in the United States is commonplace in investor-State arbitration. I ask: Why should that be so if, in fact, investor-State arbitration often involves issues of international law having an impact far beyond the individual case, and matters of the highest public order and national security for the States involved? Under these circumstances, what possible excuse is there for not holding arbitrators to the highest, rather than the lowest, conflict standards?

Aside from the ethical standards to which arbitrators should be but are not held, there is the difficult subject of issue conflicts. Up until recently, the one most could say about issue

conflict is that it exists in theory but not in practice. It is generally recognized that prior public pronouncements, including arbitral decisions on an issue that is dispositive in a case before that same arbitrator, raises questions about impartiality and, therefore, suitability of that arbitrator to sit in that case. But many fear that the system would collapse if an arbitrator who has expressed a firm view on a certain dispositive issue were to be disqualified. You can see the relationship between this point and some of the other points that I discussed earlier. In the first instance, the notion that the world is so short of distinguished international lawyers that we have no choice but to resort to arbitrators who have already pre-judged key issues is hard to accept.

But more importantly, this entire issue underscores the problem created by the reality that each tribunal is technically sovereign, not answering to a higher authority. If there were a higher authority confirming a certain interpretation, for example, of FET, whether it's a concept that reaches beyond the minimum standard of treatment, then it wouldn't matter whether an arbitrator happened to hold a contrary view in his or her personal capacity. A U.S. federal judge may disagree with a Supreme Court decision, but will follow it nonetheless or risk reversal. If

the same were true of investor-State arbitration, the subject of issue conflict would become largely irrelevant. But in the world of investor-State arbitration where arbitrators feel free to follow their preferred school of thought or even to invent law without fear of appellate review, issue conflict has to be taken more seriously.

That brings me to Number 7 on my Top Ten list, which is closely related to Number 6, and that's that far too many cases are effectively over before the first session is even held. Experienced practitioners too often can predict the outcome of a case based on the composition of the tribunal, which is why it can take forever to form the tribunal. Last year in one of our cases it took over six months before we finally reached agreement on the President of the tribunal. How can this state of affairs be squared with the notion of impartiality, which everyone says is the bare minimum qualification for arbitrators? The fact is that true impartiality is almost impossible to achieve on issues, and that's a dangerous thing when combined with the other features of the current system, including the manner of appointing arbitrators and the sovereignty of each tribunal.

Number 8 on my list is the tendency of claimants to grossly exaggerate claims. Some of you may recall that when Exxon started its litigation against Venezuela's State oil

company, PDVSA, it was claiming $12 billion plus interest. The tribunal considered around 5 percent of that amount to be more appropriate. In its ICSID case against the State--and by the way, we're expecting a decision in that case any day now--Exxon is actually claiming an even higher amount. And believe it or not, ConocoPhillips began its case against Venezuela claiming over $30 billion plus interest.

Now, we've all heard the stories about multimillion dollar claims based on coffee spills. Gross exaggeration of a claim is nothing new, but with investor-State arbitration it reaches a new level, first because of the amounts involved and, second, because there is a greater chance that some tribunal will actually take such a claim seriously than there is in a national court which is subject to more checks and balances.

Number 9 is a disturbing phenomenon that I think no one expected, and that is the rise of third-party funders. An entire industry of third-party funding has arisen in investor-State arbitration over the last few years. It doesn't take much funding to start a case and form a tribunal, get to the first session, see who you've got, and decide whether the investment is worthwhile. If you repeat that exercise ten times, the chances of getting a reasonable return are pretty good.

Now, one can wax eloquent about the positive role played by funders in getting justice that would otherwise be denied, but I think we should all be frank enough to admit that that isn't the kind of investment BITs were meant to protect.

I end with Number 10--or Number 1, if you're doing a Letterman countdown--and that's the perceived bias against States in the system. In a sense, this is largely the result of the features that I've already discussed as well as a number of others that had to be left off the Top Ten list in the interest of time. I'm not here to persuade you of the existence of bias, conscious or subconscious, but merely to inform you that that is my experience based on close to a decade of intensive work in this field. Does that mean a State can't win a case? Of course not. Does it mean that all tribunals are tilted in favor of investors? Of course not. And does it mean that States never do wrong? Of course not.

But this is not a children's debate, and we should not confuse the issue with silly arguments and non-issues. I can't help but chuckle when I hear about studies showing that states win more than 50 percent of the cases. This is not a matter of statistics. We are not playing baseball, where we measure performance through batting averages and ERAs. Saying that

states win 50 percent or more of cases is meaningless, if that same figure happens to represent the percentage of cases that never should have seen the light of day or that would never survive a motion to dismiss in a national court. It is also cold comfort if 20 or 30 percent of those cases involve manifest errors, especially if some of those cases are mega cases.

So, what can be done about all this? I don't have any panacea, and I don't consider it my job to find one. What I can do is call attention to what I've observed and what I sincerely believe are serious problems that don't often get sufficient air time at conferences such as this. After all, the first step in solving a problem is always becoming aware of its existence.

So, now I can go back to my briefs and hearings at least with the satisfaction of knowing that I have done my part in generating that awareness. I thank you for your attention, I hope I haven't offended anybody, and wish you an illuminating rest of the day.

(Applause.)

MR. LAIRD: Well, thank you very much, George. That was excellent. I think that your comments are very much in the spirit of this conference over the last eight years. We have always encouraged having a real debate and addressing both

sides of the issues. In fact, that's always the model for each and every one of our panels. We want to have a real discussion, and I think that really contributes to the debate, so thank you very much.

(Applause.)