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Environmental and Human Rights Counterclaims in International Investment Arbitration: at the Crossroads of Domestic and International Law

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ABSTRACT

Recently, environmental and human rights (EHR) counterclaims in investment arbitration have attracted much attention as a vehicle to recalibrate the investor–state relationship. However, until now, successful instances of EHR counterclaims have been admittedly rare. As explained in this paper, some of the major barriers to EHR counterclaims in investment arbitration, and some of the concerns associated with them, are rooted in the domestic law basis of such counterclaims. Contrary to the position of several commentators, this paper argues that the grounding of EHR counterclaims on international law is neither practical nor beneficial, and EHR counterclaims are necessarily based on domestic law. Therefore, when investment arbitral tribunals adjudicate EHR counterclaims, they essentially act as an alternative to domestic courts. This has several implications. First, on questions of jurisdiction and admissibility of EHR counterclaims, decisions of states and arbitral tribunals essentially turn on the pros and cons of having these claims adjudicated by investment arbitral tribunals as opposed to domestic courts. Second, weaknesses in domestic rules, including the difficulty of holding shareholders accountable, would carry over to EHR counterclaims. Such problems can only be efficiently tackled at the level of domestic law. Third, as revealed from the inconsistent decisions in *Perenco* and *Burlington* on the merits of the environmental counterclaims, having investment arbitral tribunals adjudicate domestic law-based EHR counterclaims may cause certain concerns. For EHR counterclaims to play a more beneficial role, decision-makers must bear in mind these factors and concerns when taking their policy choices.

I. INTRODUCTION

The asymmetric structure of investor–state arbitration under investment treaties was originally designed to remedy the disadvantaged position of foreign investors in relation to host states upon the making of investments. However, this asymmetry has become a cause for criticism in recent years. Lately, with the surge in investors' claims

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challenging regulatory measures and the rising nationalism worldwide, public opinions increasingly tilt against investors and criticisms are increasingly levelled against their 'over-empowerment'. It has been argued that the investment arbitration system displays a 'structural bias' favouring multinational corporations' interests to the detriment of environmental and human rights (EHR) interests.

In recent years, the increasing frequency of environmental disasters and human rights damages that are directly or indirectly connected to investors' misconduct underscores the need to regulate their behaviour. Nonetheless, investors' entitlements in the absence of obligations under investment treaties may obstruct the endeavours to regulate them. In some cases, the environmental or human rights misconduct of investors underlies the investment dispute prompting treaty claims,[1] and investors' ability to challenge the regulatory measures before international tribunals may thwart host states' effort to regulate their misconduct. Moreover, in order to secure a favourable settlement in EHR disputes with local populations, investors sometimes exert pressure on host states by threatening to launch investment arbitration.[2] Developing host states, when regulating EHR misconduct of foreign investors, already often suffer from an inadequate judicial system and weak bargaining position.[3] The availability of investment arbitration only exacerbates this situation.

Given the much criticized 'lack of balance' in investment arbitration and the difficulty of developing states to regulate investors' EHR misconduct, the idea of holding investors accountable through EHR counterclaims seems particularly appealing. Several recent arbitral decisions affirming jurisdiction over EHR counterclaims against investors thus attracted considerable attention of stakeholders and commentators.[4] Indeed, EHR counterclaims were deemed as a vehicle to recalibrate the relationship between foreign investors on the one hand and host states and local communities on the other. Commentators contended that EHR counterclaims can counterbalance the procedural privilege of investors in investment arbitration.[5] They also urged states and

1 See, e.g., *The Renco Group, Inc. v. Republic of Peru (I)*, ICSID Case No. UNCT/13/1, Claimant's Memorial on Liability (20 February 2014), 9–100; *Chevron Corporation and Texaco Petroleum Corporation v. The Republic of Ecuador*, UNCITRAL, PCA Case No. 2009-23, First Partial Award on Track I (17 September 2013).

2 See Common Frontiers-Canada, United Steelworkers, Council of Canadians, Sierra Club Canada, and MiningWatch Canada, 'Blackfire adding threats to injury in Mexico: Canadian mining firm looks to pocket $800 million via NAFTA Ch. 11' (22 February 2010), https://miningwatch.ca/news/2010/2/22/blackfire-adding-threats-injury-mexico-canadian-mining-firm-looks-pocket-800-million (visited 30 January 2021); *Bear Creek Mining Corporation v. Republic of Peru*, ICSID Case No. ARB/14/21, Award and Partial Dissenting Opinion of Professor Philippe Sands (30 November 2017); James Rochlin (ed.), *Profits, Security, and Human Rights in Developing Countries* (New York: Routledge, 2015) vol. 155, 35–73.

3 Robert V. Percival, 'Liability for Environmental Harm and Emerging Global Environmental Law', 25 Maryland Journal of International Law 37 (2010); Sarah Joseph, 'Protracted Lawfare: The Tale of Chevron Texaco in the Amazon', 3(1) Journal of Human Rights and the Environment 70 (2012).

4 At the UNCITRAL Working Group III (WG III), several states observed that counterclaims can help to address the imbalance in the investor–state relationship. See A/CN.9/WG.III/WP.176, Submission from the Government of South Africa, paras 64–65; A/CN.9/WG.III/WP.181, Submission from the Government of Mali, Annex, para 3(E); see also Barnali Choudhury, 'Investor Obligations for Human Rights', 2 ICSID Review 1 (2020), at 13–15; Jean Ho, 'The Creation of Elusive Investment Responsibility', 113 AJIL Unbound 10 (2019), at 11–12; James Harrison, 'Environmental Counterclaims in Investor-State Arbitration', 17(3) Journal of World Investment & Trade 479 (2016).

5 Ibid.

arbitral tribunals to allow EHR counterclaims grounded on international law, which can open up a pathway to hold investors responsible at the international level.[6]

In its ongoing discussions on the Investor–State Dispute Settlement (ISDS) reform, the UNCITRAL Working Group III (WG III) has included counterclaims as one of its reform options.[7] Counterclaims have only been incidentally addressed so far, partly because WG III's mandate focuses on the procedural aspects of the ISDS reform, whereas counterclaims are intertwined with substantive issues.[8] Nonetheless, given the perceived potential of counterclaims in changing the balance between the protection of investors' rights and the promotion of public interests, some considered counterclaims as 'the elephant in the room' in the WG III discussions.[9]

Despite the active advocacy for allowing EHR counterclaims in the literature,[10] there remains a distinct gap between the ideal and the reality: instances of successful counterclaims are admittedly rare;[11] and in *Burlington v. Ecuador* and *Perenco v. Ecuador*, the two rare cases where tribunals ruled on the merits of environmental counterclaims, the inconsistency in the decisions provokes concerns. As ISDS reform is under discussion on various fronts, it is crucial that stakeholders understand better the legal and policy factors affecting the potentials of EHR counterclaims. In the existing literature, much attention has been given to the EHR policy favouring the admissibility of EHR counterclaims in investment arbitration. Nonetheless, certain important legal and policy constraints of EHR counterclaims, as well as concerns associated with them, have been overlooked.

Contrary to the view of some commentators,[12] this article argues that EHR counterclaims are necessarily based on domestic law and the major constraint of their potentials stems from their domestic legal basis. Despite the apparent attraction of the idea of imposing international EHR obligations on investors, this article contends that this is neither viable nor desirable. The more feasible and effective approach is to obligate states to address EHR concerns through their domestic laws. Based on this premise, this article explains that in terms of the jurisdiction and admissibility of EHR counterclaims, a crucial question for states and adjudicators to decide is whether to let investment arbitral tribunals, as opposed to domestic courts, adjudicate EHR misconduct of foreign investors under domestic law. In this regard, different states may have different preferences, and the propriety of an investment arbitral tribunal entertaining EHR counterclaims needs to be assessed in particular cases. Furthermore, weaknesses of domestic rules, such as the difficulty of holding investors accountable due to the separate legal personality of their enterprises, would carry over to EHR counterclaims.

6 Choudhury, above n 4, at 13–15; Ho, above n 4, at 11–15; A/CN.9/WG.III/WP.161, Submission from the Government of Morocco, para 9.
7 A/CN.9/1004, paras 24–25.
8 A/CN.9/930/Add.1/Rev.1, paras 3–7.
9 Karl P. Sauvant and Alexa Busser, 'Investment and Human Rights: Is There an Elephant in the Room?', Columbia FDI Perspectives No. 282 (13 July 2020).
10 See, e.g., Choudhury, above n 4, at 13–15; Ho, above n 4, at 11–12.
11 See note by the Secretariat, 'Possible reform of investor-State dispute settlement (ISDS) Multiple proceedings and counterclaims', A.CN.9/WG.III/WP.193, 8.
12 See Choudhury, above n 4, at 13–15; Ho, above n 4, at 11–15; Maggie Ng, 'Can Human Rights Counterclaims Succeed in Investment Treaty Arbitration?', 5 Transnational Dispute Management 1 (2018), at 16–17.

To address this concern and to level the playing field for investors and those affected by their conduct, improvements should be made at the level of domestic law. Moreover, since investment arbitral tribunals are essentially serving the function of domestic courts when adjudicating EHR counterclaims, procedure rules should be improved to enhance legitimacy.

Following this introduction, Section II of this paper examines, and rejects, the possibility and desirability of grounding EHR counterclaims on international law. Sections III and IV deal with jurisdictional barriers and questions of admissibility of domestic law–based EHR counterclaims. Section V discusses concerns associated with EHR counterclaims in investment arbitration and makes suggestions on future reform.

II. EHR COUNTERCLAIMS BASED ON INTERNATIONAL LAW?

Recently, the Tribunal in *Urbaser v. Argentina* upheld jurisdiction over counterclaims based on international human rights law.[13] The Tribunal in *Aven v. Costa Rica* also affirmed the possibility of hearing counterclaims based on international environmental law, despite its ultimate refusal to hear these counterclaims on other grounds.[14] At first glance, the idea of bringing investors' obligations to the same level as their treaty-based rights seems appealing: it not only enables holding investors internationally accountable but also enhances procedural equality between disputing parties. In UNCITRAL WG III discussions, *Urbaser* was mentioned in proposals on counterclaims,[15] and it was suggested that the legal basis, particularly the international legal basis, of counterclaims should be addressed.[16] However, a closer look at the *Urbaser* decision casts doubt on the viability of EHR counterclaims based on international law.

In *Urbaser*, one of the Claimant's claims concerned Argentina's termination of the water concession granted to the Claimants' enterprise. The termination was due to the alleged failure of the Claimants' enterprise to meet the requirements under the concession.[17] In its counterclaim, Argentina contended that the Claimants' failure to ensure compliance with the concession 'did not only affect mere contractual provisions, but basic human rights.'[18] While the legal basis of Argentina's counterclaim was international human rights law, Argentina did not argue that the investors were under the international obligation to provide the Argentinian populations with drinking water and sanitation services. Instead, as the tribunal noted, Argentina 'merely asserts that the performance obligation under the concession had the effect of supplying the services that are part of the population's human right to access to water.'[19] In other words, it was essentially a contractual claim under the cloak of international human rights law.

13 *Urbaser S.A. and Consorcio de Aguas Bilbao Bizkaia, Bilbao Biskaia Ur Partzuergoa v. The Argentine Republic*, ICSID Case No. ARB/07/26, Award (8 December 2016), paras 1193–21.

14 *David R. Aven and Others v. Republic of Costa Rica*, ICSID Case No. UNCT/15/3, Award (18 September 2018), paras 734–39.

15 See, e.g., ClientEarth, Aligning the Objectives of UNCITRAL Working Group III with States' International Obligations to Combat Climate Change, 8.

16 A/CN.9/1044, paras 57–59; A/CN.9/WG.III/WP.161, Submission from the Government of Morocco, para 9.

17 *Urbaser*, above n 13, paras 848–950.

18 Ibid, para 1156.

19 Ibid, para 1206.

In its analysis, although the tribunal went so far as to acknowledge that the investors bear human rights obligations under international law,[20] it rejected the idea that international human rights law imposes an obligation on private companies to perform contractual obligations in providing the required services.[21] Instead, the tribunal considered that international human rights law requires Argentina to exercise its authority over the concessionaire in order to ensure a sanitary water supply to its populations[22] and that 'the investor's obligation to perform has as its source in domestic law; it does not find its legal ground in general international law.'[23]

Thus, although the *Urbaser* decision appears groundbreaking in recognizing international human rights obligations of investors,[24] it actually confirmed the traditional position that obligations of private actors contemplated by international human rights law are implemented only through domestic law.[25] In *Urbaser*, the effect of acknowledging investors' obligations under international human rights law is more rhetorical than real.

That being said, there has been a long-standing effort advocating for direct international obligations on multinational corporations.[26] Proponents of this approach often emphasize the loopholes in domestic laws and state actions in regulating the conduct of multinational corporations and the inadequacy of soft-law instruments to remedy such insufficiencies.[27] Thus, it is worth asking, as a general matter, whether it is possible to ground EHR counterclaims on general international law or investment treaties.

Under current international law, general international human rights law only affects the obligations of private actors 'indirectly' through domestic laws.[28] Also, there is little evidence supporting the proposition that general international environmental law imposes direct obligations on private actors. Recently, there is an intergovernmental initiative seeking to establish binding international rules regulating the conduct of private enterprises. But this process confirms, instead of alters, the traditional position that international human rights law affects the human rights obligations of private

20 Ibid, paras 1194–99.
21 Ibid, paras 1208–10.
22 Ibid, paras 1213–14.
23 Ibid, para 1210.
24 Choudhury, above n 4, at 7–15; Ho, above n 4, at 13–15.
25 See Carlos M. Vázquez, 'Direct vs. Indirect Obligations of Corporations under International Law', 43 Columbia Journal of Transnational Law 927 (2005); John H. Knox, 'Horizontal Human Rights Law', 102(1) American Journal of International Law 1 (2008).
26 See, e.g., Steven R. Ratner, 'Corporations and Human Rights: A Theory of Legal Responsibility', 111(3) Yale Law Journal 443 (2001); David Weissbrodt and Muria Kruger, 'Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights', 97(4) American Journal of International Law 901 (2003); Republic of Ecuador, 'Statement on behalf of a group of countries at the 24rd session of the Human Rights Council. Transnational corporations and human rights', UN Human Rights Council (September 2013), https://media.business-humanrights.org/media/documents/files/media/documents/statement-unhrc-legally-binding.pdf (visited 20 December 2020).
27 Ratner, ibid, at 461–65.
28 Human Rights Committee, General Comment No. 31, The Nature of the General Legal Obligation Imposed on States Parties to the Covenant (26 May 2004) CCPR/C/21/Rev.1/Add.13, para 8; John Ruggie, Report of the Special Representative of the Secretary-General on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises (9 February 2007) A/HRC/4/035, para 44.

actors only 'indirectly' through domestic laws. In 2014, the Human Rights Council adopted Resolution 26/9, creating an open-ended intergovernmental working group (OEIGWG) seeking to 'elaborate an international legally binding instrument to regulate, in international human rights law, the activities of transnational corporations and other business enterprises.'[29] However, in the draft treaty released by the Chairman of the OEIGWG on 16 July 2019 (OEIGWG draft treaty), the obligations are still incumbent only on states;[30] and the liability of private enterprises for breach of human rights still arises exclusively under domestic law.[31] The only clause requiring private enterprises to respect human rights appears only in the preamble.[32]

As a matter of policy, although there are no conceptual obstacles in international law to imposing direct EHR obligations on private actors,[33] it is questionable whether international law 'should' impose such obligations. International obligations of private actors envisaged in the literature could be generally categorized into two types: obligations owed to the state and obligations owed to other private actors.[34] As regards the first type, drafters of international human rights conventions have deliberately refrained from imposing obligations owed by private actors towards states, because of the fear that states may use them as an excuse to arbitrarily interfere with human rights.[35] Furthermore, despite the overwhelming economic power of certain foreign investors, they generally do not exercise 'sovereign power' as state authorities do. While checks and balances for state powers at the international level are indispensable, the conduct of private actors could be regulated under domestic law. To regulate the conduct of private actors directly via international law, bypassing domestic jurisdiction, needs more compelling justifications. Although the legal systems of developing states sometimes face difficulties in regulating the conduct of multinational corporations, as discussed below, direct international obligations are neither practical nor efficient in addressing those concerns.

The 'horizontal' obligations owed by private actors towards other private actors are regulated differently through tort, criminal law, and other sources of legal authority under domestic laws of different states. Given the diversity of the approaches, to insert international rules into this already complicated picture may be neither politically nor

29 Human Rights Council, Elaboration of an International Legally Binding Instrument on Transnational Corporations and Other Business Enterprises with Respect to Human Rights (14 July 2014) A/HRC/RES/26/9, para 1.

30 'Legally Binding Instrument to regulate, in international human rights law, the activities of transnational corporations and other business enterprise', OEIGWG (Open-ended Intergovernmental Working Group) Chairmanship Revised Daft (16 July 2019), https://www.ohchr.org/Documents/HRBodies/HRCouncil/WGTransCorp/OEIGWG_RevisedDraft_LBI.pdf (visited 20 June 2020) (OEIGWG draft treaty), Articles 4, 5.

31 Ibid, Article 6.

32 Ibid.

33 Ratner, above n 26, at 475–76; Andrea Bianchi, 'Relativizing the Subjects or Subjectivizing the Actors: Is That the Question?', in Andrea Bianchi (ed.), *Non-State Actors and International Law* (London: Routledge, 2009) xi–xxx; Vázquez, above n 25, at 930.

34 Knox, above n 25, at 1–2.

35 Ibid, at 4–18.

practically viable.[36] This is one of the reasons why states have been reluctant to establish international rules directly regulating this area.[37]

Admittedly, in certain areas, international rules have been developed to directly regulate private actors' behaviours. For instance, international criminal law was developed partly because the nature of certain crimes makes them difficult or impossible to be effectively governed by domestic laws.[38] In relation to the exploitation of deep seabed resources, international rules were developed as the subject matter is beyond the jurisdiction of any state.[39] By analogy, some consider that the deficiency of domestic legal systems in regulating the conduct of multinational corporations justifies direct international rules. As has been pointed out regarding the EHR misconduct of foreign investors, the disparity of power between investors and developing host states could make the latter unwilling or unable to regulate;[40] parent companies could be shielded from legal liabilities by virtue of the separate legal personality of their subsidiaries; and the doctrine of *forum non conveniens* could be a bar to the jurisdiction of the home state of parent companies.[41] These factors have made some commentators believe that an international regime imposing direct obligations is necessary.

However, these difficulties mainly concern 'adjudicative' and 'enforcement' jurisdiction, instead of 'prescriptive' jurisdiction of states or the quality of their domestic laws. Direct international obligations of private actors *per se*, without an international adjudicative and enforcement mechanism, cannot relieve these challenges. On the other hand, international arbitration, which benefits from its international character and efficient enforcement mechanism, could be a promising channel to avoid certain drawbacks of domestic judicial systems. The Hague Arbitration Rules on Business and Human Rights represents a recent development in this respect.[42] As argued below, in certain cases, international arbitral tribunals can serve as a better alternative to domestic courts in settling EHR disputes involving foreign investors. But the applicable law on this subject matter should still be domestic as opposed to international law.

36 Ibid, at 19–24.

37 Indeed, even where an indirect approach is taken, states have criticized the OEIGWG draft treaty as taking an 'one-size-fit-all' approach or leaving too limited discretion to states. See 'The United States Government's continued opposition to the business and human rights treaty process' (Geneva, October 16 2019), https://geneva.usmission.gov/2019/10/16/the-united-states-governments-continued-opposition-to-the-business-human-rights-treaty-process/ (visited 28 July 2020); 中国政府 对 '跨国公司及其他工商 企业 与人权'法律文书修订案文的补 充 意见 (China's comments on the OEIGWG draft treaty) (28 February 2020) No. GJ/13/2020, https://www.ohchr.org/Documents/HRBodies/HRCouncil/WGTransCorp/Session5/add/States/China_NV.pdf (visited 19 September 2020), 1: 'The correct approach is to let member states define the scope of multinational corporations' human rights obligations' (translated by the author).

38 Knox, above n 25, at 24.

39 See Nadia Bernaz and Irene Pietropaoli, 'Developing a Business and Human Rights Treaty: Lessons from the Deep Seabed Mining Regime under the United Nations Convention on the Law of the Sea', 5(2) Business and Human Rights Journal 200 (2020), at 211–214.

40 Ibid; David Bilchitz, 'The Necessity for a Business and Human Rights Treaty', 1(2) Business and Human Rights Journal 203 (2016), at 217.

41 Robert V. Percival, 'Liability for Environmental Harm and Emerging Global Environmental Law', 25 Maryland Journal of International Law 37 (2010), at 49–53; Uglješa Grušić, 'Responsibility in Groups of Companies and the Future of International Human Rights and Environmental Litigation', 74(1) Cambridge Law Journal 30 (2015).

42 The Hague Rules on Business and Human Rights Arbitration (December 2019) (The Hague Rules).

Compared with international law, domestic laws are better placed to regulate in detail the conduct of private enterprises, to establish criteria of liability, and to prescribe remedies.[43] International law, on the other hand, may oblige states to take necessary measures or to provide appropriate remedies under their domestic laws. The indirect approach of the OEIGWG draft treaty is appropriate. Therefore, under current international law and in the foreseeable future, EHR counterclaims cannot and should not be based on general international law.

Apart from general international law, it has been suggested at the UNCITRAL WG III and in the literature that investment treaties should impose EHR obligations on investors,[44] and a small number of recent investment treaties include provisions to that effect.[45] There are two types of such provisions: those requiring investors to comply with domestic laws and those that are truly 'international' in the sense that they stipulate standalone international obligations or incorporate soft-law standards.

The effect of the first type is similar to that of an 'umbrella clause'.[46] It upgrades a breach of domestic law to a breach of the treaty.[47] However, such a clause does not alter the fact that the EHR counterclaim is still governed by domestic law.[48] The practical impact of such clauses will be discussed below.

For the second type of provisions, which stipulate standalone international obligations or incorporate soft-law standards, it is questionable whether they can actually achieve their intended purpose. In fact, since the reasons for states' rejection of direct obligations of private enterprises under general international law equally apply to treaty provisions with a similar effect, it is not a surprise that examples of investment treaties containing such provisions are rather rare and there are even fewer examples of capital-exporting states signing up to such an arrangement.[49] More importantly, where the EHR obligations under the investment treaty go beyond what the domestic laws of treaty parties already have (otherwise such provisions would be redundant), they would give investors from treaty parties a 'comparative disadvantage' relative to other investors. That would be squarely against the very *raison d'être* of an investment treaty, which is to facilitate foreign investment by guaranteeing favourable business conditions. Even though recent investment treaties tend to integrate EHR considerations with investment protection, these treaties' main purpose remains promoting free flow of capital.[50]

43 See Anne Peters et al., 'Business and Human Rights: Making the Legally Binding Instrument Work in Public, Private and Criminal Law', Max Planck Institute MPIL Research Paper Series No. 2020-06, 24–25.

44 See A/CN.9/WG.III/WP.161, Submission from the Government of Morocco, para 9; Ho, above n 4, at 11–15.

45 See, e.g., ECOWAS Supplementary (2008) Articles 11–16; Belarus–India BIT (2018) chapter III; COMESA Investment Agreement (2007) Article 13; Morocco–Nigeria BIT (2016) Article 14.

46 *Hesham T.M. Al Warraq v. Republic of Indonesia*, UNCITRAL Award (15 December 2014), paras 662–63.

47 *David R. Aven*, above n 14, paras 732–35.

48 See below text to footnotes 121–23.

49 Where this happens, the treaty is often between developing states. See ECOWAS Supplementary Investment Act (2008) Articles 11–16; Morocco–Nigeria BIT (2016) Articles 14(2), 18(3).

50 This is not to suggest that the encouragement of foreign investment and EHR protection are necessarily in conflict with each other. In fact, this is one of the major goals of several recent investment treaties. All I am suggesting here is that since a level playing field is a basic condition to allow investors to participate

Therefore, as appealing as they appear to be, EHR counterclaims grounded on international law are neither practical nor desirable. The only exception is to require investors to comply with domestic laws under investment treaties. Accordingly, future ISDS reform should proceed on the premise that EHR counterclaims are grounded on domestic laws. As discussed in the following sections, the domestic law basis of EHR counterclaims is a crucial factor affecting the potential of EHR counterclaims in investment arbitration.

III. JURISDICTIONAL BARRIERS TO EHR COUNTERCLAIMS BASED ON DOMESTIC LAW

Despite the variation in arbitration rules governing counterclaims, two core requirements are generally recognized: first, counterclaims, as independent actions brought by the respondent, must fulfil the jurisdictional requirements of the tribunal; second, consonant with the policy goals this procedure promotes, i.e. to facilitate better administration of justice and to enhance judicial economy, counterclaims must have a close connection with principal claims.[51] The second requirement is generally treated as a matter of admissibility,[52] which will be discussed in the next section. In treaty-based investment arbitration, tribunals' jurisdiction over counterclaims depends on whether they are covered by the arbitration clause in the treaty.[53] Where the arbitral proceedings are governed by the International Centre for Settlement of Investment Disputes (ICSID) Convention, the requirements under Article 25(1) of the ICSID Convention must also be fulfilled.[54] As discussed below, given the current policy trend of integrating international investment law with human rights and environmental law, states are less likely to preclude EHR counterclaims because of their subject matter *per se*. However, uncertainty lies with states' reluctance to allow arbitral tribunals to adjudicate questions of domestic law. While some at the UNCITRAL WG III encouraged broadening the scope of tribunals' jurisdiction to allow counterclaims,[55] several states are becoming increasingly defensive of their domestic jurisdiction over domestic legal issues.

Whether EHR issues fall within the scope of arbitral tribunals' jurisdiction depends on how broadly the jurisdictional clause is worded and how it is interpreted. A narrowly worded arbitration clause in the investment treaty, e.g. one that limits tribunals'

in a fair and open competition, to discriminatorily subject foreign investors to a higher standard would be counter-productive in terms of the main purpose of an investment treaty. Therefore, the enhancement of EHR protection should be achieved uniformly 'at the level of domestic law,' and investment treaties should give states sufficient policy space to achieve this or even impose obligations on states to enhance EHR standards at the domestic level.

51 See Pierre Lalive and Laura Halonen, 'On the Availability of Counterclaims in Investment Treaty Arbitration', 2 Czech Yearbook of International Law 141 (2011); Andrea Bjorklund, 'The Role of Counterclaims in Rebalancing Investment Law', 17(2) Lewis & Clark Law Review 461 (2012), at 571–73; Anne K. Hoffmann, 'Counterclaims in Investment Arbitration', 28(2) ICSID Review 438 (2013), at 445–53.

52 Lalive and Halonen, above n 51, at 144; Hoffmann, above n 51, at 442; Michael Waibel, 'Investment Arbitration: Jurisdiction and Admissibility', Cambridge Legal Studies Research Papers Series, No. 9/2014, 7–9.

53 See Lalive and Halonen, above n 51; Bjorklund, above n 51, at 571; Hoffmann, above n 51, at 445.

54 Under this article, an ICSID tribunal can only adjudicate disputes 'arising directly out of an investment'. See ICSID Convention, Article 25(1).

55 A/CN.9/WG.III/WP.193, para 41; A/CN.9/WG.III/WP.176, Submission from the Government of South Africa, paras 64–65; A/CN.9/WG.III/WP.181, Submission from the Government of Mali, Annex, para 3(E).

jurisdiction to alleged treaty violations by states,[56] may foreclose counterclaims against investors, including EHR counterclaims.[57] Where the arbitration clause is broadly drafted, e.g. covering any dispute relating to an investment,[58] it should be interpreted as broad enough to cover EHR counterclaims. Admittedly, some tribunals have interpreted the terms 'arising out of an investment' narrowly, precluding subject matters other than foreign investment protection from this scope.[59] However, a broader interpretation is more consistent with the international rules on treaty interpretation and the policy trend in this area.

First, nothing in the ordinary meaning of the phrase 'relating to an investment' or 'arising out of an investment' precludes EHR matters arising out of the operation of investments. Indeed, if governmental measures in response to investors' conduct affecting human rights and the environment fall under the scope of such a clause, it is hard to see why investors' conduct that prompts such measures cannot be 'relating to an investment'. Moreover, since the object and purpose of a typical investment treaty is to boost the development of contracting states,[60] it is inconceivable that treaty parties have intended to limit the coverage of the phrase 'relating to an investment' only to investors' private interests, precluding broader public interests of the host state. Indeed, most recent investment treaties include provisions expressly addressing EHR concerns.[61] Therefore, terms such as 'relating to an investment' should be interpreted as broad enough to cover EHR matters. The same logic applies to Article 25(1) of the ICSID Convention, which uses the similar formulation of 'any legal dispute arising directly out of an investment'.[62] In *Perenco v. Ecuador* and *Burlington v. Ecuador*, both of which were under the ICSID Convention, both the parties and the tribunals accepted without questioning that the environmental counterclaims fell within the scope of Article 25(1).[63]

In the light of the current policy trend of integrating EHR concerns in international investment law, states are less likely to preclude EHR counterclaims from the

56 See, e.g., The Energy Charter Treaty (1994) Article 26; Japan–Cambodia BIT (2007) Article 17(1); Austria–Tajikistan BIT (2010) Article 13.

57 *Vestey Group Ltd. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/06/4, Award (15 April 2016), paras 333–34; *Spyridon Roussalis v. Romania*, ICSID Case No. ARB/06/1, Award (7 December 2011), paras 868–72.

58 See UAE–Mongolia (2001) Article 9(1); Swiss–Pakistan BIT (1995) Article 9; Ethiopia–France BIT (2003) Article 9; The Netherlands–Nigeria BIT (1992) Article 9.

59 *Bernhard von Pezold and Others v. Republic of Zimbabwe*, ICSID Case No. ARB/10/15, Provisional Order No. 2 (26 June 2012), para 59; *Amco Asian Corporation and others v. Republic of Indonesia*, ICSID Case No. ARB/81/1, Decision on Jurisdiction in Resubmitted Proceedings (10 May 1988), para 126.

60 See, e.g., US–Argentina BIT (1991) preamble; US–Ecuador BIT (1993) preamble; Japan–Papua New Guinea BIT (2011) preamble; Australia–US FTA (2004) preamble; Austria–Tajikistan BIT (2010) preamble; CPTPP (2018) preamble.

61 Japan–Papua New Guinea BIT (2011) preamble; Australia–US FTA (2004) preamble; Austria–Tajikistan BIT (Tajikistan) preamble; CETA (2016) preamble; CPTPP (2018) preamble, Article 9.10(3)(d); ECOWAS Supplementary Act (2008) Articles 11–16; COMESA Investment Agreement (2007) Article 13.

62 ICSID Convention, Article 25(1).

63 *Burlington Inc. v. Republic of Ecuador*, ICSID Case No. ARB/08/5, Decision on Liability (14 December 2012), para 93; *Perenco Ecuador Ltd v. The Republic of Ecuador and Petroecuador*, ICSID Case No. ARB/08/6, Interim Decision on the Environmental Counterclaim (11 August 2015), paras 9, 19.

jurisdiction of investment arbitral tribunals because of their subject matter *per se.* As mentioned above, due to the limited capacity of developing states to regulate the EHR misconduct of foreign investors within their own legal systems, investment arbitral tribunals may serve as an appealing alternative to their domestic courts. Thus, the need to advance EHR interests may motivate states to adopt a broad formulation of arbitration clause. Some recent investment treaties, such as the COMESA Investment Agreement and Draft Pan-African Investment Code, expressly allow host states to bring counterclaims against investors.[64]

However, one must not forget the fact that EHR counterclaims are based on domestic law. Despite the broad consensus among decision-makers on the need to advance EHR interests, the major jurisdictional obstacle of EHR counterclaims is their domestic legal basis. As states are becoming increasingly defensive of their domestic court jurisdiction over domestic legal issues,[65] the future viability of EHR counterclaims in investment arbitration is getting uncertain.

For instance, in two recent investment treaties concluded by India, although investors are obliged to comply with domestic laws and to respect EHR obligations,[66] the arbitration clause limits arbitral tribunals' jurisdiction to alleged treaty breaches by host states, precluding domestic legal issues from its coverage.[67] Moreover, these treaties not only require arbitral tribunals to defer to domestic laws when interpreting treaty standards,[68] they also expressly prohibit tribunals from reviewing the merits of domestic court decisions.[69] Such clauses reveal the clear intention of treaty parties to protect the sanctity of their domestic laws and the exclusive jurisdiction of their domestic courts.

This approach is reminiscent of the position of the EU and some of its member states after the *Achmea* decision.[70] Following the principle of autonomy of the EU legal order, the CJEU held that for investment treaties to be consistent with EU law, they shall not allow arbitral tribunals to interpret and apply rules of EU law, the authoritative interpretation of which falls under the exclusive jurisdiction of the court.[71] This explains why the EU–Canada Comprehensive Economic and Trade Agreement (CETA), which was held by the court as compatible with EU law,[72] expressly precludes issues of domestic laws (including EU law) from the jurisdiction of arbitral tribunals[73] and requires tribunals to follow the interpretation of domestic laws by courts or other authorities of treaty parties.[74] This approach has been followed by other recent investment treaties

64 See Draft Pan-African Investment Code (2016) Articles 22(1), 43; COMESA Investment Agreement (2007) Articles 13, 28(9).
65 Gabrielle Kaufmann-Kohler and Michele Potestà, *Investor-State Dispute Settlement and National Courts: Current Framework and Reform Options* (Cham: Springer, 2020) 8–10.
66 Kyrgyzstan–India BIT (2019) Articles 11, 12; Belarus–India BIT (2018) Articles 11, 12.
67 Kyrgyzstan–India BIT (2019) Article 13(1); Belarus–India BIT (2018) Article 13(1), (2).
68 Kyrgyzstan–India BIT (2019) Article 23(1); Belarus–India BIT (2018) Article 23(1).
69 Kyrgyzstan–India BIT (2019) Article 13.5(1); Belarus–India BIT (2018) Article 13(4).
70 CJEU, Case C-284/16, *Slovak Republic v Achmea*, EU:C:2018:158, paras 31–60.
71 Ibid; CJEU, Opinion 1/17, ECLI:EU:C:2019:341, para 118.
72 Ibid.
73 CETA (2016) Article 8.31(2).
74 Ibid.

concluded by the EU and some of its member states.[75] In these treaties, the choice of states to safeguard the exclusive jurisdiction of their internal judicial system over issues of domestic laws would preclude investment arbitral tribunals from entertaining EHR counterclaims.

Against this background, given the general consensus over the need to integrate EHR considerations into international investment law, decisions on jurisdiction over EHR counterclaims essentially hinge on whether states choose to have these claims adjudicated by investment arbitral tribunals, as opposed to domestic courts. States have to balance the EHR interest that might be advanced by EHR counterclaims against the need to safeguard their domestic jurisdiction, and different states may have different preferences. For some states, international tribunals are an efficient alternative to their domestic courts in resolving certain EHR disputes involving foreign investors, and the benefit of settling investors' claims and EHR counterclaims before a single forum outweighs the need to safeguard their domestic court jurisdiction over domestic legal issues. On the other hand, some states may be more confident about their domestic judicial system in settling EHR disputes, and for them, to protect their domestic jurisdiction over such matters from the intrusion of international tribunals is clearly the priority.

IV. ADMISSIBILITY OF EHR COUNTERCLAIMS

Once the jurisdictional requirements are fulfilled, tribunals have to further determine whether the environmental or human rights counterclaim is admissible.[76] Whereas decisions on jurisdiction turn on the competence of the tribunal, decisions on admissibility depend on whether it is appropriate for the tribunal to hear the counterclaim.[77] Tribunals enjoy greater discretion over the latter.[78]

For the admissibility of EHR counterclaims in investment arbitration, major questions include their connection to principal claims, the propriety of having them adjudicated by an investment arbitral tribunal, and questions of legal personality. As shown below, while the domestic legal basis of EHR counterclaims may attenuate their connection to treaty-based principal claims, a strong factual connection can justify their admissibility. States intending to allow EHR counterclaims can remove uncertainties in this respect by drafting clear clauses. As regards the judicial policy concerning the admissibility of EHR counterclaims, the interests in having these claims adjudicated by investment arbitral tribunals need to be balanced against the deference to domestic courts. Moreover, the doctrine of separate legal personality of companies under domestic laws is a major legal constraint of EHR counterclaims' potential. As EHR counterclaims can only be brought against proper obligors under the applicable

75 See EU–Vietnam FTA (2019) Article 3.42(3); Hungary–Cabo Verde BIT (2019) Article 9(7), (8); Belarus–Hungary BIT (2019) Article 9(8); See also the Netherlands Model Investment Agreement (22 March 2019) Article 16(1).

76 Lalive and Halonen, above n 51, at 144; Hoffmann, above n 51, at 442; Waibel, above n 52, at 7–9.

77 Yuval Shany, *Questions of Jurisdiction and Admissibility before International Courts* (Cambridge: Cambridge University Press, 2016) 47–53; Waibel, above n 52, at 8–9.

78 Ibid.

domestic law, the difficulty of holding investors liable for the misconduct of their enterprises under domestic laws would carry over to EHR counterclaims in investment arbitration.

A. Close connection

As a general rule, a counterclaim must be sufficiently connected to the principal claim in order to be admissible.[79] According to the ICJ, this requirement is based on the need to 'ensure better administration of justice,' 'to achieve a procedural economy whilst enabling the Court to have an overview of the respective claims of the parties and to decide them more consistently,' and 'to prevent abuse.'[80] While formulations of this requirement vary in different arbitration rules,[81] the requirement of close connection is generally followed.[82] Article 46 of the ICSID Convention requires that counterclaims must be 'arising out of the subject matter of the dispute,'[83] which resembles the relevant provision in the ICJ Statute.[84] On this requirement, the ICJ maintained that 'it is for the Court, in its sole discretion, to assess whether the counterclaim is sufficiently connected to the principal claim, taking account of the particular aspects of each case.'[85] Similarly, ICSID tribunals also enjoy a degree of flexibility in their assessment.

As generally accepted in practice, the level of connection needs to be assessed both in law and in fact.[86] In terms of legal connection, domestic law–based counterclaims appear to be insufficiently connected to principal claims based on treaties. Accordingly, some tribunals have deemed such counterclaims inadmissible.[87] This approach has been criticized as overly stringent.[88] Instead, legal connection and factual connection are 'two factors' to consider rather than 'cumulative criteria' that a counterclaim must fulfil.[89] For instance, in *Armed Activities on the Territory of the Congo* before the ICJ, Uganda brought a counterclaim based on the Vienna Convention on Diplomatic

79 Lalive and Halonen, above n 51; Bjorklund, above n 51, at 571–73; Hoffmann, above n 51, at 445–53.

80 *Application of the Convention on the Prevention and Punishment of the Crime of Genocide (Bosnia and Herzegovina v. Yugoslavia)*, Counter-Claims, Order of 17 December 1997, ICJ Reports 1997, para 30.

81 ICSID Convention, Article 46; SCC Arbitration Rules (2017), Article 9(1)(iii), (iv); ICC Arbitration Rules (2017), Article 5(5); UNCITRAL Rules (1976), Article 19(3); UNCITRAL Arbitration Rules (2010), Article 21(3).

82 It is worth mentioning that the restrictive test, 'arising out of the same contract', in the 1976 UNCITRAL Rules was abandoned in the 2010 UNCITRAL Rules, which makes the UNCITRAL Rules more suitable for investment arbitration and brings them into line with other arbitration rules.

83 ICSID Convention, Article 46.

84 International Court of Justice, Rules of Court (1978) (adopted 14 April 1978, entered into force 1 July 1978, amended on 1 February 2001) Article 80.

85 *Application of the Convention on the Prevention and Punishment of the Crime of Genocide*, above n 80, para 33.

86 Ibid; *Urbaser*, above n 13, para 1151.

87 *Saluka Investments B.V. v. The Czech Republic*, UNCITRAL, Decision on Jurisdiction over the Czech Republic's Counterclaim (7 May 2004), para 79; *Sergei Paushok, et al. v. The Government of Mongolia*, UNCITRAL, Award on Jurisdiction and Liability (28 April 2011), paras 684–95; *Amco*, above n 59, at 185–88; *Marco Gavazzi and Stefano Gavazzi v. Romania*, ICSID Case No ARB/12/25, Decision on Jurisdiction, Admissibility and Liability (21 April 2015), para 154.

88 Lalive and Halonen, above n 51, at 144–45.

89 See Hege Elisabeth Veenstra-Kjos, *Applicable Law in Investor-State Arbitration: The Interplay between National and International Law* (Oxford: Oxford University Press, 2013) 150; Constantine Antonopoulos, *Counterclaims before the International Court of Justice* (The Hague: Springer, 2011) 131.

Relations whereas the principal claims concerned the use of force.[90] Although the counterclaim and the principal claims had different legal bases, the counterclaim was held admissible due to its strong factual link to the principal claims, i.e. the breach of diplomatic law resulted from the use of force.[91] Likewise, the overall connection between EHR counterclaims and principal claims in investment arbitration should be assessed by balancing the connection both in law and in fact.

Moreover, the level of connection should be considered together with judicial policy. For instance, in *Bosnia Genocide*, Judge *ad hoc* Elihu Lauterpacht opined that '[t]he policy underlying the prohibition of genocide favours the broader view' on the admissibility of counterclaims.[92] Thus, despite their different legal basis from that of principal claims, the policy relating to EHR counterclaims may militate in favour of their admissibility, which is a factor separate from the requirement of connection and will be discussed in Section IV.B.

That being said, in terms of legal connection, a seemingly more compelling reason against the admissibility of some EHR counterclaims is the 'public law taboo', which refers to the policy against enforcement of foreign public laws.[93] In *Paushok v. Mongolia*, the Tribunal refused to entertain the counterclaim concerning tax fraud, because: '[To hear this counterclaim] 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 nonextraterritorial enforceability of national public laws and, specifically, of national tax laws.'[94]

However, even though states often refrain from enforcing foreign tax law and criminal law in the absence of special agreements, it is questionable whether there is a 'generally accepted principle' 'prohibiting' extra-territorial enforcement of public law on EHR issues.[95] In some jurisdictions, the public law character of foreign laws, in and of itself, is not a reason preventing courts from applying and enforcing that law.[96] Indeed, the general trend at the international level favours the enforceability of foreign judicial decisions on EHR matters. In order to remove the enforcement loopholes in human rights litigations involving transnational corporations, the OEIGWG draft treaty requires states to recognize and enforce judgments covered by the treaty,[97] subject only to limited exceptions which 'do not include' the public character of foreign laws.[98]

90 *Armed Activities on the Territory of the Congo (Democratic Republic of Congo v. Uganda)* Judgment of 19 December 2005, ICJ Report 2005, para 322.
91 Ibid, paras 322–27.
92 *Application of the Convention on the Prevention and Punishment of the Crime of Genocide*, above n 80, Separate Opinion of Judge *ad hoc* Lauterpacht, para 14.
93 William S. Dodge, 'Breaking the Public Law Taboo', 43(1) Harvard International Law Journal 161 (2002), at 161.
94 *Paushok*, above n 87, para 695; see also *Computer Sciences Corporation and The Government of the Islamic Republic of Iran, et al.*, Award No. 221-65-1 (16 April 1986) 10 IUSCT 269, 55–56.
95 Dodge, above n 93, at 184–85.
96 See Swiss Federal Act on Private International Law of 18 December of 1987, Article 13. See also Institut de droit international, Resolution on the Application of Foreign Public Law, Session de Wiesbaden (1975) vol. 56-II; Dodge, above n 93, at 189–93.
97 OEIGWG draft treaty, above n 30, Article 10(9).
98 Ibid, Article 10(10).

Moreover, the effect of extraterritorial enforcement of domestic public law in the context of EHR counterclaims is achieved only indirectly through states' obligations under the New York Convention or the ICSID Convention, to the extent that the award applying foreign public law is covered by the convention. The effect of the enforcement obligations is mitigated by the 'public policy' exception and the possible 'commercial reservation' under the New York Convention[99] and by the limited scope of the enforcement obligations (only pecuniary obligations in the award) under the ICSID Convention.[100] In *Perenco* and *Burlington*, the ICSID Tribunals rightly decided not to refrain from applying Ecuadorian environmental laws despite the public law character of some of the legislations.[101]

Therefore, where other factors favour the admissibility of an environmental or human rights counterclaim, its domestic law basis, even public law basis, should not stop the tribunal from hearing the counterclaim. That being said, states can remove uncertainties surrounding legal connection by requiring investors to comply with domestic laws under investment treaties, thereby allowing EHR counterclaims to be grounded on the same legal basis as that of investors' claims. They can also expressly allow host states to bring counterclaims whenever investors breach their EHR obligations.[102]

In terms of factual connection, EHR counterclaims can be deemed closely connected to principal claims where the state measure challenged under the treaty was intended to address an alleged environmental or human rights misconduct of the investor and the counterclaim deals with the investor's misconduct. In *Aven v. Costa Rica*, for instance, the state took a series of measures in response to the investors' violations of Costa Rican environmental laws.[103] While the investors challenged these measures under the investment treaty, Costa Rica brought counterclaims against the investors under both Costa Rican environmental law and international environmental law.[104] The tribunal initially considered there is no 'reason of principle to declare inadmissible [such counterclaims],'[105] yet ultimately declined to exercise jurisdiction over these counterclaims on other grounds.[106] In such a case, the factual connection between the counterclaims and the principal claims is obvious.

In other cases, where the factual basis of the counterclaim is of a different nature from that of the principal claim, and where these claims arise out of different factual situations, a factual connection cannot be easily established. For instance, in *Oxus v. Uzbekistan*, the Tribunal found the factual connection lacking because the counterclaim

99 Convention on the Recognition and Enforcement of Foreign Arbitral Awards New York Convention (opened for signature on 10 June 1958 in New York, entered into force on 7 June 1959) (New York Convention) Articles I(3) and V(2)(b).
100 ICSID Convention, Article 54.
101 *Burlington*, above n 63, Decision on Ecuador's Counterclaims (7 February 2017) 74–96; *Perenco*, above n 63, Interim Decision on the Environmental Counterclaim (11 August 2015) 17–36.
102 See, e.g., COMESA Investment Agreement (2007) Articles 13 and 28(9); Draft Pan-African Investment Code (2016) Articles 22(1) and 43.
103 *David R. Aven*, above n 14, paras 93–181.
104 Ibid, paras 698–715.
105 Ibid, para 742.
106 Ibid, at 743–47.

related to the way in which the investment project operated, whereas the relevant principal claim concerned circumstances in which the claimant invested into the project.[107] This is consistent with the approach taken by the ICJ. In *Armed Activities on the Territory of Congo*, the ICJ considered that the facts underlying one of Uganda's counterclaims, which related to the methods for solving the conflict in the region, were of a different nature from the facts relied on in Congo's principal claims, which concerned acts for which Uganda was allegedly responsible during that conflict.[108]

Following this logic, the environmental counterclaims entertained by the Tribunals in *Burlington* and *Perenco* were not factually connected to the principal claims. In both cases, the claims by the investors arose out of steep increases of the windfall levy by Ecuador following an oil price spike.[109] On the other hand, the counterclaims brought by Ecuador related to the investors' breach of Ecuadorian environmental law during the operation of their investment.[110] However, since the disputing parties in both cases agreed on the tribunals' entertaining the environmental counterclaims, questions of admissibility did not arise.[111]

Presumably, the parties in *Burlington* and *Perenco* agreed to let the Tribunals hear the environmental counterclaims because the investors were likely to further challenge any domestic rulings on the environmental dispute, which may incur even greater costs for both parties. The policy on environmental protection, which will be discussed in the next section, also militates in favour of the admissibility of these counterclaims. That being said, it is worth noting that the *Perenco* Tribunal acknowledged in its final award that 'these proceedings have been lengthy, complex, multi-faceted, hard fought, and very expensive.'[112] This may be partly due to the tenuous factual connection between the counterclaims and the principal claims.

B. Policy concerning EHR counterclaims: investment arbitral tribunals vs. domestic courts

As mentioned above, when deciding the admissibility of counterclaims, the factual and legal connection should be considered together with the policy relating to the counterclaims.[113] For EHR counterclaims, the policy promoting EHR protection appears to favour their admissibility. However, given the existence of domestic court jurisdiction over the same subject matter, the right question is whether, in order to protect the relevant public interest, an investment arbitral tribunal, as opposed to domestic courts, is better placed to entertain such claims. On questions of domestic law, some tribunals

107 *Oxus Gold v. Republic of Uzbekistan*, UNCITRAL Award (17 December 2015), para 956.
108 *Armed Activities*, above n 90, Finding on Counter-claims; fixing of time-limits; Reply and Rejoinder, Order of 29 November 2001, para 42.
109 *Burlington*, above n 63, Decision on Liability (14 December 2012), paras 23–51; *Perenco*, above n 63, Decision on Jurisdiction (30 June 2011), paras 15–32.
110 *Burlington*, above n 63, Decision on Ecuador's Counterclaims (7 February 2017), paras 52–54; *Perenco*, above n 63, Interim Decision on the Environmental Counterclaim (11 August 2015), paras 34–42.
111 *Burlington*, above n 63, Decision on Liability (14 December 2012), para 93; *Perenco*, above n 63, Interim Decision on the Environmental Counterclaim (11 August 2015), paras 9, 19.
112 *Perenco*, above n 63, Award (27 September 2019), para 967.
113 Veenstra-Kjos, above n 89, at 150; see also *Application of the Convention on the Prevention and Punishment of the Crime of Genocide*, above n 80, Separate Opinion of Judge *ad hoc* Lauterpacht, para 14.

have deferred to domestic courts and thus declined to entertain the counterclaims.[114] Apart from the deference to host states' sovereignty, these tribunals may have chosen not to exercise jurisdiction also due to the comparative advantage of domestic courts in terms of their expertise and resources in handling such disputes.

On the other hand, the advantage of investment arbitral tribunals in adjudicating EHR counterclaims lies in their international character, the finality of their decisions, and the strong enforcement mechanism under the ICSID Convention or the New York Convention. As mentioned above, the disparity of power between foreign investors and developing states may hinder the latter's handling of EHR disputes within their own legal system.[115] The threat of investors to challenge domestic rulings before international tribunals may further strain the judiciary and may endanger the final settlement of the dispute in domestic courts and incur greater costs. In this context, to have EHR disputes adjudicated by investment arbitral tribunals by way of counterclaims may benefit disputing parties as well as general public of the host state. The fact that these matters are subject to domestic court jurisdiction is not an *a priori* impediment to the exercise of jurisdiction by an international tribunal, unless the relevant domestic law is a self-contained regime, conferring exclusive jurisdiction to the state's own courts.[116]

Therefore, when considering the admissibility of EHR counterclaims, the deference to domestic court jurisdiction needs to be balanced against the interest in settling EHR disputes by a neutral, international tribunal with a strong enforcement mechanism. Such an assessment needs to be undertaken on a case-by-case basis, considered together with the factual and legal connection between the counterclaim and the principal claim.

C. Questions of legal personality

Another question of admissibility is EHR counterclaims can be brought against investors for the misconduct of their enterprises. It has been regarded as a 'cardinal principle relating to the bringing of counterclaim' that 'the necessary parties to the counterclaim must be the same as the parties to the primary claim.'[117] In some cases, arbitral tribunals have refused to entertain counterclaims concerning the alleged breach of contract or domestic law by the investor's enterprise, where the latter was not a party to the proceedings.[118]

The asymmetry of investor–state relationship in international investment law is thus aggravated: whereas investors are able to claim for losses suffered by their enterprises thanks to the special arrangement under investment treaties (as interpreted by arbitral tribunals),[119] these investors themselves are shielded from claims stemming from the

114 *Amco*, above n 59, paras 125–27; *Saluka*, above n 87, para 79; *Paushok*, above n 87, paras 694–95.
115 Bernaz and Pietropaoli, above n 39, at 209; Bilchitz, above n 40, at 217.
116 Zachary Douglas, 'Enforcement of Environmental Norms in Investment Treaty Arbitration', in Dupuy Pierre-Marie and Jorge E. Viñuales (eds), *Harnessing Foreign Investment to Promote Environmental Protection* (Cambridge: Cambridge University Press, 2013) 434.
117 *Saluka*, above n 87, para 49.
118 *Paushok*, above n 87, para 686; *Al Warraq*, above n 46, para 669.
119 See David Gaukrodger, 'Investment Treaties as Corporate Law: Shareholder Claims and Issues of Consistency', 3 OECD Working Papers on International Investment 1 (2013), at 25–30; Vera Korzun, 'Shareholder

misconduct of their enterprises by virtue of the principle of separate corporate legal personality under domestic laws. At the level of domestic law, the practice of multinational corporations segregating potentially 'risky' activities through corporate restructuring has long been criticized.[120] The possibility of shareholders to directly claim under investment treaties without facing counterclaims may further disincentivize investors from taking measures to ensure that their enterprises are socially responsible.

In this context, it is worth considering whether corporate veil can be lifted under investment treaties. For instance, the COMESA Investment Agreement stipulates that 'COMESA investors and their investments shall comply with all applicable domestic measures of the Member State in which their investment is made.'[121] One may wonder whether such a clause can make investors liable for their enterprises' breach of domestic laws as a matter of treaty law. An analogy can be drawn between such a clause and the 'umbrella clause'. By interpreting the latter, some tribunals have allowed shareholders to benefit from rights belonging to their enterprises.[122] However, given that neither the umbrella clause nor the compliance-with-domestic-law clause, in their ordinary meaning, transforms the essence of the rights and obligations at stake, which are governed by domestic law,[123] it is a mistake that arbitral tribunals disregard the separate corporate legal personality under the domestic law when adjudicating claims based on such clauses. In other words, investors cannot be held liable if they do not bear obligations under the governing law in the first place. Thus, corporate veil cannot be lifted by the treaty, where the treaty itself refers to domestic law.

Admittedly, if treaty parties so intend, they can depart from relevant rules in domestic laws and make investors liable for their enterprises as a matter of treaty law. However, undesirable consequences may arise if investment treaties regulate this issue differently from applicable domestic laws. Such an arrangement risks giving rise to multiple claims against investors and their enterprises for the same EHR misconduct. This may result in double recovery and inconsistent decisions of investment tribunals and domestic courts. It may also disturb the equilibrium in the relationship between investors and their companies, as well as their relationship with third-party creditors, under domestic laws.[124] Moreover, as already mentioned, subjecting investors from the other treaty party to greater liability than other investors would result in comparative disadvantages to the former. This disrupts the level playing field for investors and is against the object and purpose of a typical investment treaty.

Claims for Reflective Loss: How International Investment Law Changes Corporate Law and Governance', 40(1) University of Pennsylvania Journal of International Law 189 (2018), at 208–21.

120 See David W. Leebron, 'Limited Liability, Tort Victims, and Creditors', 91(7) Columbia Law Review 1565 (1991).

121 COMESA Investment Agreement (2007) Article 13.

122 See *CMS Gas Transmission Company v. The Republic of Argentina*, ICSID Case No. ARB/01/8, Award (12 May 2005), paras 296–303; *Sempra Energy International v. Argentine Republic*, ICSID Case No. ARB/02/16, Award (28 September 2007), para 241.

123 See *CMS*, ibid, Decision of the *ad hoc* Committee on the Application for Annulment of the Argentine Republic (25 September 2007), paras 95–96; *Burlington*, above n 63, Decision on Liability (14 December 2012), para 214.

124 Gaukrodger, above n 119, at 32–52; Korzun, above n 119.

Therefore, the problem of legal personality can only be addressed under domestic laws, over which international law can exert some influence. While a universal standard on due diligence obligations has yet to emerge, domestic laws of several states have imposed due diligent obligations on shareholders regarding the conduct of their enterprises. In some jurisdictions, shareholders are already under a duty of care obligation regarding the conduct of companies controlled by them.[125] For instance, France adopted the Corporate Duty of Vigilance Law in 2017.[126] This law requires certain French companies to take vigilance measures regarding the operation of their subsidiaries, the failure of which may incur responsibility of the company to compensate for the harm that could have otherwise been avoided.[127] In the meanwhile, there is an international effort pushing states to impose due diligence obligations on companies in their domestic laws. In particular, the OEIGWG draft treaty requires state parties to impose due diligence obligations under their domestic laws on natural or legal persons in relation to the conduct of another natural or legal person having a contractual relationship with them.[128]

Some recent investment treaties echoed the policy in favour of due diligence obligations of investors. For instance, the Netherlands Model Investment Treaty published in 2019 not only affirms 'the importance of investors conducting a due diligence process' in relation to the social risks and impacts of its investment,[129] it also requires that '[i]nvestors shall be liable in accordance with the rules concerning jurisdiction of their home state for the acts or decisions made in relation to the investment where such acts or decisions lead to significant damage, personal injuries or loss of life in the host state.'[130] The Morocco–Nigeria Bilateral Investment Treaty (BIT) requires that investors and the investment comply with the laws of the host state as well as the home state, 'whichever is more rigorous.'[131] Such provisions, together with domestic laws imposing due diligence obligations on investors, can help to clear the hurdle in terms of legal personality for EHR counterclaims.

V. CONCERNS ARISING FROM EHR COUNTERCLAIMS

Despite the benefits EHR counterclaims might bring,[132] policymakers need to bear in mind the concerns associated with EHR counterclaims. In fact, the decisions in *Burlington* and *Perenco*, two rare cases where the tribunals ruled on the merits of environmental counterclaims, revealed some concerns. The environmental counterclaims in *Burlington* and *Perenco* arose out of an identical set of facts, and the proceedings in

125 See, e.g., *Chandler v Cape plc* [2012] EWCA Civ 525; [2012] 1 WLR. 3111; *Choc v. Hudbay Minerals Inc.*, 2013 ONSC 1414, paras 54–75.

126 LOI n° 2017-399 du 27 mars 2017 relative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre (Law No. 2017-399 on the Duty of Vigilance of Parent Companies and Ordering Companies), https://www.legifrance.gouv.fr/affichTexte.do?cidTexte=JORFTEXT000034290626&categorieLien=id (visited 5 August 2020).

127 Ibid.

128 OEIGWG draft treaty, above n 30, Article 6(6).

129 The Netherlands Model Investment Agreement (22 March 2019) Article 7(3).

130 Ibid, Article 7(4).

131 Morocco–Nigeria BIT (2016) Article 14(1).

132 See Choudhury, above n 4, at 13–15; Ho, above n 4, at 11–15; Harrison, above n 4.

both cases proceeded in parallel with each other.[133] Nonetheless, the tribunals in these two cases took different approaches both in the interpretation of Ecuadorian law and in the treatment of expert evidence. In fact, the *Burlington* Tribunal clearly was aware of the possibility of inconsistent decisions in both cases and has emphasized that '[f]or reasons linked to the value of coherence of the legal system, it considers that contradictory decisions on identical issues should be avoided to the degree possible.'[134] Despite this caution, inconsistent decisions were not avoided. In the final award rendered in 2019, the *Perenco* Tribunal observed that '[t]he two tribunals have addressed the issues in significantly different ways, both substantively, in terms of their findings on Ecuadorian law, and technically, in terms of evaluating the expert evidence of contamination in the Blocks.'[135]

On the crucial question of the standard of liability under Ecuadorian environmental law, the Tribunals in *Perenco* and *Burlington* took different views. The *Perenco* Tribunal interpreted it as taking a fault-based approach.[136] The *Burlington* Tribunal, on the other hand, found itself having 'difficulty following the *Perenco* [T]ribunal's view,' holding that the Ecuadorian courts indeed 'have established a strict liability regime.'[137]

In the assessment of environmental damages, the *Burlington* Tribunal relied primarily on the sampling by parties' experts, whereas the *Perenco* Tribunal had 'doubts about the expert evidence tendered by both Parties' and decided to appoint an independent expert in consultation with the parties.[138] As a result, these tribunals reached different conclusions on damages. Relying on the work of the independent expert, which the *Perenco* Tribunal considered to be 'in a far better position to capture and delineate the extent of the contamination,' the *Perenco* Tribunal considered the damages awarded in *Burlington* as 'a down payment.'[139]

These two decisions revealed several concerns. First, their different approaches to Ecuadorian laws and to expert evidence, and their disagreement on the amount of damages, may undermine the credibility of both awards. This is particularly troubling not only due to the significant amount of damages at stake but also because of the public interests involved. Even more importantly, the contradictory interpretations of Ecuadorian environmental law risk disturbing the coherence of the domestic legal order, which calls into question the appropriateness of having investment arbitral tribunals adjudicate EHR claims based on domestic laws. As mentioned above, several states are already sceptical about the legitimacy and suitability of investment arbitral

133 *Burlington*, above n 63, Decision on Ecuador's Counterclaims (7 February 2017), paras 64–65; *Perenco*, above n 63, Decision on Claimant's Application for Dismissal of Respondent's Counter-Claims (18 August 2017), paras 31–52.

134 *Burlington*, above n 63, Decision on Ecuador's Counterclaims (7 February 2017), para 69.

135 *Perenco*, above n 63, Award (27 September 2019), para 897.

136 *Perenco*, above n 63, Interim Decision on the Environmental Counterclaim (11 August 2015), footnote 881.

137 *Burlington*, above n 63, Decision on Ecuador's Counterclaims (7 February 2017), para 248.

138 *Perenco*, above n 63, Decision on Claimant's Application for Dismissal of Respondent's Counter-Claims (18 August 2017), para 31; Interim Decision on the Environmental Counterclaim (11 August 2015), paras 564–69.

139 *Perenco*, above n 63, Award (27 September 2019), para 898.

tribunals in applying domestic laws.[140] Such inconsistent decisions may reinforce such scepticism.

To address these concerns, stakeholders may consider the following suggestions. On the interpretation of domestic laws, a procedure requiring preliminary rulings by domestic courts can help to resolve the problem of inconsistent decisions on domestic laws.[141] Drawing on the preliminary reference procedure that operates in EU law,[142] states can insert a provision in investment treaties requiring arbitral tribunals to seek binding opinions from domestic courts over questions of domestic law that are disputed by parties. Such a procedure could function as a middle ground between keeping EHR claims within the exclusive jurisdiction of domestic courts, on the one hand, and totally 'surrendering' the jurisdiction over these claims to investment arbitral tribunals, on the other. It can allow states to benefit from the investment arbitration mechanism as a neutral alternative to domestic courts, while guaranteeing the coherence and unity of their domestic legal orders.

As regards expert evidence, independent experts appointed by tribunals are preferable. In practice, party-appointed experts usually give evidence favourable to their side, leaving tribunals to pick sides in a 'battle of experts'.[143] This may sometimes cause error and undermine the credibility of arbitral decisions. In comparison, independent experts are more appropriate when dealing with EHR disputes, particularly in the light of the complexity of technical issues that might occur. Although independent experts may incur longer and more costly proceedings, the public interests at stake may justify this approach. Some investment treaties already provide that tribunals can appoint experts on their own initiative when it comes to technical issues concerning environmental, health, safety, or other scientific matters.[144] Additionally, the inconsistent decisions in *Burlington* and *Perenco* also cast doubts on the competence and expertise of investment arbitrators to adjudicate EHR issues. If states intend to allow EHR counterclaims, they should include arbitrators with the expertise in EHR areas when making appointments.

Moreover, given the public interests involved in EHR counterclaims, transparency and the participation of affected parties must be guaranteed. Improvements have been made in recent years.[145] Notably, the Hague Arbitration Rules on Business and Human Rights include provisions on transparency tailored for arbitration concerning human

140 See above text to footnotes 65–75.

141 See Sergio Puig and Gregory Shaffer, 'Imperfect Alternatives: Institutional Choice and the Reform of Investment Law', 112(3) American Journal of International Law 361 (2018), at 405.

142 Consolidated Versions of the Treaty on the Functioning of the European Union, 2016/C 202/01, Article 267.

143 Brooks W. Daly and Fiona Poon, 'Technical and Legal Experts in International Investment Disputes', in Chiara Giorgetti (ed.), *Litigating International Investment Dispute: A Practitioner's Guide* (Leiden: Brill/Nijhoff, 2014) 323–74.

144 US–Korea FTA (2007) Article 11.24; Kyrgyzstan–India BIT (2019) Article 25; Canada–Moldova BIT (2018) Article 33; Argentina–UAE BIT (2018) Article 31.

145 UNCITRAL Rules on Transparency in Treaty-Based Investor-State Arbitration (New York, 2014); United Nations Convention on Transparency in Treaty-Based Investor-State Arbitration (adopted 10 December 2014, entered into force on 18 October 2017).

rights issues.[146] It is advisable that parties adopt such rules when dealing with EHR counterclaims.

VI. CONCLUSION

International investment law has been designed to protect foreign investors by limiting the exercise of sovereign power by states. Therefore, the asymmetry between the rights and obligations of investors under investment treaties is, to some extent, justified. Recently, as greater importance is attached to EHR interests and investors' treaty claims sometimes undermine EHR interests, stakeholders start trying to recalibrate the investor–state relationship. In this context, to allow EHR counterclaims in investment arbitration can not only help disputing parties to settle their outstanding disputes before a single forum but also benefit the general public. By counterbalancing the procedural privileges enjoyed by foreign investors under investment treaties, EHR counterclaims can also help the investment arbitration system to fend off criticisms of its 'structural bias' in favour of investors. However, for EHR counterclaims to play a more beneficial role, policymakers need to be mindful of the legal and policy constraints of EHR counterclaims and concerns associated with them.

Contrary to the view of some commentators, this paper argues that international environmental law and human rights law only regulate the conduct of investors 'indirectly' through domestic law. Thus, EHR counterclaims are necessarily based on domestic laws. At the same time, the domestic legal basis of EHR counterclaims limits their potential in investment arbitration, the root cause of which is that states and arbitral tribunals may consider domestic courts, instead of investment arbitral tribunals, to be the proper forum for these claims. On the other hand, in certain scenarios, investment arbitral tribunals have comparative advantages over domestic courts in their neutrality, efficiency, and the international enforcement mechanism. As revealed from treaty practice, different states have different preferences as regards whether to allow investment arbitral tribunals to adjudicate EHR disputes under domestic law. Although participants at the UNCITRAL WG III agree on the need to address procedural rules governing counterclaims,[147] a consensus on arbitral tribunals' jurisdiction might be hard to reach.

That being said, where state parties agree to allow EHR counterclaims, they can reduce uncertainty regarding jurisdiction and admissibility by requiring investors to comply with domestic laws and by expressly authorizing counterclaims by host states. For instance, treaty parties can stipulate that the respondent state "'shall" be entitled to bring counterclaims' against investors where the latter fail to comply with EHR obligations under the applicable domestic law.

Although several hurdles for EHR counterclaims can be cleared by proper treaty drafting, the difficulty of holding investors liable for the EHR misconduct of their enterprises, which is caused by investors' separate legal personality under domestic laws, constrains the potential of EHR counterclaims. This problem can only be effectively

146 The Hague Rules, above n 42, Articles 38–43.
147 A/CN.9/1044, para 58.

addressed at the level of domestic law, and improvements have been made in recent years.

Regarding the merits of EHR counterclaims, the conflicting decisions in *Burlington* and *Perenco* revealed certain concerns. To address these concerns, this paper proposes that states can use a preliminary reference procedure, allow independent expert evidence, appoint arbitrators with EHR expertise, and improve transparency and the participation of affected parties. At a general level, procedural rules in domestic laws are valuable resources to draw on in ISDS reform regarding EHR counterclaims.