Is there room for State counterclaims in treaty-based arbitration?

I. Introduction

It is no secret that arbitration, and particularly investor state arbitration, is currently undergoing heavy criticism. The publicity of the outcomes of the cases, makes investor-state arbitration a hot topic in the public eye, and therefore under constant scrutiny.

In my opinion, investment arbitration is far from being in the edge of the abyss, as some opinions seem to predict, and remains to be the most suitable alternative for solving investor-state disputes. However, it is paramount that the field constantly adapts to the needs of its users. In this sense, the survival of investor-state arbitration depends on how its operators (counsel, parties, states, arbitrators) find mechanisms to tackle the defects it has been criticized for.

Part of that criticism is based on the affirmation that treaty based investor-state arbitration is seen as asymmetrical. Namely, that respondent states are restricted to bring claims or counterclaims against investors, pursuant to the allegedly one-sided language of BITs.

The purpose of this essay is to analyze if and how counterclaims legally fit within treaty-based arbitration. For such purposes, it is hereunder described how institutional rules regulate counterclaims (**II**); which are the obstacles which have barred states´ counterclaims in case law (**III**); and finally, whether a flexible approach towards counterclaims should be taken, considering the policy reasons thereof (**IV**).

II. Counterclaims in institutional rules

This section will focus on how the issue is regulated under in ICSID and UNCITRAL rules.

Sections 46 and 40 of the ICSID Convention and Rules respectively provide three requirements for counterclaims to proceed. Firstly, that the counterclaims shall arise "*directly out of the subject matter of the dispute"*. Second, that the counterclaims fall within the scope of the consent of the parties; and third, that they are "*otherwise within the jurisdiction of the Centre*". The last requirement has been understood to refer to the dispute being one arising "*directly out of an investment"* as required by section 25 of the ICSID Convention.

The UNCITRAL Rules, on the other hand, appear to pose a less stringent test. The 2010 Rules– applicable to arbitration agreements concluded after August 15 2010 – provide in section 21 (3) that "*respondent may make a counterclaim or rely on a claim for the purpose of a set-off provided that the arbitral tribunal has jurisdiction over it"*. Hence, in comparison to ICSID, UNCITRAL 2010 Rules do not appear to require a "direct" degree of connection with the subject matter, therefore resulting in a less strict standard.

UNCITRAL Rules 1976 are also worth mentioning, since they will continue ruling investment arbitrations in the years to come. Section 19(3) of said Rules provides that the counterclaim shall arise "*out the same contract"*. Despite not being a suitable reference for treaty based arbitration, commentators like Lalive/Halonen have stated that as long as section 1 of the Rules also refers to disputes in relation to a contract but has been interpreted as broad enough to cover disputes under a BIT, the same reasoning applies for counterclaims.

As stated, both sets of rules require that in order for a counterclaim to proceed, jurisdiction (and therefore consent) shall first exist. Henceforth, the starting point for the assessment of counterclaims is the BIT.

III. **Legal obstacles to counterclaims in case law**

Notwithstanding how pro-counterclaim the approach towards the issue can be, the procedural success of a counterclaim shall ultimately depend on the provisions of the applicable BIT, as the starting-point of treaty based arbitration.

In such regard, states have encountered jurisdictional obstacles in case law, and tribunals have rejected jurisdiction to entertain counterclaims in several cases. In the recent years, however, the approach seems to be a more permissive one. Again, this is only possible if the BIT provisions so permit it. Case law analysis of this essay will be limited to certain landmark decisions.

The first obstacle for a counterclaim may be that the wording of the standing offer to arbitrate included in the BIT limits the claims that may be referred to arbitration, consent being therefore absent.

For instance, in *Spyridon Rousallis v. Romania*, the Greece-Romania BIT provided that "*Disputes between an investor of a Contracting Party and the other Contracting Party concerning an obligation of the latter under this Agreement* " may be submitted to arbitration by the investor. In such case, the Tribunal found by majority that their jurisdiction was limited to claims brought by the investor.

On the other hand, the tribunal in *Urbaser S.A. v. Argentina*, in the final award rendered in December 2016, asserted jurisdiction over Argentina´s counterclaims. The

Spain-Argentina BIT refers to "*Disputes arising between a Party and an investor of the other Party in connection with investments"*. Moreover, the BIT further provides in section X(3) that the dispute may be submitted by arbitration by "*either party*". The tribunal understood that the BIT did not lay out *ratione personae* restrictions to arbitral jurisdiction, allowing Argentina´s counterclaims.

A second restriction to counterclaims – closely intertwined with the first one - may arise from the fact that BITs do not generally impose obligations on the investor. In addition, whilst investors have a general obligation to comply with domestic laws, such obligation is not always a treaty obligation under BITs. This, combined with clauses that provide for arbitration of disputes "*under the treaty"* or similar, may bar counterclaims.

The tribunal in *Al Warraq v. Indonesia* admitted jurisdiction over counterclaims based on violation of domestic laws. Section 9 of the applicable treaty, imposes an obligation of investors to comply with domestic laws. The tribunal understood that "*An investor of course has a general obligation to obey the law of the host state, but Article 9 raises this obligation from the plane of domestic law (and jurisdiction of domestic tribunals) to a treaty obligation binding on the investor in an investor state arbitration"*.

On the other hand, in *Rousallis v. Romania*, the tribunal held that since the BIT did not provide obligations on investors and, where the BIT provided that the applicable law was the BIT itself and international law, counterclaims would not be within the scope of the tribunal´s jurisdiction.

Finally, the third obstacle that states have faced, is the requirement for connection between the claim and the subject matter, as required in ICSID Convention and Rules mentioned above.

Two cases provide contrasting views on the requirement for connectedness.

In *Saluka v. Czech Republic*, decided under the 1976 UNCITRAL Rules, the tribunal understood that the connection between the claim and the counterclaim shall be one of a legal nature. The applicable BIT, provided for arbitration over "*All claims (…) concerning an investment*". Surprisingly, although the BIT provided within its applicable laws the "*law in force of the Contracting State concerned*" the tribunal understood that "*The legal basis in which the Respondent has itself relied (…) is to be found in the application of Czech law (…) fall to be decided through the applicable procedures of Czech law"*.

On the other hand, the decision in *Burlington v. Ecuador*, from February 2017, adopted a more flexible approach, asserting the need of a factual connection. The tribunal stated that "*the counterclaims arise directly out of the subject-matter of the dispute, namely Burlington's investment"*. In this case, ICSID Convention consent requirement was cleared by an express post-dispute agreement of the parties to arbitrate counterclaims.

IV. Should there be any room for counterclaims?

In the opinion of the author, tribunals should make room for counterclaims provided that the policy reasons thereof are complied with (**a**). Second, it will be analyzed in which circumstances there is room for discretion to uphold such reasons (**b**).

(a) Policy reasons

As indicated by way of introduction, survival of investor state arbitration as we know it, depends on how operators continue to tailor the system to attend the criticism it has been subject to. Said endeavor, however, shall not be performed without losing sight of the rationale behind BITs: stimulate investment by providing suitable dispute resolution mechanisms.

The policy reasons that support the view that counterclaims should proceed, were lucidly summarized in Prof. Michael Reisman´s dissenting declaration in *Rousallis*, as follows: "*In rejecting ICSID jurisdiction over counterclaims, (…) directs the respondent State to pursue its claims in its own courts where the very investor who had sought a forum outside the state apparatus is now constrained to become the defendant. (…) Aside from duplication and inefficiency, the sorts of transaction costs which counter-claim and set-off procedures work to avoid, it is an ironic, if not absurd, outcome, at odds, in my view, with the objectives of international investment law.*"

This author shares the view expressed by such renowned arbitrator.

First, acceptance of counterclaims avoids duplication of proceedings, and is a proper tool of avoiding the always problematic issue of contradictory decisions.

Operators of law in general, not only within the field that concerns this essay, have a duty to avoid "litigation inflation" and the associated costs, as the purpose of procedural law is to serve the material interests of its addressees: individuals and parties.

Second, the most important accomplishment of modern investment law has been primarily of a procedural and not a substantive nature: providing access to international

arbitration in avoidance of host state courts. Rejection of counterclaims would directly hinder this achievement, dragging investors back to the forum they intended to avoid.

Henceforth, acceptance of counterclaims is not necessarily a state-friendly approach, but rather serves at the same time to the interests of the investors and to address part of the criticism towards investment arbitration.

(b) Conclusion: applicability of a flexible approach

In my view, the policy reasons expressed above shall not trump clear legal provisions in BITs which do not allow counterclaims. However, there are certain aspects of the obstacles mentioned in section III which leave room for discretion to apply a pro-counterclaim approach.

Regarding consent, there is no room for discretion when the BIT provides for disputes "*concerning an obligation of the host State"* under the BIT or similar. In such cases, the jurisdiction *ratione materiae* is strictly limited to claims for breach of obligations of host states.

On the other hand, references in BITs as to the fact that it is the investor who "*may submit the dispute*", shall not necessarily imply that counterclaims should not ensue. Provided that the reference to disputes is drafted broadly (e.g. "*disputes in relation to an investment"*) it may be argued that such kind of provision would not allow the State to act as claimant, but once the investor files a claim, counterclaims may proceed.

The problem of consent raises the issue whether, when facing broad offers to arbitrate in BITs, the investor may only accept to arbitrate its claims but expressly reject to arbitrate counter-claims. In my view, investors should not be allowed to cherry-pick provisions of the

BIT at their convenience, and acceptances to arbitrate should be unconditioned and inclusive of all BIT terms. This view was supported by the *Urbaser* tribunal.

Obstacles regarding the applicable law and absence of obligations of investors under the BIT, leave less room for discretion. Where the arbitration provision provides for "*disputes under the Treaty"* or similar, if the law upon which the State bases its counterclaim is not applicable to the treaty, no counterclaims should proceed.

However, even when domestic law is not included as applicable to the treaty, if the reference to disputes is worded as "*any disputes related to an investment*" and not specifically "*under the treaty*", a flexible approach can be taken. This is because although domestic law may not be applicable to the treaty itself, the disputes would be broader than those covered by the BIT provisions.

Finally, the requirement of connection with the subject matter should be flexibly interpreted, as requiring a factual connection with the claim, and not a legal one. Stating that the counterclaim shall arise from the same legal source as the claim (*Saluka*) would make almost impossible for counterclaims to proceed, since counterclaims are generally based on a different source of law (domestic).