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THE BEST DEFENCE IS A GOOD OFFENSE –
STATE COUNTERCLAIMS
IN INVESTMENT TREATY ARBITRATION

LLM RESEARCH PAPER

LAWS521: INTERNATIONAL ARBITRATION AND DISPUTE SETTLEMENT
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ABSTRACT

*Host state counterclaims in investment treaty arbitration are rarely pleaded and never successful, to the extent that one commentator has characterised their use as ‘thirty years of failure’. This paper navigates the obstacles that host states must contend with to assert counterclaims in investment treaty arbitration. While state counterclaims are permitted in principle under the ICSID Convention and UNCITRAL Arbitration Rules, satisfaction of the jurisdiction and admissibility requirements has proved more complex. The paper examines a number of core treaty provisions to identify the treaties that may be more or less likely to extend a tribunal’s jurisdiction *ratione materiae* over state counterclaims. Subsequently, this paper examines the requisite connection that must exist between a counterclaim and the principal claim. A survey of international jurisprudence supports the conclusion of this paper that recent treaty tribunal decisions have taken an unjustifiably narrow and often inconsistent approach to requisite connection, to the extent that it may be virtually impossible for states to assert counterclaims under its current articulation. This paper offers an alternative approach.*

The text of this paper (excluding contents page, non-substantive footnotes, bibliography and appendices) is 14,988 words.

I INTRODUCTION

International investment arbitration is often envisaged as a form of ‘quasi-judicial review of state regulatory action’ whereby the respondent state is brought to task for treating a foreign investor in a manner that violates its treaty obligations. Host state counterclaims push back against this conception, and are met with formidable resistance. Infrequently brought, the success of host state counterclaims is rarer still and no state has yet prevailed on the merits of its case. It is remarkable, however, that most of the cases in which counterclaims have been submitted have been decided within the last five years. The nature of host state counterclaims is also evolving. While early counterclaims were predominantly based on a contract with a foreign investor, recent cases show host states asserting counterclaims on the basis of its own general domestic laws. The conclusion to be drawn is that host states are becoming more aggressive in pursuit of counterclaims against foreign investors, despite the fact that their efforts have not tended to be successful.

This paper navigates the obstacles that host states must contend with to assert counterclaims in investment treaty arbitration, and critiques the reasoning of tribunals that have rejected to hear state counterclaims. To this end, this paper advances three substantive Parts. Part II provides important context to this discussion: it sets out a definition of counterclaims; explains the overarching purpose of international investment law and arbitration; and promotes the potential value that a more permissive approach to host state counterclaims could bring to the international investment regime.

Grimly noting that the current framework has resulted in ‘thirty years of failure’, Part III analyses the circumstances in which host states may assert counterclaims in investment treaty arbitration. A study of the ICSID Convention and UNCITRAL Arbitration rules reveals that counterclaims are permitted in principle. In practice, however, assertion of counterclaims has proved more complex. This paper examines a number of core treaty provisions to identify the treaties that may be more or less likely to extend a tribunal’s jurisdiction over counterclaims. Subsequently, this paper examines the requisite connection that must exist between a counterclaim and the principal claim. A survey of international jurisprudence supports the conclusion of this paper that recent cases have taken an unjustifiably narrow and often inconsistent approach to requisite connection, to the extent that it may be virtually impossible for states to assert counterclaims under its current articulation.

Part V proposes an alternative approach to the assessment of requisite connection that better adapts the requirement to treaty-based arbitration. This paper agrees that investment tribunals should undertake the assessment of requisite connection in fact and in law. Unlike current practice, however, this paper recommends that legal connection should be satisfied when a counterclaim relates to the same investment as the principal claim rather than insisting on symmetry of the legal instruments that underlie the claims. This approach is likely to be more consistent with the tribunal's jurisdiction as reflected in the relevant bilateral investment treaty. Crucially, this alternative approach also leaves open the possibility that state counterclaims may be based on the general domestic law of the host state.

II COUNTERCLAIMS

A A DEFINITION

In essence, a counterclaim is a claim presented by the respondent in opposition to a claim advanced by the claimant (the “principal claim”) in the same proceedings.¹ The nature of this opposition is not by way of defence but, rather, a counterclaim constitutes a new cause of action against the claimant.² Counterclaims are an independent cause of action in that, once properly admitted, the success or failure of a counterclaim does not depend on the subsequent fate of the principal claim.³ At the same time, counterclaims are connected to the principal claim in that it must arise from the same legal and factual context.⁴ The respondent's objective in asserting a counterclaim is to negate or mitigate the legal consequences of the principal claim.⁵ A simple illustration is found in purely contractual disputes: where a claimant alleges breach of contract, the respondent may counterclaim that the claimant is also in breach of that same contract.

¹ Dafina Atanasova, Adrián Martínez Benoit and Josef Ostřanský “The Legal Framework for Counterclaims in Investment Treaty Arbitration” (2014) 31 J. Int'l Arb. 357 at 359.

² Constantine Antonopoulos *Counterclaims before the International Court of Justice* (T.M.C. Asser Press, The Hague, 2011) at 50.

³ Antonopoulos. above n 2, at 10.

⁴ Atanasova, above n 1, at 378.

⁵ Antonopoulos, above n 2, at 63.

The central rationale underlying counterclaims is procedural economy and the better administration of justice. Consolidation of claims and counterclaims in the same proceedings allows adjudicators to hear a more complete overview of the case through the respective claims of the parties,⁶ and a fully informed tribunal may be expected to reach a more just and rational result.⁷ Where the claims are sufficiently connected, separate proceedings would require the examination of the same evidence and written and oral arguments in different fora, resulting in delays and corresponding costs. There is also a risk that the different fora would reach inconsistent decisions.⁸ Hence, consolidation of claims and counterclaims not only promotes procedural fairness between the disputing parties and saves both parties time and money; it may also safeguard the coherence of the legal system as a whole.⁹

1 DISTINGUISHED FROM A DEFENCE ON THE MERITS

Counterclaims are not the same as defences on the merits. A defence on the merits is a submission formulated by the respondent that is devised to nullify the principal claim, that is, to render the principal claim devoid of its factual or legal basis.¹⁰ For example, a respondent may submit that it is not at fault for non-performance of its contractual obligations on the grounds of *force majeure* (as was successfully argued by Iran in *Gould Marketing, Inc v Ministry of National Defense of Iran* in the Iran/United States Claims Tribunal following the Iranian Revolution).¹¹ Such a submission is a defence on the merits as its objective is to defeat the principal claim.¹²

In contrast, a respondent submits a counterclaim to seek a judgment in its favour “further” or “over and above” dismissal of the principal claim.¹³ A counterclaim may seek judgment

⁶ Hege Elisabeth Kjos *Applicable Law in Investor-State Arbitration: The Interplay Between National and International Law* (Oxford University Press, Oxford, 2013) at 128.

⁷ *Case Concerning Armed Activities on the Territory of the Congo (Democratic Republic of the Congo v Uganda)(Counter-Claims)*, Order of 21 November 2001, ICJ Rep. 2001, at 684.

⁸ Kjos, above n 6, at 128 – 129.

⁹ Kjos, above n 6, at 130.

¹⁰ Antonopoulos, above n 2, at 60.

¹¹ *Gould Marketing, Inc. v Ministry of National Defense of Iran*, Interlocutory Award, 27 July 1983, 3 Iran-US Cl. Trib. Rep. 146.

¹² Antonopoulos, above n 2, at 60.

¹³ *Case Concerning Armed Activities on the Territory of the Congo*, above n 7, at 677.

“over and above” dismissal of the principal claim by denying the principal claim as well as alleging that, instead, the claimant is at fault.¹⁴ Alternatively, a counterclaim may not deny the principal claim at all but aim to mitigate or deprive a judgement in favour of the principal claim of its adverse effect. In this way, a counterclaim may serve a defensive function in a tactical sense, but it is not a “defence” as a term of art in the law of procedure; counterclaims have an “offensive” character.¹⁵ The International Court of Justice (ICJ) succinctly noted this distinction in the *Bosnian Genocide* case:¹⁶

“[T]he thrust of a counterclaim is thus 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.”

2 DISTINGUISHED FROM A CLAIM OF SET-OFF

Counterclaims are also distinguishable from claims of set-off, even though it is common that the two are referred to in the same breath. A set-off is an equitable defence that money owed by the claimant to the respondent should be counter-balanced against the principal claim.¹⁷ The primary similarity between set-off and counterclaims is that both are presented to avoid circuity of action (in the case of set-off, between mutual debtors). However, there are distinct differences.¹⁸

A counterclaim allows a respondent to raise an independent claim, and therefore the usual practice is that two separate judgments are ultimately issued (for claim and counterclaim).¹⁹

¹⁴ For example, *Case Concerning the Land and Maritime Boundary between Cameroon and Nigeria (Cameroon v Nigeria) (Counter-Claims)*, Order of 30 June 1999, ICJ Rep. 1999, at 985: The Tribunal ruled that the “Counter-Memorial of Nigeria in submission 7 contains claims whereby Nigeria seeks further to the rejection of Cameroon’s claims to establish the latter’s responsibility and to obtain reparation on that account” and that “such claims constitute counterclaims within the meaning of Article 80 of the Rules of the Court.” [Emphasis added].

¹⁵ Antonopoulos, above n 2, at 63.

¹⁶ *Case Concerning Application of the Convention on the Prevention and Punishment of the Crime of Genocide (Bosnia and Herzegovina v Yugoslavia) (Counterclaims)*, Order of 17 December 1996, ICJ Rep. 1997 at 256.

¹⁷ S. R. Derham “The Law of Set Off: 3rd edition” (Oxford University Press, Oxford, 2003) at 1.01.

¹⁸ Christopher Kee “Set-off in International Arbitration – What Can The Asian Region Learn?” (2005) 1 Asian International Arbitration Journal 141 at 146.

¹⁹ Kee, above n 18, at 146.

In comparison, a set-off defence only reduces the potential amount for which the respondent is liable and does not allow a respondent to initiate a claim to recover in its own right. Hence, a demand based on a counterclaim may exceed the amount of the original claim while a set-off demand may not.²⁰ Counterclaims are also broader in scope than claims of set-off: counterclaims are not limited to monetary claims, but may also include claims requesting specific performance or restitution of goods, for example.²¹

Unlike counterclaims, the life of a set-off is dependent on the main claim and if a tribunal finds against the principal claim, the set-off will not be heard.²² As Berger suggests: ‘set-off, whether of substantive or a procedural quality, is not a device to attack but a mere defence of the respondent against the claimant’s claim. It can be used “as a shield, not as a sword”’.²³ Again, the “offensive” character of counterclaims sets them apart.

II INVESTMENT TREATY ARBITRATION

A PURPOSE OF INTERNATIONAL INVESTMENT LAW AND ARBITRATION

The overarching purpose of international investment law in general and investment treaty arbitration in particular is to encourage foreign investment. Foreign investment requires the long-term commitment of substantial resources by foreign investors in the territorial sovereignty of the host state.²⁴ Often, investors sink significant capital into a project at the outset of an investment, with the expectation of recouping this amount along with an acceptable rate of return during the life of the investment, sometimes running up to 30 years or more.²⁵ This is a risky enterprise. In addition to the commercial risks inherent to any long-term investment, investors also face political risks in the host state. Political or sovereign risk is the risk that a host state will exercise public power to alter its legal landscape in a way that

²⁰ Pierre Karrer “Arbitration Saves! Costs: Poker and Hide-and-Seek” (1986) 3 *Journal of International Arbitration* 35 at 38.

²¹ Kee, above n 18, at 146.

²² Kee, above n 18, at 146.

²³ Klaus Peter Berger “Set-Off in International Economic Arbitration” (1999) 15 *Arbitration International* 53 at 54, citing *Stooke v Taylor* (1880) 5 QB 569 at 575.

²⁴ Rudolf Dolzer and Christoph Schreier *Principles of International Investment Law, 2nd edition* (Oxford University Press, Oxford, 2012) at 20.

²⁵ Dolzer, above n 24. at 21.

devalues the profitability of an investment. This includes regime change, a change of general or sectorial economic and tax policy, and economic and political emergencies within the host state, to name just a few.²⁶

International investment treaties operate to reduce the level of this political risk.²⁷ In an investment treaty, the host state guarantees minimum standards of regulatory treatment to foreign investors beyond those in customary international law and, in doing so, deliberately constrains the scope of its sovereignty to regulate.²⁸ Minimum standards take the form of investment treaty obligations such as a prohibition on uncompensated expropriation, fair and equitable treatment, national treatment, full protection and security and most-favoured-nation treatment.²⁹ These obligations confer greater stability and predictability to the host state's legal landscape vis-à-vis the investor to create a more investment-friendly climate.³⁰ Hence, this quid pro quo weighs in the investor's calculus of investment risks and, theoretically, encourages increased foreign investment in the host state.³¹

Investment treaty obligations are enforceable against the host state at the suit of the investor by recourse to investment arbitration, provided for in a treaty's dispute resolution clause (*clause compromissoire*). Arbitration is 'a process by which parties consensually submit a dispute to a non-governmental decision-maker, selected by or for the parties, to render a binding decision resolving a dispute in accordance with neutral, adjudicatory procedures affording the parties an opportunity to be heard'.³² As this definition suggests, the appeal of arbitration has party autonomy at its heart. Parties to a dispute wield the "ultimate

²⁶ Christoph Schreuer "Do We Need Investment Arbitration?" in Jean E. Kalicki and Anna Joubin-Bret "Reshaping the Investor-State Dispute Settlement System: Journeys for the 21st Century" (Brill Nihoff NV, Leiden, 2015) 879 at 879.

²⁷ Zachary Douglas "The International Law of Investment Claims" (Cambridge University Press, Cambridge, 2012) at 1.

²⁸ Dolzer, above n 26, at 20.

²⁹ Douglas, above n 27, at 1 – 2.

³⁰ Dolzer, above n 25, at 22.

³¹ Whether investment treaties do in fact encourage foreign investment is a subject of debate. For detailed treatment, see Sauvants and Sachs (eds) *The Effect of Treaties on Foreign Direct Investment* (2009).

³² G. Born *International Arbitration: Law and Practice* (Alphen aan den Rijn, Kluwer Law International, 2012) at 1.

power [in] determining the form, structure, system and other details of the arbitration”.³³ Party autonomy is generally exercised to secure neutral and expert arbitrators to decide the dispute in a relatively informal forum.³⁴ Ultimately, the arbitrators’ final and binding decision is supported by strong enforcement mechanisms at international law pursuant to the New York Convention³⁵ and ICSID Convention.³⁶

In the absence of a treaty arbitration clause, foreign investors embroiled in an investment dispute only have recourse to diplomatic protection or the host state’s domestic courts. Neither of these options is ideal from the investor’s perspective. Diplomatic protection involves the espousal of the investor’s claim by its state of nationality, whereby the state pursues the claim as surrogate; a procedure designed to supplement the traditional notion that non-state actors do not have standing on the international plane.³⁷ Investors must undergo the time and expense of exhausting local remedies before diplomatic protection may be exercised and, even then, it is discretionary. The investor’s state of nationality may not wish to politicise the dispute or may not have the means to effectively pursue the claim. It is unsurprising that investors are reluctant to have such little control to vindicate their legal rights.³⁸

Recourse to a host state’s domestic courts is also unattractive. Rightly or wrongly, the domestic courts of the host state are not perceived as sufficiently impartial. This is not necessarily because it is believed the courts will be corrupt, unreliable or openly partisan as such, although that is certainly true of many jurisdictions.³⁹ Rather, there is a concern that

³³ Julian D M Lew and others *Comparative International Commercial Arbitration* (Kluwer Law International, The Hague, 2003) at 6 – 7.

³⁴ Kjos, above n 6, at 22.

³⁵ Convention on the Recognition and Enforcement of Foreign Arbitral Awards (signed June 10 1958, entered into force 7 June 1959) (‘New York Convention’).

³⁶ Convention on the Settlement of Investment Disputes between States and Nationals of other States (signed 18 March 1965, entered into force 14 October 1966) 575 UNTS 159 (‘ICSID Convention’).

³⁷ Schreur, above n 26, at 882.

³⁸ Schreur, above n 26, at 883.

³⁹ Schreur, above n 26, at 883, quoting Jan Paulsson “Enclaves of Justice” (2007) 4 *Transnational Dispute Management*: “[I]t would be preposterous to imagine that even half of the world’s population lives in countries that provide decent justice” and “[t]he rule of law is pure illusion for most of our fellow travellers on this planet.”

even the most impartial national court will show greater understanding for the plight of its home government than neutral and detached international arbitrators.⁴⁰ Moreover, domestic courts are usually bound to apply local law even if it is at odds with the host state's international obligations, and the sitting judges will often lack the expertise to resolve complex international investment disputes.⁴¹ As there is no right without a remedy, the availability of investment arbitration – a far more accessible and effective option – enables foreign investors to bypass these difficulties, and invest more readily.

B ROLE OF COUNTERCLAIMS IN INVESTMENT TREATY ARBITRATION

As is evident from the preceding discussion, investment treaties can be characterised as an asymmetrical rubric of investor rights and host state obligations. The difficulty that this structure creates for the assertion of state counterclaims in arbitration is the subject of comprehensive review in Part III of this paper. This section aims to provide important context to that review by highlighting the value that a more permissive approach to state counterclaims could bring to investment treaty arbitration.

In addition to the benefits of procedural economy and the better administration of justice, assertion of state counterclaims in investment treaty arbitration aligns with the purpose of arbitration to facilitate the resolution of disputes in a neutral forum. In the event that its counterclaims are not heard, states are likely to seek relief in its own courts or in another, contractually agreed upon, forum.⁴² There is irony in forcing states and investors to resolve disputes in domestic courts given that recourse to domestic courts is precisely what investment arbitration was designed to avoid.⁴³ Moreover, fragmentation of the dispute in different tribunals increases the risk of inconsistent decisions, and the complex impasse of injunctions against parallel proceedings.⁴⁴

⁴⁰ I. Alvik *Contracting with Sovereignty* (Oxford, Hart, 2011) at 44.

⁴¹ Christoph Schreuer *The ICSID Convention: A Commentary* (Cambridge University Press, Cambridge, 2010) at 5.

⁴² Kjos, above n 6, at 130.

⁴³ *Spyridon Roussalis v Romania*, ICSID Case No. ARB/06/01, Dissenting Opinion of W. Michael Reisman at 146.

⁴⁴ Jean E. Kalicki “Counterclaims by States in Investment Arbitration” (14 January 2013) IISD Investment Treaty News <www.iisd.org.nz>.

The ability to counterclaim would enable states to launch an offensive, rather than merely a defensive. It has been said that, without such an ability, ‘a state cannot win; the most it can hope to do is not lose’.⁴⁵ The ability to counterclaim may consequently render states more willing to arbitrate and deter investors from bringing weak claims. In turn, time and money is less likely to be spent on jurisdictional objections and cases could proceed more quickly to the merits.⁴⁶ Once a decision is rendered, states could benefit from the superior enforcement mechanisms at international law, mentioned above, which are more readily enforceable than domestic court judgments, especially as investors and (parts of) investors’ assets are likely to be situated in the investors’ home states.⁴⁷

A frequent objection to this call for greater equality between host states and investors is that the perceived unfairness under investment treaties is in fact essential to rebalance the asymmetry that would otherwise exist but for the treaty.⁴⁸ As explained, the primary purpose of investment treaties is to moderate the political risk consequent of the host state’s sovereign power. According to this objection, it is the conduct of the state, rather than that of investors, that needs to be bridled. However, this is not universally true. Some foreign investors wield economic muscle unrivalled by many host states, as was keenly felt, for instance, when the multi-billion-dollar tobacco company Phillip Morris brought proceedings against Uruguay.⁴⁹ The conduct of foreign investors may need to be restrained as often as the conduct of host states.⁵⁰

Perhaps most importantly, state counterclaims have the potential to address a growing perception that investment treaty arbitration suffers from a structural bias against states

⁴⁵ Andrea Bjorkland “The Role of Counterclaims in Rebalancing Investment Law” (2013) 17 Lewis & Clark Law Review 461 at 464.

⁴⁶ Bjorkland, above n 45, at 476.

⁴⁷ Hege Elisabeth Veenstra-Kjos “Counterclaims by Host States in Investment Treaty Arbitration” (2007) 7 Transnational Dispute Management at 11.

⁴⁸ Bjorkland, above n 45, at 462.

⁴⁹ *Philip Morris Brand Sarl (Switzerland), Philip Morris Products S.A. (Switzerland) and Abal Hermanos S.A.(Uruguay) v Oriental Republic of Uruguay* ICSID Case No. ARB/10/7, (pending). John Oliver “Tobacco” *Last Week Tonight HBO* (United States, 15 February 2015).

⁵⁰ Gustavo Laborde “The Case for Host State Claims in Investment Arbitration” (2010) 1 Journal of International Dispute Settlement 97 at 98.

Backlash against the traditional paradigm of investment arbitration as a mechanism for the exclusive protection of investors' rights increasingly poses a challenge to its legitimacy.⁵¹ The critique is that arbitration primarily benefits investors to the detriment of the state and establishes a disproportionate balance of arms; arbitral tribunals are "private fora for public issues" where social and public interests are ignored.⁵² As one commentator has remarked, "[a]s the gulf deepens, the complaints get louder and the stability of the system is undermined."⁵³ While criticism of the current international investment regime comes from many directions,⁵⁴ this paper submits that a more permissive approach to state counterclaims has the potential to allay this mounting dissatisfaction – to the benefit of host states, foreign investors, and investment arbitration as a discipline.

III COUNTERCLAIMS TO DATE: THIRTY YEARS OF FAILURE

Host state counterclaims in investment treaty arbitration are rarely pleaded and never successful, to the extent that one commentator has characterised their use as 'thirty years of failure'.⁵⁵ Indeed, up until recently, it was doubtful whether states could assert counterclaims at all.⁵⁶ To date, counterclaims have been involved in less than 3 per cent of treaty-based arbitrations. It is remarkable, however, that most of those cases have been decided within the

⁵¹ Helen Bubrowski "Balancing IIA arbitration through the use of counterclaims" in Armand de Mestral and Celine Levesque (eds) *Improving International Investment Agreements* (Routledge, New York, 2013) 212 at 214.

⁵² See for example: Jeffery Atik "Legitimacy, Transparency and NGO Participation in the NAFTA Chapter 11 process" in Todd Weilder (ed) *NAFTA Investment Law and Arbitration: Past Issues, Current Practice, Future Prospects* (Transnational Publishers, New York, 2004) 135 at 140; Mehmet Toral and Thomas Schultz "The State, a Perpetual Respondent in Investment Arbitration?" in Michael Waibet et al (eds) *The Backlash Against Investment Arbitration: Perceptions and Reality* (Wolters Kluwer, the Hague, 2010) 577 at 577 – 578.

⁵³ Toby Landau QC "Freshfields lecture 2011: Saving investment arbitration from itself" *Global Arbitration Review*.

⁵⁴ See generally: Michael Waibet et al (eds) *The Backlash Against Investment Arbitration: Perceptions and Reality* (Wolters Kluwer, the Hague, 2010) 577

⁵⁵ Ana Vohryzek-Griest "State Counterclaims in Investor-State Disputes: A History of 30 Years of Failure" (2009) 15 *International Law – Revista Colombiana de Derecho Internacional* 83 – 124.

⁵⁶ A. K. Hoffman "Counterclaims by the Respondent State in Investment Arbitrations – The Decision on Jurisdiction Over Respondent's Counterclaim in *Saluka Investments B.V. v Czech Republic*" (2006) *Transnational Dispute Management* at 5, stating that Jan Paulsson observed in 1995 that "this new world of arbitration is one where the claimant need not have a contractual relationship with the defendant and where the tables could not be turned: the defendant could not have initiated arbitration, nor is it certain of being able even to bring a counterclaim", followed by "It is now settled – not least thanks to [the *Saluka* decision – that the respondent in an investment arbitration can, theoretically bring a counterclaim".

last five years.⁵⁷ States are apparently becoming more aggressive in asserting counterclaims against investors, despite the fact that their efforts have not tended to be successful.⁵⁸

This Part examines the obstacles that host states must contend with to assert counterclaims in investment treaty arbitration and critiques the reasoning of tribunals that have refused to hear such counterclaims. To this end, this Part proceeds in three substantive sections. Section A looks to the ICSID Convention and UNCITRAL Arbitration Rules to illustrate that both sets of rules explicitly confirm the availability of counterclaims subject to certain jurisdictional and admissibility requirements. The next two sections explore those requirements in greater detail. Section B examines the effect of core treaty provisions on a tribunal's jurisdiction to hear state counterclaims – namely, the scope of the dispute, applicable law and standing. The effect of contractual forum selection clauses is also discussed. Finally, Section C critically analyses the reasoning of investment tribunals on the question of requisite connection between the subject matter of the counterclaim with that of the principal claim.

As indicated, this paper makes a distinction between jurisdiction and admissibility (requisite connection). This is not uncontroversial. In dealing with the jurisdiction/admissibility distinction, international practice has generated a 'twilight zone' of definitions,⁵⁹ and tribunals are divided over how to characterise the question of requisite connection.⁶⁰ The author prefers to characterise requisite connection as a question of admissibility. Jan Paulsson suggests that the hallmark of a successful challenge to admissibility is that the claim should not be heard at all (or at least not yet). Contrariwise, the hallmark of a successful challenge to jurisdiction is that the claim cannot be brought to the

⁵⁷ A. Rivas "ICSID Treaty Counterclaims: Case Law and Treaty Evolution (2014) 11 *Transnational Dispute Management* at 2.

⁵⁸ Bjorkland, above n 45, at 464.

⁵⁹ Jan Paulsson "Jurisdiction and Admissibility" (2005) *Global Reflections on International Law, Commerce and Dispute Resolution* 601 at 608.

⁶⁰ Some consider it a matter of jurisdiction: e.g. *Sergei Paushok and others v Government of Mongolia*, UNCITRAL Award on Jurisdiction and Liability (28 April 2011) and *Saluka Investments B.V. v Czech Republic*, UNCITRAL, Decision on Jurisdiction over Czech Republic's Counterclaim (7 May 2004). Others consider it a matter of admissibility: *Antoine Goetz and others v Republic of Burundi*, ICSID Case No. ARB/06/11, Award (21 June 2012); *Metal-Tech Ltd v Republic of Uzbekistan*, ICSID Case No. ARB/10/3, Award (4 October 2013). See also for discussion: Thomas Kendra "State Counterclaims in Investment Arbitration – A New Lease of Life?" (2013) *Arbitration International* 575 at 591.

particular forum seized.⁶¹ It is submitted that a counterclaim that is not sufficiently connected with the principal claim is not precluded from being heard in arbitration at all, just not in those proceedings. It is conceivable that the same counterclaim could be heard in arbitration at a later date, in relation to a different principal claim. It follows that requisite connection is a question of admissibility.⁶²

Article 46 of the ICSID Convention supports this characterisation. Article 46 suggests that ‘direct connection’ is distinct from the parties’ consent, as it is listed as a separate condition.⁶³ In this study, jurisdiction is understood as a function of party consent. It seems incongruous with the principle of party autonomy in arbitration to hold that a tribunal must deny jurisdiction over a counterclaim for lack of connection even if the parties have consented to the counterclaims being heard and it falls within the jurisdiction of the Centre.⁶⁴ In ICSID arbitral practice, the recent *Goetz v Burundi* decision clearly delineated jurisdiction and admissibility (requisite connection), and has subsequently been heralded as symptomatic of a growing trend in arbitral awards towards more methodical and comprehensive reasoning. It is therefore likely that future investment tribunals will adopt the same bifurcated framework.⁶⁵

The distinction between jurisdiction and admissibility is not merely semantic. This distinction can be crucial as a tribunal’s decision as to its jurisdiction can be subject to review by national courts, whereas its findings on admissibility generally are not.⁶⁶ For example, the New York Convention provides that the recognition and enforcement of an award may be

⁶¹ Paulsson, above n 59, at 617.

⁶² Atanasova, above n 1, at 371 – 372.

⁶³ Schreier, above n 41, at 751: “The close connection required by Art. 46 is not a matter of jurisdiction. The wording of Art. 46 makes it clear that the “arising directly” requirement must be fulfilled in addition to the jurisdictional requirements. A claim may well be within the Centre’s jurisdiction but not arise directly from the subject-matter of a particular dispute before the tribunal. An obvious example would be a claim arising from a different investment operation between the same investor and the same host state. Conversely, a claim may arise directly from the subject-matter of the dispute but may not be subject to ICSID’s jurisdiction.”

⁶⁴ Atanasova, above n 1, at 380.

⁶⁵ Thomas Kendra “State Counterclaims in Investment Arbitration – A New Lease of Life?” (2013) *Arbitration International* 575 at 593.

⁶⁶ Douglas, above n 27, at 141.

refused if [t]he award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration, or contains decisions on matters beyond the scope of the submission to arbitration [...]’.⁶⁷

A ARBITRATION RULES

Parties to an investment dispute will agree upon a body of rules to govern the arbitration procedure (the *lex arbitri*) in their arbitration agreement. The parties may formulate their own rules in this respect, but most often they refer to a standard set of arbitration rules. The most commonly used rules in investment arbitration are those provided in the ICSID Convention, and in the UNCITRAL Arbitration Rules.⁶⁸ Both sets of rules expressly anticipate the bringing of counterclaims. Moreover, the rules’ respective *travaux préparatoires* suggests that the drafters expected that counterclaims would form a more regular part of investment proceedings, as they do in commercial arbitration.⁶⁹

1 ICSID CONVENTION

In 1965, the World Bank promulgated the ICSID Convention in an attempt to remove legal and political obstacles to the flow of foreign investment. For this purpose, the Convention provides for an International Centre for the Settlement of Investment Disputes (ICSID) to facilitate the peaceful settlement of investment disputes between foreign investors and host states through arbitration. The ICSID Convention is purely procedural; the substantive rules to be applied to the merits of a dispute are prescribed by the relevant investment treaty.⁷⁰ In relation to counterclaims, Article 46 of the ICSID Convention provides that:⁷¹

Except as the parties otherwise agree, the Tribunal shall, if requested by a party, determine any incidental or additional claims or counterclaims arising directly out of the subject-matter of the dispute provided that they are within the scope of the consent of the parties and are otherwise within the jurisdiction of the Centre.

⁶⁷ New York Convention, above n 35, Art V(1)(c).

⁶⁸ Kendra, above n 65, at 576.

⁶⁹ Kendra, above n 65, at 575.

⁷⁰ Campbell McLachlan QC, Laurence Shore and Matthew Weiniger *International Investment Arbitration: Substantive Principles* (Oxford University Press, Oxford, 2007) at 1.05.

⁷¹ ICSID Convention, above n 36, Art 46.

The Article sets out three conditions to be fulfilled by a counterclaim in order to be considered, except otherwise expressly agreed by the parties. First, the counterclaim must be within the consent of the parties to the dispute (Part III(B) of this paper). The second requirement is that the counterclaim must be connected with the principal claim (Part III(C)). The third requirement is for the counterclaim to be within the jurisdiction of the Centre; that is to say, it must arise directly out of an investment and be lodged between a foreign investor and a state party.⁷² The intentionally undefined term “investment” has precipitated a wealth of case law and commentary.⁷³ For the purposes of this paper, it suffices to note that the counterclaim must arise out of the same investment operation as the principal claim, and the meaning of “investment” is likely to be defined in the relevant investment treaty. To compare, the third requirement is a condition for jurisdiction and refers to the overall investment, whereas the second requirement presupposes jurisdiction and refers to a particular dispute.⁷⁴

Other aspects of the ICSID Convention, and its drafting history, suggest that its drafters envisaged that host state counterclaims would become a regular feature of investment treaty arbitration. At the outset of this discussion, it should be acknowledged that, at the time the ICSID Convention was drafted, the concession contract had been an essential predicate for investment arbitration.⁷⁵ As will be discussed, contract-based arbitrations do not raise the same jurisdiction and admissibility issues as treaty-based arbitrations.⁷⁶ Nevertheless, there is nothing inherent in the text of Article 46 to suggest that it is limited to contractual disputes and excludes treaty disputes, nor has such a revision been suggested. It is submitted, therefore, that its drafting history may still be indicative of the drafters’ intentions in the investment treaty context.

⁷² ICSID, Art 25.

⁷³ Pierre Lalive and Laura Halonen “On the Availability of Counterclaims in Investment Treaty Arbitration” in Alexander J. Belohavek and Nadezda Rozehnalova *Czech Yearbook of International Law: Rights of the Host States within the System of International Investment Protection* (Juris Publishing, New York, 2011) 141 at 144.

⁷⁴ Schreur, above n 41, at 751.

⁷⁵ McLachlan, above n 70, at 1.06.

⁷⁶ Discussed in Part II(B).

The full title of the ICSID Convention refers to disputes ‘between States and Nationals of Other States’, with the use of the word ‘between’ suggesting that claims could flow in both directions. Elsewhere, Article 36(1) refers to the institution of arbitral proceedings by either a national of a contracting state or a contracting state itself. The World Bank’s Executive Board on the Convention expressly recognised the importance of host state claims and counterclaims in this respect:⁷⁷

While the broad objective of the Convention is to encourage a larger flow of private international investment, the provisions of the Convention maintain a careful balance between the interests of investors and those of host States. Moreover, the Convention permits the institution of proceedings by host States as well as investors and the Executive Directors have constantly had in mind that the provisions of the Convention should be equally adapted to the requirements of both cases.

The treaty tribunal in *Amco v Indonesia* echoed this same sentiment when it said ‘the Convention is aimed to protect, to the same extent and with the same vigour, the investor and the host State [...]’.⁷⁸ Finally, it is notable that the 1968 Model Clauses proposed by the ICSID Centre provided for claims made only by investors, but the document was later revised to contemplate claims by states.⁷⁹

2 UNCITRAL RULES

The UNCITRAL Arbitration Rules were originally designed for international commercial disputes, but have since acquired an important role in investment treaty arbitration. The UNCITRAL Arbitration Rules are not promoted by an arbitration institution like ICSID, but are instead applied to *ad hoc* arbitrations. Before looking to the current version of the UNCITRAL Arbitration Rules, it is pertinent to examine its predecessor, as it is the version

⁷⁷ Report of the Executive Directors of the International Bank for the Reconstruction and Development on the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, at 13; Schreur, above n 41, at 733 – 734.

⁷⁸ *Amco v Indonesia*, Decision on Jurisdiction, 25 September 1983, at 23.

⁷⁹ Schreur, above n 41, at 733 – 744.

most applied by *ad hoc* investment treaty tribunals to date. Article 19(3) of the 1976 UNCITRAL Arbitration Rules provided that:⁸⁰

In its statement of defence, or at a later stage in the arbitral proceedings if the arbitral tribunal decides that the delay was justified under the circumstances, the respondent may make a counter-claim arising out of the same contract or rely on a claim arising out of the same contract for the purpose of a set-off.

The difficulty of transposing this provision into the investment treaty context is the reference to ‘the same contract.’ In treaty arbitration, principal claims are typically based on an alleged treaty violation and there may not be a contract between the host state and investor at all.⁸¹ Despite the specific language of Article 19(3), tribunals did exercise jurisdiction over counterclaims under the former UNCITRAL Arbitration Rules. The tribunal in *Saluka v Czech Republic* decided that, as a matter of principle based on similar provisions in the ICSID Convention and the Iran/United States Claims Settlement Declaration, where consent to arbitration is expressed in wide terms, the tribunal is conferred jurisdiction over host state counterclaims.⁸² The same reasoning was adopted in *Paushok v Mongolia*.⁸³ In other cases, jurisdiction has either been assumed without discussion,⁸⁴ or conceded by the claimant in order to reinforce an assertion of a broad jurisdiction over the principal claims.⁸⁵

Nevertheless, the UNCITRAL Arbitration Rules were revised in 2010 to modernise the text and adapt it to its current use. The provisions relating to counterclaims were widened as the specific reference to ‘the same contract’ was removed.⁸⁶ The Commission in charge of the Rules’ modification specifically intended this change to more clearly permit counterclaims in

⁸¹ Douglas, above n 27, at 258.

⁸² *Saluka Investments B.V. v The Czech Republic*, Decision on Jurisdiction over the Czech Republic’s Counterclaim (UNCITRAL, 7 May 2004) at 76.

⁸³ *Paushok v Mongolia*, Award on Jurisdiction and Liability (UNCITRAL, 28 April 2011), at 687.

⁸⁴ *Genin v Estonia* (Merits) 6 ICSID Rep 236, 271/201, 301-2/376-8 (counterclaim dismissed on the merits without consideration of jurisdiction).

⁸⁵ *SGS v Pakistan* (Procedural Order) 8 ICSID Rep 388; *SGS v Pakistan* (Preliminary Objections) 8 ICSID Rep 406, 426-7/108-9; *SGS v Philippines* (Preliminary Objections) 8 ICSID Rep 518, 528/40; *Sedelmayer v Russia* (Merits).

⁸⁶ Kendra, above n 65, at 578.

investment treaty arbitration; in their words, ‘[t]he limitation to contracts is simply inappropriate to arbitration arising under investment treaties’.⁸⁷ Article 21(3) of the 2010 UNCITRAL Arbitration Rules now provides that:

In its statement of defence, or at a later stage in the arbitral proceedings if the arbitral tribunal decides that the delay was justified under the circumstances, the respondent may make a counter-claim or rely on a claim for the purpose of set-off provided that the arbitral tribunal has jurisdiction over it.

Article 21(3) is silent on the degree of connection that must exist between the claim and counterclaim. The wording was regarded as ‘broad enough to encompass a wide range of circumstances and did not require substantive definitions of the notions of claims for set-off and counterclaims.’⁸⁸ It was foreseen future tribunals would apply a requirement of connection as a generally accepted principle of legal procedure, as the *Saluka* tribunal did.⁸⁹

The most commonly used arbitration rules therefore explicitly confirm the availability of host state counterclaims in principle, subject to requirements of jurisdiction and admissibility. The following sections consider those requirements in greater detail.

B JURISDICTION

Consent is the organising principle of jurisdiction in investment treaty arbitration. Host states and foreign investors must both consent to arbitrate a dispute before any proceedings can be brought before a tribunal, including counterclaims. Consent to arbitrate is generally perfected in two steps. First, an investment treaty is negotiated between sovereign states. In signing a treaty, a state party extends a standing offer of arbitration to eligible investors of the other signatory state (or states, in the case of multilateral investment treaties).⁹⁰ This standing

⁸⁷ J. Paulsson and G. Petrochilos *Revision of the UNCITRAL Arbitration Rules* (September 2006), “informal and unpublished report prepared for the UNCITRAL Secretariat and cited in official documentation” at 92 -93.

⁸⁸ United National Commission on International Trade Law *Report of the Working Group on Arbitration and Conciliation on the Work of its fiftieth session* (New York, February 2007), at 31.

⁸⁹ Paullson, above n 87, at 31.

⁹⁰ Douglas, above n 27, at 258.

offer delineates the substance of future arbitral proceedings, and is deemed to be irrevocable so long as the investment treaty remains in force.⁹¹

Secondly, a foreign investor accepts the offer to arbitrate. Some instruments require that the investor gives notice of its acceptance in writing,⁹² but acceptance is typically deemed to occur when a foreign investor serves a notice of arbitration upon the host state or the arbitration institution designated by the contracting state parties in the treaty.⁹³ It has been suggested that an investor may preclude the assertion of host state counterclaims by limiting its acceptance of the offer solely to its specific grievance. According to proponents of this view, the required mutual consent between the parties would only exist to the extent of the overlap between the host state's offer and the investor's acceptance (that is, the treaty violation).⁹⁴ This position must be rejected. By analogy with fundamental contract law principles, a host state's unilateral offer in an investment treaty sets out the terms of its consent, nothing more and nothing less. Limited acceptance is akin to a counteroffer, not acceptance, and cannot support a finding of mutual consent unless the host state accepts those limited terms.⁹⁵

The investor's acceptance of the host state's offer as set out in the investment treaty culminates in the parties' arbitration agreement. The arbitration agreement constitutes the basis of the parties' consent and, therefore, a tribunal's jurisdiction to settle the dispute.⁹⁶ By

⁹¹ Jan Paulsson "Arbitration without Privity" (1995) 10 ICSID Review – FILJ 232 at 234.

⁹² Energy Charter Treaty (opened for signature Dec 17, 1994), Art 26(4); North American Free Trade Agreement (NAFTA), Art 1121 (opened for signature Dec 17, 1992).

⁹³ Douglas, above n 27, at 258.

⁹⁴ Schreur, above n 41, at 203 and 756. See also H.C. Alvarez "Arbitration Under the North American Free Trade Agreement" (2000) 16 Arb. Int'l 393 at 410 – 411.

⁹⁵ Douglas, above n 27, at 491; Kjos, above n 6, at 135 – 136; W. Ben Hamida "L'arbitrage Etat-investisseur cherche son equilibre perdu: Dans quelle mesure l'Etat peut introduire des demandes reconventionnelles contre l'investisseur prive?" (2005) 7 International Law FORUM du droit international 261 at 269. See also *Saluka*, above n 82, where the tribunal rejected the claimant's argument that the host state's offer to arbitration 'was only accepted by Claimant in respect of claims based on the Treaty, and the Parties' mutual consent to arbitration was limited accordingly'; Lalive and Halonen, above n 73, at 150.

⁹⁶ Atanasova, above n 1, at 366.

virtue of the principle of *kompetenz/kompetenz*, the tribunal itself decides the extent of its jurisdiction to decide the dispute by reference to the arbitration agreement.⁹⁷

The assertion of host state counterclaims in arbitration is therefore contingent on whether the parties' have consented that the tribunal has jurisdiction to decide counterclaims. The most significant obstacles in this respect stem from the asymmetrical structure of investment treaties. Substantively, most investment treaties impose obligations on states to maintain minimum standards of regulatory treatment vis-à-vis the investor but do not impose any reciprocal obligations on investors towards host states.⁹⁸ Moreover, the arbitration agreement does not incorporate the substantive provisions of the BIT nor does it make them applicable bilaterally. Thus there can be no legal basis for a counterclaim in the treaty or arbitration agreement itself.⁹⁹ Nor does international law impose obligations on private parties.¹⁰⁰ Instead, counterclaims must be based on an investor's alleged non-compliance with the host state's domestic laws and regulations or breach of an investment contract.¹⁰¹

These obstacles to the assertion of host state counterclaims are very unique to the investment treaty context. In contract-based investment arbitration, tribunals have traditionally found no difficulty in accepting counterclaims where the investor's claim is based on a pre-existing contract with the host state that includes an arbitration clause.¹⁰² Consent to international arbitration in contract-based disputes is generally found in a single instrument: the contract. Contracts are normally bilateral in substance and procedure, in that they impose readily recognisable obligations on both parties that may form the legal basis of a counterclaim, and dispute resolution clauses usually permit both parties to bring claims against the other.¹⁰³ As the same cannot be said of treaty-based arbitration, the terms of

⁹⁷ Kjos, above n 6, at 112.

⁹⁸ Bjorkland, above n 45, at 462.

⁹⁹ James Crawford, "Treaty and Contract in Investment Arbitration" 24 (2008) *Arbitration International*, at 364.

¹⁰⁰ Kjos, above n 6, at 149.

¹⁰¹ Bjorkland, above n 45, at 465.

¹⁰² Kjos, above n 66, at 129.

¹⁰³ Kalicki, above n 44.

consent given in the BIT must be carefully scrutinised to determine whether the parties' intended for the tribunal to exercise jurisdiction over counterclaims at all.¹⁰⁴

This section examines the core provisions that a treaty tribunal must scrutinise to ascertain the extent of its jurisdiction over state counterclaims, and highlights how those provisions may be more or less 'counterclaim-friendly'. There are two key provisions in this respect.¹⁰⁵ The first is the scope of disputes that the parties have agreed to arbitrate. The applicable law that the parties have prescribed for resolution of the dispute, while not strictly relevant to jurisdiction, may assist to refine this scope.¹⁰⁶ The second is whether or not the treaty confers standing to both parties. A third consideration that may arise in relation to contractual counterclaims is whether the contract is subject to a forum selection clause.¹⁰⁷

1 SCOPE OF THE DISPUTE

The definition of disputes that may be submitted to arbitration provided for in the arbitration agreement has a significant influence on the possible assertion of host state counterclaims. The scope of the dispute may be defined broadly or narrowly for the purpose of jurisdiction *ratione materiae*.¹⁰⁸ To facilitate the assertion of state counterclaims, the scope of disputes must be broad enough to include investor obligations that could form the legal basis of a counterclaim. Allied to this, the treaty must not preclude the tribunal from applying the host state's general domestic law and/or contract law because host state counterclaims will invariably be based in domestic or contract law, not international law.¹⁰⁹

The mutual consent of the parties is found in the arbitration agreement but, as this agreement is a function of the offer in the investment treaty, a survey of common treaty

¹⁰⁴ Bjorkland, above n 45, at 468.

¹⁰⁵ Atanasaova, above n 1, at 370.

¹⁰⁶ Dafina Atanasova, Carlos Adrian Martinez Benoit and Josef Ostransky "Counterclaims in Investor-State Dispute Settlement (ISDS) under International Investment Agreements (IIAs) (The Graduate Institute of International and Development Studies in Geneva, Trade and Investment Law Clinic Papers 2012) at 47, noting that *AMTO v Ukraine* and *Roussalis v Romania* considered the applicable law provision contained in the investment agreement as relevant in assessing their jurisdiction on counterclaims brought by the respondent state.

¹⁰⁷ Kjos, above n 6, at 146.

¹⁰⁸ Atanasova, above n 1, at 370.

¹⁰⁹ Kjos, above n 6, at 118.

dispute resolution provisions is helpful in this respect. There are three ‘prototype provisions’ that are commonly used in BITs to define the scope of disputes in arbitration.¹¹⁰ This section analyses each prototype provision to designate them as more or less ‘counterclaim-friendly’ and addresses a number of issues raised in arbitral practice that may affect this designation.

(a) INCLUSIVE OF INVESTOR OBLIGATIONS

The first prototype provision permits ‘all’ or ‘any’ disputes relating to investments to be submitted to an investment treaty tribunal. This is by far the most prevalent type of dispute resolution clause in BITs.¹¹¹ One example is the Netherlands-Czech BIT applied in *Saluka v Czech Republic*, which refers to ‘[a]ll disputes between one Contracting Party and an investor of the other Contracting Party concerning an investment of the latter [...]’.¹¹²

It has been held that this broad form treaty provision is capable of extending the tribunal’s jurisdiction to host state counterclaims.¹¹³ One point of controversy, however, has been whether broad dispute resolution provisions permit treaty tribunals to exercise jurisdiction over contractual disputes in particular. This question is pertinent to the availability of counterclaims as many disputes have a contractual origin, and because contracts impose obligations on investors that might form the basis of host state counterclaims.¹¹⁴

The objection that has been raised is that purely contractual claims should not, as a matter of principle, be covered by broad dispute resolution clauses in BITs. Absent specific language to the contrary, the objection contends that a treaty tribunal should not interpret a treaty to confer jurisdiction when it has not even been called upon to rule on alleged violations of that treaty. Emmanuel Gaillard warns, ‘[t]here is always a danger of divorcing the jurisdictional provisions from the substantive terms of the same treaty in that this may

¹¹⁰ Douglas, above n 27, at 234 – 235. In fact, Douglas suggests that there are four prototype BITs. The prototype not covered by this paper are treaties that limit the *ratione materiae* jurisdiction of a tribunal to disputes about the quantum payable in the event of a proscribed expropriation.

¹¹¹ Douglas, above n 27, at 234.

¹¹² Netherlands-Czech Republic BIT, Art 8.

¹¹³ *Saluka Investments B.V. v Czech Republic*, UNCITRAL, Decision on Jurisdiction over the Czech Republic’s Counterclaim (7 May 2004)

¹¹⁴ Kjos, above n 6, at 134.

suggest that the treaty-based tribunal has jurisdiction but is invited to rule in a vacuum'.¹¹⁵ Distinguishing purely contract claims from those that would also constitute a violation of the BIT, the Tribunal in *SGS v Pakistan* decided that contractual disputes are not included even when the dispute resolution clause is broadly formulated.¹¹⁶ Although it acknowledged that violations of the BIT and the contract could both be characterised as “disputes with respect to investments”, it held that this term:¹¹⁷

While descriptive of the *factual subject matter* of the disputes, does not relate to the *legal basis* of the claims, or the *cause of action* asserted in the claims. In other words, from that description alone, without more, we believe that no implication necessarily arises that both BIT and purely contract claims are intended to be covered by the Contracting Parties in [the dispute resolution clause].

In contra, the *SGS v Philippines* tribunal decided that contractual disputes were included under an identically worded dispute resolution clause. The *SGS v Philippines* tribunal found that the term “disputes with respect to investments” is not limited by the legal classification of the claim that is made'.¹¹⁸ It recognised that ‘investments are characteristically entered into by means of contracts or other agreements with the host state and the other investment partner’; and therefore, ‘the phrase “disputes with respect to investments” naturally includes contractual disputes’.¹¹⁹ The parties to the BIT could have chosen to limit the dispute resolution clause to ‘claims concerning breaches of the substantive standards contained in the BIT’ or to ‘claims brought for breach of international standards’ but they did not do so.¹²⁰

¹¹⁵ E. Gaillard “News – International Arbitration Law” (October 2005) 234 NYLJ.

¹¹⁶ Stanimir A. Alexandrov “Breaches of Contract and Breaches of Treaty: The Jurisdiction of Treaty-Based Arbitration Tribunals to Decide Breach of Contract Claims in *SGS v Pakistan* and *SGS v Philippines* (2006) 3 Transnational Dispute Management 555 at 574.

¹¹⁷ *SGS Societe Generale de Surveillance S.A. v Islamic Republic of Pakistan*, ICSID Case No. ARB/01/13, Decision of the Tribunal on Objections to Jurisdiction of 6 August 2003, 18 ICSID Rev – FILJ 307 at 161.

¹¹⁸ *SGS Societe Generale de Surveillance S.A. v Republic of the Philippines*, ICSID Case No. ARB/02/6, Decision of the Tribunal on Objections to Jurisdiction of 29 January 2004, at 131.

¹¹⁹ *SGS v Philippines*, above n 118, at 132(d).

¹²⁰ *SGS v Philippines*, above n 118, at 132(e).

The reasoning of *SGS v Philippines* should be endorsed, on a textual and policy basis. Article 31(1) of the Vienna Convention on the Law of Treaties provides that ‘a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose’.¹²¹ The ordinary meaning of a broad dispute resolution clause strongly suggests that “disputes with respect to investments” include disputes between an investor and the host state relating to a breach of an investment contract. State practice shows that parties’ who wish to make a distinction will set it out specifically in the BIT.¹²² From a policy perspective, this paper disagrees with Gaillard; to the contrary, the *exclusion* of contractual disputes would require the treaty tribunal to rule in a vacuum: ‘If treaties and contracts were ‘clean different things’, one would expect them to inhabit different worlds... [b]ut even in legal systems which give no such effect to treaties as such, a dualistic construction does not prevail’.¹²³ In effect, an interpretation of broad dispute resolution clauses that includes contractual and non-contractual disputes more accurately reflects the diverse range of legal relationships implicated in investment disputes.¹²⁴

The second prototype provision supports this conclusion as to purely contractual disputes under the first prototype. The second prototype provision, inspired by the USA Model BIT (1994) specifically extends the scope of the treaty tribunal’s *ratione materiae* to three legal sources, as those ‘arising out of or relating to an investment authorisation, an investment agreement or an alleged breach of any right conferred, created or recognised by this Treaty with respect to the covered investment’. The relevant treaties in *Alex Genin* and *Goetz* employed language similar to this prototype.¹²⁵ This provision is “counterclaim-friendly” as it encompasses investment authorisations and agreements which include investor obligations. Counterclaims presented on the basis of the host state’s domestic law pertaining to other matters, however, would fall outside the jurisdiction of the tribunal.¹²⁶

¹²¹ Vienna Convention on the Law of Treaties, 1155 UNTS 331, Art 31(1).

¹²² Alexandrov, above n 116, at 573.

¹²³ Crawford, above n 99, at 360.

¹²⁴ This conclusion is supported by Douglas, above n 27, at 238 – 240.

¹²⁵ Douglas, above n 27, at 234.

¹²⁶ Atanasova, above n 106, at 15.

In sum, it is submitted that the first and second prototype provisions are ‘counterclaim-friendly’, as the tribunal’s jurisdiction extends beyond claims founded upon an investment treaty obligation.¹²⁷ In addition, applicable law clauses which include investment contracts and/or the domestic law of the host state are more conducive to the assertion of counterclaims than those referring only to the treaty itself and international law, as both contracts and the domestic law of the host state usually provide for obligations on the part of investors.¹²⁸

While not a treaty prototype *per se*, an express provision granting the right to counterclaim is, of course, one way to confer jurisdiction on the treaty tribunal to hear counterclaims. At present, the Common Market for Eastern and Southern Africa (COMESA) Investment Agreement is the only investment agreement that expressly grants such a right, in the following terms: ‘A Member State against whom a claim is brought by a COMESA investor under this Article may assert as a defence, counterclaim, right of set off or other similar claim, that the COMESA investor bringing the claim has not fulfilled its obligations under this Agreement [...]’. The COMESA Agreement itself also provides a legal basis for such counterclaims by imposing substantive obligations on investors to comply with domestic laws: ‘COMESA investors and their investments shall comply with all applicable domestic measures of the Member State in which their investment is made’.¹²⁹

(b) EXCLUSIVE OF INVESTOR OBLIGATIONS

The third prototype provision restricts the subject matter of arbitration exclusively to alleged violations of substantive provisions of the treaty. A minority of treaties are of this type. In such cases, counterclaims would fall outside the parties’ consent to arbitration and consequently the tribunal could not exercise jurisdiction to hear them.

Spyridon Roussalis v Romania is notable as the only case to reject a counterclaim on the basis of absence of consent. In the case, Roussalis claimed that its investments were subject to a series of ‘malicious and unjustifiable acts taken by various agencies of the Romanian government’, amounting to an indirect expropriation or, at least, substantial impairment, of

¹²⁷ Douglas, above n 27, at 235.

¹²⁸ Atanasova, above n 1, at 374 – 375.

¹²⁹ Investment Agreement for the COMESA Common Investment Area, Art 28(9).

its investments in violation of the applicable Greece-Romania BIT.¹³⁰ In turn, Romania asserted counterclaims against the claimant arising out its alleged failure to make post-purchase payments under a share purchase agreement.¹³¹

The majority declined jurisdiction over Romania's counterclaims on the basis that the investor had not consented to the counterclaims being heard. The BIT provided that the tribunal had jurisdiction over '[d]isputes between an investor of a Contracting Party and the other Contracting Party concerning an obligation of the latter under this Agreement...'.¹³² The majority noted that this dispute resolution clause referred only to the bringing of proceedings by the investor in the event that the state breaches its obligations. This 'undoubtedly limit[s] jurisdiction to claims brought by investors about obligations of the host state.'¹³³ Furthermore, the applicable law clause of the BIT reinforced this conclusion, as it did not refer to domestic law but only to international law and the BIT itself.¹³⁴

The third arbitrator in *Roussalis*, Professor Michael Reisman, disagreed with the analysis of the majority.¹³⁵ Reisman cited two main reasons for his dissent. First, in his view, the investor must be deemed to have consented to the bringing of counterclaims when instituting ICSID proceedings:

When the State Parties to a BIT contingently consent, *inter alia*, to ICSID jurisdiction, the consent component of Article 46 of the Washington Convention is *ipso facto* imported into any ICSID arbitration which an investor then elects to pursue. It is important to bear in mind that such counterclaim jurisdiction is not only a concession to the State Party: Article 46 works to the benefit of both respondent state and investor.

¹³⁰ *Spyridon Roussalis v Romania*, ICSID Case No. ARB/06/1, Award, 7 December 2011, at 760 and 763.

¹³¹ Crawford, above n 99, at 365.

¹³² Greece-Romania BIT, Art 9.

¹³³ *Roussalis*, above n 130, at 869.

¹³⁴ *Roussalis*, above n 130, at 871.

¹³⁵ *Spyridon Roussalis v Romania*, ICSID Case No. ARB/06/01, Dissenting Opinion of W. Michael Reisman at 146.

Reisman’s second reason for allowing the counterclaims recalls the rationale and role of counterclaims identified in Part II of this paper:

In rejecting ICSID jurisdiction over counterclaims, a neutral tribunal – which was, in fact, selected by the claimant – perforce directs the respondent state to pursue its claims in its own court where the very investor who had sought a forum outside the state apparatus is now constrained to become the defendant. (And if an adverse judgment ensues, that erstwhile defendant might well transform to claimant again, bringing another BIT claim.) 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 view has found support in arbitral practice. In the recent *Goetz* decision, the tribunal endorsed Reisman’s reasoning, even though such a finding was unnecessary for the tribunal to exercise jurisdiction over the counterclaims before it. The *Goetz* tribunal commented that:¹³⁶

... by the very act of entering the Treaty, Burundi has accepted that any disputes which go to arbitration under the ICSID framework will be governed by the terms of and according to the rules laid down under the Washington Convention. In particular, it is accepted that incidental or additional claims or counterclaims brought during proceedings would be considered by the Tribunal under the conditions laid down by Article 46 of the Convention of Article 40 of the Arbitration Rules. By accepting the offer made in the Treaty, the *Goetz* parties for their part accepted that this would be the case. This two-fold consent gives the tribunal jurisdiction to hear counterclaims.

With respect, the reasoning of Professor Reisman should not be followed. Reisman’s interpretation means that the bringing of a claim to ICISD could in and of itself be construed as consent to any counterclaim, as long as the counterclaim arises directly out of the principal claim.¹³⁷ In the author’s view, *ipso facto* incorporation of Article 46 brings with it the three requirements set out above, including the requirement that the parties have given consent to

¹³⁶ *Antoine Goetz and others v Republic of Burundi*, ICSID Case No. ARB/01/2, Award, 21 June 2012, at 278. The tribunal did not need to make such a finding because the wording of the Belgium-Luxembourg-Burundi treaty invoked defines ‘disputes relating to investments’ broadly, covering individual investment agreements, any investment authorisations, or any rights under the BIT itself.

¹³⁷ Atanasova, above n 1, at 367.

counterclaims. In other words, the application of Article 46 presupposes consent; it does not determine consent. This point is supported by the scheme of the ICSID Convention and its *travaux préparatoires*. Article 46 is located in the Convention’s section on “Powers and Functions of the Tribunal” and not in the section on the “Jurisdiction of the Centre”.¹³⁸ Moreover, Aron Broches, the principal architect of the ICSID Convention, made clear that Article 46 was ‘in no way intended to extend the jurisdiction of the arbitral tribunal’¹³⁹; ‘rather, it is intended to obviate separate proceedings for connected claims, but in all cases there must be a specific undertaking to admit the question to arbitration.’¹⁴⁰

On the other hand, Douglas has argued that Reisman’s dissent should be followed. He argues that ‘a limitation upon the scope of the host state’s consent to arbitration in respect of investor’s *claims* does not necessarily apply to the host state’s *counterclaims*... [I]f a counterclaim is sufficiently factually linked with the main claim, it *ipso facto* falls within the jurisdiction of the arbitral tribunal’.¹⁴¹ The difficulty with this argument is that there is no apparent reason to treat the jurisdictional requirement of consent to counterclaims differently to that of principal claims. Indeed, a counterclaim constitutes a separate and independent claim by virtue of which the host state may be awarded a remedy against the investor, and it is therefore reasonable that the latter must be deemed to have consented to the bringing of that counterclaim.¹⁴² Only once this consent is established should the factual connection of counterclaims to the principal claims be scrutinised.

Admittedly, the notion of implied consent from the very act of bringing a claim is an attractive one, especially in view of the value that counterclaims could bring to investment arbitration identified in Part II of this paper. In this respect, an analogy can be drawn with the

¹³⁸ Schreur, above n 41, at 733.

¹³⁹ *Summary Record of Proceedings, Geneva Consultative Meeting of Legal Experts* (February 17 -22, 1964) in *History of the ICSID Convention*, Vol. 2 (ICSID 1970) 367, 422.

¹⁴⁰ *Chairman’s Report on the Regional Consultative Meetings of Legal Experts*, in *History of the ICSID Convention*, Vol. 2 (ICSID 1970) 557, 573.

¹⁴¹ Zachary Douglas “Enforcement of Environmental Norms” in Pierre-Marie Duuy and Jorge E. Vinuales (eds) *Harnessing Foreign Investment to Promote Environmental Protection: Incentives and Safeguards* 412 at 433.

¹⁴² Kjos, above n 6, at 129.

field of sovereign and diplomatic immunity.¹⁴³ In *Banco Nacional de Cuba v Sabbatino* (1964), the United States Supreme Court held that even though a state would normally be immune from suit by private parties in foreign courts, ‘fairness has been thought to require that when the sovereign seeks recovery, it be subject to legitimate counterclaims against it’.¹⁴⁴ In other words, the fact that a state presents a claim estops it from benefiting from its immunity with respect to counterclaims. There are, however, fundamental differences between the decision of a domestic court to ‘cut into the doctrine of immunity’ and an arbitral tribunal’s decision to exercise jurisdiction over a counterclaim that is not covered by the arbitration agreement. Sovereign and diplomatic immunity is a reason for the court not to exercise jurisdiction *that it already has* over a defendant. In contradistinction, an arbitral tribunal’s jurisdiction is dependent on the investor’s consent.¹⁴⁵ Therefore, the tribunal does not have the same freedom to permit counterclaims in pursuit of fairness, procedural economy, justice, or otherwise.

In sum, counterclaims cannot be asserted under a dispute resolution clause that restricts the scope of the parties’ consent to breach of host state obligations under the relevant investment treaty. This is true regardless of whether or not the treaty incorporates the ICSID Convention and Arbitration Rules. Hence, a BIT that adopts this third prototype provision is closer to an ‘international quasi-review of national regulatory action’, where there is no place for counterclaims.¹⁴⁶ For completeness, it must be noted that the two most prominent multilateral investment treaties, the North American Free Trade Agreement (NAFTA) and the Energy Charter Treaty (ECT), adopt clauses similar to this third prototype provision.¹⁴⁷

¹⁴³ Kjos, above n 6, at 144.

¹⁴⁴ *Banco Nacional de Cuba v Sabbatino*, 376 U.S. 398, 438 (1964). See also US Foreign Immunities Act, 28 USCA 1607(b); European Convention on State Immunity, art 1(2)(a); R. B. Loper “Counterclaims Against a Foreign Sovereign Plaintiff” (1956) 50 Am. J. Int’l L. 647 (1956).

¹⁴⁵ Kjos, above n 6, at 144 – 145.

¹⁴⁶ T. Weiler and T. W. Walde “Investment Arbitration under the Energy Charter Treaty in the light of new NAFTA Precedents: Towards a Global Code of Conduct for Economic Regulation” (2004) 1 Transnational Dispute Management.

¹⁴⁷ NAFTA Arts 1116, 1117; ECT, Art 26(1).

2 STANDING

The host state's *locus standi* in an investment treaty may offer clues as to the scope of the parties' consent over counterclaims – but it is not dispositive. It is likely that a treaty that permits host state claims would also permit host state counterclaims.¹⁴⁸ This follows from the proposition that a counterclaim is a separate claim 'to be treated by the arbitral tribunal essentially in the same manner as if it were an original claimant's demand'.¹⁴⁹ The United States-Estonia BIT, at issue in *Alex Genin*, is an example. That BIT provides '[o]nce the national or company concerned has so consented [to binding arbitration], *either Party* to the dispute may initiate arbitration in accordance with the choice so specified in the consent.'¹⁵⁰ Similar provisions are found in the UK-Jamaica BIT,¹⁵¹ the Iranian and the Peruvian Model BITs,¹⁵² and the ASEAN Agreement for the Promotion and Protection of Investments.¹⁵³

The opposite is not necessarily true, however. In treaties where host states do not have *locus standi*, the situation is not substantially different than when they do, as the separate consent of the investor is always required. In this way, a treaty that does not provide *locus standi* to host states may simply better reflect the practical function of investment treaty arbitration and express the host state's unqualified willingness to arbitrate.¹⁵⁴ Accordingly, sole reference to investors *locus standi* does not constitute an obstacle to host state counterclaims.¹⁵⁵

¹⁴⁸ Kjos, above n 6, at 139.

¹⁴⁹ UNCITRAL Secretariat *Possible Future Work in the Area of International Commercial Arbitration*, 6 April 1999, A/CN.9/460 at 72.

¹⁵⁰ US-Estonia BIT, Art VI(1)(b).

¹⁵¹ UK-Jamaica BIT, Art 9.

¹⁵² Iranian Model BIT, Art 12(2); Peru Model Agreement, Art 8.

¹⁵³ ASEAN Agreement (An Agreement Among the Governments of Brunei Darussala, the Republic of Indonesia, Malaysia, the Republic of the Philippines, the Republic of Singapore, and the Kingdom of Thailand for the Promotion and Protection of Investments, 15 December 1987), Art X(2).

¹⁵⁴ Douglas, above n 27, at 364.

¹⁵⁵ Kjos, above n 6, at 140.

3 FORUM SELECTION CLAUSE

Forum selection clauses affect the admissibility of a contract. A forum selection clause is a provision in a contract whereby the parties agree that any litigation resulting from that contract will be settled in a specific forum. Where the legal basis of a counterclaim is a contract subject to a forum selection clause that designates a forum other than arbitration, investment tribunals will generally decline or stay its jurisdiction.¹⁵⁶ This was the basis for the majority holdings in *SGS v Pakistan* and *SGS v Phillipines* that a contractual claim under a BIT cannot be pursued in breach of an applicable exclusive jurisdiction clause, in line with the *pacta sunt servanda* principle.¹⁵⁷

The same tribunal may, however, retain jurisdiction over the investor's treaty claim.¹⁵⁸ In cases where the line between the contract and the treaty aspects of the investor's claim are sufficiently blurred, the parties may be advised, in the interests of procedural economy, to rescind the forum selection clause so that the tribunal is be competent to hear both contract and treaty claim.¹⁵⁹ This is particularly compelling where the investor has requested a stay of proceedings. As was noted in *SGS v Pakistan*:¹⁶⁰

It would be inequitable if, by reason of the invocation of ICSID jurisdiction, the Claimant could on the one hand elevate its side of the dispute to international adjudication and, on the other, preclude the Respondent from pursuing its own claim for damages by obtaining a stay of those proceedings for the pendency of the international proceedings, if such international proceedings could not encompass the Respondent's claim.

Rescission of the forum selection clause, however, is a decision for the investor and the host state and not the tribunal. Hence, contractual form selection clauses may pose a significant obstacle for a state to assert counterclaims based on contract in arbitration.

¹⁵⁶ Atanasova, above n 1, at 377.

¹⁵⁷ Alexandrov, above n 116, at 562 – 563.

¹⁵⁸ *Compania de Aguas, SA and Vivendi Universal v Argentina*, ICSID Case ARB/97/3, Decision on Annulment at 98.

¹⁵⁹ Kjos, above n 6, at 147.

¹⁶⁰ *SGS v Pakistan*, above n 117, Procedural Order, 18-1 ICSID Rev-FILJ 293, 303 (2003).

4 INTERIM CONCLUSIONS ON JURISDICTION

A tribunal's jurisdiction over counterclaims depends upon the extent to which a particular counterclaim falls within the scope of disputes as defined in the parties' arbitration agreement. The *Roussalis* minority view that incorporation of arbitration rules by reference in the arbitration agreement may be used to ascertain consent must be rejected as contrary to the scheme and *travaux préparatoires* of Article 46.

It would be easier for host states to assert counterclaims where the tribunal's jurisdiction *ratione materiae* is broad, whether it is generic referring to 'all disputes' or delineates a number of legal sources such as authorisations and agreements. Counterclaims cannot be asserted where the tribunal has narrow jurisdiction *ratione materiae* pertaining solely to host state obligations. Moreover, it is easier for host states to assert counterclaims where it has *locus standi*, but lack of *locus standi* is not dispositive. An applicable law clause that directs the tribunal to exclusively apply international law or the BIT itself prevents the assertion of state counterclaims as neither international law nor the BIT impose obligations on investors.¹⁶¹

An important addendum to these conclusions is that the investor may at any stage consent to the assertion of host state counterclaims (provided that the counterclaim complies with admissibility and time frame requirements). An investor may wish to do so given the time and expense that may be saved in consolidating the parties claims into one set of proceedings.¹⁶² However, this incentive has its limits. An investor may be well advised to refuse its consent to jurisdiction over counterclaims as a litigation strategy. In particular, it may force the state to initiate claims before a separate forum in the hope that the additional time and expense will deter the state from bringing the claim at all. Refusing consent may also be a strategic way to turn the eye of the tribunal away from the investor's wrongdoing to focus more on the behaviour of the host state.¹⁶³

Going forward, host states should be advised to make express provisions for counterclaims in their BITs. In this respect, the author notes that the United Nations

¹⁶¹ *Roussalis*, above n 130.

¹⁶² Kjos, above n 47, at 1.

¹⁶³ Lalive, above n 73, at 142.

Conference on Trade and Development, in its recent World International Investment Report, made the same recommendation.¹⁶⁴ Whether foreign investors would be amenable to the inclusion of such express provision remains to be seen.

C REQUISITE CONNECTION

1 FACTUAL AND LEGAL CONNECTION

The next obstacle that host states must contend with to bring counterclaims is that the subject matter of a counterclaim must be connected with that of the principal claim. As stated in *Saluka v Czech Republic*, ‘a legitimate counterclaim must have a close connexion with the primary claim to which it is a response’.¹⁶⁵ This requirement is applied in virtually all legal systems in which counterclaims operate and thus it is an ideal subject for the comparative exercise undertaken in this section.¹⁶⁶

In most treaty arbitrations involving counterclaims, the requisite connection issue has not been discussed. Counterclaims tend to be either dismissed at the jurisdiction stage or, on the other hand, their close connection with the subject matter is deemed “too obvious” to merit attention. In a few cases, requisite connection was neither raised by the parties nor addressed by the tribunal. Only rarely have tribunals made a specific finding that a counterclaim relates to the object of the dispute or that it is admissible in principle. As a result, it is difficult to discern a consistent methodology from the cases.¹⁶⁷

This section surveys the jurisprudence of the ICJ, the Iran/US Claims Tribunal and early contract-based arbitration for guidance on the question of requisite connection. It then analyses the recent treaty tribunal practice on the same issue. This section argues that recent treaty tribunal practice has taken an unjustifiably narrow approach to requisite connection

¹⁶⁴ United Nations Conference on Trade and Development “World Investment Report 2012: Towards a New Generation of Investment Policies (July 2012), at xx, 135, 150, 152, 154.

¹⁶⁵ *Saluka Investments B.V. v Czech Republic*, UNCITRAL, Decision on Jurisdiction over the Czech Republic’s Counterclaim (7 May 2004) at 55 – 57.

¹⁶⁶ ICSID Convention, Art 46; Rules of the International Court of Justice, Art 80. Other international dispute settlement bodies have held that the close connection requirement is an ubiquitous part of general principles of law of procedure, e.g. *Westinghouse Electric Corp v Islamic Republic of Iran* Case No. 389, 12 Feb 1987, Award 6 Iran-US CTR II (1984) at 1; UNCITRAL Arbitration Rules 2010, Art 21(3).

¹⁶⁷ Schreur, above n 41, at 752 – 753.

that renders the assertion of host state counterclaims virtually impossible. It is submitted that the recent cases of *Saluka v Czech Republic* and *Paushok v Mongolia* unduly relied on the jurisprudence of earlier tribunals that dealt with principal claims based on contract and, in doing so, neglected to sensibly adapt the requisite connection requirement to treaty-based arbitrations. The most recent case of *Goetz v Burundi* appears to have taken a more flexible approach to requisite connection but its brief reasoning is of little assistance to future tribunals.

(a) CONNECTION IN THE INTERNATIONAL COURT OF JUSTICE

Article 80 of the ICJ Rules of Court is almost identical to Article 46 of the ICSID Convention and, as such, is a particularly useful point of comparison. Article 80 permits the Court to ‘entertain a counterclaim only if it comes within the jurisdiction of the Court and is directly connected with the subject-matter of the claim of the other party’.¹⁶⁸

In *Oil Platforms*, the United States submitted counterclaims asserting that Iran’s conduct prior to the US’ alleged wrongful acts was a violation of international law and that the US’ measures were in fact countermeasures. Iran claimed that the ICJ lacked jurisdiction to hear the counterclaims as the US’ attacks could not be considered as related to commerce and navigation, which was the subject matter of the treaty invoked as jurisdictional title by Iran. Moreover, Iran contended that there was no direct connection because the claims were too general.¹⁶⁹

The majority held that it had jurisdiction to hear the counterclaims, as freedom of commerce and navigation was broad enough to encompass anything that might inhibit it. With respect to direct connection, the Court stated that due to the lack of definition of “direct connection” in the Rules, it was for the Court, in its sole discretion, to determine on a case-by-case basis, both in facts and in law, whether such connection exists.¹⁷⁰ The Court ultimately found that the counterclaims were admissible as the facts on which the parties relied formed part of the ‘same factual complex’ as the principal claims,

¹⁶⁸ International Court of Justice Rules of Court, Art 80.

¹⁶⁹ Atanasova, above n 106, at 27.

¹⁷⁰ *Case Concerning Oil Platforms (Islamic Republic of Iran v United States of America)*, Counter-Claim, Order of 10 March 1998, Separate Opinion of Judge Oda, ICJ Reports 1998, at 37.

specifically, the counterclaims are alleged to have occurred at the same time and within the same area, and pursue the same legal aim (that is, establishment of a violation of the Treaty of Amity 1955 – the Court found them to be admissible).¹⁷¹ Virtually the same test was articulated in the earlier case of *Genocide Convention*.¹⁷²

Direct connection in the ICJ is thus evaluated on a case-by-case basis in facts (space and time) and law (the legal instrument invoked and the legal aim).¹⁷³ Higgins was careful to note that ‘direct connection’ is not a strict test requiring identity in both fact and law:¹⁷⁴

In both civil and common law domestic systems, as in the Rules of the Court, a defendant seeking to bring a counter-claim must show the Court has jurisdiction to pronounce upon them. But it is not essential that the basis of jurisdiction in the claim and in the counterclaim be identical. It is sufficient that there is jurisdiction. (Indeed, were it otherwise, counter-claims in, for example, tort could never be brought, as they routinely are, to actions initiated in contract.)

This flexible approach was reiterated in the *Armed Activities* case: “[A]s the jurisprudence of the Court reflects, counter-claims do not have to rely on identical instruments to meet the “connection” test of Article 80 [of the ICJ Rules]”.¹⁷⁵ This flexibility has its limits, however. Judge Oda in *Oil Platforms* warned, too broad a definition of counterclaims may lead to a situation in which ‘we put what may have originally been somewhat distinct matters into one melting-pot without making careful examination of the essential character of [the] claim[s]’.¹⁷⁶

¹⁷¹ *Oil Platforms*, above n 170, at 37.

¹⁷² *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, ICJ Reports 243, 1997 (Dissenting Option of Vice President Weeramantry).

¹⁷³ Atanasova, above n 106, at 27.

¹⁷⁴ *Case Concerning Oil Platforms*, above n 170, (Counter-Claim Order, Separate Opinion of Judge Higgins).

¹⁷⁵ *Case Concerning Armed Activities on the Territory of the Congo (Democratic Republic of the Congo v Uganda)* Counter-Claims Order (29 November 2011) ICJ Rep 660 at 326.

¹⁷⁶ *Case Concerning Oil Platforms*, above n 170, (Counter-Claim Order, Separate Opinion of Judge Oda) at 8.

(b) CONNECTION IN THE IRAN/US CLAIMS TRIBUNAL

The Iran/US Claims Tribunal was established under the Algiers Declarations to ‘resolve the crisis’ in Iran/US relations stemming from the ‘November 1979 hostage crisis... and the subsequent freezing of assets by the United States’.¹⁷⁷ Article II(1) of the Algiers Accords provides that a counterclaim ‘must arise out of the same contract, transaction or occurrence that constitutes the subject matter of [the] national’s claim.’¹⁷⁸ The Tribunal’s extensive jurisprudence is helpful in relation to counterclaims arising from a different contract than the one invoked by the claimant in the proceedings, and arising out of domestic law.¹⁷⁹

In most cases, determination of whether a counterclaim arises out of the same contract as the principal claim is unproblematic. Exceptionally, the tribunal has found that a series of separate contracts can be treated as one “transaction” for the purpose of counterclaims.¹⁸⁰ *Westinghouse Electric Crop v Iran* is a seminal decision on the admissibility of counterclaims regarding a separate contract.¹⁸¹ The principal claims were based on four contracts concerning the development of an Integrated Electronics Depot (the “Depot”) which the claimant had designed and assisted the respondent in establishing for the repair and maintenance of weapon and electronics systems. The counterclaims were based on different contracts than the principal claim, which nevertheless involved Depot. In the Tribunal, it was evident that each of the contracts on which the counterclaims were based was legally separate and distinct from the contracts referred to in the principal claim. However, examination of the contracts revealed that they had a strong factual interrelationship and the Depot project as a whole went forward as a joint venture. The counterclaims were found to be admissible.¹⁸²

¹⁷⁷ Iran-United States Claims Tribunal “About the Tribunal” <www.iusct.net>.

¹⁷⁸ Algiers Accords, Art II(1).

¹⁷⁹ Atanasova, above n 106, at 28.

¹⁸⁰ David D. Caron, Lee M. Caplan and Marri Pellonpaa *The UNCITRAL Arbitration Rules: A Commentary* (Oxford University Press, Oxford, 2006) at 414.

¹⁸¹ *Westinghouse Electric Corporation v The Islamic Republic of Iran*, Award No. ITL 67-389-2 (2 February 1987), 14 Iran-US CTR 104 (1987-1).

¹⁸² J. C. Adlam and M. E. Macglashan *The Iran-US Claims Tribunal Reports 14 1987-1* (Grotius Publications Ltd, Cambridge, 1987) at 105 – 110.

At the time of that decision, *American Bell* was the only case that had found separate contracts to constitute a transaction.¹⁸³ In that case, three contracts were concluded to cover the continued performance of the same work by the claimant for successive periods of time in a single project. The claims were based on the second and third contracts (each covering one year periods) while the counterclaims were based on the first contract (which covered a three and a half month interim until the second contract was concluded). The Tribunal found that, in light of these particular circumstances, the linkage between all three contracts is “sufficiently strong” to make them a single transaction for the purpose of admissibility.¹⁸⁴

It may be however, that a purported counterclaim based on a contract or transaction cannot be said to “arise out” of it. The Iran/US Claims Tribunal jurisprudence is relatively settled on this question: a counterclaim does not arise out of a contract where any person or entity may find itself in a position to fulfil the obligations arising from general domestic law, notwithstanding the existence of any specific contractual or other relationship with the state. This includes domestic laws, such as tax law, social security law, custom duties and penal law. This rule does not apply where “the contract includes provisions which create specific obligations, which do not exist in the law, of one party towards the other, in relation to the burden of taxes to be paid, or provisions which set forth conditions for payment of amounts earned under the contract in relation to the payment of taxes”.¹⁸⁵

(c) CONNECTION IN THE CONTRACT-BASED ARBITRATION

Most early cases in investment arbitration arose from the breach of an investment contract. In contract-based arbitration, tribunals have generally accepted that the pleaded counterclaims are sufficiently connected with the principal claims without discussion.¹⁸⁶

¹⁸³ *American Bell International Inc.*, (Award No. ITL 41-48-3).

¹⁸⁴ Adlam, above n 182, at 109.

¹⁸⁵ Caron, above n 180, at 415.

¹⁸⁶ Voheyzek- Greist above n 55, at 92; *Benevenuti and Bonfant v Congo* is illustrative of this lack of careful reasoning. The Tribunal in that case accepted that counterclaims based on non-payment of duties and taxes, overpricing and moral damages were connected with the principal claim simply because: ‘[c]onsidering that the counterclaim relates directly to the object of the dispute, that the competence of this Tribunal has not been disputed and that it is within the competence of the Centre,

Klöckner v Cameroon was the first case to closely analyse the conditions for bringing counterclaims in contract-based arbitration.¹⁸⁷ The case is a classic example of the kind of failed industrial projects that often occur in developing countries.¹⁸⁸ Klöckner, a German investor, undertook to construct a fertiliser factory in Cameroon; to be responsible for its technical and commercial management for at least five years; and to be a 51 per cent shareholder in a Cameroonian joint venture. In turn, Cameroon undertook to develop a furnished site for the factory and guarantee payment of a loan.

Unfortunately, after 18 months of unprofitable and sub-capacity operation under Klöckner's management, the factory was shut down in 1978. Klöckner brought ICSID arbitration on the basis of its own contract with Cameroon to claim the outstanding balance of the price of supplying the factory. In response, Cameroon made a counterclaim against Klöckner, alleging that the joint venture failed due to Klöckner's flawed management. Cameroon's counterclaim was based on a different contract than the principal claim.

After finding jurisdiction,¹⁸⁹ the Tribunal held that the counterclaim was connected to the principal claim. The different contracts were viewed as part of the same deal, a contractual ensemble 'bound together by a close connecting factor'. The Tribunal noted, '[t]he reciprocal obligations had a common origin, identical sources, and an operational unity [...] They were assumed for the accomplishment of a single goal, and are thus interdependent.'¹⁹⁰ Ultimately, however, the Tribunal rejected Klöckner's claim and Cameroon's counterclaim on the merits because responsibility for the failure of the project was shared.¹⁹¹

the Tribunal considers, therefore, that is bound to uphold its competence'. This statement is nothing more than pure tautology.

¹⁸⁷ *Klöckner Industrie-Anlagen GmbH and others v United Republic of Cameroon and Societe Camerounaise des Enrais* ICSID Case No. ARB/81/2, Award, 21 October 1983.

¹⁸⁸ Jan Paulsson "The ICSID *Klockner v Cameroon* Award: The Duties of Partners in North-South Economic Development Agreements" (1984) 1 *Journal of International Arbitration* 145 at 145.

¹⁸⁹ Jurisdiction was actually one of the thorniest issues of the case, but not pertinent to this analysis.

¹⁹⁰ *Klöckner*, as quoted by Paulsson, above n 188, at 152.

¹⁹¹ Kendra, above n 65, above n 581.

Klöckner was decided before *Westinghouse* and *American Bell* and appears to have adopted similar reasoning, in looking to the ultimate purpose of the contracts and their interrelationship to ascertain whether different contracts were connected. This reflects a pragmatic approach to the specific circumstances of that case; a pragmatism which is not indicative of the future ahead.

2 RECENT TREATY TRIBUNAL PRACTICE

(a) *SALUKA INVESTMENTS V THE CZECH REPUBLIC (2004)*

While the subsequent years after the *Klöckner* decision did see counterclaims raised by host states from time to time, the UNCITRAL Tribunal in *Saluka v Czech Republic* is the first to examine the question of requisite connection in detail.¹⁹² In a partial privatisation, Saluka acquired a substantial minority shareholding in a state-owned bank. After a series of controversial events, the bank became insolvent and was put into involuntary administration and sold for a pittance to another bank. Saluka brought claims against the Czech Republic under the Netherlands-Czech Republic BIT alleging deprivation of investment and violation of fair and equitable treatment. The Czech Republic brought counterclaims for, *inter alia*, various breaches of Czech banking, competition and tax laws.

The Tribunal held that it could exercise jurisdiction over the counterclaims as they fell within the broad scope of consent in the Netherlands-Czech Republic BIT as a dispute ‘concerning an investment’.¹⁹³ However, the counterclaims were ultimately rejected for lack of requisite connection with the principal claims. In so deciding, the Tribunal observed that no universal attempt to define requisite connection is likely to be successful.¹⁹⁴ To inform its reasoning, the Tribunal nevertheless drew heavily from the jurisprudence of ICSID and the Iran/US Claims Tribunal,¹⁹⁵ including *Klöckner*, *Westinghouse* and *American Bell*.

¹⁹² *Saluka Investments B.V. v The Czech Republic* Decision on Jurisdiction over the Czech Republic’s Counterclaim (UNCITRAL), 7 May 2004.

¹⁹³ *Saluka*, above n 192, at 60.

¹⁹⁴ *Saluka*, above n 192, at 62.

The Tribunal held that the Czech Republic’s counterclaims were not connected with the principal claims because they involved ‘non-compliance with the general law of the Czech Republic’ or ‘rights and obligations which are applicable, as a matter of general law of the Czech Republic, to persons subject to the Czech Republic’s jurisdiction’. It followed, according to the Tribunal, that the disputes underlying the counterclaims ‘in principle fall to be decided through the appropriate procedures of Czech law and not through the particular investment protection procedures of the Treaty’. To reach this decision, the Tribunal directly quoted *Klöckner* with approval, and stated that the Czech Republic’s counterclaims ‘cannot be regarded as constituting an “indivisible whole” with the primary claim... or as invoking obligations which share with the primary claim “a common origin, identical sources, and an operational unity”’.¹⁹⁶

This approach to requisite connection cannot be endorsed in the context of investment treaty arbitration. This paper objects to the tribunal’s reasoning in two main respects. First, a requirement of legal symmetry of the principal claim and counterclaim does not reflect the practical reality of investment treaty disputes; and, secondly, the wholesale rejection of state counterclaims based on general domestic law for lack of requisite connection is unsupported in law and in principle.¹⁹⁷

Saluka’s insistence that the claim and counterclaim have “identical sources, and an operational unity” is a function of its reliance on *Klöckner*, *Westinghouse* and *American Bell*. In treaty arbitration, this proposition would have the effect of excluding a treaty tribunal’s jurisdiction over counterclaims whenever the principal claim is based on an alleged treaty violation. This is because, as discussed, investment treaties do not include any investor obligations on which a counterclaim could be based.

The *Saluka* Tribunal was not attentive to the unique aspects of treaty arbitration that would warrant departure from previous contract-based jurisprudence. In relation to *Klöckner*, the test in that case was adopted to identify a single on-going ‘transaction’ or ‘business relationship’ that could serve to connect different contracts.¹⁹⁸ This test for

¹⁹⁶ Douglas, above n 27, at 260.

¹⁹⁷ Atanasova, above n 1, at 383.

¹⁹⁸ Douglas, above n 27, at 261.

requisite connection is inappropriate in the investment treaty context, where a host state may not have any direct relationship with the investor, contractual or otherwise. In fact, *Klöckner*'s suitability in contract-based arbitration beyond its specific facts can also be questioned as, recalling Judge Higgins comments, counterclaims based on tort are regularly admitted in disputes arising out of a contract.¹⁹⁹

In relation to the Iran/US Claims Tribunal, the Algiers Accords confers jurisdiction over counterclaims 'which arise out of the same contract, transaction or occurrence that constitutes the subject matter' of the primary claim. Hence, the Iran/US Claims Tribunal is specifically directed to analyse the legal symmetry of the claim and counterclaim. In contra, the Netherlands-Czech Republic BIT has a broad dispute resolution clause that extends the Tribunal's jurisdiction over '[a]ll disputes between one Contracting Party concerning an investment of the latter'. This is significantly broader than the jurisdiction granted to the Iran/US Claims Tribunal, and thus requisite connection should not be dismissed due to mere legal asymmetry.²⁰⁰

The second objection is that *Saluka*'s wholesale rejection of state counterclaims based on domestic law for lack of connection is unsupported in law and in principle. The Tribunal relied on several precedents where the principal claim is based on a contract with the host state, and the counterclaim was founded on an obligation in general domestic law (such as a tax obligation). From ICSID, the Tribunal relied on *Amco v Indonesia No 2*.²⁰¹ In that case, Indonesia raised a counterclaim for 'tax fraud' on the part of the claimants and sought restitution of sums representing the tax allegedly evaded by the claimants throughout the relevant period of the investment. The counterclaim was ultimately rejected on the basis of jurisdiction. *Saluka* appears to have heavily relied on the following passage from *Amco*:²⁰²

¹⁹⁹ Atanasova, above n 1, at 384.

²⁰⁰ Douglas, above n 27, at 263.

²⁰¹ Douglas, above n 27.

²⁰² *Amco v Indonesia No. 2* (Preliminary Objections) 1 ICSID Rep 543 at 565.

[I]t is correct to distinguish between the rights and obligations that are applicable to legal or natural persons who are within the reach of a host state's jurisdiction, as a matter of general law; and rights and obligations that are applicable to an investor as a consequence of an investment agreement entered into with that host state. Legal disputes relating to the latter will fall under Article 25(1) of the Convention. Legal disputes concerning the former in principle fall to be decided by the appropriate procedures in the relevant jurisdiction unless the general law generates an investment dispute under the Convention.

The obligation not to engage in tax fraud is clearly a general obligation of law in Indonesia. It was not specially contracted for in the investment agreement and does not arise directly out of the investment.

This passage from *Amco* echoes the Iran/US Claims Tribunal on this matter. The *Saluka* Tribunal appears to have understood this passage as a wholesale rejection of state counterclaims based on domestic law in treaty arbitration. However, this fails to recognise the context in which the statement is made. *Amco* declined jurisdiction over the tax claim, not for lack of requisite connection, but because it was not based on a 'legal dispute arising directly out of the investment' as required by Article 25 of the ICSID Convention (the third requirement in Article 46, discussed at Part III(A) of this paper).²⁰³ It follows that the tax claim may have been heard if it was a legal dispute arising directly out of the investment. As the *Saluka* Tribunal *did* find that the Czech Republic's counterclaims were within its jurisdiction as 'concerning an investment', reliance on *Amco* to reject the counterclaims was misplaced.

The test under Article 25 of ICSID for a 'legal dispute arising out of an investment' is substantially similar to the dispute resolution clause in the Netherlands-Czech Republic BIT. Therefore, in light of *Amco*, it may have been open to the *Saluka* Tribunal to reject the Czech Republic's counterclaims for lack of jurisdiction on the basis that the counterclaims did not concern an investment.²⁰⁴ In electing to decide the case on the basis of requisite connection instead, the tribunal adopted a test that denies that counterclaims can ever be based on the domestic laws of the host state.

²⁰³ Douglas, above n 27, at 262.

²⁰⁴ Kjos, above n 6, 152.

In sum, *Saluka*'s insistence on legal symmetry to establish requisite connection and its denial that general domestic law can ever form the basis of a state counterclaims renders the assertion of state counterclaims virtually impossible. The reasoning in *Saluka* is based on non-treaty jurisprudence which obscured the unique context of treaty arbitration. The focus of investment treaties is the 'investment', a potentially broad term. Insistence on legal symmetry of the principal claim and counterclaim overlooks the "mosaic of laws" that may be involved in an investment dispute (international, domestic and contractual).²⁰⁵

(b) PAUSHOK V MONGOLIA (2011)

Despite the deficient reasoning of *Saluka*, the case was cited with approval by the UNCITRAL Tribunal in *Paushok v Mongolia*.²⁰⁶ The investor, a Russian national who owned gold mines through a company, claimed that Mongolia had breached the applicable Russia-Mongolia BIT by implementing a windfall profit tax commodities and a fee on foreign workers. Mongolia advanced seven counterclaims on various grounds: tax evasion, claims to pay back workers fees, illicit inter-group transfers leading to further tax and levies evasion, violation of a licence agreement obliging the claimant to extract gold in a manner leading to further loss in taxes and revenues, violations of environmental and allegations of drug smuggling.²⁰⁷

The Russia-Mongolia BIT contained a broadly worded dispute resolution clause similar to that in *Saluka* in terms of subject matter and *locus standi*, and the reasoning of *Saluka* was extensively referred to by the *Paushok* tribunal. The Tribunal pronounced the test that it applied in considering the counterclaims in the following terms:²⁰⁸

In considering whether the Tribunal has jurisdiction to consider the counterclaims, it must therefore decide whether there is a close connection between them and the primary claim from which they arose or whether the counterclaims are matters than are otherwise covered by the general law of Respondent.

²⁰⁵ Douglas, above n 27, at 40.

²⁰⁶ *Paushok v Mongolia*, Award on Jurisdiction and Liability (UNCITRAL) 28 April 2011.

²⁰⁷ Kendra, above n 65, at 583.

²⁰⁸ *Paushok*, above n 206, at 678.

Paushok's either/or proposition denies that matters covered by general domestic law can ever be closely connected with the principal claim. As to the counterclaims relating to Mongolia tax law, it opined:²⁰⁹

All these issues squarely fall within the scope of the exclusive jurisdiction of Mongolian courts, and are governed by Mongolian public law, and cannot be considered as constituting an indivisible part of the Claimant's claims based on the BIT and international law or as creating a reasonable nexus between the Claimant's claims and the Counterclaims justifying their joint consideration by an arbitral tribunal exclusively vested with jurisdiction under the BIT.

It follows from these comments that counterclaims arising from any source of law other than international law or the BIT itself are inadmissible. The decision has been criticised as 'a typical example of arbitral decisions that often suffer from a lack of structured reasoning and of a greater conception of international investment law',²¹⁰ and it may be that the Tribunal conflated the issues of jurisdiction and admissibility. Insofar as the passages above are intended to refer to the requisite connection criterion, *Paushok* hence suffers from the same deficiencies in logic as *Saluka*.

(c) ANTOINE GOETZ v REPUBLIC OF BURUNDI (2012)

The recent decision in *Goetz v Burundi* appears to have adopted a better approach.²¹¹ The facts are briefly as follows. AFFIMET, founded and owned by Antoine Goetz and others, was engaged in the production and trade of precious metals in Burundi. AFFIRMET claimed that Burundi had breached conditions of a settlement agreement that had damaged its profitability. In addition, it claimed that other Burundian companies in which they held shares, including the African Bank of Commerce (ABC) had suffered expropriatory measures, including the seizure of documents, which paralysed ABC's banking activities and culminated in the closure of the bank by police in 2000.²¹²

²⁰⁹ *Paushok*, above n 206, at 694.

²¹⁰ Roland Klager "Case Comment: Sergei Paushok, CJSC Golden East Company, CJSC Vostokeytegaz Company v Mongolia" (2012) 27 ICSID Review 16 at 20.

²¹¹ *Antoine Goetz et consorts v Republic of Burundi*, ICSID Case No. ARB/95/3, Award, 10 February 1999.

²¹² *Kenda*, above n 65, at 587.

Burundi counterclaimed on the basis that ABC had failed to respect the conditions of its operating certificate. Burundi's counterclaims were for prejudice suffered arising from taxes not received and from the manner in which ABC had exercised its free zone economic licence allegedly resulting in unfair competition towards other banks and in market distortion.²¹³

The Tribunal accepted jurisdiction over the counterclaims. It also held that the counterclaims were connected to the principal claims, in the following terms:²¹⁴

In the present case, however, there can be no doubt [that there is a close connection between the principal claim and counterclaim]. The main dispute relating to ABC concerned the lawfulness of the suspension of the free enterprise zone certificate and the resulting closure of the bank as a result of breaches of its obligations. The counterclaim relates to prejudice said to have been suffered by Burundi because of those same breaches. It therefore relates directly to the subject matter of the dispute, and it follows that it is admissible.

Hence, *Goetz* found that both the claim and counterclaim related to the conditions and actions carried out on the basis of the certificate and as a result there was a connection.²¹⁵ The counterclaims were ultimately rejected on the merits. However, it is promising that *Goetz* appears to depart from the reasoning of *Saluka* and *Paushok* in finding that there need not be legal symmetry of the claim and counterclaims. Nor did it shy away from counterclaims based on the domestic law of Burundi. Unfortunately, the tribunal's finding that there is 'no doubt' requisite connection is satisfied offers little assistance to future tribunals. In the next Part of this paper, this paper proposes to supplement the tribunal's reasoning with a recommended approach to requisite connection.

3 INTERIM CONCLUSIONS ON REQUISITE CONNECTION

The jurisprudence of the ICJ, the Iran/US Claims Tribunal, and contract-based arbitration is consistent in that, as a general rule, the existence of requisite connection between the

²¹³ Kendra, above n 65, at 588.

²¹⁴ *Goetz v Burundi*, above n 211, at 285.

²¹⁵ Kendra, above n 65, at 589.

counterclaim and principal claim must be assessed in both fact and in law. However, the Iran/US Claims Tribunal and contract-based arbitration has interpreted legal connection strictly to require legal symmetry of the counterclaim and principal claim. This is uncontroversial in those jurisdictions: the parties can usually readily identify a contract or series of contracts under which the parties' rights and obligations can be determined by reference to the same – national – legal order, which governs the contract as a whole.²¹⁶

The same cannot be said of host state counterclaims in investment treaty arbitration. Host state counterclaims cannot find a legal basis in the BIT or in international law to satisfy legal symmetry. In the treaty context, not only is the nature of the claims different; the tribunal is called to apply two different legal orders.²¹⁷ Moreover, *Saluka's* dismissal of counterclaims based on domestic law rests on a misreading of *Amco*. The unique structure of investment arbitration therefore requires an alternative approach.

V ALTERNATIVE APPROACH TO REQUISITE CONNECTION

This paper submits that requisite connection should be determined by reference to the connection between the counterclaim and *the investment* forming the object of the principal claim.²¹⁸ This is a legal and factual inquiry. It is a legal inquiry because the definition of investment is a legal concept defined by the parties, and not determined by the tribunal in fact. This focus on the investment rather than on symmetry of legal instruments makes more sense in the investment treaty context where there is not necessarily any direct legal relationship between the parties.²¹⁹

There are three other reasons why requisite connection should be established where the counterclaim concerns the same investment as that is implicated by the primary claim. First, it is a more sensible reading of broad jurisdictional clauses in BITs that confer consent over 'all disputes concerning an investment' (despite what *Saluka* and *Paushok* suggest).²²⁰ That is not

²¹⁶ Kjos, above n 6, at 149.

²¹⁷ Kjos, above n 6, at 150.

²¹⁸ Douglas, above n 27, at 263; Atanasovaa, above n 1, at 387.

²¹⁹ Atansaova, above n 387.

²²⁰ Douglas, above n 27, at 260.

to conflate the requirements of jurisdiction and admissibility. A key difference is that a counterclaim cannot be based on *any* investment; it must be based on the same investment on which the principal claim is based.²²¹ While there is a difference, closer alignment of the jurisdiction and admissibility requirements is reasonable in a forum largely predicated on party consent. As opined in *SGS v Paraguay* ‘having found jurisdiction, we would have to have very strong cause to decline to exercise it’ and it would be ‘incongruous’ to find consent and therefore jurisdiction yet to dismiss the claim on admissibility grounds.’²²²

This alternative approach finds support in from the ICSID Secretariat and ICSID itself. The ICSID Secretariat issued the following guidance on requisite connection:

... to be admissible such claims must arise “directly” out of the “subject-matter of the dispute” [...] The test to satisfy this condition is whether the factual connection between the original and the ancillary claim is so close as to require the adjudication of the latter in order to achieve the final settlement of the dispute, the object being to dispose of all the grounds of dispute arising out of the same subject matter.

This note does not refer to a ‘legal’ connection; rather, it emphasised the factual aspects of the connection required. In ICSID itself, Article 25 refers to a “legal dispute”. *Argumentum a contrario*, it would have been clearly stated in Article 46 if legal connection was a strict requirement.²²³

Third, the international practice of the ICJ suggests that legal connection ought to be construed more as a factor for the tribunal to take into account, rather than a necessary prerequisite. Recalling Judge Higgins that, ‘it is not essential that the basis of jurisdiction in the claim and counter-claim be identical.’²²⁴

²²¹ Atanasova, above n 1, at 387.

²²² *SGS Societe Generale de Surveillance SA v Republic of Paraguay* ICSID Case No. ARB/07/29, Decision of Jurisdiction, at 176.

²²³ Lalive, above n 73, at 147.

²²⁴ *Case Concerning Oil Platforms*, above n 170, (Counter-Claim Order, Separate Opinion of Judge Higgins), above n 174.

This broadening of legal connection entails that greater emphasis must be placed on factual connection. This paper recalls the caution of ICJ Judge Oda that too broad a definition of counterclaims may lead to a situation in which ‘we put what may have originally been somewhat distinct matters into one melting-pot without making careful examination of the essential character of [the] claim[s]’.²²⁵ This is an important concern. The extent to which host state counterclaims can improve procedural economy and the better administration of justice is undermined if the scope of permissible counterclaims is extended too far. So too is the parties’ consent to arbitration.²²⁶ The counterclaims that are admissible in any particular case is impossible to determine in the abstract, but this paper suggests that reference to *Oil Platform*’s ‘factual matrix’ may assist.

The upshot of this alternative approach with its broader limits on legal connection is two-fold. First, contractual counterclaims should be admissible against both contract- and treaty- based principal claims, provided that the counterclaim is connected to the same investment as the principal claim and sufficiently factually connected to warrant consolidation of claims. The second is that counterclaims based on domestic law should be admissible against both contract- and treaty- based claims (on the same provisions above). This conclusion finds support in scholarship:²²⁷

In accordance with the terms of the contracting state parties’ consent to arbitration in the investment treaty, the tribunal’s jurisdiction *ratione materiae* may extend to counterclaims by the host contracting state party founded upon a contractual obligation, a tort, or a public act of the host contracting state party, in respect of matters directly related to the investment.

It should be remembered that a counterclaim cannot be asserted unless it is admissible *and* the tribunal has jurisdiction over it. This paper proposes that a tribunal that wishes to exclude claims based on domestic law must do so on the basis of jurisdiction, not admissibility. This may be difficult to do in the face of a broad dispute resolution clause, especially where the treaty explicitly directs the application of host state law. A tribunal may elect to do so by application of the Iran/United States Claims Tribunal jurisprudence (transposed to investment treaty arbitration, ‘it does not arise out of investment’ but out of the operation of domestic

²²⁵ *Case Concerning Oil Platforms*, above n 176.

²²⁶ Kjos, above n 6, at 149.

²²⁷ Douglas, above n 27, at 255. See also: Atanasova, above n 1, at 387.

law’). It is submitted that exclusion of host state counterclaims in domestic law on this basis will be more difficult in the treaty context, given the “mosaic of laws” implicated in investment disputes.

VI CONCLUSION

A greater role for host state counterclaims in investment treaty arbitration has the potential to save host states and foreign investors the time and expense of extended battles in different fora over related disputes. Even in the same fora, arming both parties with the means to launch an offensive, rather than reserving that right for investors, may render states more willing to arbitrate and deter foreign investors from bringing weak claims. Investment law and arbitration generally would reap the benefits of a less fragmented system, and may enjoy a boost in legitimacy at a time where backlash against the traditional paradigm of investment as a mechanism for the exclusive protection of investors’ rights is becoming more pronounced.

Despite these benefits, host state counterclaims are infrequently brought and never successful. The obstacles to host state counterclaims largely stem from the asymmetrical structure of investment treaties. This asymmetry is concordant with the aim of investment treaties and arbitration to attract foreign investment, but also has the potential to undermine the benefits identified. Hence, this paper proposed to navigate the obstacles that host states must contend with to assert counterclaims in investment treaty arbitration.

In principle, the ICSID Convention and UNCITRAL Arbitration Rules provide that host state may assert counterclaims and their associated *travaux préparatoires* suggests that the drafters may have expected counterclaims to play a greater role in investment disputes. Alas, the availability of host state counterclaims has proven more complex in practice.

The first obstacle is jurisdiction. Investment treaties extend a standing offer to foreign investors that, once accepted, culminates in an arbitration agreement. This agreement determines the jurisdiction of the tribunal. The definition of the scope of disputes the parties have agreed to submit to arbitration is the most important in this respect. It will be easier for host states to assert counterclaims where the tribunal’s jurisdiction *ratione materiae* is broad, whether it is generic referring to ‘all disputes’ or delineates a number of legal sources such as authorisations and agreements. Host states cannot assert counterclaims under dispute

resolution clauses that limit the scope of dispute to host state obligations or the exclusive application of international law and/or the BIT, despite the doubt cast on this point by Reisman in *Roussalis*. Other, subsidiary, provisions of the BIT may also assist to delineate the scope of disputes. It will be easier for host states to assert counterclaims where it has *locus standi* or where the treaty explicitly directs the tribunal to apply host state's general domestic law – but neither are dispositive.

The second obstacle is requisite connection. A survey of international jurisprudence shows a general trend to treat requisite connection as a matter of both fact and law. The ICJ has taken a flexible approach to the issue, treating both fact and law as relevant but neither determinative. The Iran/US Claims Tribunal and contract-based arbitral tribunals have taken a stricter approach, insisting on symmetry of the legal instruments that underlie the counterclaim and claim.

Recent treaty tribunal practice in *Saluka* and *Paushok* has followed the latter approach. While a strict approach to legal symmetry may make sense in a commercial context, it does not translate to treaty arbitration since host states cannot assert counterclaims on the basis of the BIT. Nothing on the text of the BIT suggests that such a strict requirement is necessary. In addition, tribunal practice suggests that counterclaims based on domestic law are *prima facie* inadmissible. The conclusion reached is that it would be virtually impossible for states to assert counterclaim under the current articulation of the test for requisite connection.

Accordingly, this paper proposed an alternative approach to requisite connection. Requisite connection should be established when the counterclaim is related to the *the same investment* forming the object of the principal claim. Reference to the overall investment is broader than a single instrument and thus brings state counterclaims based on domestic law back into the fold. This paper does not venture to delineate precisely what domestic laws could form the legal basis of a host state counterclaim. Rather, this paper hopes to disrupt recent tribunal practice that is trending towards absolute exclusion of host state counterclaims, and redirect the inquiry away from legal symmetry and towards the essential focus of BITs: the investment.

APPENDIX 1

**TABLE OF PUBLIC ARBITRATIONS INVOLVING STATE COUNTERCLAIMS
(IN CHRONOLOGICAL ORDER)²²⁸**

CASE NAME	RULES	DISPOSITION	SUMMARY OF CLAIMS
<i>Adriano Gardella S.p.A v Republic of Ivory Coast</i> , ICSID Case No. ARB/74/1, Award (Aug 29, 1977).	ICSID	Rejected on merits	Counterclaim for claimant's failure to perform its contractual obligations and declaratory relief. Both counterclaims rejected on merits; no apparent discussion over counterclaims.
<i>S.A.R.L. Benvenuti & Bonfant v People's Republic of the Congo</i> , ICSID Case No. ARB/77/2, Award (Aug 8, 1980)	ICSID	Rejected on merits	Counterclaims for non-payment of duties and taxes arising from allegedly illegal importation, over-invoicing of raw materials, faults in the design of claimant's plant, contractual non-performance, and moral damages. The tribunal concluded that it had jurisdiction over the counterclaims under the parties' agreement. The tribunal rejected all of the counterclaims on the merits.
<i>Klockner Industrie-Anlagen GmbH and others v Republic of Cameroon</i> , ICSID Case No. ARB/81/2, Award (Oct, 21, 1983)	ICSID	Rejected on merits	Counterclaim for losses suffered as a result of failed fertilizer plant project (initial capital contribution, capital increases, and loans guaranteed by the Government), as well as moral damages. The tribunal held it had jurisdiction over the counterclaim given the direct connection between the parties' contracts and the claims, but rejected the counterclaims on the merits.
<i>Atlantic Triton Company v People's Revolutionary Republic of Guinea</i> , ICSID Case No. ARB/84/4, Award (Apr, 21, 1986)	ICSID	Rejected on merits in part, no jurisdiction in part	Contractual and tortious counterclaims for damages and interest for abuse of process and breach of ICSID arbitration clause resulting from claimant's recourse to French courts for seizure of vessels as security, costs of restoration and refit of vessels, and damages from mechanical breakdown of vessels and moral damages. The tribunal rejected the contractual claim for breach of the ICSID arbitration clause, the "quasi-tortious" claim for abuse of process, and the claim for contractual non-performance on the merits. Following an objection by claimant, the tribunal found that the parties' agreement did not grant it jurisdiction over the counterclaim for expenses incurred in the restoration and repair of the vessels.
<i>Amco Asia Corporation and others v Republic of Indonesia (Resubmitted Case)</i> , ICSID Case No. ARB/81/1, Decision on Jurisdiction (May, 10, 1988)	ICSID	No jurisdiction	Counterclaim in resubmission proceedings for restitution of unpaid corporate taxes and tax fraud. The tribunal held that it did not have jurisdiction over the tax fraud claim because it did not arise directly out of the investment. Indonesia had also submitted counterclaims in the original proceedings.

²²⁸ Mark W. Friedman and Ina C. Popova "Can State Counterclaims Salvage Investment Arbitration?" (2014) 8 World Arbitration & Mediation Review 139 – 179.

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<i>Maritime International Nominees Establishment (MINE) v Republic of Guinea</i> , ICSID Case No. ARB/84/4, Final Award (Jan, 6, 1988).	ICSID	Partially rejected and partially accepted on merits	Counterclaims for damages representing costs incurred (1) because of claimant's wrongful institution of AAA instead of ICSID arbitration and (2) in obtaining release of attachments on Guinean property while improperly attempting to enforce the AAA award. The tribunal denied the first counterclaim on the merits and awarded reduced damages on the second counterclaim, which was applied as a set-off to the amounts awarded to claimant.
<i>Southern Pacific Properties Ltd v Arab Republic of Egypt</i> , ICSID Case No. ARB/84/3, Award (May, 20, 1992)	ICSID	Rejected on merits	Counterclaim for US\$30 million in damages arising out of the failure of a planned hotel project, including costs. The Tribunal found that claimant did not commit the faults alleged and dismissed the counterclaim on the merits without separately analysing jurisdiction.
<i>Franz Sedelmayer v Russian Federation</i> , Award (July, 17, 1998)	SCC	N/A	The parties disputed whether or not the respondent had filed a counterclaim. Respondent claimed that its remarks were condition on acceptance of jurisdiction by the tribunal and constituted a defence (not a separate claim); claimant argued that the assertion of a counterclaim constituted separate consent to the tribunal's jurisdiction. The tribunal found it had jurisdiction under the treaty, but did not separately analyse the alleged "counterclaim."
<i>Alex Genin and others v Republic of Estonia</i> , ICSID Case No. ARB/99/2, Award (June, 25, 2001)	ICSID	Rejected on merits	Counterclaim for sums allegedly transferred out of claimants' bank by claimant, although the legal basis for the counterclaim is unclear. The tribunal rejected the claim on the merits, questioning in a footnote whether the respondent was even the proper party to assert the counterclaim.
<i>Saluka Investments B.V. v Czech Republic</i> , UNCITRAL, Decision on Jurisdiction over Czech Republic's Counterclaim (May 7, 2004)	UNCITRAL	No jurisdiction	Counterclaims for breach of a share purchase agreement, violation of the Czech Commercial Code, wilfully providing and causing others to provide false, incomplete and misleading information, violation of "proper morality" by benefitting from violation of Czech law, breach of duties of members of bank's supervisory board, and wilful breach of corporate law notification obligation. The tribunal found it did not have jurisdiction over any of the claims: the share purchase agreement was between different parties and contained a mandatory arbitration provision; the claims based on violation of Czech law fell outside the scope of the treaty.
<i>Patrick Mitchell v Democratic Republic of Congo</i> , ICSID Case No. ARB/99/7, Award (Feb 9, 2004)	ICSID	Rejected on merits	Counterclaim for damages for "nuisances" and damage to reputation of the DRC. The tribunal rejected the counterclaim because it found claimant's claim was unjustified.
<i>Zeevi Holdings v</i>	UNCITRAL	Partially	Counterclaims for failure to invest,

<i>Republic of Bulgaria and the Privatisation Agency of Bulgaria</i> , UNCITRAL Case No. UNC39/DK, Award (Oct 25, 2006)		rejected and partially accepted on merits	misappropriation of proceeds, bad faith, and breach of joint venture and investment agreements. The tribunal accepted certain counterclaims and rejected others on the merits.
<i>Desert Line Projects LLC v Republic of Yemen</i> , ICSID Case No. ARB/05/17, Award (Feb 6, 2008)	ICSID	Partially rejected and partially accepted on merits	Counterclaim for restitution of amounts received under ineffective contract, and damages and/or set-off for the value of contractual non-performance. The tribunal partially upheld the restitution claim and rejected the contractual non-performance claim on the grounds of estoppel.
<i>Amco LLC v Ukraine</i> , SCC Case No 080/2005.	SCC	No jurisdiction	Counterclaim for damage to reputation (and request for costs). The tribunal rejected the counterclaim on the grounds that there was no basis in the applicable law for such a claim.
<i>RSM Production Corporation v Grenada</i> , ICSID Case No. ARB/05/14, March 13, 2009.	ICSID	Rejected on merits	Counterclaims for (1) expenses incurred in compensating fishermen for damage caused by RSM, (2) nominal damages for failure to submit timely application for exploration licence and (3) rescission of contract based on misrepresentation. All counterclaims rejected on merits.
<i>Gustav F. W. Hamester GmbH & Co KG v Republic of Ghana</i> , ICSID Case No. ARB/07/24, Award (June 18, 2010)	ICSID	No jurisdiction	General counterclaim for damages for “losses... sustained as a result of [claimant’s] conduct,” apparently based on fraudulent conduct and breach of fiduciary duty in connection with a joint venture agreement. The tribunal rejected the counterclaims for lack of jurisdiction, noting that the losses would have been suffered by an entity that is not a party to the arbitration and is not an organ of the State.
<i>Sergei Paushok and others v Government of Mongolia</i> , UNCITRAL, Award on Jurisdiction and Liability (Apr 28, 2011)	UNCITRAL	No jurisdiction	Counterclaims for unpaid “windfall profits” taxes; unpaid foreign worker fees; taxes, fees and levies evaded by illicit transfers; breach of licence agreements causing loss of tax revenue and loss of employment of Mongolian nations; violation of environmental obligations; damages for gold smuggling; and failure to comply with an order from the House of Lords. Counterclaims based on Mongolian domestic law rejected as beyond the scope of the tribunal’s jurisdiction. Other counterclaims rejected as failing to present a sufficiently close connection with the primary claims and relating to different parties.
<i>Spyridon Roussalis v Romania</i> , ICSID Case No ARB/06/1, Award (Dec 7, 2011)	ICSID	No jurisdiction	Counterclaims against claimant and his companies for (1) damages for breach of investment obligations, (2) damages for misappropriation of funds, (3) damages for breach of contractual pledge to transfer shares and (4) declaratory relief and damages regarding invalidity of resolution to increase share capital.

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			The tribunal, by a majority, found it did not have jurisdiction over the counterclaims because there was no consent to State counterclaims about obligations of the investor on the terms of the treaty.
<i>Antoine Goetz and others v Republic of Burundi</i> , ICSID Case No. ARB/01/2, Award (June 21, 2012)	ICSID	Rejected on merits	Counterclaim for damages for failure to comply with the conditions of an operating licence. The tribunal found that the counterclaim was within the scope of the parties' consent and arose directly from the subject-matter of the dispute, but dismissed it on the merits.
<i>Occidental Petroleum Corp and Occidental Exploration and Production Company v Republic of Ecuador</i> , ICSID Case No. ARB/06/11, Award (Oct 5, 2012)	ICSID	Rejected on merits	Counterclaims for (1) abuse of process, (2) breach of contractual waiver of recourse to diplomatic channels, (3) lost production and property damage, (4) failure to pay assignment fee and failure to renegotiate a contract. The tribunal rejected all counterclaims on the merits, without discussing jurisdiction or admissibility.
<i>Inmaris Perestroika Sailing Maritime Services GmbH and others v Ukraine</i> , ICSID Case No. ARB/08/8, Award (Mar 1, 2012)	ICSID	Rejected on merits	Counterclaim for the cost of storing a shipping vessel in the winter. The tribunal found that it had jurisdiction over the counterclaim under the treaty and that the counterclaim was a component of the larger dispute submitted to the tribunal, but dismissed the counterclaim on the merits.
<i>Metal-Tech Ltd v Republic of Uzbekistan</i> , ICSID Case No. ARB/10/3, Award (Oct 4, 2013)	ICSID	No jurisdiction	Counterclaim for damages including lost profits; lost tax, customs and foreign exchange revenue; and consequential damages including increased unemployment, arising from claimant's unlawful conduct and misrepresentations. The tribunal had found that there was no qualifying investment as the investment had been made by bribery, and held that there was thus no consent to arbitrate counterclaims relating to "non-investments".
<i>Burlington Resources Inc v Republic of Ecuador</i> , ICSID Case No. ARB/08.5	ICSID	N/A	Ongoing. Counterclaims relating to alleged environmental contamination and infrastructure
<i>Perenco Ecuador Ltd v Republic of Ecuador</i> , ICSID Case No. ARB/08/6	ICSID	N/A	Ongoing. Counterclaims relating to alleged environmental contamination and infrastructure.

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