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ROOTS OF CONFLICT, BRANCHES OF CHANGE: CONFRONTING CHALLENGES AND EXPLORING IMPLICATIONS IN ENVIRONMENTAL COUNTERCLAIMS

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Introduction

The current development of globalization has unveiled a highly active global investment system, leading to a corresponding rise in cross-border disputes. The Investor-State Dispute Settlement ["**ISDS**"] system is based on investment treaties that show a systemic bias against States, with the absence of investors' obligations to States or States' claims against investors.[1] Host States face an unbalanced legal relationship with the power to prevent losses but lacking any capacity to achieve wins.[2] Among them, investment treaty arbitration is perceived as antagonistic to environmental conservation efforts owing to the host States' ability to file a counterclaim involving environmental considerations. This occurs as Bilateral Investment Treaties ["**BITs**"] and International Investment Agreements ["**IIAs**"] are commonly used by investors to contest the host States' environmental policies that oppose their economic interests. Therefore, environmental counterclaims represent a decisive instrument that protects environmental priorities by upholding the States' desire to protect their environmental authority alongside their readiness to defend environmental assets when facing investment interests.[3] However, attempts to invoke Environmental-based Counterclaims ["**EBCs**"] have been relatively rare, and successful counterclaims are even rarer because of jurisdictional and other preliminary hurdles.

[1] Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (3rd ed, Oxford University Press 2008).
[2] Andrea Bjorklund, 'The Role of Counterclaims in Rebalancing Investment Law' (2013) 17(2) Lewis & Clark Law Review 461.
[3] Maxi Scherer, Stuart Bruce and Juliane Reschke, 'Environmental Counterclaims in Investment Treaty Arbitration' (2021) 36(2) ICSID Review-Foreign Investment Law Journal 413, 415.

In light of this, this article presents the procedural and substantive legal difficulties for bringing counterclaims and places them within the particular framework of conflicts pertaining to the environment. Additionally, the article addresses the potential consequences of environmental counterclaims regarding liability and compensation, along with the attendant ramifications of counterclaims on upcoming disputes considering evolving global environmental policy and sustainable development.

Winding Roots: Mapping Jurisdictional Barriers

The requirement for investor consent stands as both an inherent quality and a fundamental precondition for arbitral jurisdiction to establish authority over counterclaims. The personal (*ratione personae*) and substantive (*ratione materiae*) jurisdiction of a tribunal must be considered when deciding whether the parties' consent encompasses the host States' (environmental) counterclaim.[4] This has been a critical hindrance to counterclaims as consent to jurisdiction is not explicitly devoted to in majority of the investment treaties. This is because, except for newly negotiated IIAs, investment treaties provide investors with international avenues for recourse against their host governments.[5] Moreover, the IIAs dispute resolution clause often grants jurisdiction over duties or obligations based on a treaty, making it challenging for host States to establish EBCs, as investment treaties typically exclude investors' obligations,[6] and thus, tribunals cannot decide claims without a treaty foundation.

Furthermore, the specific wording of dispute resolution provisions under narrow investment treaties enables tribunals to only address violations that arise from treaty commitments but prohibits their ability to challenge alleged treaty violations.[7] This restricts claims to breaches of obligations under the IIAs, foreclosing the possibility of a tribunal entertaining counterclaims concerning environmental obligations under international law or based on a contract or the host States' domestic law, to the extent they: i) expressly restrict "disputes" to claims concerning '*compliance by the State with the BIT*'[8] or ii) do not contain any provision setting forth obligations on

[4] Anne K Hoffmann, 'Counterclaims' in Meg Kinnear and others (eds), *Building International Investment Law: The First 50 Years of ICSID* (Kluwer Law International 2015).

[5] Yasmin Lahlou and others, 'The Rise of Environmental Counterclaims in Mining Arbitration' in Jason Fry and Louis-Alexis Bret (eds), *The Guide to Mining Arbitration* (Global Arbitration Review 2019).

[6] Dafina Atanasova and others, 'The Legal Framework for Counterclaims in Investment Treaty Arbitration' (2014) Journal of International Arbitration 31(3) 357, 379.

[7] Agreement Between Japan and the Kingdom of Cambodia for the Liberalization, Promotion and Protection of Investment (Japan-Cambodia) (adopted 14 June 2007, entered into force 31 July 2008) art 17(1).

[8] *Spyridon Roussalis v Romania*, ICSID Case No ARB/06/1, Award (7 December 2011) ¶ 869.

the investor.[9] Indeed, the tribunals have rejected the host States' counterclaims, since they were based on breaches of contract and domestic law, respectively. Consequently, they were deemed to be outside the purview of the IIAs limited dispute resolution provisions, which primarily addressed BIT disputes.[10] Accordingly, it would be nearly impossible for a State to successfully advance environmental counterclaims where the IIAs dispute resolution clause restricts "disputes" to claims concerning '*compliance by the State with the BIT*'.

Besides this, the tribunals often see a reduction in potential EBCs owing to the choice of applicable law standards. Dispute resolution clauses that are broad, combined with laws that assign restricted jurisdiction (which limit tribunals to applying only IIAs, international law, and/or pertinent treaties between contracting States), make counterclaims based on environmental duties from investment contracts and/or domestic statutes unlikely to maintain their validity.[11] Multiple tribunals have established that they cannot exercise jurisdiction over counterclaims that depend on legal instruments that are not present in the applicable law provisions of these IIAs.[12]

Admissibility: Adherence to Procedural and Substantive Standards

i. *Fragile Links: The Challenge of Establishing Connectedness*

The relationship between an investor's main claim and the host States' counterclaim must be *'directly related to the dispute'* before investment tribunals can review a counterclaim. The existing procedural problems emerge due to missing *jurisprudence constante* foundations, together with ambiguous requirements for assessing main claims against counterclaims. Environmental counterclaims encounter important legal challenges because they typically lack direct dependence on investor-backed IIAs invoked by investors. The tribunal in *Saluka v Czech Republic* ["**Saluka**"], concluded that 'a general legal principle as to the nature of the close connexion which a counterclaim must have with the primary claim' exists and insisted upon the 'interdependence and essential unity of the instruments on which the original claim and counterclaim are based'.[13] Since a few IIAs currently in effect impose environmental obligations on investors, a narrow interpretation of the connectedness test, such as that of the *Saluka* tribunal, would be problematic

[9] *Anglo-American PLC v Bolivarian Republic of Venezuela*, ICSID Case No ARB(AF)/14/1, Award (18 January 2019) ¶ 529.

[10] *Rusoro Mining v Bolivarian Republic of Venezuela*, ICSID Case No ARB(AF)/12/5, Award (22 August 2016) ¶¶ 623, 627–628.

[11] *Georg Gavrilović and Gavrilović d.o.o. v Republic of Croatia*, ICSID Case No ARB/12/39, Award (26 July 2018) ¶ 420.

[12] *Marco Gavazzi and Stefano Gavazzi v Romania*, ICSID Case No ARB/12/25, Decision on Jurisdiction Admissibility and Liability (21 April 2015) ¶¶ 156–161.

[13] *Saluka Investments BV v The Czech Republic*, PCA Case No 2001-04, Partial Award (17 March 2006).

for environmental counterclaims, as they are more likely to be based on obligations under domestic or international law, investment contracts, permits, and licenses. Moreover, the narrowness of this test has also been criticized from a policy perspective, for hindering the counterclaim's efficiency, increasing the risk of inconsistent judgments, and undermining investment arbitration's objective of denationalizing these types of investor disputes.[14] This narrow test would severely limit host States' ability to bring environmental counterclaims, as the source of environmental-based obligations rarely comes from the same instrument as investor claims, the IIAs.

ii. *Eroded Foundations: Overcoming Pleading Deficiencies*

Indeed, investment treaties require that 'the disputing party shall specify precisely the basis for the counterclaim', thus placing a pleading standard. The *Hamester v Ghana* ["**Hamester**"] tribunal dismissed the counterclaim, concluding that even though the treaty gave counterclaims approval, the host State *neither specified the basis for the tribunal's jurisdiction over the counterclaim nor the losses allegedly suffered.*[15] The *Aven v Costa Rica* ["**Aven**"] tribunal stated that the requirements of pleadings, including all the documents and other evidence relied upon[16] to establish the claim, equally applied to counterclaims. However, the counterclaim was denied because Costa Rica ignored them in its response, post-hearing brief, or counter-memorial, failing to specify clearly and precisely the facts which evidence that the investors were the perpetrators of all environmental damages. Moreover, the pleading requirement creates additional difficulty concerning the quantification of the losses in the context of environmentally induced harm from both a legal and a factual perspective, as the host State must identify the applicable legal standard for remedying the environmental harm. The pleading requirement is therefore likely to be an unachievable standard if the pleadings do not extend beyond the host States' failure to declare any accurate method of valuation.

iii. *Roots of Authority: Establishing Standing*

The standing requirements of procedural legal systems are problematic in circumstances involving counterclaims over environmental depreciation since the applicable law holds that the host State also has to suffer the loss. Tribunals routinely deny counterclaims filed by the State on behalf of those harmed by environmental failure. Among other reasons, the tribunal dismissed Ghana's objections in *Hamester* because they were predicated on a contract to which Ghana had never been a party.[17] A claim for environmental damage was initiated by Ecuador in *Chevron v Ecuador II*

[14] *Spyridon Roussalis v Romania*, ICSID Case No ARB/06/1, Declaration of Michael Reisman (28 November 2011).
[15] *Gustav F W Hamester GmbH & Co KG v Republic of Ghana*, ICSID Case NoARB/07/24, Award (18 June 2010) ¶ 352.
[16] *Aven and Ors v Costa Rica*, ICSID Case No UNCT/15/3, Award (18 September 2018) ¶ 744.
[17] *Gustav* (n 15) ¶ 356.

["**Chevron**"], but it was dismissed for lack of standing.[18] The tribunal determined that *individual claims for personal harm from environmental damage ... are not and cannot be claims asserted by the Respondent in its own right against Chevron*. Instead, the arbitration panel stated that any entitlement connected to environmental harm was a right belonging only to these individual plaintiffs alleging personal harm. Consequently, tribunals encounter substantial difficulties in defining the requirement of standing or the existence of a legal right to bring specific counterclaims,[19] whereby every question in this regard must be decided concerning individual circumstances.

iv. *The Right Stewards: Identifying Proper Parties*

A direct legal relationship is also part of the considerations connected with admissibility, depending on the identity of a party.[20] As the *Perenco Ecuador Ltd. v Republic of Ecuador* ["**Perenco**"] tribunal noted, the 'legal relationship between an investor and the State' must be that it 'permits the filing of a claim by the State for environmental damage caused by the investor's activities'.[21] Counterclaims require matching identities between the original claimants and submitter parties in arbitration, but this approach creates challenges for EBCs. The lack of privity becomes problematic when environmental counterclaims rely on contractual agreements or host State domestic law because any underlying duty transfers to the jurisdiction where counterclaims are developed.[22] Practice has shown that a counterclaim may be inadmissible when the investor's environmental obligations arise under domestic law, and that law only grants a personal right to claim to those directly affected by the misconduct at issue. This requirement can cause considerable complications for environmental counterclaims, at least when the legal instrument invoked for the counterclaim concerns obligations owed to State instrumentalities or other entities (rather than the State itself) or the obligations of a subsidiary or parent company (rather than the investor itself).[23]

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[18] *Chevron Corporation and Texaco Petroleum Corporation v Republic of Ecuador (II)*, PCA Case No 2009-23, Second Partial Award on Track II (30 August 2018) ¶¶ 7.37–7.45.

[19] Stefan Dudas, 'Treaty Counterclaims Under the ICSID Convention' in Crina Baltag (ed), *ICSID Convention After 50 Years: Unsettled Issues* (Kluwer Law International 2016).

[20] *Dafina* (n 6) 389.

[21] *Perenco Ecuador Ltd. v Republic of Ecuador*, ICSID Case No ARB/08/6, Interim Decision on the Environmental Counterclaim (11 August 2015) ¶ 34.

[22] *Tethyan Copper Company Pty Limited v Islamic Republic of Pakistan*, ICSID Case No ARB/12/1, Decision on Jurisdiction and Liability (10 November 2017) ¶¶ 1421-1422.

[23] Enikő Horváth and Panos Theodoropoulos, 'Investment Arbitration, Environmental Counterclaims in Investment Treaty Arbitration Status Quo And The Way Forward' in Christian Klausegger and others (eds), *Austrian Yearbook on International Arbitration 2024* (Kluwer Law International 2024).

Obligations in the Canopy: Enforcing Investor's Environmental Obligations

After the host States have crossed the jurisdiction and admissibility hurdles, the State must demonstrate that the accord imparts the counterclaim a cause of action, failing which the counterclaim will be dismissed. Tribunals have decided that they can only settle disputes arising from the applicable treaty and not from breaches of domestic law obligations.[24] In *Rusoro v Venezuela* ["**Rusoro**"], the tribunal denied Venezuela's counterclaim, stating 'the Tribunal's power is limited to adjudicating disputes which arise from the BIT rather than under the Venezuelan law.'[25] Hence, it can be concluded that the BITs do not authorize the tribunals to adjudicate a cause of action arising under national laws. Under international law, the same requirement exists where international obligations deriving from international instruments need express mention in the relevant treaty to become actionable against investors.[26] Most of the current international law instruments pertaining to corporations are soft law, and the voluntary nature of these instruments hinders anyone from identifying positive obligations that could form the ground for a treaty-based counterclaim. Even when a State party assumes an obligation under international law to protect and promote environmental or human rights, that obligation is not transferred to foreign investors operating in that State under an investment treaty, since these instruments, at best, impose a prohibition 'not to engage in activity aimed at destroying such rights' and not impose affirmative obligations on the private parties. As stated in aspirational language, they lack the mandatory nature of many treaty provisions, thus creating difficulty in arising a cause of action for States asserting environmental counterclaims.

Ripples of Responsibility: Liability and Environmental Redress

As recorded earlier, procedural and substantive requirements have cropped unwanted difficulties in the realm of EBCs. To date, few investment arbitration tribunals have addressed the questions of liability and compensation for host States' counterclaims. This is due, in part, to the rather typical reality that the host States are responsible for proving their counterclaim,[27] but may find it difficult to do so. The arbitration panel in *Goetz v Burundi* ["**Goetz**"] rejected Burundi's demand for compensation as Burundi failed to provide adequate evidence.[28] In Hesham, although the tribunal did not contest that damages occurred, but it rejected compensation because the host

[24] *Spyridon* (n 14) ¶¶ 870-71.
[25] *Rusoro* (n 10) ¶ 628.
[26] *Urbaser S.A. and Consorcio de Aguas Bilbao Biskaia, Bilbao Biskaia Ur Partzuergoa v Argentine Republic*, ICSID Case No ARB/07/26, Award (8 December 2016) ¶ 1192.
[27] Frederic Sourgens and others, *Evidence in International Investment Arbitration* (Oxford University Press 2018).
[28] *Antoine Goetz et consorts v Republique du Burundi (I)*, ICSID Case No ARB/95/3, Award (10 February 1999) ¶¶ 53, 56.

State did not establish a legal basis for its counterclaim.[29] In addition, based on the precedent set by *Urbaser v Argentina* ["**Urbaser**"], it may be challenging for the host State to justify compensation under international law for a purported infringement of the private or communal ecological entitlements of its residents.[30]

Additionally, for host States to seek compensation regarding liability issues and counterclaims, they must demonstrate thorough investigation and due diligence.[31] Depending on the type and scope of due diligence obligations, an IIA may or may not afford investor protection from counterclaims based on the main claims. The arbitral tribunal in *Perenco* reached its conclusion by examining the applicable legal framework on the day of the disputed act, combined with Perenco's environmentally sound practices and its strict, fault-based environmental damage liability model. Examples of the carelessness of Perenco's environmental procedures were given, and it was found that the investor had a duty of care when addressing fault-based responsibility.[32] Compensation changes emerge from due processes, while they can also develop from relative negligence together with relative contributory negligence and relative causation.

Sowing Implications for Future Disputes

In investment treaty arbitration, the broad application of jurisdiction and sources of responsibilities may be utilized to incorporate environmental and climate change-related problems appropriately.[33] The manifestation of such a probability rests on the limited doctrinal and jurisprudential developments as of date, and the establishment of the cause of action for EBCs. Initially, it might be helpful to demand an explanation about the processes by which States execute laws affecting investor conduct in environmental matters, together with climate change initiatives and the United Nations ["**UN**"] Sustainable Development Goals implementation.[34] Second, it may improve the equilibrium of processes between host States and investors, providing both efficiency and legal certainty.[35] Third, allowing claims to be set off might reduce the incidence and problems of so-

[29] *Hesham Talaat M. Al-Warraq v The Republic of Indonesia*, UNCITRAL, Final Award (15 December 2014).
[30] *Urbaser* (n 26) ¶ 1220.
[31] Jorge Viñuales, 'Investor Diligence in Investment Arbitration: Sources and Arguments' (2017) 32(2) ICSID Review-Foreign Investment Law Journal 346, 363.
[32] *Perenco* (n 21) ¶¶ 389–90.
[33] Annette Magnusson, 'New Arbitration Frontiers: Climate Change' in Jean Kalicki and Mohaed Abdel Raouf (eds), *Evolution and Adaptation: The Future of International Arbitration* (Kluwer Law International 2020).
[34] Juan Pablo Moyano Garcia, 'Moral Damages in Investment Arbitration: Diverging Trends' (2015) 6(3) Journal of International Dispute Settlement 485, 514.
[35] Mohamed Sweify, 'Investment-Environment Disputes: Challenges and Proposals' (2016) 14(2) DePaul Business and Commercial Law Journal 133, 204–5.

called *litispendence,* which is the pursuit of legal actions simultaneously before various courts or tribunals.[36]

Another possibility is to modernize the IIA regimes by implementing reform initiatives such as the United Nations Commission on International Trade Law ["**UNCITRAL**"] Working Group III,[37] the United Nations Conference on Trade and Development ["**UNCTAD**"],[38] and bilateral IIAs to accommodate international environmental policy, including a variety of procedural (like counterclaims)[39] and substantive elements within their purview to rebalance the ISDS system. To achieve this reform, recently negotiated or modified BITs should incorporate environmental objectives in their preambulatory clauses,[40] provide guidance on evaluating indirect expropriation in relation to environmental protection measures,[41] or clarify host States' authority on environmental matters,[42] or address the arbitration of specific environmental issues.

Furthermore, States can use multiple environmental policies containing net-zero emission targets alongside energy efficiency programs and renewable energy projects[43] to fulfill international policy mandates and agreement obligations, and meet climate change regulations. States enforce identical standards through national energy plans alongside carbon storage/reduction measures, zoning regulations, concession agreements, and public procurement requirements, which deliver those international responsibilities to investors under IIA terms.[44] These regulatory shifts can produce major effects on legal applications, together with contractual requirements and responsibility standards in economic disputes.

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[36] Tim Stephens, *International Courts and Environmental Protection* (Cambridge University Press 2009).

[37] UNCITRAL 'Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-sixth session' (6 November 2018) UN Doc A/CN.9/964.

[38] UNCTAD 'UNCTAD's Reform Package for the International Investment Regime' (24 October 2018).

[39] Agreement between the Slovak Republic and the Islamic Republic of Iran for the Promotion and Reciprocal Protection of Investments (Iran-Slovakia) (adopted 19 January 2016, entered into force 30 August 2017) art 14(3).

[40] Camille Martini, 'Balancing Investors' Rights with Environmental Protection in International Investment Arbitration: An Assessment of Recent Trends in Investment Treaty Drafting' (2017) 50(3) The International Lawyer 529, 31.

[41] Ying Zhu, 'Do Clarified Indirect Expropriation Clauses in International Investment Treaties Preserve Environmental Regulatory Space?' (2019) 60(2) Harvard International Law Journal 377.

[42] Kate Parlett and Mark Tushingham, 'Recalibrating the Balance Between Protecting Foreign Investments and Protecting the Environment: Is Asia Taking the Lead?' (2018) 20(4) Asian Dispute Review 166, 171.

[43] Megan Darby and Iasbelle Gerresten, 'Which countries have a net zero carbon goal?' (*Climate Home News*, 14 June 2019) <https://www.climatechangenews.com/2019/06/14/countries-net-zero-climate-goal> accessed 19 January 2025.

[44] Maxi Scherer, n (3).

Final Thoughts

The introduction of environmental counterclaims begins to address the dilemma that States often face in international investment law. The balance of power tilts toward the States when they gain EBCs that punish investors who fail to meet environmental standards. States tend to support legislation that fulfils treaty requirements more strongly when they can maintain effective investment compliance monitoring or when they establish counsellor investor environmental standard violations. Likewise, investors will fully comply with them because failure to uphold environmental standards results in profit losses or opens them to counterclaims from States. EBCs in ISDS could serve as a tool to promote effective environmental stewardship. This presents an opportunity to harmonize international investment law with broader global efforts to address the environmental crisis.