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Jurisdiction of Investment Tribunals Over Host States' Counterclaims: Wind of Change?

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The beginning of 2017 has already been remarkable to contribute to discussions regarding counterclaims in investment arbitration: two recently finalized cases against Latin America states (*Urbaser et al. v The Argentine Republic*, ICSID Case No ARB/07/26 ; *Burlington Resources Inc. v Republic of Ecuador*, ICSID Case No. ARB/08/5) provide several noteworthy points for further debates on the host states' counterclaims towards investors.

While both the jurisdictional and merits findings in these cases worth particular attention, this post looks at them primarily from the jurisdictional perspective.

Urbaser et al. v The Argentine Republic

The counterclaim by the Argentine Republic related to the Claimants' investment obligations under the concession contract for water and sewage services in the Province of Greater Buenos Aires. Respondent alleged that by failing to make the agreed investments, Claimants violated the principles of good faith and *pacta sunt servanda* under both Argentine law and international law, but more importantly – basic human rights to water and sanitation, which affected the health and the environment of people in that area. The Tribunal found itself competent to hear Argentina counterclaim, but rejected it on the merits.[1)]

Asymmetric nature of BITs: too categorical understanding of investment treaties

First of all, the Tribunal rejected the Claimants' objection regarding the asymmetric nature of BITs that, in the Claimants' view, prevented a host state from invoking any right based on the BIT. Claimant asserted that since BITs do not impose obligations upon investors, a right to counterclaim 'would run counter to the object and purpose of treaty arbitration, which is to grant the investors a one-sided right of quasi-judicial review of national regulatory action'.

The Tribunal, referring to the dispute resolution clause of the Spain-Argentina BIT:

> 'Disputes arising between a Party and an investor of the other Party in connection with investments within the meaning of this Agreement shall, as far as possible, be settled amicably between the parties to the dispute' (Article X (1))

interpreted it as not indicating that a state party cannot sue an investor in relation to a dispute concerning an investment, as opposed to dispute resolution provisions in the treaties from the arbitral decisions invoked by Claimants (eg, *Roussalis v Romania*; *Amco v Indonesia (II)*), that are more narrowly drafted. Also, in the merits part of the award, the Tribunal reiterated that such a categorical understanding of the nature of the BIT, as Claimant suggests, is wrong.

Scope of consent: not restricted without express exclusion of counterclaims agreed by both parties

The Tribunal then moved to rejecting the Claimants' objection regarding the scope of their acceptance of the offer to arbitrate, that, according to the Claimants, was limited only to disputes arising from damage caused to their investment, ruling out any potential losses by Argentina. Noting that Claimants admitted that their acceptance did not explicitly excluded counterclaims, the Tribunal pointed out that it would be contradictory to further admit that Claimants would be able to render the right to counterclaims nonexistent merely by restricting the acceptance to their own claims.

There was no indication that the offer to submit to arbitration could be split into any parts and Article 46 ICSID Convention does not open the door for any unilateral determination of the Tribunal's competence. Moreover, even if assuming that Claimants had restricted its acceptance of the offer in any way, this would result in no agreement being concluded between the parties to arbitration. The Tribunal probably made this conclusion based on the basic principles of contract formation ('mirror image rule') that an acceptance with modifications is a rejection of an offer and constitutes counteroffer.

Connection with original claims: factual link is sufficient

The Tribunal also dismissed the Claimants' objection that the Respondent's counterclaim had no connection with its original claims, as required under Article 46 ICSID Convention. In a manner, somewhat different from the most of the previous arbitral practice (eg., *Saluka v Czech Republic; Sergei Paushok v Mongolia*), it was highlighted that the factual link between original and ancillary claims would suffice to establish jurisdiction over counterclaims. This conclusion represents a considerable move from interpreting overrestrictively connection requirement as implying both legal and factual nexus and, thus, deserves welcoming.

Cooling-off periods and local courts requirement: not applicable for counterclaims

The Tribunal also addressed quite an unconventional objection to counterclaims regarding failure to comply with preliminary steps for negotiation and submission to the jurisdiction of local courts by Respondent. Pointing at the Claimants' own failure

to comply with domestic litigation requirement and its further success in arguing the irrelevance of this step, the Tribunal found it purposeless to require the same from Respondent. As regards cooling-off period for counterclaims, the Tribunal also found it unreasonable to request Respondent to attempt prior settlement, particularly, in light of the Claimant's criticism for not raising counterclaims as soon as the arbitration commenced.

Although quite understandable under the circumstances of the case at hand, the answer to the potential objections regarding cooling-off period for counterclaims does not seem unequivocal in investment arbitration. Hypothetically, if respondent state raises counterclaims even long after the start of arbitration by claimant, it can still attempt at settling them amicably, which may also give respondent some leverage over the original claims. However, a careful look at the wording of the cooling-off period requirement is essential, as this step may be imposed only on claimants, depending on the exact formulation.

Burlington Resources Inc. v Republic of Ecuador

Ecuador raised two types of counterclaims against Claimant: environmental counterclaims related to the alleged contamination of soil and groundwater on the land sites that Claimant exploited, and infrastructure counterclaims related to the standards of maintenance of oil fields and equipment. The Tribunal granted both Respondent's counterclaims, ordering Ecuador USD 41.7 million as a set-off for Burlington's claims.[2)]

No jurisdictional objections from claimant, but still some food for thought

In jurisdictional regard, the instant case stands out from the most of the previous investment cases dealing with counterclaims: at the outset of the proceedings Claimant committed not to raise any jurisdictional objections to Ecuador's counterclaims. The parties to arbitration reached an agreement that they both would commit to the jurisdiction of the Tribunal over counterclaims, with the exclusion of jurisdiction of any other arbitral tribunals or national/international courts, 'so as to ensure maximum judicial economy and consistency'.

Nevertheless, the Tribunal still examined Ecuador's counterclaims as to its compliance with the requirements under Article 46 ICSID Convention and concluded that these conditions were met. 'Within the scope of consent' condition was met obviously due to the parties' manifest agreement and 'otherwise within the jurisdiction of the Center' condition was met due to the compliance with Article 25 ICSID Convention.

As regards 'arising directly out of the subject-matter of dispute' condition, it was also met, as the counterclaims related to the same investments (in Block 7 and 21) that Claimant addressed in the principal claims. The Tribunal did not go to examine whether the counterclaim and the principal claim were based on the same legal instruments. It is possible to infer from it that the Tribunal interpreted the 'connection' requirement under Article 46 as implying factual nexus, rather than legal.

Key takeaways

Taken that the backgrounds in both cases are quite specific (in *Urbaser* – broadly worded BIT dispute resolution clause, in *Burlington* – the agreement regarding the jurisdiction over counterclaim between the parties), they are not likely to become game changers in the arbitral practice on the host states' counterclaims. Nevertheless, both cases provide some important points for respondent states to take note of.

Firstly, the approaches of tribunals both in *Burlington* and *Urbaser* indicate a long-awaited move from the restrictive interpretation of connection criterion in *Saluka v Czech Republic*, where the Tribunal required the same legal instrument underlying both the claim of investor and the counterclaim of host state. That interpretation has been heavily criticized as leading to it being near-impossible for states to succeed with counterclaims.

Moreover, another significant step forward is the confirmation by the Tribunal in Urbaser of the principal wrongness of categorical understanding of BITS' nature as asymmetric and only protecting investments through rights exclusively granted to investors. It was also confirmed that BITs are not international investment law in isolation, fully independent from other sources of law (both national and international) that might provide for rights the respondent can invoke before an international arbitral tribunal. The fact that the Tribunal in Burlington gave protection to Respondent's right both under Ecuador domestic and international law is meaningful in this regard as well.

References

↑1 For a more detailed analysis of the merits part of the award in Urbaser from human rights perspective, see Edward Guntrip.

↑2 For a more detailed analysis of the merits part see Jarrod Hepburn, Successful Counterclaim In Burlington v. Ecuador Breaks New Ground

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