EXTRACTING THE ARTHURIAN SWORD: CHALLENGES TO COUNTERCLAIMS IN INVESTMENT TREATY ARBITRATION

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Authors' note: The views and opinions expressed in this article are those of the authors and do not necessarily reflect the views of the law firms or universities with which they are associated. The authors would like to thank LegisNations for the invitation to write this guest article. The authors may be reached at godwin.tan@cantab.net and awlc3@cantab.ac.uk.

Introduction

In Arthurian legend, there once existed a sword that was magically embedded in an anvil atop a stone. The inscription on the sword stated that only the rightful King would be able to retrieve the sword. Many nobles attempted to pull the sword out of the anvil but, despite their grand efforts, they all failed. Eventually, only King Arthur succeeded in this feat.

Raising a counterclaim in investment treaty arbitration is much like retrieving the Arthurian sword from its stone. A counterclaim functions like a sword (as opposed to a shield). Counterclaims are raised by a respondent in the same proceedings against a primary claim brought by a claimant and, crucially, they enable the respondent to seek affirmative relief from the claimant. As the International Court of Justice noted in the *Bosnian Genocide Convention* case: 'the thrust of a counter-claim is … to widen the original subject-matter of the dispute by pursuing objectives other than the mere dismissal of the claim of the Applicant in the main proceedings … for example that a finding be made against the Applicant'.[3] Furthermore, much like the noble efforts of many to extract the elusive sword, it has been difficult to successfully raise counterclaims in investment treaty arbitration, despite the efforts of many. The prospect of a successfully raised counterclaim will turn on the circumstances of each case, particularly the wording of the relevant investment instrument.

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[3] *Application of the Convention on the Prevention and Punishment of the Crime of Genocide (Bosnia and Herzegovina v Serbia and Montenegro)* (Order of 17 December 1997) [1997] ICJ Rep 243 [27].

This article considers the persisting difficulties with raising counterclaims in investment treaty arbitration (specifically under the International Centre for Settlement of Investment Disputes (**ICSID**)), as well as developments that may make it easier to raise such counterclaims in the future.[4]

Challenges to Raising Counterclaims

First, one of the key aims of the investment treaty regime is to promote foreign investment and protect such investment from arbitrary State intervention. Given that the regime aims to address asymmetries that might arise from unchecked sovereign authority, investment treaties seek to impose obligations on the host State to protect the investor's economic interests and access to justice.[5] Since most investment treaties only directly impose obligations on States (rather than on the foreign investor), it can be difficult to substantiate a counterclaim in investment treaty arbitration.[6]

Where there is a lack of investor obligations in treaties, investment treaty tribunals have on occasion held that substantive investor obligations may still exist, but these findings are not without difficulties. For instance, a tribunal may find that an investor is required to comply with its environmental obligations under the host State's domestic law. That being said, even where domestic law is deemed applicable, there remains the challenge of establishing which aspects of domestic law are applicable, the relationship between such law and international law, the content of such law and the manner in which such content must be proven.[7] Alternatively, a tribunal may, in principle, find that the investor is required to comply with obligations found under international law. Such obligations may be relevant because of article 42(1) of the ICSID

[4] For a more detailed analysis, see Godwin Tan and Andrea Chong, 'The Future of Environmental Counterclaims in ICSID arbitration: Challenges, Treaties and Interpretations' *Cambridge International Law Journal* (Forthcoming, 2020).
[5] See eg Andrea K Bjorklund, 'The Role of Counterclaims in Rebalancing Investment Law' (2013) 17(2) *Lewis & Clark Law Review* 461, 462-463 ('Procedurally, treaty arbitration is commenced when an investor submits a claim against a host state … the process must be commenced by the investor itself. Substantively, most international investment agreements (IIAs) impose obligations on states, but do not impose them on investors').
[6] See James Crawford 'Treaty and Contract in Investment Arbitration' (2008) 24(3) *Arbitration International* 351, 364 ('The core problem with counterclaims in BIT arbitration is that the treaty commitments of the host state towards the investor are unilateral, and anyway the investor is not a party to the BIT.').
[7] See Jarrod Hepburn, *Domestic Law in International Investment Arbitration* (OUP, Oxford 2017) 2.

Convention, a provision in the treaty requiring the application of international law, or article 31(3)(c) of the Vienna Convention on the Law of Treaties (the **VCLT**). The method used to incorporate or interpose the relevant investor obligation may come with its own set of difficulties. Taking article 31(3)(c) of the VCLT, for instance, commentators have contended that the use of article 31(3)(c) ought to be limited as the article is only meant to assist with the interpretation of existing treaty provisions.[8] In other words, 'the point of departure for the application of [this article] must always be a provision of the treaty to be interpreted' and, accordingly, article 31(3)(c) of the VCLT cannot be used to introduce investor obligations into an investment treaty where the relevant treaty does not already contain an 'anchor' provision indicating that the parties wanted to create substantive obligations for investors.[9]

Secondly, in many investment treaties, the scope of the parties' consent may not be sufficiently broad to permit a State from raising counterclaims under article 46 of the ICSID Convention. ICSID tribunals adjudicating counterclaims have diverged on their approach to determining whether the counterclaims fall 'within the scope of the consent of the parties', as required under article 46 of the ICSID Convention.[10] On the one hand, there are cases suggesting that whether or not counterclaims fall 'within the scope of the consent of the parties' will depend on the dispute resolution provision in the relevant investment treaty. If the provision is narrow, counterclaims will not be permitted. One such example can be found in *Roussalis v Romania*, where the dispute resolution provision in the 1997 Romania-Greece BIT states:

> 'Disputes between an investor of a Contracting Party and the other Contracting Party concerning an obligation of the latter under the Agreement in relation to an investment of the former, shall, if possible, be settled … If such dispute cannot be settled … the investor concerned may submit the dispute … to international arbitration'.[11]

The tribunal in *Roussalis v Romania* found that this clause limited jurisdiction to claims brought only by investors covering the obligations of the host State, and not vice versa.

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[8] See Patrick Abel, 'Counterclaims Based on International Human Rights Obligations of Investors in International Investment Arbitration: Fallacies and Potentials of the 2016 ICSID *Urbaser v Argentina* Award' (2018) 1(1) *Brill Open Law* 61, 75; Elliot Luke, 'Environment and Human Rights in an Investment Law Frame' in Kate Miles (ed), *Research Handbook on Environment and Investment Law* (Edward Elgar, Cheltenham 2019) 150, 168.
[9] See Abel (n 6) 75. For other difficulties with using article 31(3)(c) of the VCLT, see Tan and Chong, (n 2).
[10] See Jan Paulsson, 'Arbitration Without Privity' (1995) 10(2) *ICSID Review – Foreign Investment Law Journal* 232, 256; Jeswald Salacuse, *The Law of Investment Treaties* (OUP, Oxford 2010) 382.
[11] *Spyridon Roussalis v Romania* (Award) ICSID Case No ARB/06/1 (7 December 2011) [868].

Conversely, if the provision is broad, counterclaims will be permitted. In *Urbaser v Argentina*, the tribunal found that the dispute resolution clause was drafted broadly enough to cover claims brought by both the investor and the host State. The dispute resolution clause states the following:

> '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 … Where there is no settlement and in certain circumstances, the dispute may be submitted to an international arbitral tribunal 'at the request of either party to the dispute'.[12]

The divergence in the language and phrasing of various dispute resolution provisions in the different investment treaties mean that a tribunal may, in certain circumstances, find that it has no jurisdiction to hear a counterclaim raised by the host State.

Thirdly, there is the difficulty of satisfying the requirement of article 46 of the ICSID Convention that the counterclaims arise 'directly out of the subject-matter of the dispute'.[13] Typically, in contractual disputes involving counterclaims, the claimant and the respondent are bringing their claims and counterclaims under the same contract and, accordingly, it would be clear that the dispute arises out of the same subject-matter. However, in investment treaty disputes, the host State may need to rely on other instruments, agreements or laws (not the treaty under which the investor's claim were brought) to show that the investor owed obligations to the State and that the investor breached them. In such cases, it may be difficult for the State to show that the counterclaims it is attempting to bring arise 'directly out of the subject-matter of the dispute'.[14]

Notable Developments and New Challenges

Despite these challenges, there are notable developments that suggest it will be easier to raise counterclaims in investment treaty arbitration in the future. These developments include

[12] *Urbaser SA v The Argentine Republic* (Award) ICSID Case No ARB/07/26 (8 December 2016) [1143].
[13] See Tan and Chong (n 2).
[14] See Tan and Chong (n 2).

environmental language in treaty provisions and hints of tribunal receptiveness to consider a State's interest in protecting the environment.

First, the inclusion of treaty provisions that seek to directly impose environmental, human rights or corporate social responsibility obligations on the investor is a key development. A notable example of such a treaty is the 2016 Morocco-Nigeria BIT. The treaty includes the following provision that seeks to directly impose obligations on investors to contribute to sustainable development:

> 'In addition to the obligation to comply with all applicable laws and regulations of the Host State and the obligations in this Agreement, and in accordance with the size, capacities and nature of [the] investments, and taking into account the development plans and priorities of the Host State and the Sustainable Development Goals of the United Nations, *investors and their investments should strive to make the maximum feasible contributions to the sustainable development of the Host State and local community through high levels of socially responsible practices*' (emphasis added).[15]

The Morocco-Nigeria BIT also states that '[i]nvestors and investments shall uphold human rights in the host [S]tate'.[16] This BIT is not alone. The Iran-Slovakia BIT, for instance, states that '[i]nvestors and investments should apply national, and internationally accepted, standards of corporate governance for the sector involved, in particular for transparency and accounting practices'.[17] On the other hand, the 2016 Argentina-Qatar BIT, which states that 'investors … should make efforts to voluntarily incorporate internationally recognized standards of corporate social responsibility into their business policies and practices' (reflecting more qualified language).[18]

[15] Reciprocal Investment Promotion and Protection Agreement between the Government of the Kingdom of Morocco and the Government of the Federal Republic of Nigeria (Morocco-Nigeria BIT) (signed 3 December 2016) art 24(1). Article 14 also requires compliance with environmental assessment screening and assessment processes (applying the precautionary principle) as well as conducting of a social impact assessment.
[16] Morocco-Nigeria BIT (n 13) art 18(2).
[17] Agreement between the Slovak Republic and the Islamic Republic of Iran for the Promotion and Reciprocal Protection of Investments (Iran-Slovakia BIT) (signed 19 January 2016, entered into force 30 August 2017) art 10(3).
[18] The Reciprocal Promotion and Protection of Investments between the Argentine Republic and the State of Qatar (signed 6 November 2016) art 12.

That being said, these provisions have not yet been tested, so it remains to be seen how they will be interpreted and what standards or obligations can be derived from them. It also remains to be seen how such provisions will interact with other traditional treaty provisions such as the Most-Favoured-Nation provision. [19] It is arguable that such investor obligations may be sidestepped through an MFN provision. For example, an investor may argue that the environmental provision in the basic treaty means that it is granted 'less favourable' conditions to investors of a third State. An investor may also argue that the broad dispute resolution provision places it in a 'less favourable' position as it has to defend against potential environmental counterclaims and instead seek a narrower provision which excludes counterclaims from the proceedings. Unsurprisingly, such arguments come with their own controversies and difficulties.[20]

Secondly, there is evidence that tribunals are now more willing to consider the various States' interests in preserving and protecting the environment when adjudicating investor claims, especially in cases where the treaty language expressly refers to environmental concerns.[21] Some tribunals have also taken steps to include *obiter dicta* justifying their decision from an environmental perspective.[22]

We see this in *Perenco v Ecuador*, where the tribunal addressing the environmental counterclaim raised by Ecuador recognised the importance of State regulatory measures that address environmental risks:

> 'Proper environmental stewardship has assumed great importance in today's world … [A] State has wide latitude under international law to prescribe and adjust its environmental laws, standards and policies in response to changing views and a deeper

[19] For an example of an MFN clause in a new generation treaty see Morocco-Nigeria BIT (n 13) art 6(4).
[20] On the use of an MFN provision to remove environmental provisions, see United Nations Conference on Trade and Development (UNCTAD) Series on Issues in International Investment Agreements II, 'Most-Favoured Nation Treatment' (New York and Geneva, 2010) 62–63, noting that the decision in *CMS Gas Transmission Company v The Republic of Argentina* (Award) ICSID Case No ARB/01/8 (25 April 2005) suggests that 'the absence of a provision in a third treaty cannot be the basis for excluding a provision contained in the basic treaty by invoking an MFN provision.' On the use of an MFN provision to alter the scope of the dispute resolution provision, see Zachary Douglas, 'The MFN Clause in Investment Arbitration: Treaty Interpretation Off the Rails' (2011) 2(1) *Journal of International Dispute Settlement* 97, 98.
[21] See Jorge E Viñuales, 'Foreign investment and the Environment in International Law: Current Trends' in Kate Miles (ed), *Research Handbook on Environment and Investment Law* (Edward Elgar, Cheltenham 2019) 29-37. Also see Tan and Chong (n 2).
[22] Ibid.

> understanding of the risks posed by various activities, including those of extractive industries such as oilfields. All of this is beyond any serious dispute and the Tribunal enters into this phase of the proceeding mindful of the fundamental imperatives of the protection of the environment in Ecuador'.[23]

Another example is *Al Tamimi v Sultanate of Oman*,[24] where the tribunal dismissed the treaty claims of a mining investor. In dismissing the investor's claims, the tribunal drew guidance from a separate chapter in the relevant Free Trade Agreement, titled 'Environment', which states that '[n]either Party shall fail to effectively enforce its environmental laws … in a manner affecting trade between the Parties'.[25] It observed the following:

> 'The very existence of [the chapter on 'Environment'] exemplifies the importance attached by the US and Oman to the enforcement of their respective environmental laws. It is clear that the State Parties intended to reserve a significant margin of discretion to themselves in the application and enforcement of their respective environmental laws … . [T]he Tribunal must be guided by the forceful defence of environmental regulation and protection provided in the express language of the Treaty.'.[26]

In light of investment arbitration tribunals' increasing receptiveness towards environmental considerations and the greater prominence of environmental concerns in the language of new-generation treaties, it is likely that future tribunals will similarly be more receptive towards States that seek to raise environmental counterclaims against investors.

Conclusion

From recent developments, it is clear that parties and tribunals are alive to the possibility of relying on counterclaims to address a broader range of issues in a single arbitration. While there are limitations to raising counterclaims in investment treaty arbitration, it is indeed

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[23] *Perenco Ecuador Limited v Republic of Ecuador and Empresa Estatal Petroleos del Ecuador (Petroecuador)* (Interim Decision on the Environmental Counterclaim) ICSID Case No ARB/08/6 (11 August 2015) (*Perenco v Ecuador*) [34] and [35].
[24] *Adel A Hamadi Al Tamimi v Sultanate of Oman* (Award) ICSID Case No ARB/11/33 (3 November 2015) (*Tamimi v Oman*). See Viñuales, 'Foreign investment and the Environment in International Law: Current Trends' (n 19) 34.
[25] *Tamimi v Oman* (n 22) [388].
[26] *Tamimi v Oman* (n 22) [389].

possible to retrieve this sword from its stone. Of course, any optimism must be tempered by the reminder that only rightful claims (on both jurisdiction and merits) will succeed.