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# Three Recent Decisions Further Shaping Investment Treaty Case Law On Counterclaims: Part II

Jose Antonio Rivas and Jean Choi (Arnold & Porter LLP) · Wednesday, October 14th, 2015

Part I of this article analyzed the three jurisdictional requirements under the ICSID Convention for submission of counterclaims. Now we turn to three investor-State tribunal decisions decided within the last two years, and how they have contributed to the jurisprudence on counterclaims: *Metal-Tech v. Uzbekistan* (ICSID Case No. ARB/10/3, Award, 4 October 2013), *Al-Warraq v. Indonesia* (UNCITRAL, Final Award, 15 December 2014), and *Perenco v. Ecuador* (ICSID Case No. ARB/08/6.

***Metal-Tech v. Uzbekistan.*** Metal-Tech, a manufacturer of ceramic powders, metals and metal derivatives, formed a joint venture with two state-owned companies in Uzbekistan, to build and operate a plant for the production of molybdenum products. (paras. 1,7.) Metal-Tech paid 4 million US dollars to three individuals for their lobbying services, to assist with the operation, production, and delivery of the joint venture's products. (para. 86.) This led to local criminal proceedings against those individuals, which in turn resulted in the termination of the supply contract with the joint venture, and subsequently the liquidation of the joint venture. (paras. 37, 42, 51.) Metal-Tech brought an ICSID arbitration against the Uzbek government, claiming that the turn of events resulted in Uzbekistan's breach of its BIT obligations and Uzbek law. (para. 55.) In response, Uzbekistan brought counterclaims "to recover for damages sustained as a direct result of the Claimant's unlawful conduct." (para. 110(ix).)

In analyzing its jurisdiction to hear the counterclaims, the tribunal engaged in a two-prong test: (i) the counterclaim must be within the jurisdiction of the Centre, which includes the requirement of consent, and (ii) the counterclaim must arise directly out of the subject-matter of the dispute. (para. 407.) Finding that the claimant participated in corrupt practices to establish the investment at issue and therefore failed to satisfy the legality requirement and the definition of "investment" under the applicable BIT, the tribunal held that "the State's offer to arbitrate did not extend to this 'non-investment' and the investor's acceptance included this limitation." (para. 411.) Thus, the tribunal concluded that the first jurisdictional requirement including consent was not met. (para. 413.)

One could infer from the *Metal-Tech* decision that an investor's material violation of local law may *not* itself bar the tribunal's jurisdiction if the acts of corruption took place *after* the establishment of the investment (thus not barring the original claim and derivatively the counterclaim). In such a case, however, a counterclaim premised on alleged corruption or fraud by the investor would still need to be directly connected to the operation of the investment, in order to meet the "arising directly out of the subject-matter of the original dispute" requirement under Article 46.

***Al-Warraq v. Indonesia.*** Mr. Al-Warraq invested in a distressed Indonesian bank called Bank Century, through a company specializing in developing and executing turnaround strategies for distressed banks. (paras. 73?74.) However, after Bank Century was bailed out by the government, press reports followed, that some of the bailout funds were misused to fund the presidential election campaign. (paras. 88, 99.) Mr. Al-Warraq and two other individuals were eventually reported for banking irregularities, and a criminal verdict was rendered against one of the individuals. (para. 106.) Mr. Al-Warraq brought claims under the UNCITRAL Rules and the Organisation of the Islamic Conference ("OIC") agreement. (para. 10.) Indonesia brought a counterclaim, alleging that Mr. Al-Warraq unjustly enriched himself by retaining or misusing Bank Century's assets entrusted to him, to the detriment of Bank Century and ultimately the people of the Republic of Indonesia. (para. 460.) Based on a close review of the OIC agreement, including the broadly worded dispute settlement provision and the provision imposing a positive obligation on investors to respect the law of the host State, public order and morals, the tribunal concluded that it had jurisdiction to decide the respondent's counterclaim. (paras. 660?667.) The tribunal also found that Indonesia's counterclaim was closely connected to the subject-matter of the original claims, i.e., the bailout of Bank Century (para. 667).

The *Al-Warraq* award contributes to the evolution of the investment treaty case law on counterclaims in several ways. *First*, it follows the doctrine of offer and acceptance through a close reading of the dispute settlement provision of the agreement at issue. (*Al-Warraq v. Indonesia*, UNCITRAL, Award of Respondent's Preliminary Objections to Jurisdiction and Admissibility, 21 June 2012, ¶ 81.) *Second*, in contrast to *Metal-Tech*, where the corruption happened in connection with the establishment of the claimant's investment (see *Metal-Tech*, ¶ 372), the alleged fraud in *Al-Warraq* occurred after the investment was already in place. (see *Al-Warraq*, Final Award, ¶¶ 74, 99.) *Third*, unlike the vast majority of investment treaties, the OIC agreement imposes an affirmative obligation on investors to respect the law of the host State, public order and morals. (para. 663.)

While the tribunal found that it had jurisdiction to hear the counterclaim, it concluded that the counterclaim failed on the merits. First, the tribunal found that the respondent had failed to define the claimant's personal liability; the counterclaim did not distinguish the allegedly wrongful acts of the claimant from those of his business associate, who was not a party to the arbitration, and there were many other entities that were either primarily or jointly responsible for the alleged fraud. (para. 669.) The tribunal also found that, as the counterclaim was based on a fraud committed against Bank Century, the respondent's right to recover the losses incurred by Bank Century was not demonstrated, and that some of the allegedly fraudulent transactions were subject to different dispute resolution mechanisms. (paras. 670 ?71.)

***Perenco v. Ecuador***. In this recent ICSID decision, the tribunal analyzed in depth the merits of the respondent's environmental counterclaims. Perenco Ecuador Limited, an oil and gas company, brought claims against Ecuador for breach of Ecuador's obligations under the BIT and two participation contracts between Perenco and a state-owned enterprise acting on Ecuador's behalf, for exploration and exploitation of Block 7 and Block 21 situated in the Ecuadorian Amazonian region. (Interim Decision on Environmental Counterclaim, ¶ 4; Decision on Remaining Issues of Jurisdiction and on Liability, 12 September 2014, ¶ 4.) Ecuador brought environmental counterclaims, arguing that Perenco's breach of its obligations under Ecuadorian environmental law resulted in significant environmental damage to Block 7 and Block 21 and amounted to failure to properly maintain the Blocks' infrastructure in good working condition. (Decision on Remaining Issues of Jurisdiction and on Liability, ¶ 280.)

On August 11, 2015, the tribunal issued an interim decision on Ecuador's principal environmental counterclaim. The tribunal engaged in substantive analysis of the parties' arguments on the environmental counterclaims and made a number of findings of fact and law, which would in turn be applied to ascertain the extent of damages for which Perenco would be held liable. (Interim Decision, ¶¶ 317?318.) The tribunal found that the claimant violated certain environmental law provisions, and appointed an independent environmental expert to assist the tribunal in ascertaining the environmental condition of the Blocks. (para. 610.) However, the tribunal did not articulate in its decision any jurisdictional analysis. The claimant may not have raised a jurisdictional objection to the counterclaims, or perhaps it was evident to the tribunal that it had jurisdiction over the counterclaims because the arbitration clauses in the participation contracts provide for ICSID arbitration over "any technical and/or economic dispute" (relating to Block 21) and "controversies" (relating to Block 7) arising out of such contracts. (Decision on Jurisdiction, 30 June 2011, ¶¶ 126, 160.) It is possible that based on those contractual provisions, which provided broadly for ICSID jurisdiction, the tribunal concluded that Ecuadorian law would govern its evaluation on the environmental conditions of the blocks. (Interim Decision, ¶ 611(1).)

**Conclusion**. While the tribunals in *Metal-Tech* and *Al-Warraq* rejected the respondents' counterclaims, respectively on jurisdictional grounds and on the merits, they have shed additional light on what a respondent must show to establish that a tribunal has jurisdiction to hear its counterclaim and to demonstrate an adequate legal basis for its counterclaim. In addition, although a final award is still pending, the interim decision in *Perenco* seems to confirm that counterclaims brought under a contract between the State and the investor may call for a more straightforward jurisdictional analysis than treaty-based counterclaims.

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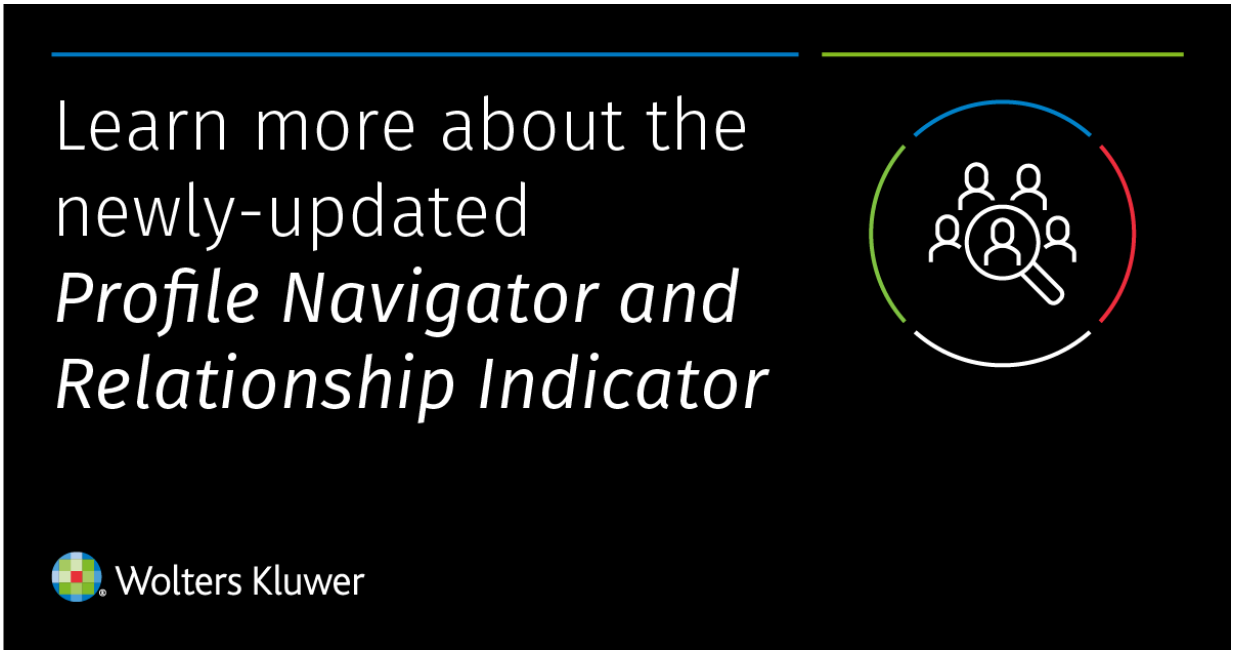


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