

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

I. Introduction

Recently, counterclaims in treaty-based arbitration have become a burgeoning issue and nowadays are widely discussed by arbitration practitioners. However, even acknowledging that there is room for state counterclaims in investment arbitration, what is not that obvious regarding conflicting attitudes towards that matter among scholars, does not solve a problem but rather triggers further questions. BITs as treaties aiming at protecting foreign investors and their investment in a host state almost always confer certain rights only upon investors, not states. Often a typical BIT contains an arbitration clause and also a state's irrevocable consent to arbitrate disputes between that state and a threatened investor. Such a situation poses a question on whether only an investor can be a claimant in arbitration proceedings, or whether there is a room for counterclaims launched during such proceedings by a state. More often states claim that an investor's activity while carrying out an investment has caused a serious threat to their interests. In many cases it is just an excuse, but in some of them states' claims seem to be reasonable and justified. This essay will try to depict legal framework for counterclaims in treaty-based arbitration and answer a question on whether there is a room for state counterclaim in treaty-based arbitration.

II. Legal Framework

As in any other arbitration proceedings, in treaty-based arbitration a consent of parties to arbitrate is fundamental. In investment arbitration such consent is often expressed by a state in a BIT, and by an investor through commencing an arbitration proceedings against the state. The same situation occurs in case of counterclaims, which also should be encompassed by a parties' acceptance. As presented hereinafter, some commentators point out that such consent does not have to be necessarily expressed in a BIT or an investment contract. The analysis should be started by invoking a deliberation over state's counterclaims in famous case handled by ICSID tribunal in *Roussalis v. Romania*, where arbitrators denied their jurisdiction over counterclaims having relied on a wording of arbitration clause in *Greek-Romanian BIT*, which encompassed only disputes concerning an obligation of the state. Contrarily, it does not cover obligations of investors, which breach could be a basis for a state's action (Article 9(1) of BIT). Nevertheless, the aforementioned holding drew attention of the public, because of a dissenting opinion given by *Prof. Reismann*. *Prof. Reismann* said that by submitting their disputes under ICSID rules parties also agreed that Article 46 of ICSID, which provides a possibility of filing counterclaim, should be applied. Such point of view seems to be controversial regarding a strictly procedural nature of ICSID and a fact that it does not constitute any substantive rights in general.

In this case two conflicting attitudes clash. First one, emphasizing that an arbitration jurisdiction stems plainly from BIT provisions, and once an investor expressed their consent to arbitrate under BIT provisions, the jurisdiction is set up. Such consent limits a scope of jurisdiction of arbitration panel. Therefore, counterclaims to which investor does not give a consent falls outside the scope. It must be also said that

when analyzing a tribunal's jurisdiction under ICSID, both ICSID and BIT provisions must be taken into consideration, otherwise the tribunal shall have no competence over the case. Regarding a wording of BITs, some of them shape a dispute settlement model in a way which does not certainly exclude a possibility of launching counterclaims i.e. in *Czech Republic -The Netherlands BIT* its Article 8 (2) sets forth that each contracting state gives a consent to arbitrate, but not specify who is really entitled to go to arbitration, only investor, or investor and state. On the other hand, Article 26 (2) of the Energy Charter Treaty 1994 confers such right only upon an investor. A broad wording of a BIT arbitration clause can be a loophole for arbitrating counterclaims. In case *Saluka v. Czech Republic* the arbitral tribunal denied its jurisdiction because did not find a close relationship between claim and counterclaim, but , a wording of BIT which did not specify who had a right to go to arbitration could potentially establish jurisdiction.

Second attitude represents a standpoint addressed by *Prof. Reismann* that by applying rules of an arbitration institution parties also agree for submitting counterclaims. At this point it is necessary to resort to some rules of the arbitration institutions.

Article 46 of ICSID sets forth a possibility of filing counterclaims, however, some conditions must be met. The counterclaim must arise directly out of a subject matter of a dispute and be within the scope of a consent of both parties, as well as falls within the jurisdiction of the institution. Also UNICTRAL Arbitration Rules 2010 (Article 21 (3)) provide an opportunity for a defendant to launch a counterclaim in a statement of defense. Moreover, ICC Arbitration Rules establishes a procedural

way of submitting counterclaims (Article 5(5)). It seems that among most prestigious arbitration institutions there is an acceptance for submitting counterclaims. Under prevailing scholars' opinion, shaped by the aforesaid provision, a counterclaim needs to meet the following requirements: (1) parties' consent, (2) close relationship between claims of claimant and defendant, (3) parties' identity. When regarding a parties' consent arbitral tribunal will likely resort to BIT treaty which is a basis for a claim. Therefore, a lot would depend on a wording of such treaty. If it only covers claims going in one direction – towards a state, therefore a dispute will likely falls outside a tribunal's jurisdiction. Nevertheless, there is no obstacle for parties to draw up an additional agreement in which they would express their will to have also counterclaims handled by the tribunal.

Resultantly, if an arbitration clause in a BIT is broad enough to cover also state's claims, the requirement of consent, once investor has accepted a state's offer, is met. Concerning counterclaims also a parties' identity seems important. A counterclaim can be brought only against an entity, which is a claimant in arbitration. Sometimes the issue can be really complicated regarding a fact that some foreign investors operate in host states through a chain of subsidiaries with a purpose of mitigating their potential risk of liability. Therefore, one entity can be a claimant and another entity from state's perspective a real wrongdoer or a decision-maker, against whom state wanted to launch the claim.

The next issue concerns a problem of a relationship between claims. Article 19 (3) of UNCITRAL Arbitration Rules 1976 uses the wording as follows: "*claim arising out of the same contract*", "*for the purpose of set-off*". What is interesting, revised

UNCITRAL Arbitration Rules 2010 mention only “*a purpose of set-off*” and omit a requirement of claims arising out from the same contract. Although new regulation does not contain requirement of close relationship understood as claims resulting from the same contract, it is obvious that such relationship, especially in investment arbitration, should exist. Article 25(1) of ICSID uses a term “*arising directly out of an investment*”. Sometimes to describe such relationship scholars use epithets such as “*interdependent*” or “*indivisible*”. Some also say that both claims should not only have the same factual basis, but also legal basis, what practically would exclude a possibility of filing counterclaims by states. It is obvious that potential state’s claims are of different nature than investor’s ones. Mostly, states derive their claims i.e. from environmental protection regulations, while investors from BIT solely.

Such interpretation of provisions does not seem to be very friendly to a concept of counterclaims in treaty-based arbitration. On the other side, in last ICSID case *Perenco Ecuador Ltd. v. Republic of Ecuador* arbitral tribunal accepted its jurisdiction over counterclaims launched by Ecuador on a basis of violations of Ecuadorian environmental regulations. Tribunal held that *Perenco* was not liable in this case. Nevertheless, what is important, the tribunal decided over counterclaims, although claims were of a different legal nature.

Consequently, there is a legal space for counterclaims in treaty-based arbitration, however, some strict requirements must be met. Firstly, both parties’ consent to such counterclaim must appear. As international practice shows, that it can be expressed in a separate agreement between parties, in an investment contract or in a BIT treaty. Thus, in case of BIT a lot would depend on a wording of BIT. If it covers also

investor's obligations and arbitration clause does not specify which party is entitled to commence arbitration, it can be possible. Furthermore, both claims must be interrelated and stems from the investment. Also parties must be towards each other both claimants and respondents. Apart from the aforesaid procedural issues regarding mainly a tribunal's jurisdiction over counterclaims it is necessary to identified a problem of substantive law issues. At this point, there is a serious question on what kind of situations can be a basis for a state's counterclaim.

III. Nature of counterclaims

Typically, a problem of counterclaims in treaty-based arbitration is associated with a bribery, an environmental pollution, a tax evasion or an abuse of local community. Some of them of course are of a such nature, nonetheless, state's counterclaims can turn up in a far different situation i.e. in a complex investment in financial market or in a context of banking law. It is necessary to establish a close relationship between claims. There is not rule on which counterclaims can be brought to arbitration. It depends on BIT treaty and parties.

IV. Question of fairness

By prevailing opinion of experts one of the biggest obstacles in accepting counterclaims in treaty-based arbitration is a fact, that in many cases state's claims cannot be derived from BIT provisions. BITs rarely impose any obligations on investors, what means that even their unlawful or objectively malicious action that has caused harm to a state and its citizens could not be an issue in treaty-based arbitration. In author's opinion actions such as a fraud, a bribery, an exploitation of

natural resources, an environmental pollution are generally condemned by international society, and can be treated as a part of transnational public policy – peculiar *soft law*. Prof. Ruggie in his paper “*Protect, Respect, Remedy*” addresses a problem of so-called “*Business and Human Rights*”. A central thesis of his paper concentrates on a problem of violations of human rights by multinational corporations in developing countries. It says that also foreign companies are obliged to respect human rights in a country where they operate. Thus, it is worth considering whether obligations related to Business and Human Rights as a part of transnational law do not constitute obligations on investor’s side, parallel to treaty’s provisions, even if BIT does not expressly provide them. Eventually, breach of them could also entitle a state to file counterclaims in treaty-based arbitration. Nevertheless, such point of view has been unexplored yet and demands further analysis.

V. Conclusion

Answering the question put at the beginning of the essay, there is a room for counterclaims in treaty-based arbitration, nevertheless, an additional comment must be made. Firstly, a tribunal’s jurisdiction over a counterclaim would depend on a wording of BIT. If BIT is broad enough to cover also state’s claims towards investor, there is a leeway for that. Arbitration is consensual, therefore, parties’ consent should be construed through BIT provisions. Some scholars propose to establish a jurisdiction on a basis of procedural rules i.e. ICSID or UNCITRAL Arbitration Rules 2010, however, such a standpoint seems to be still an unexplored tenet. Furthermore, counterclaim itself must meet the following conditions. There must be (1) parties’ consent. (2) close relationship between claims stemming from the

investment, (3) parties must be both claimants and defendants. Apart from jurisdiction, there is a question of a content of counterclaim. Mostly it will cover issues such as consequences of environmental pollution, tax evasion etc. Such claims do not have to necessarily stem from BIT itself, because almost always BIT does not impose any obligations on investors. Nevertheless, it does not have to mean that such obligations do not exist. Each entity should be precluded from committing fraud or environmental damage.