Environmental counterclaims in ICSID arbitration: Options for the model clause proposed by the Working Group III.

1. Introduction

States are, nowadays, increasingly incurring obligations and commitments to confront the emerging reality of global warming, climate change, and biodiversity losses. At the same time, they are providing commitments for investment protection by ratifying myriad International Investment Agreements (Bilateral Investment Treaties, Multilateral Investment Treaties, Treaties with Investment Provisions, and Investment Contracts). Besides investment protection, States' commitments to environmental protection are getting increased reflections in the International Investment Agreements (IIAs) in the post-Rio Summit.[1] For example, while only 2% of the IIAs concluded in 1991 contain references to environmental protection, ten years later, that proportion augmented to 6%, then to 31% in 2011, and then 56% in 2020.[2] In addition, the States are also increasingly ratifying international environmental agreements and accordingly reforming their domestic legal framework for ensuring environmental protection. Despite the increase of environmental commitments in all these treaties, investor-State arbitral tribunals cannot give due regard to environmental protection issues because these tribunals, generally, can only decide the breach of investment protection. Consequently, when the tribunals decide the breach of investment protection standards, they struggle to entertain environmental issues, including environmental counterclaims. The Working Group III considered the State's opportunity to raise counterclaims (of every kind) essential because it reduces uncertainty, promotes fairness and the rule of law, and ultimately ensures a balance between respondent States and claimant investors.[3] In such backdrop, this extended abstract will first briefly address the concept of environmental counterclaim in investment arbitration. Secondly, it will identify the ICSID[4] tribunal's jurisdictional constraints in considering counterclaim. Thirdly, it will describe Working Group III's recent proposal on how the tribunal

[1] United Nations Conference on Environment and Development, Rio de Janeiro, Brazil, 3-14 June 1992.
[2] Rodrigo Polanco, 'Sustainable Development in Swiss International Investment Agreements' (2021) 31 Swiss Review of International and European Law 211, 215.
[3] Report of the UNCITRAL Working Group III (Investor-State Dispute Settlement Reform) Thirty-ninth session (New York, 30 March- 3 April 2020), UNGA Res. A/CN.9/WG.III/WP.193 dated 22 January 2020, para 38.
[4] Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the ICSID Convention 1965), (opened for signature 18 March 1965, entered into force 14 October 1966) (ICSID Convention)

can be empowered to consider environmental counterclaims. Fourthly, it will analyse some suitable options to empower the tribunal regarding the counterclaim issue.

2. The concept of environmental counterclaim in ICSID arbitration

IIAs are designed to guarantee the investment protection standards and, thereby, afford only the investor the *standi* to bring a claim against the State in which it invests for any damage caused to it due to any regulatory measures of the State and its failure to give the committed protections. In contrast, the host State can only defend the claim as the IIAs traditionally do not allow the State to initiate a claim against the investor. Even the State cannot bring a counterclaim against the investor before the investor-State arbitral tribunal because such an empowering provision is usually absent in IIAs.

However, some IIAs[5] and ICSID Convention[6] allow the submission of a counterclaim by the respondent State, subject to several conditions (discussed in the next part). Such possibility to raise the counterclaim in investor-State arbitration brings the concept of counterclaim in the investment law regime. Scherer et al. defined a counterclaim as not a defence aimed at dismissing or limiting an investor's claim, rather, as a new, autonomous claim—or attack—in and of itself.[7] Counterclaims are thus independent of the defence arguments and may effectively broaden the scope of the original dispute while at the same time enhancing the judicial economy.[8] Therefore, a counterclaim is a claim raised by the respondent State in the same arbitral proceedings against a primary claim brought by an investor. A respondent State raises an environmental counterclaim if the claimant-investor violates domestic or international environmental obligations. With an environmental counterclaim, the respondent-State is not defending against the primary claim but instead exercising its rights to bring an action and seeking affirmative relief from the claimant's breaches of environmental obligations.[9] There are 11 known investor-State cases where counterclaims have been filed, and the tribunal found

[5] For example, Common Market for Eastern and Southern Africa (COMESA), opened for signature 5 November 1993, entered into force 8 December 1994.
[6] ICSID Convention 1965, art 46.
[7] Maxi Scherer, Stuart Bruce, and Juliane Reschke, 'Environmental Counterclaims in Investment Treaty Arbitration' (2021) 36(2) ICSID Review 413, 414.
[8] Ibid.
[9] Godwin Tan, Andrea Chong 'The future of environmental counterclaims in ICSID arbitration: challenges, treaties, and interpretations' (2020) 9(2) Cambridge International Law Journal 176, 180.

jurisdiction in five cases only.[10] Of these, (environmental) counterclaims were successful in only two cases: *Burlington v. Ecuador,*[11] and *Perenco v. Ecuador.*[12]

3. ICSID tribunal's jurisdictional constraints in considering counterclaim

A State can raise a counterclaim (environmental inclusive) in ICSID arbitration irrespective of its existence in the concerned IIAs. For it, the tribunal need to be satisfied of some conditions described in Article 46 of the ICSID Convention, which provides that-

> 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.

Therefore, the ICSID tribunal can only find jurisdiction on (environmental) counterclaims if those satisfy three conditions: (i) counterclaims must arise out of the subject matter of the dispute; (ii) they are within the scope of the consent of the parties; and (iii) they are otherwise within the jurisdiction of ICSID.[13] Of these, the 'scope of the consent of the parties' to the arbitration is a significant issue for the tribunal in entertaining the counterclaims.[14] It is essential for ensuring the enforceability of the award.[15] Even in the recently amended ICSID Arbitration Rules, it remained unchanged that the counterclaims must be 'within the scope of the consent of the parties' to the arbitration.[16]

Express consents of the parties in IIAs are necessary for deciding the tribunal's jurisdiction over the counterclaim. A very few IIAs adopted clauses allowing the States to submit a counterclaim. For example, COMSEA article 28(9) provides that '[A] Member State against

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[10] Flavia Marisi, *Environmental Interest in Investment Arbitration* (Kluwer Law International, The Netherlands 2020) 238. Marisi mentioned the cases- *Perenco v. Ecuador, Burlington v. Ecuador, Urbaser v. Argentina, Oxus v. Uzbekistan, Hesham v. Indonesia, Methal-Tech v. Uzbekistan, Goetz v. Burundi, Spyridon Roussalis v. Romania, Saluka v. Czech Republic, Amco Asia v. Indonesia and Klöckener v. Cameroon.*

[11] *Burlington Resources Inc. v Republic of Ecuador,* ICSID Case No ARB/08/5, Date of Decision on Jurisdiction 2 June 2010; Date of Decision on Liability 14 December 2012, Date of Decision on Counterclaims 7 February 2017, Date of Decision on Reconsideration and Award 7 February 2017 (*Burlington v Ecuador*).

[12] *Perenco Ecuador Ltd. v The Republic of Ecuador,* ICSID Case No ARB/08/6, Decision on Jurisdiction dated 30 June 2011, Decision on Remaining Issues of Jurisdiction and one Liability dated 12 September 2014, Interim Decision on the Environmental Counterclaim dated 11 August 2015, Award dated 27 September 2019 (*Perenco v Ecuador*).

[13] Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the ICSID Convention 1965), art 46.

[14] Tan and Chong (n 9) 185.

[15] UNCITRAL Model Law, arts 34(2)(iii) and 36(1)(a)(iii): award may be set aside or recognition and enforcement refused if it 'deals with a dispute 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;' ICSID Convention, art 52: manifest excess of power by the tribunal is a ground for annulment.

[16] ICSID Arbitration Rules (as amended on 1 July 2022), r 48.

whom a claim is brought by a COMESA investor under this Article may assert as a defense, counterclaim, right of set off or other similar claim, that the COMESA investor bringing the claim has not fulfilled its obligations under this Agreement.' Similar empowering provisions can also be found in some BITs.[17] For example, Article 14(3) of Iran-Slovakia BIT provides that '[T]he respondent may assert as a defense, counterclaim, right of set off or other similar claim that the claimant has not fulfilled its obligations under this Agreement to comply with Host State law or that it has not taken all reasonable steps to mitigate possible damages.'

An express consent to the tribunal's jurisdiction to decide a counterclaim can also be given by concluding a subsequent/ separate agreement. It happened in *the Burlington v. Ecuador* and *Perenco v. Ecuador* cases (both were parts of *the Burlington* consortium[18]). These two are the only cases till today wherein the State's environmental counterclaims were successful. Ecuador, in these counterclaims, submitted that the investors breached its environmental laws, constitutional provisions on environmental protection, and contractual obligations. After submitting the counterclaims and during the pendency of the proceedings, *Burlington* consortium and Ecuador concluded a separate agreement agreeing that the investors would not contest the tribunals' jurisdiction over the counterclaims to receive an economical solution to the dispute.[19] So, the tribunals could decide the counterclaim because of having such a subsequent express consent.

Additionally, there are some examples of inferring consent regardless of the specific empowering provisions in IIAs. In *Roussalis v. Romania,*[20] Professor Reismen, in his dissenting opinion, commented that whenever an investor initiates an ICSID arbitration, the consent component in article 46 of the ICSID Convention becomes *ipso facto* applicable in that arbitration. Another tribunal in *Goetz v. Burundi,* took a similar approach.[21] The tribunal, in this case, held that it had the jurisdiction to decide the counterclaims because referring the dispute to ICSID arbitration means that the parties had agreed to the tribunal's jurisdiction to arbitrate the counterclaim, too, irrespective of the existence of a consent clause in the BIT.[22]

Although some cases provide some direction and the parties' consent can generally be established in these ways, Scherer et al. commented that future disputes about the scope and

[17] Iran- Slovakia BIT, art 14(3); Argentina- UAE BIT, art 28(4); Indian Model BIT, art 14(11), Morocco- Nigeria BIT arts 14, 18, 24.
[18] *Perenco v Ecuador,* Decision on Liability dated 12 September 2014, para 43.
[19] *Burlington v. Ecuador* (n 11) paras 60, 61.
[20] *Spyridon Roussalis v. Romania,* ICSID Case No. ARB/06/1, Award dated 28 November 2011, Declaration by Professor Reisman.
[21] *Antoine Goetz et consorts v Republique du Burundi*, ICSID Case No ARB/95/3, Award dated10 February 1999 (*Goetz v. Burundi*).
[22] *Ibid,* para 278.

content of consent to counterclaims could be minimised, or avoided, through express and clear drafting in new and re-negotiated IIAs.[23] Tan & Chong showed pessimism about the future of environmental counterclaims in case of the absence of any specific provision in the IIAs regarding counterclaims.[24] It seems true even for a subsequent consent agreement if we consider the aftermath of *the Burlington* decision. The tribunal, in this case, decided its jurisdiction on the counterclaim because there was an agreement between the parties. When Ecuador was successful in its environmental counterclaim in the *Burlington* case, *Perenco* filed an Application for Dismissal of Ecuador's Counterclaims, urging any counterclaim to be inadmissible.[25] Although this application was rejected, it reminds us that having the parties' express consent in IIAs is necessary for deciding environmental counterclaims.

4. Working Group III's proposal on the scope of the consent of the parties

To address the issue of consent, the Working Group asked the Secretariat[26] to prepare model clauses that could be used as consent clauses, whether in treaty-based arbitration or a multilateral standing body, that would condition a State's consent to Investor-State Dispute Settlement (ISDS) tribunals to hear counterclaim.[27] It was said that such a clause could clarify the jurisdiction of the ISDS tribunals to hear counterclaims as well as the question of admissibility.[28] It appears that formulating such a clause and its subsequent adoption in the IIAs would empower the tribunals to consider (environmental) counterclaims while deciding breaches of investment protection.

5. Options for the model clause

To formulate the model clause on the scope of the consent of the parties, the UNCITRAL Secretariat can consider two options: a model of default consent clause and a broader dispute resolution provision. Firstly, since the issue of environmental protection is nowadays attracting the highest priority, a model clause can be developed which would incorporate 'environmental counterclaim' as a matter of default consent of the parties to the arbitration. The wording of such a clause could be like this- 'the tribunal shall assume jurisdiction over an environmental

[23] Scherer et al., (n 7) 434-35
[24] Ibid
[25] *Perenco v Ecuador,* Decision on *Perenco*'s Application for Dismissal of Ecuador's Counterclaims dated 18 August 2017
[26] The Secretariat of United Nations Commission on International Trade Law (UNCITRAL).
[27] Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-ninth session (Vienna, 5-9 October 2020), United Nations General Assembly Res. A/CN.9/1044 dated 10 November 2020, para 61.
[28] Ibid.

counterclaim if it arises out of the subject matter of the dispute.' In the model clause, the term 'environmental counterclaim' also needs to be explained. Article 14.11 of the Indian Model BIT 2015 provides that '[A] Party may initiate a counterclaim against the Investor or Investment for a breach of the obligations set out under Articles 9, 10, 11 and 12 of Chapter III of this Treaty before a tribunal established under this Article…' This article refers to article 12 of the BIT, which includes, among others, the investor's responsibility to comply with the host State's environmental law and the laws relating to the conservation of natural resources. The counterclaim should not be confined to only the host State's environmental laws; it should rather include the host State's international obligations to environmental sustainability because, sometimes, the host State's environmental legal framework does not get consistent development momentum with the global environmental commitments. It may restrain the tribunal from deciding the investor's responsibilities to comply with the host State's international environmental obligations. For example, in *Niko v. Bangladesh*[29], the tribunal decided not to apply Bangladeshi environmental laws for tort action because those were not more developed than the environmental provisions of the Joint Venture Agreement (JVA). To avoid such a narrower application of environmental counterclaim, the model clause can follow the Morocco Model BIT 2019, which includes domestic laws and international obligations in the list of investor's responsibilities.[30] A State with asymmetrical negotiation power may struggle to enshrine in the IIA such a model clause, which incorporates a default consent to environmental counterclaim extending the investor's responsibilities to both domestic environmental laws and international environmental obligations. In such a situation, the Secretariat can, at least, encourage those States to adopt the second option.

Secondly, States should be encouraged to adopt a sufficiently broader dispute resolution provision so that the tribunals can decide environmental counterclaims. As said earlier, generally, IIAs adopt a typical and narrower dispute resolution provision, giving only the investor the *standi* to forward a claim for a breach of investment protection standard,[31] and consequently, host States cannot submit any claim or counterclaim. A few IIAs adopt broader dispute resolution provisions, giving the investor and the State the *standi* to forward a claim/counterclaim. For example, article 14 of Rwanda- United Arab Emirates BIT 2017

[29] *Niko Resources (Bangladesh) Ltd v Bangladesh Petroleum Exploration & Production Company Ltd & others,* ICSID Case No ARB/10/11 and ICSID Case No ARB/10/18, Decision on Liability on 28 February 2020 (*Niko v Bangladesh*).
[30] Morocco Model BIT 2019, Section III.
[31] For example, Burkina Faso- Turkey BIT 2019, art 10: 'This Article shall apply to disputes between a Contracting Party and an investor of the other Contracting Party concerning an alleged breach by that Contracting Party of one of its obligations under this Agreement, which results in loss or damage to the investor or to its investments.'

adopted that '…an Investment-State Dispute may be submitted …to the … arbitration by either party under… the ICSID Convention...' In *Urbaser v. Argentina*[32] case, the tribunal found that article X of Spain- Argentina BIT 1991 allowed the tribunal to settle '[d]isputes arising between a Party and an investor of the other Party in connection with investments' at the request of either party to dispute.[33] The tribunal found that this dispute resolution provision is drafted broadly and completely neutral as to the identity of the claimant or respondent in an investment dispute, and therefore, it can exercise jurisdiction over the State's counterclaim.[34] Such a decision suggests that the broader the wording of a dispute resolution clause, the more likely an investment tribunal will find that it has jurisdiction over (environmental) counterclaims.[35] However, Ling found this second option less preferable and stressed the importance of drafting express provisions (something like the first option) to reduce uncertainties in treaty interpretations while deciding environmental counterclaims and to bring uniformity in counterclaim jurisprudence.[36]

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[32] *Urbarser SA and Consorcio de Aguas Bilbao Bizkaia, Bilbao Biskaia Ur Partzuergoa v The Argentine Republic* (Award) ICSID Case No ARB/07/26, Award dated 8 December 2016.
[33] Ibid, para 1143.
[34] Ibid, paras 1143-1155.
[35] Scherer et. al., (n 7) 420.
[36] Andrew Ling, 'Adjudicating State Counterclaims in ICSID Investor-State Arbitration' (2021) 57(1) Texas International Law Journal 103.