

SYMPOSIUM ON INVESTOR RESPONSIBILITY: THE NEXT FRONTIER IN INTERNATIONAL INVESTMENT LAW

COUNTERCLAIMS AND THE RULE OF LAW IN INVESTMENT ARBITRATION

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While the rule of law was originally developed with reference to domestic constitutional orders, it is also widely embraced by international lawyers.¹ This essay argues that the admission of counterclaims in certain circumstances helps investment arbitration advance the rule of law on several counts. The rule of law is defined here to include not only formal elements such as rule-by-law and formal legality, but also “thicker” elements attached to certain substantive values, including fundamental human rights.² The UN’s work on the rule of law clearly adopts a broad interpretation of this concept.³ This essay examines the potential for counterclaims to bridge the gap between the lack of effective mechanisms to hold foreign investors accountable for their conduct and the extensive protection of foreign investors in international investment law. By doing so, counterclaims in investment arbitration may promote the thicker elements of the rule of law such as accountability to the law, access to justice, and fairness in the application of the law.

The Need for a New Paradigm in Investment Arbitration

In investment treaty arbitration the claims always go in one direction, from the investor to the host state. With a limited number of exceptions, investment treaties do not create investor obligations that can constitute the legal basis for a cause of action for host states to bring arbitral claims against an investor. Moreover, in investment treaty arbitration, a host state may not file its principal claims insofar as the investor withholds its consent to the specific request for arbitration made by the host state. The asymmetric structure of investment treaty arbitration is explained by the fact that the investment treaty regime has developed as a mechanism to protect foreign investors who are in a weaker bargaining position with respect to the host state.⁴ However, where a foreign investor’s activities have significant implications for the public interest of the host state, the investment dispute involves the interest of citizens and residents of the host state, a situation that goes beyond the bilateral and generally asymmetrical relationship between the investor and the host state. In such cases, the traditional paradigm of investment arbitration as a mechanism for the sole protection of investor’s rights no longer adequately reflects all dimensions of the investment dispute.

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¹ See, e.g., [Speech by H.E. Judge Rosalyn Higgins, President of the International Court of Justice, at the United Nations University on “The ICJ and the Rule of Law”](#) (Apr. 11, 2007); James Crawford, [International Law and the Rule of Law](#), 24 ADEL. L. REV. 3, 10 (2003).

² Lord Bingham, [The Rule of Law](#), 66 CAMBRIDGE L.J. 67, 75–77 (2007).

³ See, e.g., [GA Res. 67/1](#) (Nov. 30, 2012); UN Secretary-General, [The Rule of Law and Transitional Justice in Conflict and Post-Conflict Societies](#), UN Doc. S/2004/616 para. 6 (Aug. 23, 2004).

⁴ W. Michael Reisman, [International Investment Arbitration and ADR](#), 24(1) ICSID REV. 185 (2009).

Nevertheless, in the current system, neither host states nor individuals and communities injured by an investor's conduct may pursue the investor's responsibility in investment treaty arbitration. Indeed, there is no effective international law mechanism for holding investors accountable for damage caused by their activities. States have not created an international instrument with wide scope of application that directly constrains corporate activities. Although work to draft an international legally binding instrument⁵ on transnational corporations and other business enterprises with respect to human rights is under active consideration in the UN Human Rights Council,⁶ this process lacks support from developed countries—fourteen members of the Council, including the United States, Japan, and the member states of the European Union opposed the adoption of the resolution—as well as the international business community.⁷ Even when obligations of private persons are included in treaty texts, there is generally no mechanism for their enforcement in the international law sphere. One sure way to hold private parties such as investors to account is through an agreement to resort to international arbitration included in a contract between the state and such a private party. Such arbitral clauses, unlike those embodied in investment treaties, are more likely to allow states to bring a case against a private party such as an investor.⁸ However, investment arbitration based on such contracts remains unusual: 14 percent of new cases registered in the International Centre for the Settlement of Investment Disputes (ICSID's) fiscal year 2018 under the ICSID Convention and Additional Facility Rules are contract-based.

Limitations of Domestic Adjudicatory Mechanisms

When individuals and communities suffer harm due to the conduct of foreign investors, the most immediate way to pursue the responsibility of the latter would be litigation in the domestic jurisdiction of the host state. Indeed, if the judiciary and other dispute settlement organs of the host state meet the rule-of-law requirements, namely independence, impartiality, effectiveness, and accessibility, then domestic dispute settlement mechanisms would be a more desirable option than raising counterclaims in investment arbitration.⁹ When the victims are the claimants themselves, there is no risk that the state may compromise the case and limit the victims' claims.¹⁰ There is also the possibility that the host state pursues investors' responsibility at the domestic level through judicial, administrative, or even criminal proceedings. Pertinent here is the argument that admission of counterclaims in investment arbitration, especially those based on domestic laws of the host state, undermines the rule of law because it inhibits the development of the domestic judiciary of the host state by depriving it of incentives to compete with international tribunals.¹¹

⁵ See Human Rights Council, [Legally Binding Instrument to Regulate, in International Human Rights Law, the Activities of Transnational Corporations and Other Business Enterprises – Zero Draft](#) (July 16, 2018).

⁶ UN Human Rights Council, [Resolution 26/9](#), UN Doc. A/HRC/Res/26/9 (July 14, 2014).

⁷ International Chamber of Commerce et al., [Response of the International Business Community to the “Elements” for a Draft Legally Binding Instrument on Transnational Corporations and Other Business Enterprises with Respect to Human Rights](#) (Oct. 20, 2017).

⁸ See [Balkan Energy v. Ghana](#), PCA Case No. 2010–7, Award (Apr. 1, 2014).

⁹ For a comparative institutional analysis between investment law and other adjudicatory and nonadjudicatory mechanisms including domestic dispute settlement mechanisms, see Sergio Puig & Gregory Shaffer, [Imperfect Alternatives: Institutional Choice and the Reform of Investment Law](#), 112 AJIL 361 (2018).

¹⁰ See Lise Johnson & Brooke Skartvedt Guven, [The Settlement of Investment Disputes: A Discussion of Democratic Accountability and the Public Interest](#), 8(1) INVESTMENT TREATY NEWS 7 (2017).

¹¹ Tom Ginsburg, [International Substitutes for Domestic Institutions: Bilateral Investment Treaties and Governance](#), 25 INT'L REV. L. & ECON. 107, 123 (2005).

However, in many jurisdictions, domestic judicial institutions do not meet the rule-of-law requirements identified above. The story of the Ecuadorian *Lago Agrio* judgments¹² demonstrates that judicial corruption remains a reality.¹³ Domestic judicial institutions may be susceptible to political interference. Moreover, especially in developing countries, there is a variety of practical barriers to effective judicial remedy, including the lack of financial and other resources to gain access to information and legal services as well as the lack of institutional capacity of local courts. In such circumstances, using domestic dispute settlement mechanisms either undermines the rule of law or is an unrealistic option.

Another option for seeking judicial redress for the victims would be to bring the claims in the domestic courts of the investor's home state. However, although they are not prohibited from regulating the extraterritorial activities of the investors "provided there is a recognized jurisdictional basis,"¹⁴ these courts—with a few important exceptions¹⁵—tend to be reluctant to hear civil liability claims against investors arising from their conduct in foreign countries. Local courts have denied jurisdiction over such claims on various grounds, including the doctrine of *forum non conveniens*, statutes of limitations, and a principle that shields the parent company from liability for damage committed by foreign subsidiaries.

In the United States, claims against multinational corporations based on their conduct in foreign territories have been brought under the Alien Tort Statute (ATS). However, in 2018, the Supreme Court in *Jesner v. Arab Bank* concluded that "foreign corporations may not be defendants in suits brought under the ATS."¹⁶ This placed significant limitations on the scope of the ATS as a cause of action.¹⁷

Counterclaims by the Host State

The lack of an international mechanism to effectively pursue investors' responsibility and various limitations of domestic adjudicatory mechanisms highlight the potential importance of counterclaims in investment arbitration. This could create an avenue through which host states could try to hold investors liable for any damage allegedly caused with respect to the investment. Individuals and communities who directly suffer harm due to an investor's conduct do not have legal standing before investment arbitration. A host state is, however, the right counterclaimant with standing to bring claims on behalf of individuals and communities on its territory who suffer harm.¹⁸ This is because a state is responsible not only for its own human rights violations but also for human rights abuses by private entities that occur in its territory.¹⁹ A state has a duty of due diligence in authorizing or monitoring the operation of

¹² *Aguinda v. ChevronTexaco*, No. 2011–0106 (Sucumbios Prov. Ct. J., Nueva Loja App. Div. Jan. 3, 2012) (Ecuador); *Aguinda v. ChevronTexaco*, No. 002003, Judgment (Prov. Ct. J., Nueva Loja in Lago Agrio, Feb. 14, 2011) (Ecuador).

¹³ See *Chevron v. Ecuador*, PCA Case No. 2009–23, Second Partial Award on Track II, part V (Aug. 30, UNCITRAL, 2018); *Chevron v. Donziger*, 974 F. Supp. 2d 362, 386–546 (S.D.N.Y. 2014); *Chevron v. Donziger*, ___ F.3d ___, 2016 WL 4173988 (2d Cir. Aug. 8, 2016).

¹⁴ Commentary to Principle 2 of the *UN Guiding Principles on Business and Human Rights* (2011) (hereinafter UN Guiding Principles).

¹⁵ See, e.g., *Lungowe v. Vedanta Resources* [2017] EWCA Civ 1528 (UK); *Dooh v. Shell*, ECLI:NL:GHDHA:2015:3586 (Court of Appeal The Hague, Dec. 18, 2015) (Neth.).

¹⁶ *Jesner v. Arab Bank*, 584 U.S. ___ (2018), 18–26. See also *Kiobel v. Royal Dutch Petroleum*, 569 U.S. 108 (2013).

¹⁷ For additional discussion, see Andrew Sanger, *Transnational Corporate Responsibility in Domestic Courts: Still out of Reach?*, 113 AJIL Unbound 4 (2019).

¹⁸ The issue of coexistence of domestic remedies and counterclaims based on the same factual and legal grounds remains and should be addressed by, for example, requiring the host state to waive its right to file the claims against the claimant investor at any jurisdiction other than the relevant investment arbitration as a condition for filing counterclaims.

¹⁹ See UN Human Rights Comm., *General Comment No. 31, Nature of the General Legal Obligation Imposed on States Parties to the Covenant*, UN Doc. CCPR/C/21/Rev.1/Add.13 para. 8 (May 26, 2004); *UN Guiding Principles*, *supra* note 14, para. 1.

private businesses, and when its failure to fulfil this duty results in human rights damage caused by private entities, the state has the duty to provide access to remedies. The African Commission on Human and Peoples' Rights clearly explained these obligations in *Social and Economic Rights Action Center (SERAC) and Center for Economic and Social Rights (CESR)/Nigeria*, a case based on the African Charter of Human and Peoples' Rights.²⁰ The Commission concluded that Nigeria, by allowing oil companies "to devastatingly affect the wellbeing of the Ogonis" in the companies' oil operations, breached its obligation to protect persons against interference with the enjoyment of their rights,²¹ and appealed to the Nigerian government to ensure adequate compensation to victims of the human rights violations.²²

Certainly, even when counterclaims are available to the defendant state in investment arbitration, in the current framework of international law, there is no mechanism to ensure that the state would use counterclaims as a way to fulfil its duty of protection against actions by private entities. For example, there is no guarantee that the state actually would effect payment in satisfaction of the victims' claims. There is also the possibility that the state would decide not to raise counterclaims even when there is no effective judicial venue available to the victims, or that the state would limit the victims' claims by compromising the case.²³ A possible way to address these issues would be to establish an international mechanism to monitor the implementation of the states' duty of protection. The Office of the Compliance Advisor/Ombudsman for International Finance Corporation and Multilateral Investment Guarantee Agency might be a good model.

Counterclaims and the Rule of Law

As discussed above, there are circumstances in which fair and effective judicial redress is not expected under domestic dispute settlement mechanisms. Raising counterclaims in investment arbitration in such circumstances serves the rule of law in the following ways. First, the 2012 UN Resolution declares accountability to the law as an element of the rule of law at the national and international levels: "all persons, institutions and entities, public and private, including the State itself, are accountable to just, fair and equitable laws."²⁴ It likewise emphasizes "the right of equal access to justice for all, including members of vulnerable groups,"²⁵ which is closely related to fairness in the application of the law. By providing an avenue to pursue investors' responsibility for conduct that resulted in concrete harm to the public interest, the use of counterclaims advances these rule-of-law requirements. In cases where the investor's liability is established, the rights of the victims are arguably better secured in investment arbitration than in domestic courts, because the former has a much stronger international enforcement mechanism than that of domestic court judgments.²⁶ Greater recognition of the investor's responsibility in investment arbitration through counterclaims might also contribute to improving corporate governance.

²⁰ African Commission on Human and Peoples' Rights, [Communication No. 155/96](#) (Oct. 27, 2001). For other cases in which the human rights treaty dispute settlement bodies found that states breached their obligations to protect against actions by private entities, see Robert McCorquodale, *Corporate Social Responsibility and International Human Rights Law*, 87(2) J. BUS. ETHICS, 385, 387 (2009).

²¹ [African Commission on Human and Peoples' Rights](#), *supra* note 20, at paras. 57–58.

²² *Id.*, holding.

²³ See Johnson & Skartvedt Guven, *supra* note 10.

²⁴ [GA Res. 67/1](#) para. 2 (Nov. 30, 2012).

²⁵ *Id.* at para. 14.

²⁶ The membership of the [Convention of 30 June 2005 on Choice of Court Agreements](#) is limited to the European Union and its member states, Mexico, Montenegro, and Singapore (as of Nov. 29, 2018).

Second, counterclaims will advance the principle of procedural equality in two different but related ways. Counterclaims redress an asymmetry in the current investment arbitration system, at least to a certain extent.²⁷ Further, when the rule of law is weak in the host state, the host state's act of filing a claim against the investor using domestic dispute settlement mechanisms immediately creates the risk that the host state exercises its home-field advantage.²⁸ This risk does not exist with investment arbitration, and in this sense also, counterclaims advance the principle of procedural equality.

Conclusion

I have argued in this essay that admitting counterclaims promotes the rule of law in investment arbitration in certain circumstances. However, in current law and practice, this option is not readily available to the defendant state. Article 46 of the ICSID Convention requires that, in the absence of a specific agreement between the disputing parties to jurisdiction over counterclaims, counterclaims must: (i) arise directly out of the subject matter of the dispute; (ii) be within the scope of the consent of the parties; and (iii) be otherwise within the jurisdiction of the Centre. Non-ICSID arbitral tribunals have required the fulfilment of similar conditions in assessing jurisdiction over counterclaims.

Of these requirements, the one relating to consent to jurisdiction over counterclaims has been the first hurdle to overcome to establish jurisdiction since *Roussalis v. Romania*.²⁹ For investment treaty arbitration, the presence or absence of consent to jurisdiction over counterclaims is assessed by reference to the relevant investment treaty. Particular attention is given to whether the scope of arbitrable disputes and claims is limited to those arising from the host state's alleged breach of investment treaty obligations or is more broadly defined to include disputes with respect to investment activities. When the relevant investment treaty provides a narrow scope of arbitrable disputes/claims, arbitral tribunals have consistently rejected jurisdiction over counterclaims for lack of consent.³⁰ Even when jurisdiction over counterclaims is established, counterclaims have rarely succeeded on their merits, with the important exceptions of *Burlington v. Ecuador*³¹ and *Perenco v. Ecuador*.³² These cases are highly exceptional in that the claimant investors actually consented to jurisdiction over the host state's counterclaims based on the former's breach of its own domestic law. Moreover, in current investment treaty-making, there does not seem to be a trend towards the general facilitation of counterclaims in investor-to-state dispute settlement.³³

These factors hinder the potential of counterclaims to advance the rule of law in investment arbitration. However, to address the pressing need to (re)establish confidence in the investment treaty system, it is essential to integrate the demands of the rule of law in investment arbitration. This being so, discussion about the future direction of investment arbitration should consider ways to enable the active use of counterclaims.

²⁷ Walid Ben Hamida, *L'arbitrage Etat-investisseur cherche son équilibre perdu: Dans quelle mesure l'Etat peut introduire des demandes reconventionnelles contre l'investisseur privé?*, 7 INT'L L. F. DU DROIT INT'L 261, 271 (2005).

²⁸ Susan D. Franck, *Foreign Direct Investment, Investment Treaty Arbitration, and the Rule of Law*, 19 GLOBAL BUS. & DEV. L.J. 337, 372 (2007).

²⁹ *Spyridon Roussalis v. Romania*, ICSID Case No. ARB/06/1, Award (Dec. 7, 2011).

³⁰ See, e.g., *Rusoro Mining v. Venez.*, ICSID Case No. ARB(AF)/12/5, Award (Aug. 22, 2016) and *Vestey Group v. Venez.*, ICSID Case No. ARB/06/4, Award (Apr. 15, 2016).

³¹ *Burlington Resources v. Ecuador*, ICSID Case No. ARB/08/5, Decision on Ecuador's Counterclaims (Feb. 7, 2017).

³² *Perenco Ecuador v. Ecuador*, ICSID Case No. ARB/08/6, Interim Decision on the Environmental Counterclaim (Aug. 11, 2015). See also *Desert Line Projects v. Yemen*, ICSID Case No. ARB/05/17, Award (Feb. 6, 2008).

³³ See, e.g., Article 8.18(1) of the *EU-Canada Comprehensive Economic and Trade Agreement* and 9.19(2) of the *Comprehensive and Progressive Agreement for Trans-Pacific Partnership*.