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Counterclaims in Investment Arbitration: Reflections on UNCITRAL WG III Reform

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The discussion within UNCITRAL Working Group III (WG III) on counterclaims has still remained, to a certain extent, deadlocked, as opposed to discussions on other topics under the table. As a result, the UNCITRAL Secretariat has been put (at least) until now in the unfortunate position of being unable to bring a coherent package of draft provisions on the matter to the attention of WG III delegates.

During the intersessional meeting of WG III, organized by the Republic of Korea at the beginning of September 2021, the debate has not progressed further than the reiteration once again that "the current work on ISDS reform should not address the obligation of investors or the legal basis for counterclaims" and "drafting such obligation [i.e. substantive obligations on the part of investors in investment treaties] was not within the mandate of the Working Group focusing on procedural reforms."

The Janus-faced nature (i.e., both procedural and substantive) of counterclaims has surely made States' counterclaims in ISDS not an easy matter for consideration by the WG. The view of counterclaims as possibly a general means of correcting the asymmetry of the current investment regime, or of enforcing investors' "…obligations in relation to human rights, the environment as well as to corporate social responsibility", which, as such, is not among those concerns the procedural reform efforts are meant to address, has made the discussion even more complicated.

That having been said, the debate within the WG seems to have also remained quite unfocused and untechnical against the backdrop of the legal concept of counterclaims, as generally understood at both the international and domestic levels.

Consideration for the general features of counterclaims, as generally acknowledged under both international and domestic laws, would, however, help the WG to properly grasp the boundaries, rationale and purpose of such juridical institution, and, thus, exactly delimit the scope of discussion. Such consideration would shed light on the essential prerequisites for a respondent's counterclaims, including the circumstances under which a State might file counterclaims against foreign investors, bringing the UNCITRAL discussion back to more constructive terms, and refocusing it on procedural aspects of ISDS.

Counterclaim

A counterclaim, as generally understood at both international and domestic levels, is an autonomous claim of a respondent party against a claimant, which albeit reactive and therefore incidental to the principal claim of the latter, aims at obtaining something more than the mere dismissal of the principal claim. This description also evidences rationale and purpose of counterclaims as operating on both the international and domestic plane.

On the one hand, the right to counterclaim is a fundamental element of the respondent's right to present its case on an equal footing with the original claimant, as a general principle of law, and rests on reasons of fairness. As also pointed out in international jurisprudence, even when the right of filing counterclaims is not expressly provided for or regulated, international arbitral tribunals "have the inherent power to hear counterclaims", thus giving each party a full opportunity to be heard.[1)] On the other, counterclaims, besides guaranteeing the equality of parties in pursuing their own case before the tribunal, promote procedural economy and consistency in decision-making, contributing to a better administration of justice, but "must necessarily relate to the aims thus pursued and be subject to conditions designed to prevent abuse".[2)]

Since a counterclaim can serve the aforementioned procedural economy and finality purposes only when it is sufficiently connected with a claimant's primary claim, a counterclaim is admissible, and thus legitimate, only when it meets the direct connection requirement. The direct connection requirement is, in fact, a counterclaims' condition for admissibility common to both international litigation and domestic litigation, as opposed to the jurisdictional requirement, which is peculiar to the former. Several corollaries follow from such a general concept. First of all, considerations based on the asymmetry of IIAs and ISDS in themselves do not *a priori* exclude a respondent state's possibility to counterclaim against investors under investment treaties. Contrary to what has been said by a few investment tribunals, neither the silence of an investment treaty on such possibility, nor its explicit reference just to investors' right to claim under the treaty thus supports in itself restrictive approaches on the matter. Secondly, the framework for counterclaims cannot be by definition expanded to include claims by third parties against the claimant. Such claims by third parties, which usually can be advanced against either a claimant or a respondent in domestic legal systems, do not and cannot qualify as counterclaims, but fall into other universally acknowledged concepts of procedural law, such as those of cross-claims and *intervention des tiers*. Thirdly, a counterclaim is not a mere defence aimed at obtaining the dismissal of claimant's legal action, but rather an action which is an autonomous, albeit reactive, legal act by a respondent against a claimant for the latter being responsible for the breach of the obligations it owes to the former, as pointed out above. Thus, any counterclaim has to properly be legally substantiated for avoiding early dismissal for lack of a legal basis or a tangible one since an adequate and sufficiently developed cause of action is a necessary minimum requirement of any pleaded claim, therefore of not only investors' primary claims but, also counterclaims of respondent States.

Counterclaims Case-law

In this respect, current investment case-law offers a quite significantly high number of examples of counterclaims grossly defective in terms of cause of action especially in comparison with the overall small number of investment arbitration cases where states' counterclaims were at stake.

According to our overview,[3)] in more than half over just 25 investment proceedings where respondent states advanced counterclaims against investors, such counterclaims were either found, among others, completely legally or factually unsubstantiated, or, when admitted, they were dismissed for lack of a legal basis or lack of substantiation. In some arbitral cases such non-compliance of respondents' counterclaims with the aforementioned necessary minimum pleading requirements was so serious as to make their counterclaims possibly dismissed in *limine litis* for being unmeritorious, when not abusive.

In the *Urbaser* and *Aven* cases, the tribunals, after having admitted the counterclaims of respondents in general and abstract terms, dismissed them since the nature of human rights obligations as State obligations, rather than international obligations upon investors as (counter)claimed by respondent states, makes it impossible for them to merely shift from States to corporations. As a consequence, the counterclaims in these two cases ultimately resulted as completely unsubstantiated. In *Al Warraq v. Indonesia*, the counterclaim was admitted in the abstract, but subsequently dismissed since the respondent did not have *jus standi* to claim the damages it asked for under its own law (i.e. damages suffered by third parties). Also, in *Tethyan v. Pakistan*, the respondent did not have *ius standi* for advancing the domestic law-based counterclaim under its own law. In *Paushok v. Mongolia* the taxation obligations under municipal law at the basis of respondent's counterclaim, found by the tribunal as inadmissible for lack of a reasonable connection with the investors' claims under the BIT and public international law, were also incumbent upon a third party to the procedure, and, in any case, had been already enforced by national authorities before domestic judges. Also, in *Inmaris v. Ukraine* claimants were found not responsible for the specific claim advanced by respondent by way of counterclaim, and such claim could not be brought against them. In the *Hamester*, Respondent's counterclaim was so completely unsubstantiated, including any indication of a possible legal basis, as to put the tribunal in the unfortunate position of being unable to determine, even *prima facie*, whether or not it had jurisdiction to entertain it. The same holds true in respect to the counterclaim filed by Argentina in the *Teinver* case: because the respondent did not identify any legal right or obligation, neither in international law nor in domestic law, on which it could rely in order to bring its counterclaim, the tribunal found that it could not assert jurisdiction over the respondent's counterclaim. Similarly, the *Amto* tribunal could not but conclude for the dismissal of respondent's counterclaim for lack of any legal basis for having been the Respondent unable to present any legal basis in the applicable law for it. Also, in the *Rusoro* case, the counterclaim by Venezuela against the claimant was not only outside the jurisdiction of the Tribunal limited just to "a claim by the investor that a measure taken or not taken by [the host State] is in breach of [Art. XII (1) Canada-Venezuela BIT], but it was also completely unsubstantiated. Finally, in other cases, the counterclaim before the arbitral tribunals, besides presenting some other flaws, was also already submitted, as either principal claim or counterclaim, before other *fora*. For instance, this was the case in *Saluka v. the Czech Republic*, where the claims advanced by the Respondent as counterclaims in the treaty-based arbitration were already before a contract-based arbitration tribunal as principal claims, and in the *Gavazzi v. Romania*, where Respondent's pleaded by way of counterclaim in the investment treaty arbitration were not only advanced before but also finally decided in favour of the investors by both domestic judges and contract-based arbitration tribunal.

The above overview clearly points to the poor performance of respondent states' counterclaims in ISDS, which were ultimately upheld in just two cases out of 25 investment arbitration cases. The asymmetry of the investment regime does not seem to bear specific responsibility for such an outcome.

As some investment cases, such as *Aven* and *Al Warraq,* illustrate, there is, to a certain extent, an inclination by respondent states to conflate mere defences either on jurisdiction and admissibility, or on merits and which are based on investor's breach of, or non-compliance with, relevant domestic laws and regulations, and proper legal actions against investors. However, this alone does not explain the statistics on counterclaims. Indeed, a further explanation might come from the 'public law' nature of the domestic regulations in which States generally ground their counterclaims. Breaches of 'public law' regulations by investors require host state's public authorities to take appropriate actions against wrongdoers within the framework of their domestic legal system. A State cannot be held liable at public international law for actions and measures which are triggered by and constitute a reasonable response to inadequate, wrongful, or deficient behaviour of the claimant investor; as a result, investors' breach of, or non-compliance with, relevant domestic laws and regulations can exclude State liability, or, operating by way of set-off plea, reduce it. However, such reactive actions, which are taken by host states' authorities in the exercise of their public powers, are a manifestation of sovereign power, have a unilateral, rather than a consensual, nature, and, thus, are generally not framed as damages actions pursuant to the relevant domestic legal system. As a result, such states' actions do not fit in with the liability model followed by investment law, and cannot be directly enforced via ISDS, including by way of counterclaims. Indeed, such issue has been touched upon by the *Paushok* tribunal when it observed that upholding jurisdiction over the counterclaim based on taxation obligations would have run contrary to the international principle of non-extraterritorial enforceability of national public law. It follows, as a matter of practice, that the possible ambit of operation of counterclaims in ISDS is not so different from that of counterclaims within the framework of investment contracts and other similar domestic law instruments creating reciprocal obligations for parties. In such instances counterclaims by respondent states are, in fact, a normal occurrence, as ICSID contract arbitration practice, Iran-US Claims Tribunal case-law, and *Burlington v. Ecuador*, and *Perenco v. Ecuador* (the only two recent investment cases where respondent's counterclaims were upheld) clearly illustrate.

Conclusions

A few conclusions can be drawn from the general concept of counterclaims and its corollaries above.

First of all, the direct connection requirement cannot be disregarded since it is an inherent element of counterclaims, as a general law concept which serves its institutional purposes of procedural economy, finality, and ultimately a better administration of justice. It is for the court or tribunal, in its sole discretion, to assess whether a given counterclaim is sufficiently connected to the principal claim, considering the particular circumstances of each specific case.

Secondly, respondent states' counterclaims do not (and cannot) have any potential at all as a means of enforcing legal obligations – whatever origin (international or domestic) they might have – foreign investors owe to third parties, and not directly to the respondent state, contrary to what the discussion within the WG seems, sometimes, to assume. The possible ambit of counterclaims in ISDS is much more limited than the discussion at UNCITRAL appears to indicate.

Thirdly, the asymmetry of investment law and arbitration in itself does not limit the state's right to counterclaim. Limitations on states' possibility to advance counterclaims against foreign investors

mirror those on the scope of application of ISDS just to Parties' breaches of their international treaty obligations. Many IIAs of old and new generation limit the scope of application of ISDS to investment disputes just on alleged breaches by contracting Parties of their international treaty obligations; and they indicate as governing law just treaty provisions and applicable rules of international law, thus excluding states' possibility to counterclaim. This is, for instance, the case with NAFTA and CETA, as opposed to the CPTPP which provides for respondent states' counterclaims, and indicates, as governing law, applicable domestic rules (Article 9.25.2 CPTPP). These limitations on international jurisdiction over investment matters reveal deliberate treaty policy choices of the Contracting Parties towards restricting international jurisdiction of investment tribunals, rather than expanding it.

The above highlights the uneasiness with drafting treaty clause options on counterclaims by taking as model clauses specific provisions on the matter included in existing treaties. Among these are (not only Article 9.19.2 CPTPP but also) Article 17 of Slovakia-UAE BIT, Article 14, in combination with Article 17, of Iran-Slovakia BIT, and Article 28(4) of Argentina-UAE BIT. Such an exercise risks being sterile since it would put each relevant provision out of its specific treaty context. In order to be fully appreciated (even just in terms of best practice) all afore-mentioned provisions on counterclaims cannot be taken in isolation from their 'background' provisions: first in line, the clauses delimiting the 'primary' scope of jurisdiction of the international investment tribunal under any given backing treaty; and then the other relevant treaty clauses, such as, for instance, the clauses on governing law, and those including covered investment's definitions.

Moreover, these issues, starting from the scope, and limits of international investment jurisdiction are (not merely outside the scope of the discussion at UNCITRAL, but) core matters of treaty policy for each state to decide within the context of the negotiation and conclusion of any given investment treaty, balancing, among others, its offensive and defensive interests on a case-by-case basis, as existing treaty practises' divergences on the matter demonstrate.

In conclusion, all the above considered, the question arises as to whether the discussion on counterclaims within the WG has been, to a certain extent, "much ado about nothing". Moreover, it is also questionable whether 'counterclaims in ISDS' is really a cross-cutting issue, thus relevant to all reform proposals on the table.

References

?1 *The 'Erica Lexie' incident (Italy v. India)*, PCA Case No. 2015-28, Award of 21 May 2002, paras 254-255

?2 ICJ, *Application of the Convention on the Prevention and Punishment of the Crime of Genocide (Bosnia and Herzegovina v. Yugoslavia)*, Counter- Claims, Order of 17 December 1997, I.C.J. Reports 1997, p. 256, para. 30

?3 This brief overview is part of a broader study by the present authors on counterclaims in ISDS.

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