The Role of Counterclaims in Rebalancing Investment Law

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The ability of counterclaims to help rebalance investment law depends on whether and how investment law lacks equilibrium. The asymmetry in investment treaties is somewhat overstated – arguably the investment treaty helps to address the asymmetry that exists if a State can exercise its sovereign authority to change the playing field on which the investor is operating, sometimes in an unfair manner, without being held to account in its local courts, whether because of state immunity, bias in the local judiciary, or a lack of separation of powers between the branches of government. Yet it is certainly true that looking at the investment arbitration itself the procedure is usually one-sided, and that disequilibrium might be redressed by the ability of States to submit counterclaims against investors.[1] Indeed, although States are not without any ability to seek redress even absent the ability to submit counterclaims, the advantages to investment arbitration that investors appreciate, such as the enforceability of arbitral awards, might appeal to States as well.[2]

Another at least apparent imbalance is the substantive obligations undertaken by investors and host States. Most international investment agreements (IIAs) impose obligations on States, but do not impose them on investors. There may be requirements, both implicit and explicit, that an investor comply with host State laws, but rarely is there any express provision permitting a State to challenge an investor for a failure to abide by those obligations. This means that investors can submit claims against States, but States cannot necessarily submit counterclaims against investors, when the substance of the dispute is a violation of an international investment agreement. Indeed, many IIAs specifically limit the jurisdiction of tribunals to hear claims of violation of certain provisions of the treaty, and explicitly require that there be a "measure" – a state act – to challenge. These limitations are meant to circumscribe the power of an arbitral tribunal. In so doing, they may prevent the assertion of counterclaims, a somewhat ironic outcome in that this particular circumscription of power is not necessarily desired by those who would otherwise support restraining the authority of investor-state arbitral tribunals.

States are becoming more aggressive in asserting counterclaims against investors. Their efforts have met with varying degrees of success. Thus, whether a State can submit a counterclaim against an investor – most likely based on investor's alleged non-compliance with host State's domestic laws and regulations or its breach of an investment contract, where there was one – is an unresolved issue. Of course, even if a state cannot submit a counterclaim, allegations of improper behavior on the part of an investor might help a State to defend itself from the investor's claims on grounds of fair and equitable treatment violations by demonstrating

[1] See, e.g., A.K. Bjorklund, "Improving the International Investment Law and Policy Regime: Report of the Rapporteur", in J.E. Alvarez, K.P. Sauvant & K.G. Ahmed (eds.) *The Evolving International Investment Regime: Expectations, Realities, Options* (OUP 2011); p. 213, 229-31; UNCTAD, *International Investment Rule-Making: Stocktaking, Challenges and the Way Forward* (2008), pp. 75-76.

[2] The tenacity with which investors resist counterclaims suggests that they would rather defend themselves in municipal courts than in international arbitration. It might also be simply litigation/arbitration strategy.

that the State's conduct was warranted because of the investor's actions. More controversial is whether a State can or seek diminution of the damages awarded against it by a arguing that they should be "set off" against damage caused by the investor. In both of those examples, however, the State can only seek to diminish the investor's rights; it cannot seek affirmative relief from the investor.

Counterclaims show promise as a means to rebalance investment law by bringing within the purview of a single tribunal's authority all claims related to the subject matter at hand. The ability to submit claims must be accompanied by agreement about the applicable law to govern the investor's conduct. Yet one should not lose sight of a bigger question of balance – the allocation of authority between domestic courts and international tribunals. Giving investor-State tribunals the authority to hear counterclaims may well alter that balance of power as well; whether that is a reasonable trade off depends on one's view of the importance of preserving the jurisdiction of an encourage recourse to local courts and tribunals.

This article first explores the bases for an investment tribunal's authority to hear counterclaims under the current investment law regime. It then explores the advantages and the disadvantages of bringing counterclaims within the remit of investment tribunals. Finally it concludes with the assessment that counterclaims will have to become part of the landscape if investor-State dispute settlement is to survive, though that will probably take State activity as drafters of treaties as well as State activity as defendants in investor-State disputes.

I. Basis for Tribunal Authority to Hear Counterclaims

The ability of a State to assert a counterclaim will depend on whether or not the investor has consented to arbitrate counterclaims against it. Arbitration is a creature of consent; the tribunal draws its authority from the agreement of the parties to submit certain claims to it. The investment agreement is generally held to contain a unilateral offer of consent on the part of the host State which is accepted by the other disputing party, the investor or, in some cases, the investment itself, by instituting the arbitration proceedings.[3]

1. Treaty Provisions

The breadth of the investor's consent (i.e. whether it encompasses counterclaims), and the related question of whether the tribunal will have jurisdiction over counterclaims, will depend first on the treaty's language regarding the scope of investor-State dispute settlement (ISDS). The applicable law clause in a treaty might also be relevant to the availability of a counterclaim. Some treaties direct tribunals to apply the treaty itself (and relevant international law), whereas others list the domestic law of the host State as one of the sources of applicable law. In the former case, it is less clear that a State could submit claims against the investor as it is unlikely to have obligations under the treaty or international law. In the latter case, allegations of breaches of host State law might more readily be brought before the investment tribunal. It is possible to argue that the tribunal's authority to apply international law includes its ability to apply conflict-of-laws rules to select the appropriate law, and that in most cases the law applicable to the

[3] Schreuer et al. p. 211, paras. 447-448.

conduct of the investor would be host-state law. Thus, the tribunal would have the authority to apply the domestic law of the host state regardless of whether the investor's duty to comply with domestic law is mentioned in the treaty. In such a case, though, the hurdle of consent might be that much more difficult to overcome.

A very few treaties explicitly address counterclaims. The COMESA Investment Agreement (2007) provides in Article 28(9):

> A Member State against whom a claim is brought by a COMESA investor under this Article may assert as a defence, counterclaim, right of set off or other similar claim, that the COMESA investor bringing the claim has not fulfilled its obligations under this Agreement, including the obligations to comply with all applicable domestic measures or that it has not taken all reasonable steps to mitigate possible damages.

Notably, the part of the COMESA Agreement, which sets out the general substantive obligations, also includes a general obligation of investors to comply with domestic laws:

> Article 13
> Investor Obligation
> COMESA investors and their investments shall comply with all applicable domestic measures of the Member State in which their investment is made.

IIAs frequently refer to compliance with domestic laws at the stage of making the investment, yet the COMESA Agreement explicitly extends this obligation to the post-establishment phase.[4] The general obligation of investors to comply with national law is thereby raised to the international treaty level. This, in turn, puts it on an equal footing with the obligations of the host State, and thereby gives jurisdiction over the possible counterclaims to an investment tribunal constituted under the treaty.[5]

Absent an explicit clause, one has to look at the treaty provisions that might have some bearing on the matter. Some ISDS provisions are quite broad and confer on tribunals the authority to hear "any dispute between an investor of one Party and the other Party in connection with an investment," or some similar formulation. Such a clause appears to be more conducive to counterclaims compared to narrow ISDS clauses that limit arbitrable claims to those alleging the breach of a treaty provision. Because most treaties do not impose obligations on investors, that latter formulation makes the argument that treaty confers jurisdiction on a tribunal to hear a counterclaim difficult. Indeed, based on this argument, the tribunal in *Roussalis v. Romania*, refused to entertain counterclaims against the foreign investor.[6]

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[4] Recent Indian BITs include a provision that goes in the same direction as the COMESA Agreement. Article 12(1) of the India-Nepal BIT (2011) and Article 15(1) of India-Slovenia BIT (2011) state: "*Except as otherwise provided in this Agreement, all investments shall be governed by the laws in force in the territory of the Contracting Party in which such investments are made.*"

[5] Presumably investors have a duty to comply with host State law at the commencement of an investment and throughout its maintenance of activities in the State even in the absence of treaty clauses referring to host-State law; the question is whether a failure to comply with those laws are actionable on the international plane.

[6] *Roussalis v. Romania*, ICSID ARB/06/01, Award, 7 December 2011, paras. 869-972. Professor Michael Reisman disagreed with the conclusion of the majority.

Another textual hook for a counterclaim is an "observance of undertakings" clause, also called an "umbrella" clause.[7] Umbrella clauses have been interpreted to transform a claim that a government has breached the terms of a contract it has with a foreign investor into claims that the State has breached a treaty obligation. This is because a failure to honor the contract is also a failure to honor the guarantee made by the State in the treaty. An investment treaty tribunal hearing a claim brought under the umbrella clause will effectively be hearing a breach of contract claim, which suggests counterclaims with respect to the contract would appropriately be heard as well. Yet, if the scope of the treaty reached only claims that there was a breach of the treaty, one could argue that the tribunal's jurisdiction encompasses the umbrella clause claim only to the extent it involved a breach by the State.

2. Applicable Arbitration Rules

Further arguments supporting an investor's consent to counterclaims may be found in the arbitration rules that frequently govern investor-State disputes. Thus, the ICSID Convention foresees the possibility of counterclaims in Article 46:

> Except as the parties otherwise agree, the Tribunal shall, if requested by a party, determine any incidental or additional claims or counterclaims arising directly out of the subject-matter of the dispute provided that they are within the scope of the consent of the parties and are otherwise within the jurisdiction of the Centre. [8]

The UNCITRAL Arbitration Rules 1976 provide that a respondent may "make a counter-claim arising out of the same contract or rely on a claim arising out of the same contract for the purpose of a set-off" (Article 19.3). The UNCITRAL Arbitration Rules 2010 provide that a tribunal may hear counterclaims provided the tribunal has jurisdiction over them (Article 21.3). The main questions regarding counterclaims thus concern to consent and to the scope of a tribunal's jurisdiction.

3. Arbitral Practice

As so often happens in cases of ambiguity or lacunae in the treaty, tribunals have come to different conclusions regarding the possibility of counterclaims. The issue has arisen only infrequently, but several recent cases have addressed the matter. In one case, *Saluka Investments B.V. v Czech Republic*, the Czech Republic's advance of a counterclaim against the investor was not permitted because the specific agreement between the Czech Republic and Saluka anticipated arbitration under different rules in the event of a dispute (thus negating any suggestion that the investor had consented to the treaty tribunal's jurisdiction to hear the counterclaim based on the contract) and because the counterclaim was not closely connected to the allegations regarding breaches of the investment protection rules (thus falling outside the tribunal's jurisdiction).[9] The

[7] A typical umbrella clause is one found in Article 2.2 of the Bahrain-Turkmenistan BIT (2011): "*Each Contracting Party shall observe any obligation it may have entered into with regard to investments of investors of the other Contracting Party.*"

[8] For the discussion of these conditions, see Schreuer et al. (2009), p. 731, paras. 1 – 95.

[9] *Saluka Investments B.V. v. Czech Republic*, UNCITRAL, Decision on Jurisdiction, 7 May 2004, paras. 77-80.

Saluka tribunal made clear that the scope of the treaty, which reached any disputes relating to investments, in principle permitted counterclaims.[10] The *Roussalis* tribunal, on the other hand, determined that the treaty did not grant it jurisdiction to consider counterclaims.[11] [add more discussion of Paushok and *Reisman* dissent in Roussalis]

II. Benefits of Counterclaims

Bring all related claims together into the same case brings several benefits.

Procedural Efficiency. Procedural efficiency would presumably be enhanced by permitting governments to submit counterclaims. Complex facts developed through the course of the treaty-based claim would be relevant for the domestic law claims as well. A one-stop-shop for all claims related to the same cluster of events would encourage efficient decision-making with the arbitrators well informed about all relevant facts. It would also facilitate the assessment of damages and the calculation of counterbalancing damages.

Legitimacy. Permitting governments to file counterclaims redresses concerns about the asymmetry of investor-State dispute settlement in which investors have both rights and remedies whereas States have neither. Though one can readily argue that ISDS redresses the asymmetry that exists in its absence – a situation where States have sovereign power to act as they see fit and investors are often without redress due to poorly functioning, non-independent courts or state immunity rules or the like – it remains true that the spectacle of investors seeking multimillion dollar awards against host States with no response expected from the State.

Enhance the rule of law. Permitting counterclaims makes it more possible that investors will be called to account for their actions. Though this can happen in the local courts in the place where the dispute is heard, those decisions sometimes lack force given perceptions about bias in the judiciary. [egregious example: Chevron Ecuador; see also denial of justice cases]

III. Drawbacks to Submitting Counterclaims

As is so often (inevitably?) the case, the disadvantages are the mirror-image of the advantages.

Procedural Disadvantages. The idealized picture of international arbitration as a speedy and efficient way to resolve international disputes has largely been debunked in both commercial and in investment arbitration. Enlarging the dispute to include counterclaims will simply accelerate this tendency. It will also likely raise issues related to the intersection between domestic and international dispute settlement. Ideally treaty provisions such as fork-in-the-road clauses would accommodate these concerns by requiring any actions in the local court to cease once

Aggrandize investor-State tribunals. Permitting counterclaims is very likely to encourage the submission of counterclaims. In the first instance, this would likely aggrandize the power of

[10] Ibid., para. 39. The tribunal in Se*rgei Paushok et al. v. Mongolia*, UNCITRAL, Award on Jurisdiction and Liability, 28 April 2011, pp. 162-67, came to the same conclusion.
[11] *Roussalis v. Romania*, ICSID ARB/06/01, Award, 7 December 2011, paras. 869-972.

ISDS tribunals, who would be hearing all aspects of complex, multilayered disputes. For those concerned about the mechanism of ISDS itself, entrusting tribunals with the authority to hear counterclaims would possibly cement their status as alternatives to domestic courts.

Minimize opportunities for capacity building in domestic courts. One of the criticisms of ISDS has been its siphoning off from domestic courts disputes that might otherwise have been resolved locally. Domestic courts then lose both the opportunity to exhibit their effectiveness and their ability to enhance their capacity to hear complex disputes. To the extent ISDS continues to be an attractive venue, or becomes an even more attractive venue, this problem will continue.

Conclusion

On balance the advantages of permitting counterclaims outweigh the disadvantages. First and foremost is the question of legitimacy. As long as ISDS is open to the charge of asymmetry, its bona fides will be subject to question. The procedural issues are important but not decisive. Moving in this direction take some State initiative, however. If a State wants to ensure that an ISDS tribunal has the authority to hear counterclaims, including an explicit provision in its IIA long with lines of the one in COMESA 2007 (excerpted above) would obviate the need to make complex arguments about consent and would ensure a Tribunal's jurisdictional reach. Future treaties should do that and should include in the grant of authority to tribunals the power to consider claims under municipal as well as under international law.