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Counterclaims in Investor-State Arbitration

Yaraslau Kryvoi*

Abstract: This paper provides a comprehensive analysis of the legal regime governing counterclaims in investor-State disputes. It challenges the frequent presumption that the right to assert counterclaims is hindered by the fact that investment treaties impose no obligations on foreign investors and only protect their rights. The paper demonstrates that the right to assert counterclaims is a procedural right, and subject matter jurisdiction over counterclaims depends on whether the investor has breached obligations found in applicable law. The paper shows that foreign investors' substantive obligations can be found in sources of international law other than investment treaties. The paper also highlights the difficulties of asserting counterclaims in non-commercial areas such as human rights and environmental protection. Finally, it also shows that tribunals may pierce the corporate veil of foreign investors in the context of counterclaims.

I INTRODUCTION

Although foreign investors now enjoy the right to sue States in international tribunals, States rarely assert counterclaims to address investors' misconduct. This paper discusses why this is the case and deals with the main legal problems arising out of counterclaims in investor-state arbitration.

Foreign investments dramatically grew in the twentieth century and became the main cause and manifestation of globalisation.¹ According to an almost

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universal consensus foreign investments benefit investors and host countries.² Cross-border investment flows improve the long-term efficiency of the host country. They stimulate greater competition, transferring capital, technology, and managerial skills, and create new jobs.³ Foreign investors also benefit from their access to new markets, cheaper natural resources, and labour force.⁴

To facilitate foreign investments States conclude international investment treaties. According to UNCTAD, states concluded over 2,500 bilateral investment treaties, as well as numerous regional and multilateral agreements, which regulate foreign investments.⁵ On the domestic level, governments across the globe adopt very similar approaches to legal regulation of treatment of private foreign investment. The standards include rules of entry, guarantees against expropriation, general standards of treatment, and procedures for the settlement of disputes.⁶

Nearly all investment treaties provide for arbitration to resolve investment disputes. Typically, investors have a choice between submitting disputes to ICSID or to an ad-hoc tribunal established under the rules of the United Nations Commission on International Trade Law (UNCITRAL).⁷ Other treaties may also provide for dispute resolution before other arbitral institutions, such as the International Chamber of Commerce, Stockholm Chamber of Commerce in Paris, and London Court of International Arbitration.⁸

The most distinctive feature of the system of investor-state disputes is that it firmly establishes the capacity of private persons – either individuals or corporations – to submit a claim against a state without intervention of their respective national governments. This has made investment disputes from a purely political into international law issue, which generally facilitates faster and more efficient resolution of disputes. Up to this day, the Convention is regarded as one of the most important treaties to recognises individuals as subjects of international law.⁹ Clearly, the system benefits investors who gain an independent right to initiate dispute settlement directly against the host state instead of forcing them to

¹ See, eg, G. Garrett, *The Causes of Globalization*, *Comparative Political Studies* (2000) 33 (6/7) 941, 944-947; FDI in figures, July 2011 (Paris: Organisation for Economic Cooperation and Development) at <<http://www.oecd.org/dataoecd/60/43/48462282.pdf>>.

² See, eg, OECD, *Foreign Direct Investment for Development: Maximising Benefits, Minimising Costs* (Paris: OECD Publishing, 2002.)

³ *ibid.*, 10-18.

⁴ *ibid.*

⁵ UNCTAD, *Investment Agreements Monitor No. 3* (2009): Recent developments in international investment agreements (2008-June 2009) (Geneva: United Nations Commission on Trade and Development), 3.

⁶ See, eg, UNCTAD, 'Latest Developments in Investor-State Dispute Settlement' (IIA Issues Note, No1, 11 March), 1-3 at <http://www.unctad.org/en/docs//webdiacia20113_en.pdf>.

⁷ See, eg, *Argentina-United States: Treaty Concerning the Reciprocal Encouragement and. Protection of Investment*, Washington, November 14, 1991 (1992) 31 *ILM* 124, Art VII.

⁸ See, eg, *Agreement between the Government of the Republic of Belarus and the Government of the Kingdom of Denmark on encouragement and mutual protection of investments*, dated March 31, 2004, Art 9.

⁹ I. Seidl-Hohenveldern, *International Economic Law* (Dordrecht: Kluwer Law International, 1999), 10.

rely either on dispute resolution in domestic courts or on interstate dispute resolution.¹⁰

However, the system also provides for the right to submit counterclaims. Counterclaims make investor-state dispute resolution more efficient and facilitate equality of the parties but present a number of particular legal problems. This paper explains that it is often difficult to establish obligations of investors vis-à-vis the host State. Most investor-state disputes arise out of bilateral investment treaties (BITs) concluded with the purpose of protecting foreign investors in host States. BITs usually do not articulate the rights of States, and States tend to rely on their domestic judiciary to resolve disputes with foreign investors. Moreover, interpreting BITs in the light of their purpose of protecting investors creates an additional constraint for jurisdiction over counterclaims.

BITs usually do not regulate non-commercial aspects of investors' activities in areas such as human rights or protection of environment. As a result, investor-state tribunals are reluctant to broaden their subject-matter jurisdiction to non-commercial areas. Moreover, undercapitalised local subsidiaries often appear as claimants in arbitral proceedings. Because of separation of corporate entities, it is difficult to obtain and enforce arbitral awards against properly capitalised parent companies. Counterclaims against undercapitalised subsidiaries make little sense, and tribunals are reluctant to pierce the corporate veil of such companies.

The paper suggests that these constraints are not fatal to the States' right to assert counterclaims against foreign investors. The right to counterclaim is a procedural right provided by all major arbitration rules such as ICSID, UNCITRAL, or ICC. Although BITs are typically concluded in the interests of investors, they usually provide for broad jurisdiction over disputes 'concerning an investment' and do not restrict the parties' obligations to those contained in the BITs. Obligations of investors arise out of applicable law, which is either stipulated in the BIT or determined by the investor-state tribunal.

It is demonstrated that investors' obligations may arise under sources of international law other than BITs, such as general principles of law or secondary sources of international law such as case law and scholarly writings. With certain reservations, relevant investors' obligations can also be found in contracts of investors with States. Tribunals may also pierce the corporate veil of local undercapitalised subsidiaries to ensure procedural equality between the State and the foreign investor.

The paper is structured as follows: The next part gives an overview of legal rules and practice of asserting counterclaims by States under major procedural rules used in investor-state disputes such as United-States Iran Claims Tribunal, ICSID, and UNCITRAL. Part III sets out the main problems related to consent of investors to counterclaims. Most importantly, it explains why the procedural right to assert counterclaims is not hindered by the fact that BITs do not contain

¹⁰ C. Brower and S. Schill, 'Is Arbitration a Threat or a Boon to the Legitimacy of International Investment Law?' (2008-2009) 9 *Chi. J. Int'l L.* 471, 476.

investors' obligations. Part IV suggests that substantive obligations of investors can be found in other sources of international law, and with certain reservations, in investor-state contracts. Part V concludes.

II PROCEDURAL RULES FOR ASSERTING COUNTERCLAIMS

INVESTOR-STATE DISPUTES AND COUNTERCLAIMS

Counterclaims are claims submitted by the party different from the one which requested the institution of the proceedings. Since investors initiate nearly all investor-State disputes,¹¹ counterclaims are typically submitted by host States. There are a number of reasons to allow counterclaims in investor-State disputes.

First, counterclaims facilitate more equality between the parties. Although BITs are inherently asymmetrical and provide investors with rights but not obligations, States can initiate and submit counterclaims.¹² Second, counterclaims arising from separate but related agreements between the parties would enhance efficiency of dispute resolution. It would be preferable and less time-consuming to resolve all disputes in one set of proceedings. Given the high cost of resolving disputes in international arbitration,¹³ this reason is particularly important for less developed countries. Successful counterclaims may also deter frivolous claims and provide the State with motive to bypass jurisdictional objectives.

Third, counterclaims may be in the interest of the host State for other reasons. For instance, recourse to arbitration offers superior international enforcement prospects compared to domestic court judgments. ICSID arbitration awards do not require any recognition or enforcement; State parties to the ICSID Convention are obligated to enforce the pecuniary obligations imposed by that award within its territories as if it were a final judgement of a court in that State.¹⁴ Most other awards, such as rendered under UNCITRAL Arbitration Rules, can be enforced under the 1958 Convention on Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention).

In addition, an award of an international tribunal may appear truly neutral and be better for the country's reputation. It may be well within the best interests of

¹¹ See ICSID, 'The ICSID Caseload - Statistics 2011-1' at <<http://icsid.worldbank.org>>.

¹² See, eg, 'Report of the Executive Directors of the International Bank for Reconstruction and Development on the Convention on the Settlement of Investment Disputes between States and Nationals of other States', Art 13 (as amended 10 April 2006) [ICSID Convention], 18 March 1965 at <<http://icsid.worldbank.org/ICSID/ICSID/Rulesmain.jsp>>: 'The convention permits the institution of proceedings by host States as well as by 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.'

¹³ For instance, in *Plama Consortium v Bulgaria*, ICSID Case No. ARB/03/24, the legal costs to the claimant (related to both the jurisdiction and merits phases of the arbitration), amounted to \$4.6 million, while the respondent's legal costs (for both phases) were \$13.2 million.

¹⁴ ICSID Convention, n 12 above, Art 54.1.

investors to encourage counterclaims because investors would have all their disputes resolved in a neutral forum rather than a local court.¹⁵

There is also a fairness argument. Many suggest that foreign investors often have economic muscle that can hardly be surpassed by many host States.¹⁶ Today some multinational enterprises have budgets far exceeding the budgets of many developing countries.¹⁷ Foreign investors often have economic muscle that can hardly be surpassed by many host States.¹⁸ Already in mid-1990s, of the 100 largest economies in the world, 51 are now global corporations, and only 49 are countries.¹⁹ It must be noted, however, that only States have a monopoly on using force and on regulating the activities of all economic actors in their own territory.

It appears that an unfair asymmetry would arise if the claimant can sue the host State for breaches arising out of contracts while the State may not do the same. As the tribunal in *SGS v Pakistan* put it:

[i]t would be inequitable if, by reason of the invocation of ICSID jurisdiction, the [foreign investor] could on the one hand elevate its side of the dispute to international adjudication and, on the other, preclude the [host State] from pursuing its own claim for damages [...].²⁰

To sum up, counterclaims are supposed to facilitate procedural equality of the parties, enhance efficiency of dispute resolution, and improve enforcement prospects. Host States can now assert counterclaims against investors under all major arbitration rules.²¹ Most notably, counterclaims have been asserted at the Iran-US Claims Tribunal (IUSCT), at ICSID, and under UNCITRAL Arbitration Rules. Despite the view expressed in the literature that counterclaims always fail,²² the next sections show that this is not always the case.

¹⁵ G. Laborde, 'The Case for Host State Claims in Investment Arbitration' (2010) 1 *Journal of International Dispute Resolution* 97, 110.

¹⁶ K.H. Boeckstiegel, 'Enterprise v State: the New David and Goliath?' (2007) 23 *Arbitration International* 93, 94.

¹⁷ See A.C. Hubbard, 'The Integration of Human Rights in Corporate Principles in The Integration of Human Rights in Corporate Principles' in OECD, *OECD Guidelines for Multinational Enterprises Annual Report* (Paris: OECD, 2001), 99.

¹⁸ Boeckstiegel, n 16 above.

¹⁹ United Nations Conference on Trade and Development, *World Investment Report 1995* (Geneva: UNCTAD, 1996).

²⁰ *SGS Societe Generale de Surveillance S.A. v Islamic Republic of Pakistan*, ICSID Case No. ARB/01/13, Procedural Order No. 2, 16 October 2002, 302.

²¹ See, eg, ICSID Arbitration Rule 40 and the ICSID Convention, n 12 above, Art 46; UNCITRAL Arbitration Rules, Art 19.3; Rules of the Arbitration Institute of the 1999 Stockholm Chamber of Commerce, Art 10.3; 1998 International Chamber of Commerce Rules of Arbitration, Art 5(5).

²² A. 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, 84: 'State counterclaims in investor-State disputes always fail.'

IRAN-US CLAIMS TRIBUNAL

So far the largest number of counterclaims asserted by States was under the rules of the IUSCT. The IUSCT was established under an understanding known as the Algiers Accords of January 19, 1981.²³ It resolved claims by United States nationals for compensation for nationalisations by the Iranian government, claims by the governments against each other, and counterclaims of States against investors. The Claims Settlement Declaration, which constitutes the basis of the IUSCT jurisdiction, provides that the Tribunal was

[...] established for the purpose of deciding claims of nationals of the United States against Iran and claims of nationals of Iran against the United States, and any counterclaim which arises out of the same contract, transaction or occurrence that constitutes the subject matter of that national's claim [...].²⁴

The IUSCT jurisprudence suggests that jurisdiction over a counterclaim depends entirely on the presence of jurisdiction over the claim.²⁵ If jurisdiction over the claim fails, related counterclaims should also be dismissed. However, if the tribunal asserted its jurisdiction over the counterclaim it can stand alone, even if the main claim has been withdrawn.²⁶ Because IUSCT jurisdiction is defined in rather broad terms, thousands of counterclaims have been filed at the IUSCT.²⁷ They included counterclaims for advance payments, breach of contract, services rendered, defective products, and other categories.²⁸ All these counterclaims arose out of investors' contractual obligations.

ICSID CONVENTION

The ICSID Convention adopted in 1966 established the capacity of private entities to submit claims against States without intervention of their respective national governments.²⁹ The ICSID Convention and the ICSID Arbitration Rules provide for jurisdiction over counterclaims arising directly out of the subject matter of the dispute and within the scope of consent of the parties.³⁰ Article 46 of the ICSID Convention provides:

²³ See, generally, C.N. Brower and J.D. Brueschke, *The Iran-United States Claims Tribunal* (The Hague: Kluwer Law International, 1998).

²⁴ *Claims Settlement Declaration*, Art II, para 1, 1 *Iran-U.S. Cl. Trib. Rep.* 9.

²⁵ See, eg, *Phillips Petroleum Company Iran and the Islamic Republic of Iran*, Award No. 435-39-2 (29 June 1989), reprinted in 21 *Iran-U.S. Cl. Trib. Rep.* 79, 146-48.

²⁶ *ibid.*

²⁷ Brower and Brueschke, n 23 above, 99.

²⁸ *ibid.*

²⁹ Y. Kryvoi, *International Center for Settlement of Investment Disputes* (Alphen aan den Rijn: Kluwer Law International, 2010), 26-30.

³⁰ ICSID Convention, n 12 above, Art 46; ICSID Arbitration Rule 46.

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.

The ICSID Convention's drafting history suggests that the reason for inclusion of counterclaims was to eliminate the necessity to start new proceedings.³¹ It was emphasised in the course of drafting that counterclaims should be covered by consent of the parties and cannot go beyond the tribunal's competence.³² According to the Report of the Executive Directors of the World Bank, the Convention is meant to be equally adapted to the requirements of institution of proceedings by investors as well as by host States.³³

Until now, most counterclaims by States against foreign investors asserted under ICSID rules were for costs arising out of non-ICSID proceedings,³⁴ interest payment,³⁵ or taxes³⁶. In majority of ICSID cases where tribunals asserted jurisdiction over counterclaims, subsequently they were denied on the merits.³⁷ In other cases tribunals agreed with counterclaims asserted by States.³⁸

UNCITRAL ARBITRATION RULES

The UNCITRAL Arbitration Rules were originally adopted in 1976 and most recently revised in 2010.³⁹ They provide for a set of rules for an ad hoc arbitration and are commonly used in investor-State disputes. Until recently, the UNCITRAL Arbitration Rules provided that the respondent can bring a

³¹ *Documents Concerning the Origin and the Formulation of the ICSID Convention, Vol. II*, (Washington: World Bank, 2001), 270.

³² *ibid*, 270, 337, 422.

³³ International Bank for Reconstruction and Development (18 March 1965), para 13.

³⁴ See eg *Maritime International Nominees Establishment v Republic of Guinea*, ICSID Case No. ARB/84/4, Award of 6 January 1988, (1997) 4 *ICSID Reports* 61, 77.

³⁵ *Benvenuti & Bonfant v Congo*, ICSID Case No. ARB/77/2, Award of 15 August 1980, (1993) 1 *ICSID Reports* 330, 342, para 3.5.

³⁶ *Amco v Indonesia*, Resubmitted Case, Decision on Jurisdiction of 10 May 1988, (1993) 1 *ICSID Reports* 562, 562-564.

³⁷ See eg *Klöckner v Cameroon*, ICSID Case No. ARB/81/2, Award of 21 October 1983, (1994) 2 *ICSID Reports* 9, 16; *Alex Genin v Republic of Estonia*, ICSID Case No. ARB/99/2, Award of June 25, 2001, (2002) 17 *ICSID Rev. FILJ* 395, paras 196-201; *S.A.R.L. Benvenuti and Bonfant v The People's Republic of Congo*, ICSID Case No. ARB/77/2, Award of 8 August 1980, (1982) 21 *ILM* 1478, paras 4.95-4.96; *Adriano Gardella spa v Republic of the Ivory Coast*, ICSID Case No. ARB/74/1, Award of 29 August 1977; *Southern Pacific Properties (Middle East) Limited v Arab Republic of Egypt*, ICSID Case No. ARB/84/3, Decision on Jurisdiction of 27 November 1985.

³⁸ See eg *Maritime International Nominees Establishment v Republic of Guinea*, n 34 above (counterclaims dealt with recovery of legal expenses that the government incurred because of the investor's non-compliance with the tribunal's recommendation).

³⁹ UNCITRAL Arbitration Rules at <http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/1976Arbitration_rules.html>.

counterclaim ‘arising out of the same contract’.⁴⁰ That rule was amended in 2010. Currently, Article 21.3 of the Rules provides as follows:

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 counterclaim or rely on a claim for the purpose of a set-off provided that the arbitral tribunal has jurisdiction over it.

Counterclaims in UNCITRAL investor-state disputes have been rare, which is a consequence of a rather narrow scope of jurisdiction of investment tribunals under the old version of the rules.⁴¹ The requirement that a dispute should arise out of the same contract was completely inappropriate in the context of investor-state disputes.⁴² Since the Rules’ revision in 2010, more counterclaims are likely to be asserted by States.

More liberal rules on counterclaims may change investors’ preferences in choosing forum for arbitration. It may motivate them to choose arbitration rules less favourable to counterclaims. The revised UNCITRAL rules on jurisdiction over counterclaims appear to be less restrictive compared to ICSID rules.

As this review of major arbitration rules suggests, investor-state tribunals can assert jurisdiction over counterclaims. But because most BITs do not provide for any obligations of foreign investors and are generally concluded for the benefit of foreign investors, a legitimate question is whether investors consent to such counterclaims when they initiate arbitral proceedings.

III CONSENT TO COUNTERCLAIMS

PURPOSE OF BITs AND ARBITRATION AGREEMENTS

Historically, the main aim of investment treaties and contracts was to moderate the exercise of sovereign power by host States. The idea is that it is the conduct of States, rather than the conduct of investors, which needs to be kept in check.⁴³ Most treaties explicitly provide that their main goal is to protect investors and facilitate foreign investments.⁴⁴ An important aim of investment treaties and

⁴⁰ UNCITRAL Arbitration Rules (1976 edition), Art 19(3).

⁴¹ See eg *Saluka Investments BV v Czech Republic*, UNCITRAL, Decision on Jurisdiction over the Czech Republic’s Counterclaim of 7 May 2004, paras 78-79; *Zeevi Holdings v Bulgaria*, UNCITRAL, Final Award of 25 October 2006.

⁴² See J. Paulsson and G. Petrochilos, ‘Revision of the UNCITRAL Arbitration Rules’ at <http://www.uncitral.org/pdf/english/news/arbrules_report.pdf>.

⁴³ G. Laborde, n 15 above, 98.

⁴⁴ See eg Preamble to the Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of Kazakhstan for the Promotion and

contracts is to moderate the exercise of sovereign power by host States.⁴⁵ Some even dubbed investment arbitration as an ‘international quasi-judicial review of national regulatory action’.⁴⁶

BITs or investment protection legislation, which contain arbitration clauses, effectively serve as a unilateral offer of jurisdiction to investors. Investor's acceptance of such offer defines the scope of the tribunal's subject matter jurisdiction both over primary claims and counterclaims. Consent remains a cornerstone of the system of international adjudication in general⁴⁷ and investor-State arbitration in particular.

In practice, most BITs only enable the investor, rather than the State, to submit claims to ICSID.⁴⁸ Under international treaties, investors are privileged and ‘traditionally being afforded rights without being subject to obligations’.⁴⁹ Investors’ legal position under BITs can be compared to third party beneficiaries in contracts – they have rights under BITs but not obligations.⁵⁰ The purpose of BITs and similar instruments is to encourage investments and protect investors’ rights. Similarly, BITs neither provide for the procedure for submission of State’s counterclaims nor even mention the right of investor to submit counter-claims.⁵¹ As all international treaties, BITs are supposed to be interpreted in the light of their object and purpose.⁵² In the absence of any specific language in BITs providing for a possibility of counterclaims against foreign investors, allowing such counterclaims may seem problematic.

If the investor limited its acceptance of jurisdiction to claims based on the treaty, should only the treaty be the source of rights and obligations over which the tribunal can assert jurisdiction? To answer this question, it is important to understand that the BIT itself is not the basis for the tribunal’s jurisdiction. Suggesting otherwise would mean that any award rendered under such agreement would be impossible to enforce under the New York Convention.⁵³

When a State enters into a BIT, it extends a standing offer to eligible investors to arbitrate any relevant investment dispute through international arbitration. If the investor chooses to accept the offer, it usually does so by

Protection of Investments, 23 November 1995 (‘desiring to create favourable conditions for greater investment by nationals and companies of one State in the territory of the other State’).

⁴⁵ Laborde, n 15 above.

⁴⁶ H.E. Veenstra-Kjos, ‘Counter-claims by Host States in Investment Dispute Arbitration “Without Privity”’ in P. Kahn and T. Waelde (eds), *New Aspects Of International Investment Law* (2004), 597, 600.

⁴⁷ E. Lauterpacht, *Aspects of Administration of International Justice* (Cambridge: Grotius Publications Limited, 1991), 23.

⁴⁸ See eg the Romania-Greece BIT, Art 9(2).

⁴⁹ M. Jacob, ‘International Investment Agreements and Human Rights’ (INEF Research Paper Series 03/2010, 2010), 21.

⁵⁰ Laborde, n 15 above, 112.

⁵¹ *ibid.*

⁵² According to the Vienna Convention on the Law of Treaties (1969), Art 31.1, ‘[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 the light of its object and purpose’.

⁵³ *ibid.*, 3: ‘If the agreement to arbitrate was a treaty, the resulting award would not be enforceable under the New York Convention of 1958, which has no application to international law arbitrations, e.g. between States or other international legal persons.’

initiating arbitration proceedings, thereby perfecting the parties' agreement to arbitrate the investment dispute. Investor's consent to arbitration is manifested in an agreement to arbitrate a claim under the BIT. Such consent usually constitutes a separate written contract, which typically incorporates by reference a certain set of arbitration rules, which the parties agree to apply in full. If the arbitration rules include the procedural right to submit counterclaims, the parties are bound by it.⁵⁴ As explained above, the ICSID Convention, UNCITRAL Arbitration Rules, and other arbitration rules explicitly provide for the right to assert counterclaims.

Moreover, in a number of cases States themselves initiated ICSID proceedings against investors under BITs,⁵⁵ which makes submission of counterclaims a less controversial issue. The vast majority of BITs in investor-State disputes mentioned above did not contain any provisions regarding counterclaims and had a sufficiently generic dispute resolution clause. Tribunals asserted their jurisdiction over counterclaims in the absence of such provisions based on the agreed set of procedural rules and the applicable law.

In this context it is useful to compare two cases, which involved counterclaims under UNCITRAL Arbitration Rules but had different treaty provisions regarding resolution of disputes. In *AMTO v Ukraine*, the dispute was invoked on the basis of the Energy Charter and Treaty the Rules of the Arbitration Institute of the Stockholm Chamber of Commerce (SCC).⁵⁶ The Energy Charter Treaty contains no mentioning of the right to counterclaim while the SCC rules do. The State asserted a counterclaim for non-material injury to its reputation.⁵⁷ The tribunal ruled that counterclaims were outside of its jurisdiction because the State failed to specify the basis for its counterclaim in applicable law.⁵⁸ The tribunal explained that:

[...] the jurisdiction of an Arbitral Tribunal over a State Party counterclaim under an investment treaty depends upon the terms of the dispute resolution provision of the treaty, the nature of the counterclaim and the relationship of the counterclaims with the claims in arbitration.⁵⁹

In this case, provisions of a relevant treaty limited its offer of jurisdiction to disputes over violations of obligations stipulated in the Energy Charter Treaty itself. In particular, Article 26 of the Energy Charter only covers the following category of disputes: 'Disputes between a Contracting Party and an Investor of

⁵⁴ See also P. Karrer, 'Jurisdiction on Set-Off Defenses and Counterclaims' (2001) 67(2) *Arbitration* 176, 177: 'an arbitral tribunal should have jurisdiction over counterclaims between the same parties, even if these counterclaims are not covered by the arbitration agreement which confers jurisdiction on the arbitral tribunal over the main claim [...]'.
⁵⁵ Laborde, n 15 above, 100.
⁵⁶ *AMTO LLC v Ukraine*, Final Award, SCC Case No 080/2005, IIC 364 (2009).
⁵⁷ *ibid*, 116-118.
⁵⁸ *ibid*, 118.
⁵⁹ *ibid*.

another Contracting Party relating to an Investment of the latter in the Area of the former, which concern an alleged breach of an obligation of the former under Part III [of the Energy Charter].’

Because the State’s claim did not arise out of substantive obligations provided by the Energy Charter, the tribunal in *AMCO v Ukraine* decided it could not go beyond its subject matter jurisdiction and declined to assert jurisdiction over the claim. The North American Free Trade Agreement (NAFTA) may also present the same problem because the dispute settlement clause there is limited to obligations under specified articles of NAFTA.⁶⁰

Had the relevant treaty covered a wider category of disputes or provided for investors’ obligations the outcome would be different. In another UNCITRAL arbitration, *Saluka v Czech Republic*, the dispute resolution clause of the relevant BIT covered ‘[a]ll disputes between one Contracting Party and an investor of the other Contracting Party concerning an investment of the latter’⁶¹. The tribunal explained:

[t]he language of Article 8, in referring to ‘All disputes,’ is wide enough to include disputes giving rise to counterclaims, so long, of course, as other relevant requirements are also met. The need for a dispute, if it is to fall within the Tribunal’s jurisdiction, to be ‘between one Contracting Party and an investor of the other Contracting Party’ carries with it no implication that Article 8 applies only to disputes in which it is an investor, which initiates claims.⁶²

Saluka and *AMTO* are UNCITRAL cases which demonstrate that if the relevant BIT dispute provision is broad enough and is not limited to obligations specifically provided by the BIT, it is possible to assert counterclaims against investors. However, not all investors’ obligations fall under subject matter jurisdiction of investor-state tribunals as explained below.

SUBJECT MATTER OF COUNTERCLAIMS

As demonstrated above, all major arbitration rules require that counterclaims relate to the substance of the already initiated dispute. Under IUSCT rules counterclaims should relate to the subject matter of the main claim. ICSID Rules require that counterclaims arise ‘directly out of the subject matter of the dispute’. Under ICSID Rules, the counterclaim may relate to the main substance of the dispute or may be an incidental or additional claim.⁶³ The revised UNCITRAL

⁶⁰ Under the NAFTA, Arts 1116 and 1117, the only claims which may be submitted to arbitration are claims that another NAFTA Party has breached an obligation under specified articles of Chapter 11.

⁶¹ The Agreement on Encouragement and Reciprocal Protection of Investments between the Kingdom of the Netherlands and the Czech and Slovak Federal Republic dated 9 April 1991, Art 8.

⁶² *Saluka Investments BV v Czech Republic*, n 41 above, para 39.

⁶³ See Note A to Arbitration Rule 40 of 1968, (1968) 1 *ICSID Reports* 100.

Arbitration rules simply state that counterclaims should be within the tribunal's jurisdiction. Typically counterclaims have defensive nature and purport to undermine the primary claim.⁶⁴

In the majority of cases in which counterclaims were presented, they related to the main substance of the case and were not of an incidental nature.⁶⁵ Investment protection treaties primarily deal with commercial obligations and usually do not go beyond that.

Only a few treaties provide for a general commitment to human rights and protection of labour rights.⁶⁶ The 2004 US Model BIT acknowledged that it is 'inappropriate to encourage investment by weakening or reducing the protections afforded to domestic environmental or labour laws'.⁶⁷ A number of treaties concluded between the United States and Latin American countries recognise 'respect for internationally recognized worker rights'.⁶⁸ In practice these provisions serve merely as declarations deprived of any specific content.

The ICSID case *Biloune v Ghana*⁶⁹ can further illustrate this point. The tribunal rejected recovery for moral damages claimed for violation of human rights resulting from arbitrary detention and unlawful forceful deportation of an investor. It ruled that deciding on human rights violations was outside its jurisdiction:

[t]he Government agreed to arbitrate only disputes 'in respect of the foreign investment.' Thus, other matters – however compelling the claim or wrongful the alleged act – are outside this Tribunal's jurisdiction [...]. [W]hile the acts alleged to violate the international human rights [...] may be relevant in considering the investment dispute under arbitration, this Tribunal lacks jurisdiction to address, as an independent cause of action, a claim of violation of human rights.⁷⁰

Proposals to add a more robust human rights dimension to BITs have been seriously discussed recently,⁷¹ but failed to materialise into concrete legal

⁶⁴ *ibid.*

⁶⁵ C. Schreuer, L. Malintoppi, A. Reinisch, and A. Sinclair, *The ICSID Convention: A Commentary* (Cambridge: CUP, 2010), 750.

⁶⁶ See 2005 Finland-Guatemala BIT.

⁶⁷ 2004 US Model BIT, Arts 12, 23.

⁶⁸ See, eg, preamble to the Treaty between United States of America and the Argentine Republic concerning the reciprocal encouragement and protection of Investment, November 14, 1991; Treaty between the United States of America and the Republic of Ecuador concerning the Encouragement and Reciprocal Protection of Investment, August 27, 1993.

⁶⁹ *Biloune v Ghana Investments Centre*, Award of 27 October 1989 and 30 June 1990, (1994) 19 *Yearbook Commercial Arbitration* 11, 16, para 7.

⁷⁰ *ibid.*, para 9.

⁷¹ L.E. Peterson, 'Investment Treaty News' (27 March 2008) at <http://www.iisd.org/pdf/2008/itn_mar27_2008.pdf>; T. Weiler, 'Balancing Human Rights and Investor Protection: A New Approach for a Different Legal Order' (2004) 27 *B.C. Int'l & Comp. L.Rev.* 429.

commitments.⁷² Counterclaims by States for investors' misconduct in non-commercial areas such as human rights remain uncommon and typically unsuccessful. Human rights violations committed by foreign investors are typically addressed in domestic courts or special international human rights bodies.⁷³ Therefore, under all major arbitration rules the subject matter of counterclaims should be related to commercial aspects of foreign investment.

COUNTERCLAIMS AGAINST AFFILIATED COMPANIES

Another issue related to consent to counterclaims is whether foreign investors consent to counterclaims against affiliated parties such as their parent companies. This is particularly important when the formal claimant in arbitral proceedings has insufficient assets in the host jurisdiction because local subsidiaries are distinct corporate entities, and their parent companies are protected from the subsidiaries' obligations by the principle of limited liability. In practice, these local subsidiaries could be undercapitalised and unable to pay any award rendered against them. It may be difficult, if at all possible, to make a parent company with deeper pockets a party to arbitral proceedings.⁷⁴

On the other hand, it is easier to submit a claim against the State party than investor's parent company. This is yet another manifestation of pro-investor asymmetry of investor-State arbitration. When a contract is signed by a State-affiliated entity, claimants might try to extend the clause to the State itself. According to the International Law Commission Articles on State Responsibility, an entity whose structure, function, and control flow from governmental authority, as well as conduct of persons empowered by the State to 'exercise elements of governmental authority' are considered the conduct of the State 'provided that the person or entity is acting in that capacity in the particular instance'.⁷⁵ It is more difficult for State to counterclaim against corporations which have not signed the arbitration agreement.

A good example of extending subject matter jurisdiction over non-signatories is *Klückner v Cameroon*, where the tribunal asserted its jurisdiction and allowed a counter-claim, which involved a locally incorporated subsidiary.⁷⁶ The government of Cameroon signed several agreements with the claimant and its domestically incorporated company, which provided for ICSID arbitration of disputes. When the issue of counterclaims against a locally incorporated company

⁷² See discussion of the draft 2007 Norwegian Model BIT in 'Norway Proposes Significant Reforms to its Investment Treaty Practices' (2008 March) *Investment Treaty News* at <<http://www.iisd.org/itn/2008/page/4/>>.

⁷³ Usually without much success because of principles of *forum non conveniens* and corporate limited liability. See Y. Kryvoi, 'Enforcing Labor Rights against Multinationals in Europe' (2007) 46 *Industrial Relations* 366.

⁷⁴ For a more detailed discussion of piercing the corporate veil, see Y. Kryvoi, 'Piercing the Corporate Veil in International Arbitration' (2010) 1 *Global Business Law Review* 169.

⁷⁵ International Law Commission Articles on State Responsibility, Art 5.

⁷⁶ *Klückner Industrie-Anlagen GmbH and others v United Republic of Cameroon and Société Camerounaise des Engrais*, ICSID Case No. ARB/81/2, Award of 21 October 1983, (1994) 2 *ICSID Rep.* 9, 16.

arose, the arbitrators focused on questions of subject matter jurisdiction over the contract to allow counterclaims, rather than personal jurisdiction over a non-signatory to the arbitration agreement.

The *Klückner* tribunal explained that the question arising in this case is not whether the tribunal has ‘*ratione personae*’ jurisdiction over the locally incorporated company.⁷⁷ The question was whether it had jurisdiction ‘*ratione materiae*’ on the application and interpretation of the Establishment Agreement.⁷⁸ The tribunal concluded that the contracts entered into by a local subsidiary establish the jurisdiction of the tribunal with respect to the counterclaim because of the direct connection between the contracts and the parties’ claims.⁷⁹

In a UNCITRAL case *Saluka v Czech Republic*, the claimant contended that the tribunal had no personal jurisdiction over the entity against which the State asserted counterclaim, because that entity had never consented to be a party to the arbitration.⁸⁰ The State argued that if the locally incorporated entity was permitted to represent the interests of the foreign parent company in arbitration, a counterclaim could be asserted against the foreign company.⁸¹ The State asked the tribunal to pierce the corporate veil and treat both companies as the same single group of companies, and redress abuse of corporate form.⁸²

The *Saluka* tribunal refrained from ruling on the issue of piercing the corporate veil and proceeded on the assumption that ‘the relationship between [the affiliated parties] is sufficiently close to enable the Tribunal’s jurisdiction in proceedings instituted by [the local subsidiary] to extend its claims against [the parent company]’.⁸³ It held that it did not have jurisdiction for two reasons – because of the absence of close connection between the primary claim and a counterclaim and because there was a special dispute resolution procedure established for the issues contested in the counterclaim.⁸⁴

Tribunals are reluctant to pierce the corporate veil in counterclaims context. Consent to arbitration is fundamental not only for arbitral proceedings but also for enforcement of arbitral awards. Even if a tribunal decides to assert jurisdiction over affiliated companies, the party enforcing the resulting award may face serious challenges. Decision on asserting jurisdiction over counterclaims can be challenged as falling outside of the tribunal’s jurisdiction. Enforcing awards against parent companies located in other countries in the absence of their consent requires piercing the corporate veil, which is problematic under applicable arbitration rules, relevant domestic law, or the New York Convention.

⁷⁷ *ibid.*, 17-18 (1993).

⁷⁸ *ibid.*

⁷⁹ *ibid.*, 8.

⁸⁰ *Saluka Investments BV v Czech Republic*, n 41 above.

⁸¹ para 29.

⁸² *ibid.*

⁸³ para 44.

⁸⁴ paras 47-82.

Unlike national courts, arbitration tribunals do not have enforcement mechanisms of their own and need to resort to national courts. The application of corporate veil piercing in international arbitration is dependent upon domestic courts' recognition and enforcement of arbitration awards.⁸⁵ Enforcing awards piercing the corporate veil in domestic courts may become a very difficult task.⁸⁶ The only exception would be awards under the ICSID Convention, which provides for a self-contained enforcement procedure.⁸⁷

It should be noted, that ICSID pierced the corporate veil of investors in the past by looking into the issue of foreign control over local subsidiaries.⁸⁸ Another approach was to pierce the veil on the basis of interpretation of the concept of 'investment' in accordance with the intent of parties to the arbitration agreement or purpose of an international treaty.⁸⁹ There is little doubt that investor-state tribunals may take these approaches also in the context of counterclaims. In many situations, counterclaims may become an effective remedy to address investors' misconduct only if arbitral tribunals and relevant domestic law allow piercing the corporate veil of locally incorporated subsidiaries to reach assets of their parent companies.

The next section will analyse in more detail whether foreign investors have not only rights but also international obligations vis-à-vis host States.

IV SUBSTANTIVE OBLIGATIONS OF INVESTORS IN INVESTOR-STATE DISPUTES

INVESTORS AS BEARERS OF INTERNATIONAL OBLIGATIONS

According to the traditional doctrine of international law, only States, not individuals, are the subjects of obligation and responsibility in international law.⁹⁰ Until the second half of the Twentieth Century, the dominant principle of international law was that a wrong done to a national of one State, for which another State was intentionally responsible, was actionable not by the injured national, but by his State. The only option available to foreign investors was invoking diplomatic protection of their home State to support their case and to initiate proceedings before an international tribunal.⁹¹ The investors were unable to proceed with an international claim against a foreign government directly.

Over the recent decades the legal status of investors in international law has shifted from this classical position. Now foreign investors can bear certain

⁸⁵ See more about enforcement problems at Kryvoi, n 74 above.

⁸⁶ *ibid.*

⁸⁷ ICSID Convention, n 12 above, Art 54.1.

⁸⁸ Kryvoi, n 74 above.

⁸⁹ *ibid.*

⁹⁰ H. Kelsen, *Principles of International Law* (New York: Rinehart & Company, Inc., 1966), 194.

⁹¹ Kryvoi, n 29 above, 27.

international rights and obligations.⁹² Norms of international law can determine that an individual by his own conduct may commit an international tort.⁹³ One of earliest examples of individual's civil responsibility is the International Convention for the Protection of Submarine Telegraph Cables, which provided for an obligation to pay for the cost of repair of submarine cables.⁹⁴ In the past, examples included piracy, breach of blockade, and carriage of contraband, or acts of illegitimate warfare.⁹⁵

The right of investors to have recourse against States by using institutions such as ICSID and the IUSCT was a significant advance of the status of individuals and corporations under international law. That was a step forward compared to claims commissions which States used to resolve investors' grievances.⁹⁶ Clearly, individual investors became subjects of international rights because they have competence to initiate an action against a State before a tribunal the jurisdiction of which the State is obliged to recognise.⁹⁷

In theory, subjects of international law are 'persons to whom international law attributes rights and duties directly and not through the medium of their States'.⁹⁸ In the investor-State context, the sole arbitrator *Texaco v Libya* explained that 'for the purposes of interpretation and performance of the contract, it should be recognized that a private contracting party has specific international capacities'.⁹⁹ It is indisputable that today foreign investors – be they corporations or individuals – have certain direct rights. As discussed below, international law also imposes certain obligations on foreign investors, attributable not through the medium of States.

In determining the source of investor's obligations the arbitral tribunals are governed by provisions of applicable law agreed by the parties. Under UNCITRAL Rules, if the parties fail to agree on the applicable law the tribunal will apply the law which it determines to be appropriate.¹⁰⁰ The tribunal also shall take into account the contract provisions and any usage of trade applicable to the transaction.¹⁰¹ ICC Arbitration Rules also follow a similar approach.¹⁰² Article

⁹² See Lauterpacht, n 47 above, 70-72; The Special Representative of the Secretary-General, Report of the Special Representative of the Secretary-General on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises, J. Ruggie: 'Business and Human Rights: Mapping International Standards of Responsibility and Accountability for Corporate Acts', delivered to the Human Rights Council, U.N. Doc. A/HRC/4/35 (9 February 2007).

⁹³ Kelsen, n 90 above, 203.

⁹⁴ See the International Convention for the Protection of Submarine Telegraph Cables (14 March 1884), Art IV.

⁹⁵ *ibid*, 203-207.

⁹⁶ For instance, Conciliation Commission established pursuant to the Treaty of Peace with Italy 1947; Property Commissions established pursuant to the Treaty of Peace with Japan 1951.

⁹⁷ Kelsen, n 90 above, 232.

⁹⁸ M. St. Korowicz, 'The Problem of the International Personality of Individuals' (1956) 50 *Am. J. Int'l. L.* 533, 535.

⁹⁹ *Dispute Between Texaco Overseas Petroleum Company/California Asiatic Oil Company v Libya* (1978) 17 *ILM* 1, 13.

¹⁰⁰ UNCITRAL Arbitration Rules, Art 35.1.

¹⁰¹ 2010 UNCITRAL Arbitration Rules, Art 35.3.

42.1 of the ICSID Convention stipulates that in such a situation the law of the host State and applicable international law come into play.

As a practical matter, in the absence of specific choice of law in BITs, investor-state tribunals usually apply international law, including provisions of a relevant BIT and the host State law.¹⁰³ In certain circumstances, tribunals may also look for rights and obligations of the parties in contracts. Each of these sources of obligations is discussed in more detail below.

INTERNATIONAL LAW

Relevant sources of international law

In some cases BITs refer both to domestic law and international law as applicable law.¹⁰⁴ The parties may even exclude domestic law altogether and apply only international law. For instance, NAFTA¹⁰⁵ and the Energy Charter Treaty¹⁰⁶ provide for international law as a sole source of the applicable law.

However, most BITs contain no provisions on the issue of applicable law.¹⁰⁷ According to Article 42 of the ICSID Convention, if the parties have not reached an agreement on the rules of the international law, the Tribunal – in addition to the law of a State Party to the dispute – applies ‘such rules of international law as may be applicable’. International law remains applicable in ICSID proceedings unless the parties have explicitly excluded it. A number of ICSID tribunals explained that international law remains applicable in ICSID proceedings unless the parties have specifically excluded its application.¹⁰⁸ If domestic law is chosen as applicable law of the dispute, international law plays a supplemental and corrective function in relation to the domestic law.¹⁰⁹ It means that international law fills the gaps in the host State's laws; in case of its conflict with the domestic law, international law prevails.¹¹⁰ Many international tribunals followed this approach in their decisions.¹¹¹ In other words, international law prevails over any conflicting domestic rules of law.¹¹²

¹⁰² 1998 ICC Arbitration Rules, Art 17.1.

¹⁰³ A. Parra, ‘Applicable Law in Investor-State Arbitration’ in A. Rovine (ed), *Contemporary Issues in International Arbitration and Mediation* (New York: Martinus Nijhoff Publishers, 2008).

¹⁰⁴ T. Begic, *Applicable Law in International Investment Disputes* (Utrecht: Eleven International Publishing, 2005), 232.

¹⁰⁵ NAFTA, Art 1131.

¹⁰⁶ Energy Charter Treaty, 1991, Art 26.

¹⁰⁷ Parra, n 103 above, 7-8.

¹⁰⁸ See, eg, *MTD Equity Sdn Bhd v Republic of Chile*, ICSID Case No. ARB/01/7, Award of 14 July 2006, para 86; *Southern Pacific Properties (Middle East) Limited v Arab Republic of Egypt*, ICSID Case No. ARB/84/3, Award of 20 May 1992, (1995) 3 *ICSID Reports* 131, 189, para 84; *Amco v Indonesia*, ICSID Case No. ARB/81/1, Resubmitted Case, Award of 5 June 1990, (1993) 1 *ICSID Reports* 413, 580.

¹⁰⁹ History of the Convention, n 31 above, 570-571, 985-986.

¹¹⁰ A. Broches, ‘The Convention on the Settlement of Investment Disputes Between States and Nationals of Other States’ (1972) 2 *Recueil des Cours* 136; Begic, n 104 above, 155.

¹¹¹ *Texaco Overseas Petroleum Company/California Asiatic Oil Company v Libya*, Award of 19 January 1977, (1978) 17 *ILM* 1, 11; *Kloeckner v Cameroon*, Decision on Annulment of 3 May 1985, (1986) 1 *ICSID Review - FJIL* 89, 112.

¹¹² See discussion of cases dealing with this issue in Begic, n 104 above, 155-164.

Where can international law rules be found? Article 38(1) of the Statute of the International Court of Justice provides a classical definition of sources of international law:

- a. international conventions, whether general or particular, establishing rules expressly recognized by the contesting states;
- b. international custom, as evidence of a general practice accepted as law;
- c. the general principles of law recognized by civilized nations;
- d. [...] judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules of law.

The Report of ICSID Executive Directors clarifies that the term ‘international law’ has the same meaning as Article 38(1) of the Statute of the International Court of Justice with allowance being made that Article 38 was designed to apply to inter-State disputes.¹¹³ Indeed, proceedings of the International Court of Justice are based on State sovereignty. Investor-State disputes are different because of formal equality of private investor and State. Therefore, principles of interpretation used in general international law may be irrelevant for investor-State disputes. Therefore, general international law should be applied differently in the context of international investment law, which constitutes a self-contained legal regime. Even in relations between States various sources of international law play different roles within self-contained legal regimes. Investor-State arbitration is regulated by a self-contained regime within international law.

In a broader sense, self-contained regimes are interrelated wholes of primary and secondary rules that cover some particular problem differently from the way it would be covered under general law.¹¹⁴ Examples of other self-contained regimes include WTO law or law of diplomatic protection.¹¹⁵ The Commentary to Article A 55 of the International Law Commission’s draft articles on responsibility of States for internationally wrongful acts makes a distinction between ‘weaker forms of *lex specialis*, such as specific treaty provisions on a single point’ and ‘strong forms of *lex specialis*, including what are often referred to as self-contained regimes’.

Such self-containedness interacts with international law’s contractual bias, ie where a matter is regulated by a treaty, there is normally no reason to have recourse to other sources.¹¹⁶ However, obligations in investor-State treaties are

¹¹³ Report of Executive Directors on the ICSID Convention, para 40 at <http://icsid.worldbank.org/ICSID/StaticFiles/basicdoc/CRR_English-final.pdf>.

¹¹⁴ ‘Fragmentation of International Law: Difficulties Arising From Diversification and Expansion of International Law’ (Report of the Study Group of the International Law Commission finalized by Martti Koskenniemi, United Nations - Geneva 2006), 68.

¹¹⁵ *ibid*, 65-69.

¹¹⁶ *ibid*, 68.

often too general and require interpretive guidance from elsewhere. A self-contained regime provides interpretative guidance that in some way deviates from the rules of general law.¹¹⁷ For instance, in *Feldman v Mexico*, a NAFTA arbitration tribunal found that the meaning of the term ‘expropriation’ under Article A 1110 of the NAFTA was ‘of such generality as to be difficult to apply in specific cases’. The tribunal then read this term against the ‘principles of customary international law’ in order to apply it in the context of State action against grey market cigarette exports.¹¹⁸

The Iran-US Claims Tribunal followed a similar logic in *Amoco v Iran*:

As a *lex specialis*, in relations between the two countries, the treaty supersedes the *lex generalis*, namely customary international law [...] however [...] the rules of customary international law may be useful in order to fill in possible lacunae of the law of the Treaty, to ascertain the meaning of undefined terms in its text or, more generally, to aid interpretation and implementation of its provisions.¹¹⁹

In the past, ICSID tribunals applied other treaties, customary international law, and general principles of law in addition to BITs.¹²⁰

International conventions

International conventions (treaties) and in particular BITs are the first and foremost source of international law applied by investor-State tribunals. In addition to BITs, multilateral treaties such as the NAFTA and the Energy Charter Treaty also may be relied upon and the jurisdictional basis of investor-State dispute. They also provide specific rights of foreign investors such as protection against expropriation and the right to fair and equitable treatment.

However, treaties create obligations for parties to them, ie States. As was noted in *Anglo-Iranian Oil Case*, legal persons lack the ability to create international law themselves, such as via treaty.¹²¹ Typically international treaties provide for States’ obligations to regulate corporations in a certain way without spelling out directly applicable rules.¹²²

¹¹⁷ *ibid*, 70.

¹¹⁸ *Feldman v United Mexican States*, Award of 16 December 2002, ICSID Case No. ARB(AF)/99/1, (2003) 126 *ILR* 58, 65, para 98.

¹¹⁹ *Amoco International Finance Corporation v Iran*, (1987-II) 15 *Iran-US C.T.R* 222, para 112.

¹²⁰ O.K. Fauchald, ‘The Legal Reasoning of ICSID Tribunals - An Empirical Analysis’ (2008) 19 *European Journal of International Law* 301, 339.

¹²¹ *Anglo-Iranian Oil Co. Case (United Kingdom v Iran)*, Judgment of July 22nd, 1952, (1952) *I.C.J. Rep.* 93, 98 at <<http://www.icj-cij.org/docket/files/16/1997.pdf>>.

¹²² See, eg, Convention for the Suppression of the Financing of Terrorism and the United Nations Convention against Transnational Organized Crime (requiring the establishment of legal person liability under national law for bribery as well as embezzlement and misappropriation of property); the Global Convention on the Control of Transboundary Movements of Hazardous Wastes (placing a duty upon states to adopt regulations which prevent and punish the illegal transport of hazardous substances executed by natural and legal persons).

Can treaties impose obligations on investors who are not parties to investment treaties? If treaties were treated as a regular contract, then no obligations can be imposed on third parties, only rights. It is a universally accepted principle of contract law that a third party cannot be subjected to a burden by a contract to which it is not a party.¹²³

A number of developing countries advocate for inclusion of investors' obligations directly in international investment agreements. In 2002 China, Cuba, India, Kenya, Pakistan, and Zimbabwe proposed that any discussion in the WTO on a multilateral framework on trade and investment should also look at legally binding measures aimed at ensuring corporate responsibility and accountability relating to foreign investors.¹²⁴ In particular, they insisted on including both investors' obligations and the obligations of their home governments and spelling out such obligations as the need to comply with all domestic laws and regulations in each and every aspect of the economic and social life of the host members in their activities.

However, it appears that investors are already under obligation to abide by domestic laws of the State in which they operate. This is a consequence not only of domestic law requirements, but also the international law principle of territorial sovereignty.¹²⁵ The host State as a sovereign actor can react to investor's misconduct by unilaterally imposing sanctions enforcing them against the assets of the investment project. This is the power the host State already possesses and that the foreign investor lacks.¹²⁶ Although this principle is sometimes spelled out in international agreements,¹²⁷ it applies by virtue of international public law in any event.¹²⁸

Tribunals also rely on investors' obligations outside of investment treaties.¹²⁹ For instance, tribunals frequently apply the Vienna Convention on the Law of Treaties when they interpret investment treaties.¹³⁰ Parties in the past also invoked

¹²³ See, eg, E. McKendrick, *Contract Law* (Oxford: OUP, 2000), 133.

¹²⁴ See WTO, 'Communication from China, Cuba, India, Kenya, Pakistan and Zimbabwe: Investors' and Home Governments' Obligations', WT/WGTI/W/152, 19 November 2002.

¹²⁵ See I. Brownlie, *Principles of Public International Law* (Oxford: OUP, 2008), 105-107.

¹²⁶ Brower and Schill, n 10 above, 482. There are also situations in which investors do not keep sufficient assets in the host States, which prevents this mechanism from working effectively.

¹²⁷ See, eg, the 1998 Framework Agreement for the Association of Southeast Asian Nations (allowing Member States to undertake any measures necessary to protect national security, public morals, the prevention of fraud or deceptive practices, and to ensure compliance with their tax obligations in the host jurisdiction.)

¹²⁸ *ibid.*

¹²⁹ A. Wythes, 'Investor-State Arbitrations: Can the "Fair and Equitable Treatment" Clause Consider International Human Rights Obligations?' (2010) 23 *Leiden Journal of International Law* 241, 253.

¹³⁰ *Plama Consortium Limited v Republic of Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction of 8 February 2005, (2005), 44 *ILM* 721, paras 117, 147-165; *Sempra Energy International v Argentine Republic*, ICSID Case No. ARB/02/16, Decision on Jurisdiction of 11 May 2005, para 141 at <<http://icsid.worldbank.org>>; *Camuzzi v Argentina*, Decision on Jurisdiction of 11 May 2005, para 133; *Noble Ventures, Inc. v Romania*, ICSID Case No. ARB/01/11, Award of 12 October 2005, para 50 at <italaw.com/documents/Noble.pdf>; *Agua del Tunari S.A. v Republic of Bolivia*, ICSID Case No.

human rights instruments such as the European Convention on Human Rights but without much success.¹³¹

Because BITs and other treaties usually do not provide for investors' obligations, such obligations should be looked for elsewhere – in other primary and secondary sources of international law.

International custom

In a typical investor-State dispute arising out of BIT, a tribunal would start its examination with the text of a relevant treaty. If the investor's obligations are not set out in those treaties, or its provisions are not sufficiently complete, the tribunal would refer to international custom unless the treaty refers to application of a different law (eg domestic law). For instance, in *ADC v Hungary*, the Tribunal first applied the relevant BIT and then explained that consent to arbitration 'must be deemed to comprise a choice for general international law, including customary international law, if and to the extent that it comes into play for interpreting and applying the provisions of the Treaty'.¹³²

According to Article 38 of the Statute of the International Court of Justice, international custom constitutes 'evidence of a general practice accepted as law'. Thus, there are two basic elements – the actual behaviour of States and the psychological or subjective belief that such behaviour is 'law'.¹³³

During the course of drafting of the ICSID Convention, a number of rules of customary international law have been raised. These included the obligation to act in good faith,¹³⁴ protection against discriminatory treatment,¹³⁵ the prohibition of measures contrary to international public policy, *pacta sunt servanda*, the exhaustion of local remedies, and rules on State succession.¹³⁶

International law prohibits a number of wrongful acts such as genocide, certain war crimes, slavery, and the so-called *jus cogens* norms. The question of applicability of the *jus cogens* norms to determine obligations of legal entities does not seem to be controversial because individuals and States are responsible for violations of such norms but not corporations.¹³⁷ Moreover, corporate criminal

ARB/02/3, Decision on Respondent's Objections to Jurisdiction of October 21, 2005, (2005) 20 *ICSID Rev. - FILJ* 450, paras 88-93, 226, 230, 239.

¹³¹ See eg *Azurix Corp. v Argentine Republic*, ICSID Case No. ARB/01/12, Award of 14 July 2006, para 254 at <<http://icsid.worldbank.org>>; *Siemens A.G. v Argentina*, ICSID Case No. ARB/02/08, Award of 6 February 2007, paras 75, 79.

¹³² *ADC Affiliate et al. v The Republic of Hungary*, ICSID Case ARB/03/16, Award of 2 October 2006, paras 288-290. See also *Siemens A.G. v Argentina*, n 131 above, para 349, looking at customary international law to determine the standard of compensation for unlawful expropriation.

¹³³ A number of commentators argue that subjective perception of a particular State does not give the final verdict as to legality of a set of usages to create a custom.

¹³⁴ History of the Convention, n 31 above, 570.

¹³⁵ *ibid*, 419.

¹³⁶ *ibid*, 801, 985.

¹³⁷ See for instance The I.G. Farben Trial. *Trial of Carl Krauch and Twenty-two Others*, Case No 57, The Judgment of the Tribunal (14 August 1947-29 July 1948) (The United Nations War Crimes Commission, Law Reports of Trials of War Criminals, vol 10).

liability generally does not exist in international law and in most domestic legal systems.¹³⁸

Customary international law develops as a result of interaction between States and is meant to create obligations for States, not private investors. On the other hand, general principles of law are helpful for determining obligations of non-State actors such as investors.

General principles of law

General principles of law have played a prominent role in arbitrations between States and foreign nationals as illustrated by the practice of the IUSCT and ICSID cases.¹³⁹ These principles usually involve questions of a less political and more technical character compared to customary international law.¹⁴⁰ Therefore, they are more relevant for determination of investors' obligations. Their main distinction of general principles of law from international customs is that they do not arise out of international public law. Instead, they come from domestic law, practice of international organisations, or relations between States and private organisations¹⁴¹.

The sole arbitrator in a non-ICSID investor-State dispute *Texaco v Libya*, explained the relevance of general principles of law when domestic Libyan law was chosen as applicable. He noted that that:

[...] the application of the principles of [domestic] law does not have the effect of ruling out the application of the principles of international law, but quite the contrary: it simply requires us to combine the two in verifying the conformity of the first with the second.

Consequently, the arbitrator declared that he would rely both on the principle of the binding force of contracts recognised by Libyan law, and on the principle of *pacta sunt servanda*, which is essential to international law.

The principle of good faith occupies the most important position. All domestic legal systems as well as the United Nations Charter recognises it.¹⁴² This principle comes into play in the context of the exercise of rights,¹⁴³ and is

¹³⁸ I. Bantekas and S. Nash, *International Criminal Law* (London: Routledge-Cavendish, 3rd ed, 2007), 47.

¹³⁹ R. Lillich, 'The Law Governing Disputes under Economic Development Agreements: Re-examining the Concept of Internationalisation' in R. Lillich and C. Brower (eds), *International Arbitration in the Twenty-First Century: Towards Judicialisation and Uniformity* (Irvington New York: Transnational Publishers, 1993), 107 et seq; K. Lipstein, 'International Arbitration between Individuals and Governments and the Conflict of Laws' in B. Cheng and E.D. Brown (eds), *Contemporary Problems of International Law: Essays in Honour of Georg Schwarzenberger* (London: Stevens & Son, 1988), 177.

¹⁴⁰ G. Hanessian, "'General Principles of Law' in the Iran-U.S. Claims Tribunal' (1989) 27 *Columbia J. Transnat'l L.* 309, 309 et seq.

¹⁴¹ *ibid.*

¹⁴² United Nations Charter, Art 2(2).

¹⁴³ B. Cheng, *General Principles of Law as Applied by International Courts and Tribunals* (Cambridge: CUP, 1953), 121. For application of the principle in ICSID context see *Inceysa v El Salvador*, ICSID Case No.

otherwise described as the prohibition of malicious injury, ie the exercise of a right – or supposed right – for the sole purpose of causing injury to another.¹⁴⁴ The principle of good faith establishes interdependence between the rights of an investor and its obligations. The exercise of the right in a manner, which prejudices the interests of the other party, ie the State, would constitute a breach of the principle. A bona fide exercise of a right would be appropriate and necessary rather than procuring an unfair advantage in the light of the assumed obligation.¹⁴⁵

The general principle of good faith gives rise to more specific rights such as good faith in the conclusion, interpretation, and performance of contracts.¹⁴⁶ Even more specific principles would be interpretation against a party, which unilaterally drafted a contract.¹⁴⁷ International arbitration tribunals developed increasingly specialised general principles of law in their case law.¹⁴⁸

Other examples of general principles of law applied by investor-state tribunals include *restitutio in integrum*, meaning that the damage caused should cover both the direct and the foreseeable prejudice,¹⁴⁹ and an injured person's duty to mitigate damages.¹⁵⁰ Tribunals also applied principles of *pacta sunt servanda*,¹⁵¹ estoppel,¹⁵² full compensation of damages resulting from a failure to fulfil contractual obligations,¹⁵³ *nemo auditur propriam turpitudinem allegans* (prohibition from benefiting from one's own fraud),¹⁵⁴ the *exceptio non adimpleti contractus* (person who is being sued for non-performance of contractual obligations can defend themselves by proving that the plaintiff did not perform their side of the bargain),¹⁵⁵ unjust enrichment,¹⁵⁶ and general principles of contract law.¹⁵⁷

ARB/03/26, Award, 2 August 2006, para 230 et seq at <italaw.com/documents/Inceysa_Vallisoleitana_en_001.pdf>.

¹⁴⁴ *ibid*, 122. For application of this principle in investor-State context, see, e.g. *Saipem S.p.A. v People's Republic of Bangladesh*, ICSID Case No. ARB/05/7, Decision on Jurisdiction and Recommendation on Provisional Measures of March 21, 2007, (2007) 22 *ICSID Rev. - FILJ* 100, paras 154-158; *Waguib Elie George Siag and Clorinda Vecchi v Arab Republic of Egypt*, ICSID Case No. ARB/05/15, Decision on Jurisdiction of 11 April 2007, paras 119, 125, 213 at <<http://italaw.com>>.

¹⁴⁵ *ibid*, 125.

¹⁴⁶ E. Gaillard, *Legal Theory of International Arbitration* (Leiden/Boston, MA: Martinus Nijhoff Publishers, 2010), 54.

¹⁴⁷ *ibid*.

¹⁴⁸ *ibid*, 54.

¹⁴⁹ See Award on the Merits in Dispute between Texaco Overseas Petroleum Company/California Asiatic Oil Co. and the Government of the Libyan Arab Republic (*Texaco v Libya*), 17 *ILM* 1, Award on the Merits of 19 January 1977, paras 97-109; *Amco v Indonesia I*, Award on the Merits of 20 November 1984, (1992) 89 *ILR* 368, para 268.

¹⁵⁰ See *Middle East Cement Shipping and Handling Co. S.A. v Arab Republic of Egypt*, ICSID Case No. ARB/99/6, Award of 12 April 2002, (2005) 7 *ICSID Rep.* 173, para 167; *Texaco v Libya*, n 149 above.

¹⁵¹ *Klöckner Industrie-Anlagen GmbH and others v United Republic of Cameroon and Société Camerounaise des Engrais*, n 76 above (excerpts).

¹⁵² *Southern Pacific Properties (Middle East) Limited v Arab Republic of Egypt*, n 108 above, 246-247; *Klöckner Industrie-Anlagen GmbH and others v United Republic of Cameroon and Société Camerounaise des Engrais*, ICSID Case No. ARB/81/2, Decision on Annulment of 3 May 1985, (1994) 2 *ICSID Reports* 95, 140-141.

¹⁵³ *Amco v Indonesia*, n 149 above.

¹⁵⁴ *Inceysa v El Salvador*, n 143 above, para 240 et seq.

¹⁵⁵ *Klockner v Cameroon*, n 37 above, 61 et seq; *Autopista Concesionada de Venezuela, C.A. v Bolivarian Republic of Venezuela*, ICSID Case No. ARB/00/5, Award of 23 September 2003, para 316 at <<http://icsid.worldbank.org>>.

Tribunals may refuse to accept jurisdiction if one of those principles is breached. For instance, in *World Duty Free v Kenya* the tribunal held that as a matter of international public order it could not hear a case in which the investment had been made through corruption and bribes.¹⁵⁸ In doing so, the tribunal went further than the *Inceysa* tribunal, finding that an investment must be lawful even when there is no express provision requiring so in the BIT.

Unlike international treaties or international customary law, general principles of law provide for obligations of private parties. In the absence of specific provisions setting out obligations of investors in international treaties, these principles of law appear to serve as an appropriate source of law to determine obligations of investors in investor-State arbitration.

Jurisprudence and scholarly writings

Some general principles of law and legal rules are codified and easy to access.¹⁵⁹ Others are more difficult to distinguish. In practice, tribunals often skip the process of finding the ‘general principles of law recognized by civilized nations’ because it is difficult and time-consuming. Instead, tribunals tend to rely on relevant international jurisprudence although international law does not operate on the basis of stare decision doctrine. Prior ICSID awards, even those applying similar BIT language, do not constitute binding precedent.¹⁶⁰

However, many investor-State tribunals found themselves not barred, as a matter of principle, from considering the position taken or the opinion expressed by other tribunals.¹⁶¹ An ICSID tribunal in *ADC v Hungary* emphasised that despite their non-binding nature, the ‘cautious reliance on certain principles developed [in case law], as persuasive authority, may advance the body of law, which in turn may serve predictability in the interest of both investors and host States’.¹⁶² In addition to case law, investor-State tribunals often rely on scholarly writings to help establish norms of law.¹⁶³ Therefore, international jurisprudence and scholarly writings can be used as subsidiary means of identifying investors’ obligations in investor-State disputes.

¹⁵⁶ *Amco Asia Corporation and others v Republic of Indonesia*, ICSID Case No. ARB/81/1, Resubmitted Case: Award of 5 June 1990, (1993) 1 *ICSID Rep.* 569, paras 154-156; *Southern Pacific Properties (Middle East) Limited v Arab Republic of Egypt*, n 108 above, paras 245-249; *Inceysa v El Salvador*, n 143 above, para 253 et seq. For a longer list of cases in which tribunals relied upon by ICSID Tribunals, see Schreuer, et al, n 65 above, 608-609.

¹⁵⁷ *Amco v Indonesia*, n 149 above, paras 180-183.

¹⁵⁸ *World Duty Free Company Ltd v Kenya*, ICSID Case No. ARB/00/7, 25 September 2006, para 157.

¹⁵⁹ See, eg, UNIDROIT Principles of International Commercial Contracts (2004) at <www.unidroit.org/english/principles/contracts/main.htm>.

¹⁶⁰ *AES Corporation v Argentine Republic*, ICSID Case No. ARB/02/17, Decision on Jurisdiction of 26 April 2005, (2007) 12 *ICSID Reports* 308, 317, paras 27-28.

¹⁶¹ *ibid.*

¹⁶² *ADC Affiliate et al v The Republic of Hungary*, n 132 above, para 293.

¹⁶³ For a survey of sources relied upon by investor-state tribunals, see Jeffrey Commission, ‘Precedent in Investment Treaty Arbitration – A Citation Analysis of a Developing Jurisprudence’ (2007) 24 *Journal of International Arbitration* 129.

DOMESTIC LAW

Often BITs provide that domestic law of the host State and international law govern the disputes between the State and the investor.¹⁶⁴ According to the ICSID Convention, if the parties fail to agree on applicable law the law of the host State applies. UNCITRAL Arbitration Rules as well as other institutional arbitration rules gives discretion to the tribunal to determine what law should apply.

A failure to comply with the laws of the host State may even act to exclude the investment from protection under the BIT. In *Maffezini v Spain*, the tribunal held that the Argentine investor's failure comply with its environmental regulations constituted a violation of the investor's obligations.¹⁶⁵ In the 2006 case of *Inceysa v El Salvador* the tribunal declined jurisdiction on the basis of a BIT provision that the investment must be made in accordance with the law of the host country, holding that an investment made through fraudulent means could not be made in accordance with law.¹⁶⁶

Applicable domestic law does contemplate investors' obligations. However, not all domestic law obligations rise to the level of international law obligations. Counterclaims arising out of application of domestic law of general applicability usually fall outside of international tribunals' jurisdiction. For instance, in a number of cases before the IUSCT Iran counterclaimed requesting contributions due for allegedly unpaid taxes and social security contributions. The IUSCT tribunals usually held that the counterclaim arose not out of the same contracts that were subject matter of the investor's claim but out of the generally applicable domestic law.¹⁶⁷ This was upheld even if the contract upon which a claim is based expressly allocates the burden to make such claims to the claimant.¹⁶⁸

A good example of an ICSID case with the same logic is *Amco v Indonesia* in which the State asserted a counterclaim seeking payment of taxes and of custom duties. Those taxes and duties would have been due but for special exemptions granted under the investment license, which had been revoked. The tribunal found against the State because the license revocation was found to be unlawful.¹⁶⁹

Following the award's annulment Indonesia modified its counterclaim and alleged tax fraud. Because Indonesia did not introduce it as counterclaim in accordance with ICSID Arbitration Rules the Tribunal considered tax fraud as a

¹⁶⁴ Begic, n 104 above, 232.

¹⁶⁵ *Maffezini v Spain*, ICSID Case No ARB/97/7, Award of 13 November 2000.

¹⁶⁶ *Inceysa Vallisoletana S.L. v Republic of El Salvador*, ICSID Case No. ARB/03/26, 2 August 2006 at <www.italaw.com>.

¹⁶⁷ See, eg, *Petrolane, Inc. v Islamic Republic of Iran*, et al, Iran-US Claims Tribunal Award No. 518-131-2 (14 August 1991), para 118, 27 *Iran-U.S. C.T.R.* 64, 104, 138; *Inc. v Ministry of National Defence of the Islamic Republic of Iran*, Iran-US Claims Tribunal Award No. 191-59-1 (20 September 1985), reprinted in 9 *Iran-U.S. C.T.R.* 107, 134-136.

¹⁶⁸ See, eg, *International Technical Products Corporation and The Government of the Islamic Republic of Iran*, Final Award No. 196-302-3 (28 October 1985), reprinted in 9 *Iran-U.S. Cl. Trib. Rep.* 206, 224-226.

¹⁶⁹ *Amco v Indonesia*, n 149 above, paras 283-287.

new claim.¹⁷⁰ The tribunal eventually ruled that because the claim did not arise ‘directly out of an investment’ as required by the ICSID Convention the tax fraud case was outside its jurisdiction. The tribunal also distinguished between rights and obligations provided by the BIT and generally applicable rights and obligations:

It is correct to distinguish between 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.

¹⁷¹

The same logic on arbitrability of domestic law claims in investor-State arbitration appeared in *Saluka v Czech Republic*, a dispute governed by UNCITRAL rules.¹⁷² The tribunal held that it did not have jurisdiction because of the absence of close connection between the primary claim and a counterclaim. Like in *Amco v Indonesia*, the tribunal emphasised that the counterclaims involved ‘non-compliance with the general law of the Czech Republic’ and ‘rights and obligations which are applicable as a matter of the general law of the Czech Republic, to persons subject to the Czech Republic’s jurisdiction’.¹⁷³ The tribunal concluded that the counterclaims were to be decided not through the BIT settlement procedure, but through appropriate procedures under Czech law.¹⁷⁴

More recently, a UNICTRAL tribunal was asked to decide a tax counterclaim in *Paushok v Mongolia*.¹⁷⁵ Because the claim arose out of public law of Mongolia the Tribunal ruled that they were not within its jurisdiction.¹⁷⁶ It explained its decision:

[...] through the Counterclaims the Respondent seeks to extend the extraterritorial application and enforcement of its public laws, and in particular its tax laws, to individuals or entities not subject to and not having

¹⁷⁰ *Amco v Indonesia*, n 36 above, 562-564.

¹⁷¹ *ibid*, paras 125-126.

¹⁷² *Saluka Investments BV v Czech Republic*, n 41 above.

¹⁷³ *ibid*, paras 78-79.

¹⁷⁴ *ibid*, para 79.

¹⁷⁵ *Sergei Paushok, CJSC Golden East Company and CJSC Vostokneftegaz Company v Mongolia*, UNCITRAL (Russia/Mongolia), Award on Jurisdiction and Liability of 28 April 2011 at <<http://italaw.com/documents/PaushokAward.pdf>>.

¹⁷⁶ *ibid*, para 699.

accepted to submit to Mongolian public law or its courts. Thus, if the Arbitral Tribunal extended its jurisdiction to the Counterclaims, it would be acquiescing to a possible exorbitant extension of Mongolia's legislative jurisdiction without any legal basis under international law to do so, since the generally accepted principle is the non-extraterritorial enforceability of national public laws and, specifically, of national tax laws.¹⁷⁷

Investment disputes that may also arise out of tort law obligations still fall under the jurisdictional reach of investor-State tribunals. As was pointed out in the *Amco Asia* case, an international tort and an investment dispute were not mutually exclusive categories.¹⁷⁸ However, only certain torts arising directly out of investment rather than out of law of general applicability can fall within the jurisdiction of ICSID tribunals.

As discussed in Section IV, international tribunals cannot serve as a replacement for domestic courts of courts of appeals. Generally applicable domestic regulations are outside of the parties' consent to arbitration.

It appears that counterclaim can be based on domestic law obligations of investors only if the same obligations were specifically mentioned in the relevant BIT or a similar instrument which provides for the tribunal's jurisdiction. Otherwise, violation of domestic law obligations is usually insufficient for an investor-State tribunal to extend its jurisdiction.

CONTRACTS

Most investor-State disputes involve one or more contracts concluded between the foreign investor and the State. That could be a privatisation contract, a concession contract, or license agreement or other contracts. Unlike BITs, in addition to obligations of States, these contracts also include concrete obligations of investors. Therefore, it is important to understand whether obligations of investors arising out of contracts can fall under the jurisdiction of investor-State tribunals.

UNCITRAL Arbitration Rules and ICC arbitration rules provide that contract provisions should be taken into account when tribunals resolve disputes.¹⁷⁹ The reason why most arbitration rules explicitly cover contractual obligations is that those rules were originally developed for resolution of purely contractual disputes between private parties. Even the ICSID Convention was adopted primarily with contractual disputes in mind; when the Convention was finalised in 1965 there were almost no BITs.¹⁸⁰

That does not mean, however, that disputes under BITs cannot cover contractual disputes. It would be also wrong to suggest that any obligations in contracts concluded between the foreign investor and the host State automatically

¹⁷⁷ *ibid*, para 695.

¹⁷⁸ *Amco v Indonesia*, n 36 above, 178.

¹⁷⁹ 2010 UNCITRAL Arbitration Rules, Art 35.3; 1998 ICC Arbitration Rules, Art 17.1.

¹⁸⁰ R. Dolzer and M. Stevens, *Bilateral Investment Treaties* (The Hague: Martinus Nijhoff, 1995), 82.

rise to international obligations arbitrable by investor-State tribunals. As James Crawford pointed out, contractual jurisdiction can be invoked under any sufficiently broad BIT dispute resolution clause as long as three conditions are met.¹⁸¹

First, the contract should be relating to an investment rather than an ordinary contract for supply of goods or services.¹⁸² Second, the contract should be with the State itself and not with a separate legal entity controlled by the State or a third party.¹⁸³ Third, such jurisdiction may arise if the contract with the State does not have its own dispute resolution clause.¹⁸⁴ The same logic applies to counterclaims. States can assert counterclaims arising out of investors' contractual obligations if there is a sufficiently broad BIT clause, and the investment contract with the State does not have its own dispute resolution mechanism.

Subject matter jurisdiction of ICSID tribunals is wider when investment treaty provisions guarantee the host State's observance of obligations or commitments entered into *vis-à-vis* foreign investors. These provisions are commonly known as umbrella clauses. A typical umbrella clause provides that 'each party shall observe any obligation it may have entered into with regard to investments'.¹⁸⁵

Umbrella clauses are often referred to as *pacta sunt servanda* clauses because their purpose is to ensure that contracts are respected.¹⁸⁶ They impose a requirement on each contracting State to observe all investment obligations entered into with investors from the other contracting State.¹⁸⁷ According to Lauterpacht, the effect of umbrella clauses is to 'put [investor-State contracts] on a special plane in that breach of them becomes immediately a breach of convention'.¹⁸⁸

The precise nature and effect of umbrella clauses is uncertain. Some commentators interpret them as investor's contractual rights against 'any interference which might be caused by either a simple breach of contract or by administrative or legislative acts'.¹⁸⁹ On the other hand, the application of this principle does not explain whether umbrella clauses also cover purely commercial contracts.¹⁹⁰ Some tribunals consider these clauses as automatically elevating the

¹⁸¹ J. Crawford, 'Treaty and Contract in Investment Arbitration' (22nd Freshfields Lecture on International Arbitration, London, 29 November 2007), 13 at <<http://www.lcil.cam.ac.uk/Media/lectures/pdf/Freshfields%20Lecture%202007.pdf>>.

¹⁸² *ibid.*

¹⁸³ *ibid.*

¹⁸⁴ *ibid.*

¹⁸⁵ United States-Argentina BIT of 14 November 1991, Art 2.2.

¹⁸⁶ See 142-147 on history of umbrella clauses.

¹⁸⁷ J. Wong, 'Umbrella Clauses in Bilateral Investment Treaties: of Breaches of Contract, Treaty Violations, and the Divide Between Developing and Developed Countries in Foreign Investment Disputes' (2006) 14 *Geo. Mason L. Rev.* 135.

¹⁸⁸ E. Lauterpacht, 'Drafting of Conventions for the Protection of Investment' in *The Encouragement and Protection of Investment in Developing Countries* (London: British Institute of International and Comparative Law, 1962), 218, 229.

¹⁸⁹ Dolzer and Stevens, n 180 above.

¹⁹⁰ See UNCTAD, *Bilateral Investment Treaties 1995-2006: Trends in Investment Rulemaking* (2007), 74-75.

host State's breaches of contract with investors to a treaty violation.¹⁹¹ Other cases rejected this interpretation without explaining the meaning of the umbrella clauses.¹⁹² The main rationale in favour of the narrow interpretation of umbrella clauses is the concern of opening the floodgates of investment treaty arbitration to every contractual claim.

In *SGS v Philippines* the tribunal stated that an umbrella clause signalled 'an implied affirmative commitment to give effect to a contractual or statutory undertaking that arises from a contract between the parties' and such a reading would be consistent with the BITs' purpose, which was 'to create and maintain favourable conditions for investment [...]'.¹⁹³ The tribunal in *Enron v Argentine Republic*¹⁹⁴ found that the ordinary meaning of the phrase 'any obligation included both contractual obligations and statutory obligations undertaken with regard to investments'.¹⁹⁵ On the other hand, in *Sempra v Argentine Republic*,¹⁹⁶ the tribunal distinguished between 'ordinary commercial breaches of a contract' and 'treaty breaches', implying that only the latter would fall under the scope of an umbrella clause. In line with the reasoning in *SGS v Pakistan*,¹⁹⁷ the *Sempra* tribunal noted that 'such a distinction is necessary so as to avoid an indefinite and unjustified extension of the umbrella clause'. Similarly, in *Impregilo v Pakistan* the Tribunal stated that the umbrella clause would not cover contracts entered into between the foreign investor and a distinct legal entity.¹⁹⁸

It is undesirable to extend jurisdiction of investor-State disputes over any contracts entered into by investors. That would turn tribunals into courts of appeals, which is not the function of investor-State tribunals. Indeed, BIT provisions, which provide for various substantive treaty standards, would be superfluous if any simple breach of a contract between the parties sufficed to bring the BIT into play.¹⁹⁹

¹⁹¹ See, eg, *SGS Société Générale 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, (2005) 8 *ICSID Rep.* 518; *Noble Ventures, Inc. v Romania*, n 130 above.

¹⁹² See, eg, *Societe Generale de Surveillance S.A. v Islamic Republic of Pakistan*, ICSID Case No. ARB/01/13, Decision on Objections to Jurisdiction of 6 August 2003, paras 164-173.

¹⁹³ *SGS v Philippines*, ICSID Case No. ARB/02/6, para 116 (internal quotations omitted).

¹⁹⁴ *Enron Corporation and Ponderosa Assets, L.P. v Argentine Republic*, ICSID Case No. ARB/01/3, Award of 22 May 2007.

¹⁹⁵ *ibid*, para 274. See also *Siemens A.G. v Argentine Republic*, n 131 above, para 205: 'In regards to the scope of Article 10(1), the Tribunal concurs with the submission that reference to disputes related to investments would cover contractual disputes for purposes of the consent of the parties to arbitration given the wide meaning of the term 'investments' and the terms of Article 7(2). However, to the extent that the obligations assumed by the State party are of a contractual nature, such obligations must originate in a contract between the State party to the Treaty and the foreign investor as, for instance, in the *SGS* cases.'

¹⁹⁶ *Sempra Energy International v Argentine Republic*, ICSID Case No. ARB/02/16 (Argentina-United States BIT), Award of 28 September 2007.

¹⁹⁷ *SGS Societe Generale de Surveillance S.A. v Islamic Republic of Pakistan*, ICSID Case No. ARB/01/13, Award on Jurisdiction of 6 August 2003.

¹⁹⁸ *Impregilo S.p.A. v Islamic Republic of Pakistan*, ICSID Case No. ARB/03/3, Decision on Jurisdiction of 22 April 2005.

¹⁹⁹ Wong, n 187 above, 136.

To sum up, investors' purely contractual obligations do not fall under jurisdiction of investor-State tribunals in the absence of an umbrella clause. However, the State may assert counterclaims under a sufficiently broad BIT clause if the investor breached its obligations under the investment contract concluded with the State.

V CONCLUSION

The growing number of counterclaims submitted by States goes hand in hand with the growing number of investor-State disputes. The recent revision of UNCITRAL Arbitration Rules, which broadened jurisdiction of UNCITRAL tribunals, is another factor which will increase the number of State counterclaims. If the plans to include environmental and human rights standards in BITs materialise, it may further extend jurisdiction of investor-State tribunals to non-commercial disputes.

Why states have not actively used counterclaims in international tribunals, despite all the benefits? Two reasons appear to be the most important. First, the State has inherent power to regulate foreign investment and often feels no need to go up to international tribunals. Another reason is difficulty with the determination of investors' substantive obligations arbitrable at investor-State tribunals. This makes the procedural aspects of counterclaims less concerning to States than the substantive.

Because BITs usually do not provide for investors' obligations, such obligations can be found in other sources of international law. These are commercial obligations, which rise to the level of international obligations. In the absence of concrete provisions setting out investors' obligations in international treaties, general principles of law appear to be an appropriate source of international law to determine such obligations. However, if the treaty contains an offer of jurisdiction only in relation to disputes arising out of obligations, provided in the treaty itself, it will be difficult for an investor-State tribunal to assert its subject matter jurisdiction.

Investors' contractual obligations do not fall under jurisdiction of investor-State tribunals with two exceptions: First, if the tribunal is willing to give a broad interpretation of an umbrella clause, thus elevating contractual obligations to international obligations. Second, the State may assert counterclaims under a sufficiently broad BIT clause if the investor breached its obligations under the investment contract concluded with the State.

Finally, often success of counterclaims depends on the tribunal's willingness to pierce the corporate veil of undercapitalised local subsidiaries to reach assets of their parent companies.