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UNCITRAL Working Group III: Counterclaims in ISDS – Challenges and Prospects in Light of the UNCITRAL Reform Process

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A cursory reading of the mandate of Working Group III reveals that the discussion at UNCITRAL of ISDS (Investor-State Dispute Settlement) reform focuses only on procedural aspects of dispute settlement under investment treaties and excludes any substantive aspects. However, the topic of respondent states' counterclaims, albeit procedural in itself, is so inextricably intertwined with substantive aspects that it has also been excluded in principle from the ISDS reform mandate. This notwithstanding (and not without some ambiguities) the UNCITRAL Working Group III has indicated that it "would not foreclose consideration of the possibility that a state might bring a counterclaim where there was a legal basis (or an underlying provision) for so doing."

Asymmetries in Investment Law

Investment agreements (IIAs) are formulated to provide protection to investors, and thus mainly impose international obligations on Contracting States towards investors. As such, generally speaking of course, they do not impose direct obligations upon investors. IIAs are therefore characterized by an inherent asymmetry, although this asymmetry is a feature the investment regime shares with many other international forums open to international claims by individuals (such as, for instance, the European Court of Human Rights). The "inherently asymmetrical character" of investment treaties has made counterclaims in ISDS problematic.

Rebalancing this asymmetry by allowing states to file counterclaims, when possible (and provided the ISDS clause at stake so permits), would allow investment tribunals to take a holistic judicial approach in analysing investment disputes. This would allow them to adjudicate (alongside alleged breaches by a host state of its international obligations under IIAs) the consequences of investors' non-compliance with domestic provisions of paramount importance, including those implementing internationally accepted core obligations related to human rights (such as, for instance, those related to environment protection). This would, in turn, promote "procedural efficiency, fairness, and the rule of law", as indeed highlighted by several UNCITRAL delegates.

It is in this perspective that states' right to file counterclaims (and investment arbitral practice thereon) deserves closer scrutiny.

Restrictive Approaches to Counterclaims in Existing Investor-State Arbitration Decisions

Tribunals to date have either opined that the consent under the relevant BIT did not include in principle claims by the host state against the investor, even where the relevant BIT contains an umbrella clause, or held that the counterclaim made did not directly arise out of the subject-matter of the dispute under the treaty, thus not meeting the necessary requirement of close connection with the primary treaty-based claim of the investor.

According to the dominant approach in arbitration case-law, respondent states' counterclaims in the form of reactive claims grounded on a different legal basis than the IIA itself (thus legally unrelated to the investors' claims based on the breaches of IIA provisions) are in principle either outside the treaty-based jurisdiction of the investment tribunal or inadmissible. This is the case even when such counterclaims are factually connected to the investor's claim. This holds true unless a specific agreement between the disputing parties extending arbitral jurisdiction to the Respondent's counterclaims and identifying its domestic law as applicable law is present.

Such a restrictive approach to counterclaims appears to be influenced by the arbitration practice concerning investment contracts. In these cases, respondent states have filed counterclaims based on the violation of domestic law provisions of general application (such as, for instance, tax laws and regulations) in response to investor claims based on an investment contract. In many of these cases, tribunals have held that such counterclaims are in principle either outside the scope of parties' consent to arbitration or not sufficiently connected (both legally and factually) with the original contractual claim of the investor. Nevertheless, the investment contract framework differs in many respects from the investment treaty one. One of the most prominent differences is related to the applicable rules of interpretation. This casts doubt on whether investment contract arbitration practice related to counterclaims is of great relevance to investment treaty cases.

It might instead be possible that a respondent state's counterclaim that relies on the same factual matrix of the original treaty claim of the investor, but grounded on a different legal basis than the IIA itself, can be considered as both within the scope of the tribunal's jurisdiction and admissible, even if no mention of the possibility for the respondent state to file counterclaims is made in the IIA. This would be the case where the ISDS clause of the relevant IIA covers "any" or "all disputes between a Contracting State and an investor of the other Contracting State" concerning a protected investment. Such a counterclaim would be especially likely to be within jurisdiction if the IIA contains a broad definition of covered investment, for example by referring to licenses and concessions conferred by law or under contract. This approach seems to be supported by the widely internationally and domestically accepted concept of counterclaims. Such practice includes set-off claims, and claims of a respondent party, which are responsive to the claims of the claimant even when legally grounded on a different instrument, provided that they are closely factually connected therewith. After all, the right to counterclaim is a core element of a defendant's right to claim on an equal footing to the original claimant as a general principle of law. Given this, any restrictive interpretation of ISDS clauses that is not explicitly justified by the wording of the treaty would unjustly limit the right of defence of respondent states. Given the status of this general principle of law related to a defendant's right to counter-claim, the question is why a respondent state should not be able *a priori* to file a counterclaim against a claimant investor based on the violation by the latter of domestic legal obligations of fundamental importance with which should have been complied with in its business activities in the host state. This is especially so when the

ISDS clause is so broadly worded as to encompass any dispute between the investor and the host state on the investment.

New Approaches to Counterclaims in Recent Arbitration Decisions?

The dominant approach described above does not facilitate such counterclaims by respondent states. It has been suggested that the recent trend in arbitration practice on counterclaims, represented by the cases *Urbaser* and *Aven*, might be less restrictive. However, these cases do not represent particularly promising developments in light of the objective of balancing IIAs' asymmetry by way of counterclaims. In these cases, the discussion focussed on the wording of ISDS clauses that are neutral as to the identity of the claimant or respondent, thus allowing in the abstract either the investor or the host State to submit a dispute in connection with the investment to arbitration. These neutrally drafted clauses were interpreted by the *Urbaser* and *Aven* tribunals so as to allow arbitral jurisdiction over respondent states' counterclaims.

However, despite judging the states' counterclaims as admissible in principle, both tribunals dismissed them on the merits. At the jurisdictional level, to support the counterclaim's admissibility, it was accepted that "it can no longer be admitted that companies operating internationally are immune from becoming subjects of international law", including HRs obligations. However, this very same argument was among the factors causing the dismissal of the counterclaims on the merits. In fact, the nature of HRs obligations as state obligations makes it impossible for them to merely shift from states to corporations. Furthermore, HRs obligations related to individuals' fundamental social, economic, and cultural rights are positive obligations which require states to actively and effectively act, but, within their sovereign discretion and, in most cases, their limited financial resources. The point made here is well illustrated by the *Urbaser* case where, although declaring Argentina's counterclaim related to the human right to water as admissible, the Tribunal could not but conclude that:

> "…the enforcement of the human right to water represents an obligation to perform. Such obligation is imposed upon States. It cannot be imposed on any company knowledgeable in the field of provision of water or sanitation services. In order to have such an obligation to perform applicable to a particular investor, a contract or similar legal relationship of civil and commercial law is required."

Respondent states' right to file counterclaims has therefore proved to be rather inoperative and ineffective in investment arbitration practice until now, even when based on the characterization of investors as subject of international law and thus holders of HRs obligations. In this respect, the observation by Professor Higgins in the late 70s that the traditional debate on natural and legal persons (corporations included) as subject or object of international law "is not particularly helpful, either intellectually or operationally" still retains its validity. Given current trends in investment case-law, the possibility for a state to effectively counterclaim in investment arbitration is contingent upon the presence of specific underlying provisions explicitly permitting it to do so.

Should UNCITRAL Working Group III Give Greater Attention to Counterclaims as a

Reform Option?

In conclusion, states' counterclaims against investors in investment disputes can be an effective means of promoting procedural efficiency, fairness, and the international rule of law. These objectives will only be realised if they are supported by explicit policy changes in investment treaty law that operate at not just a procedural but also a substantive level. Such innovation should establish an international jurisdiction not just limited to hearing investors' claims against Contracting States for breach of their international treaty obligations, but open to adjudication of investment disputes understood in a broad sense so as to include at least violations of human-rights legislation by investors in carrying out their business activities. In other terms, reforms should go beyond the provision of an investor's general duty to respect the law of the host state, and the putative inadmissibility of its ISDS claims where it fails to do so.

In this respect, the inclusion of specific treaty provisions imposing positive obligations upon investors to respect a host state's legislation – including legislation implementing internationally accepted core obligations related to human rights (such as, for instance, those related to environment protection, or labour rights) – should be considered by Contracting Parties to IIAs.[1)] Such provisions would raise these obligations from the plane of domestic law (and domestic judges' jurisdiction) to treaty obligations enforceable against investors in ISDS, thus giving respondent states the capacity to file, in such proceedings, counterclaims possessing a tangible legal basis.

Such provisions may, however, present downsides. First of all, the possibility for a respondent state to file a counterclaim will inevitably impact its capacity to advance such claim before other possibly competent fora, including its own judiciary. Since respondent states' counterclaims are generally governed by domestic law provisions and fall under the competence of the host state's judiciary, their admissibility and adjudication in ISDS raise sensitive policy issues related to the correct interpretation and application of applicable domestic law, and may risk depriving domestic judiciaries of their natural and general competence. Secondly, the provisions referred to here seems at odds with the most recent approaches in investment treaty drafting, which have delinked Contracting Parties' international commitments from their domestic legal systems. This is the case with European agreements, where such 'delinking' is required pursuant to the case-law of the Court of Justice of the EU in order to safeguard the autonomy of the European legal system (its judiciary included) from interferences by external judicial mechanisms. As a consequence, such 'delinking' seems to be, at the moment, a non-negotiable element in European investment relations with third countries. New generation IIAs are thus moving in the opposite direction than the innovation mentioned here: they limit the scope of application of ISDS to just investment disputes based on alleged breaches by Contracting Parties of their international treaty obligations, and make investors' illegalities relevant to the capacity of investors to submit treaty claims.

Notwithstanding the aforementioned downsides, providing greater scope for counterclaims in ISDS might allow tribunals to take a more holistic approach to investment disputes. This can promote international justice at large, thus curing the widely perceived legitimacy crisis of ISDS.

In light of the above analysis it still remains the case that states' counterclaims in ISDS pose fundamental issues of substantive law. These issues (together with the implied downsides mentioned above) have potential to become much more contentious than those, strictly procedural, already discussed by UNCITRAL Working Group III. However, the Working Group cannot avoid finally discussing them at its next sessions, where the focus should be on (feasible) reform options,

as pointed out by the Secretariat in its note of January 2020 on multiple proceedings and counterclaims. This in turn raises the basic issue of whether Working Group III "…should not address the topic, as its work was to focus on the procedural aspects of ISDS dispute settlement rather than on the substantive provisions in investment treaties".

Addressing states' right to counterclaim in ISDS has, certainly, the potential of contributing to a better integration between foreign investment and HRs. Considering counterclaims as a general means of adjudicating human rights-related obligations of investors is, however, too simplistic, as the above analysis of the *Urbaser* and *Aven* cases clearly shows. Furthermore, the interplay between investment and human rights goes well beyond the field of foreign investment protection, and also involves purely domestic investors and investments, calling into question effective compliance by states with their HRs obligations in regulating business activities in general. Given this, it is therefore unclear what the rationale behind expanding the framework for respondent states' counterclaims in ISDS to allow submission of claims by third parties against (presumably just foreign) investors would be. In fact, ISDS is established by interstate agreements for the settlement of investment disputes between the investors of a Contracting State and the other Contracting State. It is alike unclear what the legal basis for such third parties' claims would be exactly. Moreover, "to regulate, in international human rights law, the activities of transnational corporations and other business enterprises" is now the objective pursued by a UN treaty project. Said UN treaty project, albeit in its initial stage, holds much promise for ensuring HRs protection against corporate abuses. UNCITRAL Working Group III, albeit taking such UN treaty project in due consideration, should avoid unnecessary overlaps therewith, and be reminded of the Italian old maxim according to which "who wants everything, loses everything."

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References

?1 For instance, such innovation is under discussion among Italian competent authorities within the currently pending process of reviewing the Italian BIT model.

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