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Good morning, everyone. First, let me say that it is a privilege for me to address you today on a topic of great importance to states: investor-state arbitration. When I say states, I don't discriminate. I mean states large and small, rich and poor, east and west, north and south, states of all political persuasions. Virtually all have been participants in this system. They came in thinking that they were beneficiaries, but now many are beginning to view themselves as victims.

As some of you may know, I've had many occasions to speak on this subject in the past, but this is a special occasion because the conference is for states, not investors. Traditionally, conferences on ISDS have had a decidedly investor orientation, concentrating on how to make the system more effective for investors and developing new theories for expanding the scope of investor protection, all at the expense of states. I would say those were the predominant themes of the first quarter of a century of ISDS.

Ironically, states were not mere bystanders in this process. They were actually active participants, just as they were in creating the system, drafting, negotiating and signing treaty after treaty, bringing us to this day when we have a web of about 3,500 investment treaties, a large number of which were undoubtedly entered into with little if any understanding of the provisions being negotiated and their implications for state sovereignty. Some of you may be familiar with the characterization of such treaties by one former attorney general, who stated that they were signed "without any negotiation or consideration of the consequences," that most of the treaties 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 "a BIT provides a good photo opportunity." Unfortunately, these photo-ops have turned into what I call weapons of legal destruction.

The underlying philosophy of these treaties was that they were inherently good, even necessary to promote foreign investment, and that anything that was good for foreign investment had to be good for the country, no matter what the price. This was particularly true in the 1990s. In that decade, not only were many investment treaties concluded without serious analysis of the consequences, but many long-term concessions involving the bulk of national wealth were granted to private parties on extremely favorable terms, or I should say unfavorable terms for the states concerned. Again, many states felt they had no choice but to enter into those unfavorable deals in order to attract foreign investment, and they were comforted by the notion that anything private would eventually be in the public interest, so there was no need to drive hard bargains with private investors.

Not surprisingly, this state of affairs was a recipe for disaster. Just to take one example – not a small one considering what was at stake – look at what happened in the oil industry. The 1990s was a period of low oil prices, averaging in the teens throughout the decade. That also happened to be a decade in which privatization was the prevailing ideology, particularly with the collapse of the Soviet Union. The results were long-term contracts under terms and conditions that were in fact unsustainable in the long term. You may recall that the price of oil averaged around twelve dollars per barrel for all of 1998, but by 2008, the average for the year had increased eight-fold, reaching around 150 dollars per barrel in the middle of that year.

What do you expect the reaction of a state to be when it wakes up one day and realizes that its natural resources have been committed for the next thirty years to foreign companies reaping windfall profits and taking them out of the country? This is not matter of ideology, right or left, it is a matter of common sense. Whether you are a believer in state-run economies or a champion of privatization, the one thing everyone can agree on is that giving a nation's wealth away for almost nothing is not a good idea. But that's what happened in too many cases in the 1990s.

Now let's bring it back to ISDS. In the past, when these giveaways occurred, the mistakes could easily be rectified, because states enjoyed privileges that protected them from litigation. Under the doctrine of sovereign immunity, a state enjoyed immunity from suit and its assets enjoyed immunity from execution. Commencing in the 1950s and accelerating in the 1970s, that immunity was watered down under what was called the "restrictive theory" of sovereign immunity, so that the state could be sued in respect of its commercial activity, but it still enjoyed immunity in respect of sovereign activity, referred to as *jure imperii*. It wasn't until the proliferation of investment treaties that claims against states could routinely be brought even when they acted in the exercise of sovereign powers. In fact, the point of investment treaties is precisely to allow private parties to bring cases against states when they act in a sovereign, rather than a commercial capacity.

As a consequence, the legal balance of power in the investor-state relationship, which had been tilted heavily in favor of states, began to shift to the side of investors, and the process has continued ever since. The investment treaties not only set forth substantive obligations of states, but they also established a dispute settlement mechanism that virtually guaranteed that those substantive obligations would be developed and eventually expanded beyond anything contemplated by the states that signed those treaties.

The problem states face in ISDS is both substantive and procedural. Taking the latter first, ISDS lacks the basic attributes of a legal system, including a body of law that commands respect, judges to apply it, and checks and balances to prevent and, where necessary, correct errors. That’s why I call it the Wild Wild West of international practice.

The *ad hoc* tribunals of ISDS usually have three arbitrators, one appointed by each side and the third appointed by agreement of the two arbitrators or the two parties, or by one of the arbitral institutions, such as ICSID, the PCA, ICC or SCC. Although some of these arbitrators are extraordinary international lawyers with long and distinguished careers, many others are not, and there are no real requirements in terms of credentials or training. There are also few tangible rules of conflicts of interest. While arbitral institutions require independence and impartiality of arbitrators, the reality is that these terms have not been applied as strictly as they would be in a mature national legal system.

But the most important procedural point is the fact that arbitrators depend upon appointments for their income, at least as arbitrators. In ISDS, this feature works against the interests of states. A very large percentage of awards in investor-state arbitration are published, and they are studied not only in academic institutions, but by investors all over the world who are potential claimants in arbitration. Obviously, there is an infinite number of such claimants, and a finite number of state respondents. Whether consciously or subconsciously, an arbitrator dependent upon future appointments may be impacted by the understanding that rendering a legal decision against an investor may be detrimental to his or her own personal interest. By the same token, the arbitrator will understand that rendering an opinion with a decidedly investor leaning will enhance the chances of further appointments. That is not a matter that enters into the thinking, for example, of a federal judge in the United States, who enjoys a lifetime appointment and has no concern whatsoever about maintaining his or her caseload. Quite the contrary, most federal judges have far too much work and would be only too happy to give up cases.

The selection of the tribunal is one of the most important events in any case. Indeed, it is no exaggeration to say that an experienced practitioner can predict the outcome simply by looking at the composition of the tribunal. In far too many cases, that is more important than the legal principles or the facts at issue. Again, that is not the case in a mature legal system, where the judge's main interest is in applying the law as it stands, knowing full well that a departure from established legal principles is likely to lead to a reversal on appeal and potential embarrassment to the judge.

Unfortunately, this state of affairs makes it difficult for states to have confidence in ISDS. The problem they face when it comes time to appoint an arbitrator is that the pool of acceptable candidates is relatively limited. By contrast, investors have little difficulty finding candidates who share their outlook on the law and are willing to promote the interests of investors in their capacity as arbitrators. And when it comes time to select the all-important third arbitrator, states can only hope that the selection will be relatively neutral, as opposed to decidedly pro-investor.

On the substance, there can be no doubt that states have been victims of expansive interpretations of amorphous treaty provisions, such as fair and equitable treatment. That is a standard provision designed to incorporate the minimum standard of treatment under customary international law, but it has been interpreted in some cases to encompass far looser standards, such as legitimate expectations, which can easily morph into any governmental action that disappoints an investor.

In virtually every case involving FET, the investor argues for such broad standards, rejecting the notion that FET does no more than reflect the minimum standard of treatment under customary international law, or even worse, asserting that the broader standards adopted by some arbitral tribunals now reflect the minimum standard of treatment because customary international law has evolved. But a practice does not become a rule of customary international law unless it is adhered to generally by states out of a sense of obligation. And states all over the world have stated in no uncertain terms that these loose interpretations are erroneous. For example, the three parties to NAFTA felt they had to enter into an interpretation of NAFTA's FET clause to clarify that FET does not extend beyond the minimum standard of treatment. The model U.S. and Canada BITs now explicitly confirm that point. And many new treaties contain elaborate provisions to the same effect. One has to ask how many times is it necessary for states to make that point before tribunals get the message and accept it.

As I have pointed out previously, all of this has a very negative impact on the development of public international law, something we should all lament. But this negative impact is magnified many times when one considers the sheer size of the typical claim in today's ISDS. Years ago a $50 million claim would have been considered huge. Nowadays, you can add a zero to that number. And hard as it may be to believe, billion dollar claims are commonplace in this era of the megacase. Of course, the *Yukos* case broke all the records with a claim of over $100 billion and an award of $50 billion, more than 20 times the largest award in history up to that time. As you probably know, the *Yukos* award, after ten years of arbitration, was set aside by a court in the Netherlands. That decision has been on appeal, and the whole world is waiting for the result.

While the *Yukos* case is the largest, it is not the only multibillion dollar claim around. We have seen claims of 20, 30 billion and more, which would have been inconceivable just a short while ago.

States facing ISDS claims should pay as much or even greater attention to quantum issues as they do to jurisdiction and the merits. It is important not only to note the increase in the size of quantum claims, but also to understand the tools used to create them.

Claim exaggeration is not a new phenomenon. It happens everywhere, and even has a name. It's called the "anchoring" strategy, where a claimant starts out with an outrageous demand in order to make a lower but still outrageous figure appear reasonable. Of course, to make this strategy work, claimants often count on the assistance of economic experts to dress up their outrageous figures with a professional analysis, which usually means a discounted cash flow analysis.

DCF requires a projection of future cash flows over the life of the asset or project in question, including production, sales, prices, operating costs, capital expenditures, taxes, etc., each of which is based on assumptions, and then applying a discount rate to bring the net cash flow back to a present value. With so many variables and so many assumptions, it is easy to see the potential for abuse. In fact, the World Bank Guidelines on the Treatment of Foreign Direct Investment explicitly warn that "[p]articular caution should be observed in applying this method

[DCF], as experience shows that investors tend to greatly exaggerate their claims of compensation for lost future profits." In the words of one economic analyst: "The DCF method has indeed been tainted by misapplication, and it has been used to justify valuations which reach beyond the 'fanciful' to 'wonderland proportions'."

The difference in valuations resulting from different assumptions as to cash flows and discount rates can be hundreds of millions if not billions of dollars. We have seen many cases illustrating this point. What this means is that the manifest errors resulting from misapplication of basic legal principles are not just costly in terms of the development of international law, but they are also costly in financial terms. When so much is at stake, even one mistake is too much.

More and more states are coming to this conclusion. That's what happens when you get bitten. It's easy to support ISDS when there is no price to pay, but with each bad award, another state becomes skeptical of ISDS, realizing that its supposed benefits are grossly exaggerated and its costs can be exorbitant. We have seen heated debates on the subject in many countries, sometimes resulting in the denunciation of treaties. See, for example, the reaction in India, Indonesia, South Africa, Bolivia, Ecuador and Venezuela.

Traditionally, the U.S. and Europe, capital exporters, have been champions of ISDS, largely to protect their multinationals investing in Latin America, Africa and Asia. But in recent years, we have seen a marked rise in anti-ISDS sentiment in Europe and the United States. Why? Well, one good reason would be that European countries in recent years have become the unlikely victims of ISDS, with dozens of claims brought against them. Spain alone has faced over 40 claims in just the last few years. It's easy to champion ISDS when you don't face claims and can gain points at home for supporting your corporations doing business abroad; it's not so easy when you are on the receiving end of dozens of claims challenging what you consider to be the legitimate exercise of your sovereign powers and seeking enormous sums in damages.

The United States has long had an ambivalent attitude toward ISDS. On the one hand, the capital exporting multinationals have been a powerful force in promoting it. On the other, the U.S., particularly Republicans, will not stand for subjecting American sovereignty to an international arbitral tribunal. This tension up until now has been resolved in favor of continuing support for ISDS, while reigning in arbitral tribunals with more precise definitions of concepts such as FET and MFN. The U.S. could afford to walk that line because, as it has proudly proclaimed, it has never lost a case. One can only imagine what Mr. Trump would do if the U.S. actually did lose a case. And if it happened to be a $50 billion or $20 billion or even $10 billion claim, what do you think would be more likely: pay it and sing the praises of ISDS, or demand the immediate dismantling of the system?

In any event, even before that time, the U.S. attitude seems to be changing. During the recent NAFTA renegotiation, 230 professors signed an open letter to President Trump urging him "to remove ISDS from NAFTA, as well as to leave ISDS out of any future trade or investment pact." I don't know whether he was listening to them, but the negotiations did result in the elimination of the ISDS provisions with Canada and a curtailment of them with Mexico. Underlying the Trump Administration's position appears to be some combination of a desire to discourage foreign investment by denying American companies protection for their investments abroad and an anti-internationalism which refuses to acknowledge the authority of any international body, much less that of an *ad hoc* arbitral tribunal. I don't particularly share either sentiment, but it is hard to take issue with the anti-ISDS stance. That's because ISDS is a system so flawed and so dangerous that any move toward its dismantling is worthy of applause, even if the motivations are wrong.

This brings us full circle. Remember at the outset I noted that, traditionally, most conferences on ISDS started from the premise of its inherent goodness, the main question being how to improve its efficiency for investors. The discussion on the conference circuit is more balanced today because there is an increasing realization that the system is deficient and not serving the interests of the states who created it.

This has led to cries for reform and the formation of UNCITRAL Working Group III, whose mandate is to analyze whether the system is in need of reform and, if so, to recommend changes. These issues are being taken seriously now, but I have to say I am still not very optimistic at the outcome of this process and remain concerned that the cure may be worse than the disease. The UNCITRAL Working Group excludes substance from its mandate, meaning that it is not supposed to address the recurring substantive issues that have caused problems in ISDS. The Group is focusing only on procedural issues, such as the methods of formation of arbitral tribunals and the possibility of introducing an appellate mechanism. Those are indeed serious issues, but addressing them without addressing the underlying substantive issues runs the risk of institutionalizing the bad and paving the way for the worse. As they say, be careful what you wish for.

Another problem I see with the Working Group is that even though there is more of an emphasis on the interests of states, there is still a tendency to view ISDS as a system with many stakeholders, including investors, as if all of these stakeholders have a vested interest in the system. This means that any proposed reform is likely to reflect compromises that may well not fix the existing problems and create new ones. In general, any result that is based on the premise that the existing system is good and needs only minor tinkering is likely not to serve the interests of states.

That is why I think states would be well advised to rethink their investment treaties and explore options for terminating their ISDS provisions, agreeing with their counterparties on the interpretation of other key provisions of their treaties, or terminating the treaties altogether if agreement cannot be reached.

It would also be useful to set down basic principles on substantive issues that should command the support of large numbers of states. In that regard, it is not necessary to await consensus on a model investment agreement, or even on the precise wording of model clauses dealing with individual issues. Substantive progress can be made incrementally. Statements of principle on recurring issues in investor-state arbitration can be of assistance if large numbers of states adopt them. And as long as the endeavor is not too ambitious, it should not be that difficult to achieve broad consensus on at least some principles. That is just a matter of translating the positions states are already taking when claims arise into statements of principle enunciated outside of the arbitrations.

For example, even if there are nuances in the positions of different states, it should not be that difficult to obtain broad support for at least the following general propositions: that absent express language to the contrary, the concept of FET is only meant to cover the minimum standard of treatment under customary international law; that the content of the minimum standard of treatment is the prohibition of shocking and egregious conduct that falls so far short of minimum standards as to be readily apparent to any reasonable person; and that absent express language to the contrary, an MFN clause refers to nationality-based discriminatory treatment, and does not allow the importation of either jurisdictional provisions or standards of treatment from other treaties.

In the meantime, again to circle back, it should be clear that the days of signing investment agreements because they are good photo-ops should be over.

Thank you for your attention. I'll be happy to take any questions later.