Queen Mary University of London
Centre for Commercial Law Studies

TradeLab

International Economic Law Clinic

COUNTERCLAIMS IN INTERNATIONAL INVESTMENT LAW

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Submitted by

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To: **Investment, Services and Digital Economy Division, Undersecretariat for International Economic Relations, Government of Chile**

Executive Summary

This report engages with the broader conversation on counterclaims in international investment law and the growing trend of including counterclaim provisions within modern investment agreements. It outlines the major issues arising in connection with counterclaims provisions and suggests a model counterclaim provision drawing inspiration from existing treaty practice and the process of reform being carried out at the UNCITRAL Working Group III on Investor-State Dispute Settlement Reform (UNCITRAL WG III).

The **key features of this report** are as follows:

- Analyzing the procedural requirements for submission of a state counterclaim under the ICSID Convention, the ICSID Arbitration Rules and the UNCITRAL Arbitration Rules in light of the relevant jurisprudence of arbitral tribunals – particularly parties' consent to counterclaims **(jurisdiction)** and the existence of a connection between a state counterclaim and the investor's primary claim **(admissibility) (Section 2)**;
- Identifying the impact of **applicable law provisions** on state counterclaims in light of the relevant jurisprudence of arbitral tribunals **(Section 3.1)**;
- Identifying whether **investor obligations** – when not codified in the investment agreement itself – can be sourced from other provisions in the investment agreement or from contracts related to the investment, the domestic law of the host state, or international law **(Section 3.2)**;
- Critically assessing the draft counterclaim provision prepared by UNCITRAL WG III (*i.e.* **UNCITRAL Draft Provision D**) and identifying its pros and cons **(Section 4)**;
- Engaging in a comparative analysis of counterclaim provisions in a selected sample of modern investment agreements and model BITs (see **Figure 1** below) to assess critically alternative wording and the consequences attached to the wording chosen **(Section 5)**;
- Presenting a **model counterclaim provision** based on UNCITRAL Draft Provision D with flexible options for drafting that take into account the practical and theoretical hurdles discussed in the report **(Section 5)**.

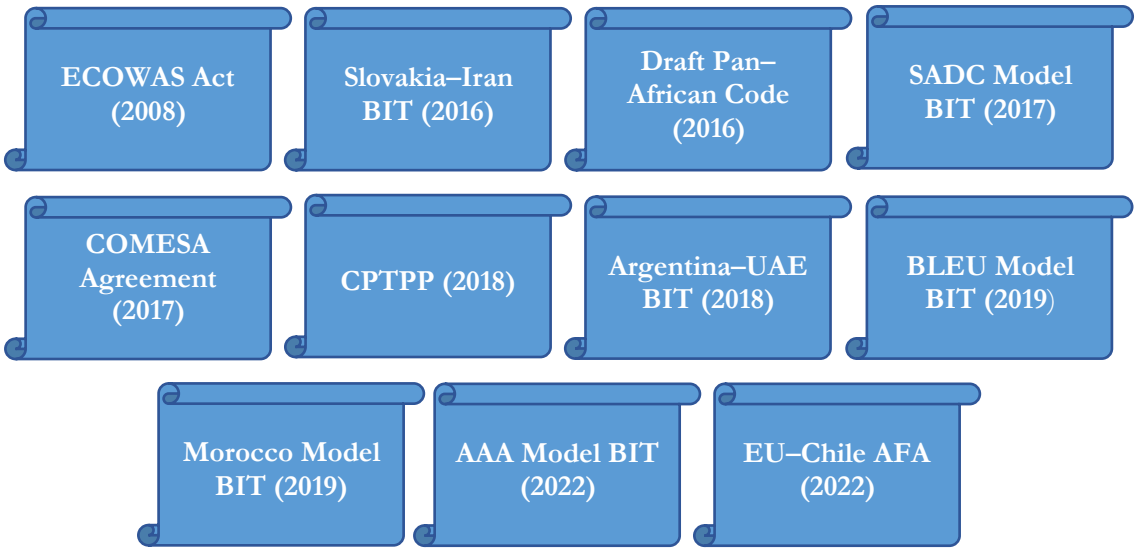

Figure 1: Investment agreements examined in this report

The report answers **two fundamental questions**:

1. How can jurisdiction, admissibility, and applicable law issues arising in connection with counterclaims in ISDS be effectively addressed?
2. What would a model counterclaim provision building on existing treaty practice look like?

Assessing Procedural and Substantive Hurdles for ISDS Counterclaims

This report analyzes how arbitral tribunals have interpreted investment agreements when presented with a state counterclaim and examines whether inconsistencies in their interpretation are owed to differences in treaty language. The key findings, in brief, are as follows:

In relation to **jurisdiction** (*i.e.* **the consent requirement**):

- ICSID and UNCITRAL provide similar requirements regarding consent;
- Consent concerning counterclaims can be implied or express;
- A broad dispute resolution provision, that leaves room for implied consent, makes it more likely that a counterclaim will be heard by an arbitral tribunal;
- Modern investment agreements no longer rely on implied consent and provide for express consent of the parties.

In relation to **admissibility** (*i.e.* **connection requirement**):

- While the ICSID Convention specifically prescribes a connection between a state counterclaim and the investor's primary claim, the current UNCITRAL Arbitration Rules no longer refer to a connection requirement. However, recent caselaw indicates that – even

under the revised UNCITRAL Arbitration Rules – tribunals investigate whether a connection between a state counterclaim and the investor's primary claim exists;

- The connection between a state counterclaim and the investor's primary claim can be either legal or factual. Tribunals' interpretations of the connection requirement and recent treaty practice addressing this issue are inconsistent. The report finds that it is easier to establish a factual than a legal connection between a counterclaim and the primary claim;
- The caselaw reveals that tribunals enjoy a wide margin of discretion when establishing admissibility. This report finds that tribunals might be willing to move away from a strict legal connection requirement and consider a factual connection as solely sufficient.

In relation to **applicable law**:

- Both Article 42(1) of the ICSID Convention and Article 35(1) of the UNCITRAL Arbitration Rules favor parties' autonomy and require tribunals to apply the law designated by the parties to the merits of dispute. Parties can choose from a variety of sources, including international law, the domestic law of the host state (or of a third state), or the law of the underlying contract. There is a presumption that this law would also apply to any counterclaims raised by the state against the investor;
- In the absence of an agreement of the parties on the applicable law, Article 42(1) of the ICSID Convention requires tribunals to apply the law of the host state (including its conflict of law rules) and any applicable rules of international law. Article 35(1) of the UNCITRAL Arbitration Rules adopts a more tribunal-centric approach and delegates to the tribunal the determination of the "appropriate" rules to adjudicate the dispute (including any counterclaims).
- While not all investment agreements contain an applicable law provision, states concerned with legal certainty are encouraged to include an applicable law provision in the agreement and to draft it carefully as to include/exclude any sources of law which they want/do not want tribunals to use to adjudicate the dispute, including any counterclaims.

In relation to **investor obligations**:

- The cause-of-action for a counterclaim can either (a) be found in direct investor obligations stipulated in the investment agreement or (b) be sourced indirectly from the law applicable to the merits of the dispute. Old-generation investment agreements tend not to contain any direct investor obligations, but revised and modern investment agreements are

progressively incorporating such obligations, thus strengthening the position of host states willing to submit a counterclaim;

- When direct investor obligations are not expressly codified in the investment agreement, they may be able to be sourced via other provisions in the investment agreement, such as (i) umbrella clauses, or, alternatively, (ii) environmental (and other) exceptions. In practice, however, counterclaims based on investor obligations imported via an umbrella clause or an environmental exception have so far been unsuccessful;
- Similarly, in the absence of direct investor obligations in the investment agreement, these obligations may be able to be sourced indirectly from the underlying contract between the host state and the investor. In practice, however, contract-based counterclaims are also unlikely to succeed if the contract at issue contains (as is often the case) its own forum selection clause. In fact, in these circumstances, arbitral tribunals tend to give effect to such a clause and decline jurisdiction to hear the counterclaim;
- Counterclaims may also be able to be based on obligations of the investor sourced from domestic law. This is, in principle, possible insofar as the investment agreement contains (a) a broad dispute resolution provision and (b) an applicable law provision expressly referring to domestic law. So far, however, counterclaims based on domestic law breaches have been successful only in two exceptional instances, *i.e. Burlington v. Ecuador* and *Perenco v Ecuador*.
- Host states intending to designate domestic law as a source for investor obligations should also consider the consequences of their domestic law being interpreted by international tribunals. Hence, host states concerned about these consequences should explicitly exclude domestic law from the applicable law provision in the investment agreement.
- Finally, counterclaims may also be based on obligations of the investor sourced from international law. As for counterclaims based on domestic law, this is possible, in principle, insofar as the investment agreement contains (a) a broad dispute resolution provision and (b) an applicable law provision expressly referring to international law. While *Urbaser v. Argentina* and *Aven v. Costa Rica* have opened the door for the possibility of investor obligations to be sourced from international law, it should be noted that counterclaims based on international have so far been unsuccessful.

Model Counterclaim Provision

The report also presents a Model Counterclaim Provision (see **Figure 2** below). While modelled on UNCITRAL Draft Provision D, this Model Provision deviates from the UNCITRAL Draft Provision in certain respects to incorporate select wording from some of the other counterclaim

provisions reviewed in this report (*see* the Argentina/UAE BIT, the EU/Chile AFA, and the CPTPP).

Model Counterclaim Provision

1. When an investor submits a claim under this investment agreement, the **investor consents** that the host state may submit a counterclaim pursuant to paragraph 2.

2. The host state may make a counterclaim:
   a) in connection with the **factual or legal basis** of the claim, and
   b) that the claimant has **breached its obligations** under [this investment agreement or international law, domestic laws of the host state or of any third state expressly designated by the parties, or investment contracts].

3. [The selected arbitral tribunal] **shall decide any counterclaims on the basis** of this investment agreement, the general principles of international law, and, for the avoidance of any doubt, on the basis of any rules of law designated in paragraph 2(b).

Figure 2: Model Counterclaim Provision (in-depth discussion in **Section 5**)

The report identifies the main issues concerning the language of UNCITRAL Draft Provision D and provides strategic changes to address these issues: (1) it makes the investor's consent to counterclaims much more explicit; (2) it makes a counterclaim admissible both when a factual or a legal connection between the counterclaim and the investor's claim exist; and (3) it creates an ad hoc applicable law sub-clause for counterclaims that is distinct from a general applicable law provision. Notably, the suggested counterclaim provision addresses the concerns expressed by some host states that counterclaims may encourage tribunals to interpret their domestic law, thereby interfering with their regulatory autonomy. The wording of the provision is flexible enough to allow room for adjustments by negotiators. **Figure 3** below showcases the most relevant wording drawn upon to create the Model Provision.

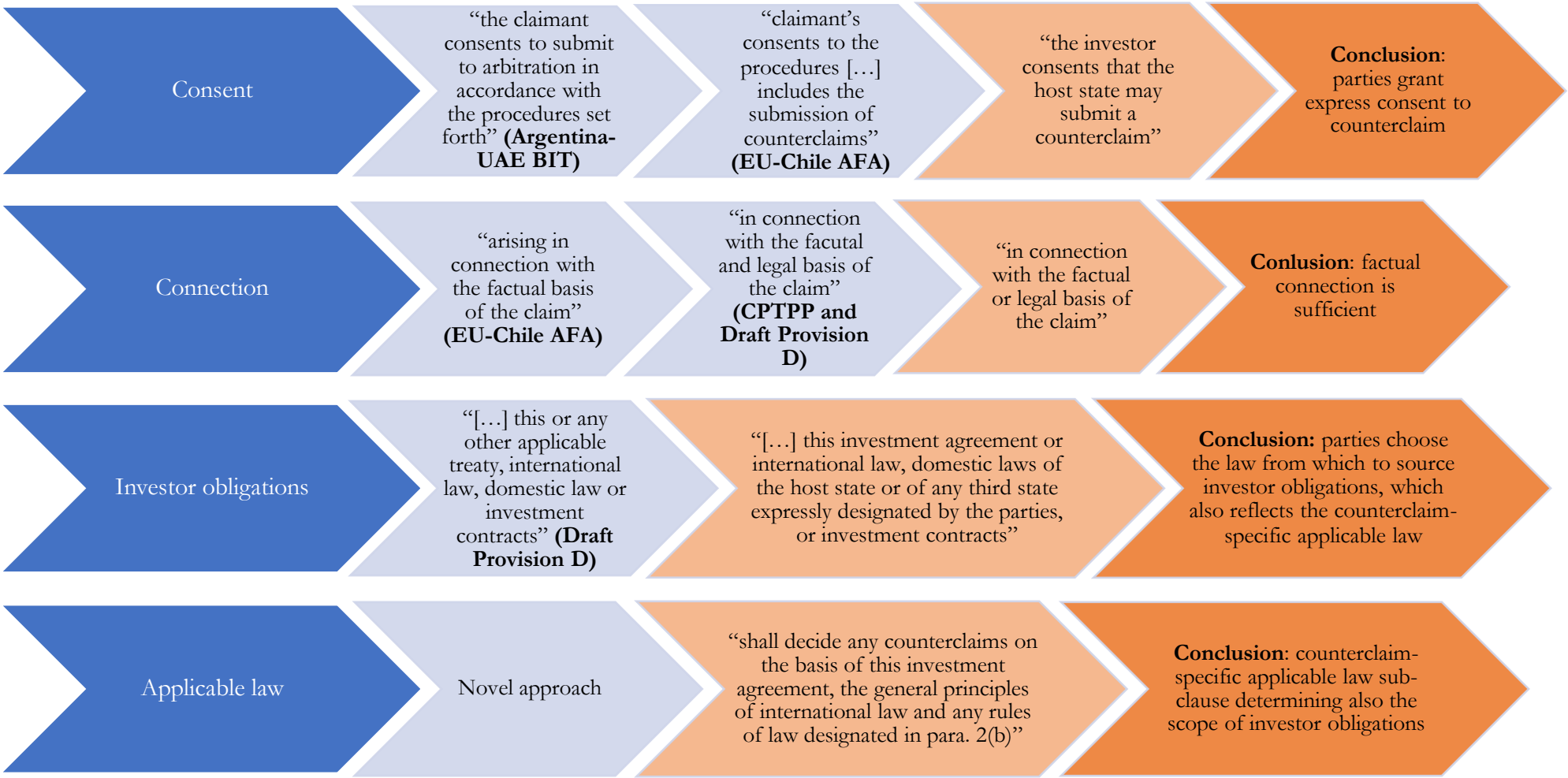

Figure 3: Wording from existing counterclaim provisions that influenced the Model Counterclaim Provision