

# Kahale calls for overhaul of BIT system

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**George Kahale III** of Curtis Mallet-Prevost Colt & Mosle has used a keynote speech to criticise investment treaty arbitration as a “seriously flawed” system in need of a complete overhaul.



Speaking at a conference in Washington, DC, on 28 March, Kahale set out his “top ten” criticisms of investment arbitration, adding that this was not a comprehensive catalogue of all of the system’s “troubling aspects”. He argued repeatedly that the importation of practices and principles from private commercial arbitration was ill-suited for deciding investor-state disputes.

Kahale portrayed a system in which a small club of arbitrators often apply personal interpretations of law, unconstrained by fear of appeal, awarding huge sums of money against states through unclear lines of reasoning. In his view, claimants are prone to bring exaggerated claims, encouraged by the availability of third-party funding, and are supported by a systemic bias against states.

## How we got into this mess

Kahale began by decrying the spread of investment treaties, which he described as “weapons of legal destruction” adopted by governments without due regard for their consequences. He cited an interview with a former attorney general of Pakistan that had referred to signing BITs as a “good photo opportunity” for visiting dignitaries.

Investors are exploiting these 3,000 treaties and seeking to expand their breadth, said Kahale, to the point that “virtually any governmental act, gesture or statement” might give rise to a claim under a treaty’s fair and equitable treatment standard.

## Who’s in the club?

Second, he raised concerns that a “club of international arbitrators” was now shaping a new body of international law – a club that Kahale said he had declined to join.

Yet these arbitrators often lack training in international law, have “other interests not necessarily consistent with their functions as arbitrators”, and are dependent upon the parties or arbitral institutions for additional appointments.

Kahale observed that arbitrators' professional background could inform how they approach a case. Those from a private commercial law background may put a premium on resolving the case at hand for business reasons, regardless of whether their award contributes to a settled body of law, he suggested.

"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," he said.

"Legally bankrupt decisions are cited in subsequent cases involving the same issue 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," he said.

While acknowledging that "quite a few" arbitrators were competent and professional, Kahale argued that the system of dispute resolution in private commercial arbitration was unsuitable for investor-state arbitration.

### **Abuse of treaty standards**

Kahale's third complaint was against the substantive provisions in investment treaties that were "susceptible to abuse", particularly the most-favoured nation (MFN) and fair and equitable treatment (FET) standards.

"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," he said. The US, Canada and Mexico had been "taken aback" by the expansive interpretation of FET by some tribunals, leading those states to agree a new FET standard in NAFTA.

MFN, meanwhile, was "a dangerous provision to be avoided by treaty drafters whenever possible." He described an MFN clause as a "magic wand" that allows "one bad treaty" to provide protections "never imagined for virtually an entire world of investors".

### **Speed over justice**

Kahale said that the importance placed on speed and finality in arbitration – another inheritance from commercial arbitration – denied parties the opportunity to correct injustices.

He cited an ICSID annulment committee's refusal in 2007 to annul a US\$133 million award in favour of CMS Gas against Argentina. Although it found that the award contained manifest errors of law, the committee said it had a limited mandate under the ICSID Convention. How is Argentina supposed to feel when it is expected to honour an award that was a product of manifest errors of law? he asked.

### **Tribunal adventurism**

Kahale suggested that “mega cases” worth more than US\$1 billion were brought too casually against states. “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,” he said.

He took aim against the majority ICSID award in *Occidental v Ecuador*, which at US\$1.8 billion plus interest is the largest known award in investment treaty arbitration’s history, and is currently the subject of annulment proceedings.

While previous damages awards have been relatively restrained, the Occidental case demonstrates that “tribunal adventurism” needs to be taken seriously. Kahale also raised questions as to how the tribunal arrived at the decision to reduce the compensation by 25 per cent, or US\$600 million.

“I’m not against the reduction, but I’m scratching my head as to how [they] arrived at that figure,” he said. “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.’”

He also noted that Ecuador had been held liable in the case even though it had won on “the underlying issue giving rise to the case” – namely Occidental’s violation of its concession agreement by assigning an interest in the project to a third party without ministerial approval.

Kahale also criticised last year’s ICSID award on liability in favour of ConocoPhillips against Venezuela, a case in which he is acting for the state. He said it was hard to follow the reasoning of the majority that issued that award. Venezuela unsuccessfully sought a reconsideration of that decision and is now seeking to disqualify arbitrators **Kenneth Keith** and **Yves Fortier**.

He observed that the dissenting arbitrator in the Conoco case, **Georges Abi-Saab**, had described the majority’s findings as “a legal comedy of errors” and “travesty of justice”.

### **The high bar to disqualify**

Kahale observed that arbitrator challenges rarely succeed because the rules of investor-state arbitration set too high a bar for disqualification.

“Conduct wholly unacceptable for a federal judge in the United States is commonplace in investor-state arbitration,” he said, despite the fact that the issues of international law decided have an impact far beyond the individual case.

In addition, the bar is set too high to disqualify arbitrators on the basis of issue conflicts, he argued. “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.”

The obstacles to removing arbitrators underscores the problem of the finality of their decisions, he observed. While a judge will follow a superior court’s interpretation of law or risk reversal of his decision, there is nothing to stop an arbitrator from applying their personal interpretation of law.

“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,” he said.

### **Over before it’s begun**

Related to the question of issue conflicts is the fact that the selection of arbitrators can determine the outcome of a case before it even reaches a first session, Kahale said. Experienced practitioners are able to predict the outcome of a case purely based on the composition of the tribunal – which is why the selection of tribunals is now subject to long delays.

“How can this state of affairs be squared with the notion of impartiality, which everyone says is the bare minimum qualification for arbitrators?” he asked. “The fact is that true impartiality is almost impossible to achieve on issues, and that’s a dangerous thing when combined with other features of the current system, including the manner of appointing arbitrators and the sovereignty of each tribunal.”

### **Claim exaggeration**

Kahale went on to criticise claimants’ tendency to exaggerate claims, observing that ExxonMobil had initially sought US\$12 billion in a claim against Venezuela’s state oil company PDVSA (also a client of Kahale’s) but received 5 per cent of that amount in a final ICC award.

“Gross exaggeration of a claim is nothing new,” he said, “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.”

### **Third-party funding**

He also cited the “disturbing phenomenon” of third-party funding. “One can wax eloquent about the positive role played by funders in getting justice that would otherwise be denied,” he said, “but I think we should all be frank enough to admit that that isn’t the kind of investment BITs were meant to protect.”

### **Bias against states**

Kahale's final criticism was "the perceived bias against states" in the investment arbitration system, which he said was largely a result of the features he had already discussed. This did not mean that states never win cases, that tribunals are always titled in favour of investors, or that states never do wrong, he said.

While defenders of the system have cited studies showing that states win more than 50 per cent of cases, Kahale said this figure was "meaningless" if it also represented cases that "should never have seen the light of day."

He concluded, "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. After all, the first step in solving a problem is always becoming aware of its existence."

Kahale was speaking at the eighth annual Juris Investment Treaty Arbitration Conference in Washington, DC, on 28 March.

It is not the first time Kahale has spoken out against investor-state arbitration. At GAR Live New York in 2012 he argued that ICSID suffered from a legitimacy problem, and that the institution had strayed from its original ambit. An essay on the same subject, "Is Investor-State Arbitration Broken?", won a prize last year for distinguished legal writing.