Kluwer Arbitration Blog

Regime Interaction in Investment Arbitration: Counterclaims

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This post deals with the conceptual underpinnings and theoretical justification for the practice of counterclaims in investment arbitration. First, it is important to delineate this post from an analysis of counterclaims case-law in investment arbitration, as ample accounts of the counterclaim debate in practice can be found here, here, and here. Equally, this post does not deal with regime interaction as such. For a fuller account of regime interaction in investment arbitration, see for example here and here.

To understand the conceptual underpinning of counterclaims and the theoretical justification for allowing such practice, one must *not* look only at the practice and evolution of international investment law ("IIL") and investment arbitration, but also to conflicting interests as manifested in other regimes of public international law ("PIL") and the practice of other international courts and tribunals. International investment agreements ("IIAs") are formulated with the exclusive intention to provide protection to investors and to facilitate and promote foreign investments. As such, these instruments impose one-way obligations on states towards investors. Thus, it is important that the discussion on enforcing investor obligations through, for example, counterclaims, starts from the right end, i.e., with a discussion of PIL *per se*, in the light of the asymmetrical nature of IIL, and the adjudicatory mission of enforcing a holistic and all-encompassing ("thick") global rule of international law in mind.

Put simply, it is impossible to understand the adjudicatory mission of investment arbitration without understanding PIL more broadly. Those who try otherwise, fail. The time is ripe for investment arbitrators to shift their focus from the norm-hierarchical viewpoint and instead approve the interaction of other equally specialized regimes in their decision-making process. Meanwhile, the arbitral procedure should seek ways to optimize the procedure's efficiency without undercutting the fundamental elements of international arbitration.

This inevitable need for a perspective shift culminates in a reform debate, generally, and more specifically in a discussion of reinterpreting current IIAs and arbitration rules, on the one hand, and the long-term mission of redrafting IIAs and investment arbitration rules to align with "conflicting" regimes, on the other hand. As was

explained in the Introduction to the IISD Model International Agreement on Investment for Sustainable Development in 2005:

> "[T]he model for IIAs developed 50 years ago no longer meets the needs of the global economy in the 21st century. … We believe the time is ripe to propose a new model for IIAs, a new direction that is consistent with the goals and requirements of sustainable development and the global economy of the 21st century." (p. 11)

All in all, it is evident that some reform is necessary. This is especially prevalent in light of the current backlash against IIL and investment arbitration. Such reform is welcomed and should be aligned with constitutional values of democracy, the rule of law, and fundamental liberal values (e.g., human rights and environmental law). There are many ways of reforming IIL and investment arbitration without undercutting its fundamental elements and therefore its adjudicatory mission of enforcing a liberal and pragmatic global rule of law, for example, by: (a) redrafting IIAs, (b) adopting and redrafting investment arbitration rules, and (c) broadening host states' defences where IIL clashes with other regimes of PIL.

This post deals with one out of a handful of possible and sensible reforms, namely, the heightened standing and increased currency of counterclaims in investment arbitration. The ongoing dialogue on regime interaction further entrenches the enhanced role of counterclaims.

Counterclaims in Investment Arbitration

Filing a counterclaim can serve both as an independent claim for liability and damages, as well as a tool (incidentally) focused on the dismissal or set-off of the investor's legal action. A counterclaim can be explained as a fundamental element of the respondent state's right to present its case on an equal footing with the investor. It is, therefore, to be treated as a general principle of law that rests on reasons of fairness. Moreover, counterclaims can be said to promote procedural economy and consistency in decision-making, contributing to a better administration of justice by creating reciprocal obligations for parties. For example, judicial economy would be preserved and the procedural integrity, too, when the procedure deals with all connected claims collectively. In so doing, counterclaims could potentially facilitate the enforcement of a thick global rule of law.

As has been mentioned on this blog, there are several bases upon which an investment tribunal might find that it has jurisdiction over a counterclaim; for example, it can find jurisdiction on the basis of: (1) an IIA explicitly, (2) an IIA implicitly, or (3) on agreed-upon arbitration rules, (4) consent.

For example, the ICSID Convention expressly maintains the right to file a counterclaim. Article 46 of the ICSID Convention reads as follows:

> *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.*

Treating a state claim as "incidental" or "additional" to, or as "arising *directly* out of" the subject-matter and yet "within the scope of consent" is a cumbersome threshold to square with regime interaction, unless some proactive decision-making is conducted and rooted in a broader understanding of PIL. It is this threshold that has allowed investment tribunals to treat counterclaims conservatively.

The jurisdictional hurdle is followed by the question of the source of an investor's alleged obligation. Such an obligation can arise from either a domestic law or an international law. But should an investment tribunal allow for counterclaims pursuant to both types of alleged obligations? The most controversial types of counterclaims include where (a) the state is seeking to enforce the rights of third parties, (b) the counterclaims are based on domestic law obligations, and (c) the states could instead request commercial arbitration or litigation pursuant to an investor-state contract.

The Standing and Currency of Counterclaims in the Current and Future Web of IIAs

Today, there are approximately 3,000 IIAs in force, for which the majority fails to provide guidance as to how issues of, for example, human rights and environmental protection should be exhaustively addressed in the context of investment promotion and protection. IIAs are frequently narrowly defined and limited in their IIL scope, focusing on attracting, promoting, and finally protecting FDI and thereby enforcing only state obligations. This can be redressed by harmonizing otherwise conflicting regimes through systemic interpretation. This technique – embedded in Article 31(3)(c) Vienna Convention on the Law of Treaties ("VCLT") – allows for the interpretation of international rules holistically.

The emphasis on and importance of counterclaims is indeed an expression of regime interaction. If regime interaction is properly facilitated through either the redrafting of IIAs, arbitration rules, or systemic interpretation, investment tribunals would be empowered to enforce investor obligations by allowing for counterclaims on legal bases outside IIL.

Investment arbitration must accommodate the changing times. As much as the imbalance between investors and states constituted the foundation of investment arbitration, the perceived reversed imbalance in the current IIA and investment arbitration landscape is at the heart of today's backlash and legitimacy crisis. For that reason, the investment arbitration community is currently considering proposals concerning whether investor obligations should be enforced through investment arbitration. However, the current ISDS reform is limited to procedural aspects without addressing core issues of rights and obligations of both investors and states. As such,

a holistic consideration of counterclaims as a tool for ensuring a balanced system is somewhat limited. Undoubtedly, counterclaims have the potential to rebalance IIL and the investment arbitration procedure by enforcing investor obligations. The threat of a counterclaim may indeed incentivize investors to operate in a more sustainable manner (a reasonable "counterclaim-chill"), and it may likewise discourage investors from challenging state decision-making aimed at regulating public policy concerns (and thereby avoid the supposed "regulatory-chill").

All in all, it has rightly been noted that the case-law on counterclaims "clearly points to the poor performance of respondent states' counterclaims in investor-state dispute settlement ("ISDS"), which were ultimately upheld in just two cases out of 25 investment arbitration cases". Beyond the case-law, which has been, thus far, rather restrictive, IIAs and investment arbitration procedural rules further, generally speaking, exclude a respondent state's right to submit a counterclaim under most of the current web of IIAs. Arbitration stemming from investor-state contracts falls within an entirely different discussion, along with counterclaims on behalf of third parties. We are not dealing with those scenarios here.

The Continued Adjudicatory Mission of Investment Arbitration through Regime Interaction

IIL is facing both fragmentation from within, as well as being part of a fragmented international law web. Regime interaction is needed to provide for a coherent and effective global rule of law and that investment arbitration is best equipped to enforce such rules. Domestic courts (and court-like institutions) routinely enforcing domestic law cannot, as such, properly handle such matters of global concern.

Thus, arbitral tribunals should not view IIL in isolation but should instead integrate conflicting legal regimes through systemic interpretation. If a proper approach to systemic interpretation were to be employed, both legitimacy and effectiveness of international law and investment arbitration would stand to benefit. Systemic interpretation would help deal with fragmentation by reconciling or integrating otherwise conflicting legal regimes. In this broader quest, arbitral tribunals should allow counterclaims by integrating other international law regimes, including human rights and environmental law. While it is true that states have found ways to counteract IIA's general lack of substantive obligations for investors by, for example, asserting that investors have obligations under customary international law or otherwise asserting breaches of domestic law, it is vital that reform of IIL and ISDS takes a comprehensive approach.

Providing a mechanism for respondent states to counterclaim is an important development in investment arbitration and ensures that there is an appropriate balance between states and investors by promoting equality of arms, democracy, liberal values manifested in and protected through public international law, fairness, and finally by facilitating the enforcement of a thick global rule of law.

To read our coverage of regime interaction in investment arbitration, click here.

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