



Ecuador's Experience with International Investment Arbitration

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1. Introduction

This policy brief briefly reviews Ecuador's experience with international investment treaties and arbitration. It begins by presenting Ecuador's Audit Commission on the topic. It further explains the historical and geopolitical context of the decisions Ecuador has taken, beyond the traditional criticism on rules of arbitration or the role of arbitrators. Then it reflects on some of the cases Ecuador has faced in the last decade, in light of the current criticisms against investor-state dispute settlement (ISDS). Finally, it presents a case for the way forward with a series of national, regional and global alternatives currently pursued by the Ecuadorean government.

2. CAITISA: Audit Commission on BITs and Arbitration

In light of Ecuador's experience, President Correa decided to establish, by executive decree in May 2013, a joint government-civil society commission to study and audit its bilateral investment treaties and the international investment arbitration system (referred to as 'CAITISA', for its Spanish acronym). This audit commission is a sequel to the audit commission that studied Ecuador's foreign debt commitments at the beginning of President Correa's administration that led to a selective default that saved about \$8 billion in cash flow.

CAITISA intends to verify the legality, legitimacy and lawfulness of investment treaties, rules and Ecuador's commitments, and the possible inconsistencies and irregularities in the decisions of arbitration tribunals that may have caused negative impacts to the Ecuadorean State. It is organized into three working groups: bilateral investment treaties (BITs); arbitration cases; and foreign investment and development. The first group is in charge of analyzing the historical background and geopolitical context of how Ecuador became party to BITs, fundamental clauses and their legal compatibility with other national, regional and international laws and legal defense doctrine and alternatives.

The second group is in charge of studying the legal bases and legitimacy of the current investment arbitration system including: backgrounds of arbitration cases that concern or may concern ISDS cases against Ecuador; proce-

dures; threats; acts and decisions of foreign jurisdictions; awards and decisions by other jurisdictions; basis of consent (treaties and laws) for claims; conflicts of interest; role of law firms; legal defense strategies; costs; and consequences of the demands. CAITISA has already been criticized by Occidental¹, which demanded Ecuador to establish a "security" for the amount of the award in the case it brought against Ecuador on the grounds that CAITISA "underscores the risk that Ecuador will not comply with the Award if its annulment application fails"².

The third group is in charge of analyzing the relations between BITs, foreign direct investment (FDI) and the national development regime. The study is divided into a general component that will study whether BITs attracted investment and in what circumstances, and a specific component that will examine the behavior of the specific companies that have brought investment arbitration claims against Ecuador. Finally, CAITISA must deliver conclusions and recommendations and an open and publicly available large information system.

3. BITs: Historical Context

The commission has so far found plenty of irregularities regarding how Ecuador entered into BITs. It was not uncommon to find documents³ from rich countries and Bretton Woods institutions pressuring Ecuador into signing these agreements in the 80s and the 90s. A large set of the most important treaties, including the United States-Ecuador BIT and the Washington (International Centre for Settlement of Investment Disputes (ICSID)) Convention did not fulfill the constitutional and legal ratification processes.

The geopolitics of ICSID are intertwined with those of the Bretton Woods system because of the World Bank's power to determine the arbitrators⁴. The President of the World Bank designates the arbitral tribunals' president when the parties' arbitrators do not agree on a common name⁵. Likewise, and more gravely, the President of the World Bank designates the three members of the Annulment Committee (a sort of last recourse of an arbitration proceeding)⁶ after an award has been made. The President of the World Bank has always been a US citizen, and most commonly, a former high ranking US government official.

* At the time of writing this policy brief (December 2014), Mr. Arauz was serving as Deputy Secretary for Planning and Development of Ecuador. This paper in no way compromises his institution, Ecuador's defense, sovereign decision-making or may be used as an interpretation in claims, awards, award set-asides, execution procedures or any act against the Republic of Ecuador.

The US has blocked World Bank loans to states that have ICSID awards pending⁷. During all of ICSID's history, the US has not lost one case as a defendant. Thus, ICSID as a forum for investor-state dispute settlement in the context of the Transatlantic Trade and Investment Partnership (TTIP) is dangerous even for European Union Member States.

Ecuador denounced ICSID in 2009. It can be considered that this is a *de facto* termination of BITs that had ICSID as its only forum for investor-state dispute settlement. Even the US State Department has admitted⁸ that in these cases there is no alternative left to file claims against Ecuador. Nevertheless, under these treaties, states can rarely⁹ file international claims against investors; thus, states can never "win", they can only "not lose"¹⁰.

Geopolitics is also relevant in the decision-making process to withdraw from the BITs, especially considering recent criticism of international investment arbitration. Ecuador denounced 11 BITs between 2008 and 2010, mostly with Latin American countries whose investors had not initiated any cases against Ecuador and whose investment in Ecuador was insignificant¹¹. Ecuador also denounced its BITs with two EU countries: Romania and Finland. The Romanian government replied with a note rejecting the denunciation and postponing effects to a later date. Finland's position is unclear. As part of its internal process, Ecuador's Constitutional Court has already declared that all BITs are unconstitutional and Ecuador's National Assembly has already approved the denunciation of BITs with Germany, France, Sweden and the United Kingdom.

In a State visit by President Correa to Germany in 2013, Chancellor Merkel publicly stated the need for "legal certainty" for German and European investments in Ecuador¹². This was endorsed by the German ambassador in Quito¹³. Similar statements were made by the EU Trade Commissioner when South Africa denounced its BITs with European countries¹⁴. However, a few months after those statements, the EU and the Southern African Customs Union signed a trade agreement¹⁵. This is evidence that these kind of statements do not constitute a credible threat.

The European countries' positions seem to contradict these countries' statements during the current post-crisis juncture, particularly regarding the Canada-EU Investment and Trade Agreement and the US-EU Investment and Trade Agreement. Besides statements by German officials, and other statements that have been reviewed elsewhere¹⁶, the resolution by the French National Assembly rejecting the Canada-EU treaty¹⁷ is paradigmatic:

[...] la Commission européenne a suspendu les négociations sur ce point et a organisé une consultation publique. Toute décision sur l'inclusion d'une telle clause [de règlement des différends entre les investisseurs et les États] avec les États-Unis est suspendue. Quelle est alors la légitimité de prévoir de telles dispositions dans l'accord avec le

Canada, préjugant de la suite qui serait donnée à la consultation dont les résultats ne seront connus que fin octobre ? Et si l'Union européenne accepte ce précédent, comment pourra-t-elle défendre autre chose au cours des négociations transatlantiques ?

[...] la définition de l'expropriation indirecte constitue une épée de Damoclès pour la puissance publique et peut porter atteinte à la possibilité des États à réguler ; [...]

Ce type de mécanisme qui se caractérise par le flou des motifs pour lesquels les États peuvent être mis en cause, l'opacité des procédures, le coût des litiges, le risque de conflits d'intérêts ne se justifie pas dans un accord entre des États de droit. [...]

(Unofficial translation is provided in the footnote for information purposes¹⁸.)

And the Resolution adopted¹⁹:

5. S'oppose à tout mécanisme d'arbitrage des différends entre les États et les investisseurs et demande en conséquence la révision substantielle des chapitres 10 et 33 sur la protection des investissements.

(Unofficial translation is provided in the footnote for information purposes²⁰.)

If one were to substitute Canada with a developing country like Ecuador, the arguments for denunciation of the Ecuador-France BIT would be readily available. Likewise, there is the statement by the French foreign trade minister, Matthias Fekl, in the French Senate²¹: "*Il faut conserver le droit des États à éditer des normes et à les voir appliquées, d'avoir une justice indépendante et impartiale et d'avoir la capacité pour les peuples de France et du monde entier de faire valoir leurs préférences collectives*" (emphasis added). It is worth taking note that the Minister refers to the right of the people of the entire world to assert their collective values.

It's worth pinpointing some further contradictions in EU investment policy. The EU had frozen negotiations and launched a public consultation regarding ISDS in the Transatlantic Trade and Investment Partnership (TTIP). However, the consultation was based on a pre-fabricated questionnaire on only some of the issues. The European Court of Justice (ECJ) has determined that there are contradictions between several of the EU Member States' BITs (including those in force with developing countries) and the Lisbon Treaty²². To date, these issues have not been resolved. After Lisbon, the competence for investment negotiations now lies in the European Council but the jurisdictional issue has not been fully resolved regarding what occurs with pre-Lisbon BITs. There subsist several intra EU (mainly West-East) BITs still in force. Justifying these treaties by referring to deficient legal systems is anachronistic if both Parties share a common higher court (ECJ) and share the same laws (directives and regulations) and "Constitution" (Rome and Lisbon Treaties). There are even West-East claims based on EU-mandated directives, European Parliament laws and EU issued regulations.

This last issue has been of concern for the European

Union, to the point that they have issued a special Regulation²³ for managing financial responsibility linked to investor-to-state dispute settlement tribunals. In practice, it establishes the right for the Commission in the execution of awards. In 2013, there was already a case involving Romania where the European Commission declared “any award requiring Romania to reestablish investment schemes which have been found incompatible with the internal market during accession negotiations, is subject to EU State aid rules [and] the execution of such award can thus not take place if it would contradict the rules of EU State aid policy.”²⁴ This interesting practice can be brought up by developing nations when faced with execution of arbitral awards that go against their national laws, regional treaties, WTO laws and even their “collective values”.

4. Cases: Clauses and Causes

The investment chapter in the EU-Singapore free trade agreement (FTA) could set a new type of standard for negotiations worldwide. The EU acknowledges errors and omissions of treaties in force and has produced a “fact sheet”²⁵ on its investment provisions. It is up for developing countries to bring up this document in negotiations, after denunciation of current BITs. However, factual experience with arbitration shows that no matter how well-written a BIT is, because of the ‘Most Favored Nation’ clauses and litigation revenue incentives, arbitrators tend to abuse their power and interpret these texts expansively, thus favoring investors.

These treaties begin with a risky clause: the definition of investment. While one traditionally thinks that physical assets (machinery, equipment and factories) constitute foreign investment, the lax definition basically allows anything to be considered investment. Intellectual property is included as investment²⁶, limiting the possibility of countries to demand certain types of technology transfer. Even sovereign debt owned by speculators is considered investment²⁷; this limits sovereign management of public finances. These “investments” (with their judicial and attachment rights) have been packaged and sold to third parties, such as the case of Argentina’s ICSID claims that were sold to vulture funds²⁸.

An expansive interpretation of the non-exhaustive definition of investment in the US-Ecuador BIT could include *any asset* of the investor in the host country²⁹. However, the worst cases of abuse for the definition of an investment are in the cases Chevron II³⁰ and Chevron III³¹. In Chevron II, the tribunal defined a lawsuit in Ecuadorean courts as a kind of investment. In Chevron III, the tribunal defined contractual rights supposedly waiving environmental *contingent liability* (off balance-sheet) that Chevron (formerly Texaco) might have to pay to *private citizens and communities* of Ecuador for its lack of remediation in the Amazon rainforest as a kind of investment. Both decisions ignore the fact that Texaco (Chevron’s current subsidiary) left Ecuador in 1992 (prior to the US-Ecuador BIT’s entry into force) and

that it has no significant *assets* in Ecuador.

The definition of investor is also a huge risk for developing countries. The use of “special purpose entities” (shell or mailbox companies) for treaty shopping (tax or investment, or both) is a characteristic of modern cross-border investment flows³². This crude reality is ignored by arbitrators when making decisions on jurisdiction. They have approached interpretation expansively and allowed for “indirect” investors to initiate claims against sovereign nations, even if the company has changed jurisdiction exclusively in order to bring a claim. In this regard, the Conoco Phillips (a US company with a Netherlands mailbox subsidiary) case against Venezuela³³ is perhaps the roughest case, followed by a case – and a threat of a case³⁴ – against Ecuador. Perenco (1) is a company established in the tax haven Bahamas, owned by another Perenco (2) company in the Bahamas, in turn owned by another Perenco (3) company in the Bahamas, in turn owned by another Perenco (4) company in the Bahamas, in turn owned, partially, by a dead French citizen. The arbitral tribunal decided that Perenco (1) from Bahamas could sue Ecuador under the France-Ecuador BIT.

A much more serious and recent case is Yukos, where companies established in tax havens, but owned by a Russian citizen, have sued Russia under the investor-state dispute settlement provision in the Energy Charter Treaty. It is worth noting that Russia never ratified and later withdrew its signature of the Energy Charter. This opens the door for all nationals to have “foreign investor treatment” in their own country just by establishing an intermediate mailbox company (for both tax and investor right purposes). This behavior was found to be common in Ecuador (besides the case of Perenco), where several companies were domiciled in the US but their capital was registered in tax havens: Chevron, Burlington and City Oriente were registered in the Bermudas; Noble Energy was registered in the Cayman Islands and Murphy was registered in Panama. They all invoked the US-Ecuador BIT³⁵.

One of the most offensive clauses under BITs has to do with indirect expropriation. In the case of Ecuador, arbitrators awarded Occidental over \$75 million³⁶ over a tax dispute even though taxation was explicitly excluded from the US-Ecuador BIT. In the case of Burlington (US) and Perenco (France), even though they formed one company in Ecuador, the tribunals’ decisions and awards are directly in contradiction regarding the taxation issue. In Europe, the suspension of Spanish subsidies for renewable energy has been declared indirect expropriation merely because it affected companies’ future cash flows. It seems highly controversial as well that a nation-wide referendum in Ecuador, providing a decision against casinos, has been challenged by a Spanish gaming corporation³⁷, presumably under the indirect expropriation clauses of the Spain-Ecuador BIT.

The ‘Fair and Equitable Treatment’ clause is the most ambiguous and expansively interpreted clause by arbitrators. In Occidental II case, the tribunal found that Occidental was guilty of violating Ecuadorean law when it

transferred rights to Canadian company EnCana (formerly Alberta Energy Co), but deemed that the law that mandated the State to punish this violation was disproportionate. Occidental's penalty was -a completely arbitrary- 25% deduction of the amount to be compensated. Translated into dollars, Ecuador must compensate³⁸ Occidental \$2.6 billion (including interest to date), the largest ever ICSID award³⁹.

Geopolitics also played a role in the Occidental case. Both the US-Ecuador BIT as well as the concession contract renounced the use of diplomatic or consular means in specific companies' investment issues. Ecuador accused Occidental of "repeated use of diplomatic channels to put improper pressure on Ecuadorian authorities"⁴⁰. The Tribunal "found no evidence [...] that the Claimants ever sought assistance from the US Government". However, two recently revealed diplomatic cables and a lobbying filing by Occidental are evidence of the opposite. In September 2004, the US Embassy informed the Department of State that "Oxy and Embassy officials will continue to quietly press the case with GOE (Government of Ecuador) officials and keep one another informed of developments in the matter"⁴¹. In March 2005, the then President of Ecuador was warned by the US Embassy that "a declaration of caducity (contract nullification and seizure of assets) against Oxy would cost the GOE the support of the USG (United States Government)"⁴². This can help explain why in 2006 Occidental lobbyists Ian David and Robert McGee contacted six US Federal agencies (including the White House, the US Trade Representative and the Department of State) and both houses of the US Congress⁴³ regarding the "Ecuador - arbitration" and spent part of \$8.9 million in the matter.

The tribunal was presided by Canadian Yves Fortier, current lawyer and arbitrator, former chairman of the board of Rio Tinto Alcan, former ambassador to the UN Security Council, current chairman of the World Bank's Sanctions Board and current high-ranking intelligence official of the Canadian government⁴⁴. Yves Fortier shared the Rio Tinto Alcan board of directors with Gwyn Morgan, former President and CEO of EnCana at the time of the referred illegal transaction⁴⁵. Yves Fortier also chaired the three "Yukos" v. Russia tribunals. In those cases, with the same logic, the tribunals found that Yukos did violate Russian law and double taxation treaties, but nevertheless, even though taxation issues are not covered in the Energy Charter Treaty, it is Russia who must compensate⁴⁶ the (non-foreign) former owners of Yukos by the exorbitant amount of over \$50 billion (after the same arbitrary 25% deduction), the largest ever investment award.

5. There is Always an Alternative

It would be unwise to read both these awards and interpretations without a geopolitical prism. Unlike the dominant discourse of "there is no alternative", the world is transitioning to an alternative investment regime. In fact, Ecuador has been successful in taking a

leading role with civil society and other developing nations in the approval of a United Nations Human Rights resolution (Resolution A/HRC/RES/26/9) establishing a negotiations mandate on an international legally binding instrument to regulate, in international human rights law, the activities of transnational corporations and other business enterprise. This opens the way for enhancing the ethical behavior of transnational corporations around the world. The voting results⁴⁷ of this initiative show the geopolitical nature of the regulation of foreign investment even in regard to universal values, like human rights.

Some BRICS countries are moving away from the international investment arbitration regime. Brazil has not ratified any treaties to date and is not a part of ICSID⁴⁸. India is reviewing all of its treaties and has signaled that it will withdraw from them. South Africa is withdrawing from all of these treaties and is not part of ICSID. Russia has withdrawn its signature from the Energy Charter Treaty and one of its largest companies, Rosneft, has announced⁴⁹ that it will not agree to arbitration in "Western" jurisdictions. Other large developing countries like Indonesia are withdrawing from investment treaties.

In South America, Bolivia withdrew from all its treaties and from ICSID. Venezuela denounced the Netherlands-Venezuela BIT that was most prone to treaty shopping and withdrew from ICSID. South America is establishing its own investment dispute settlement forum. Ecuador is leading the establishment of an international global South observatory of transnational investment disputes, in partnership with the South Centre, which hopes to share strategic information for legal defense and motivate collective action regarding the investment regime.

Considering the reality of the links between BITs and FDI, Ecuador has determined that natural resource availability and the possibility to resolve disputes with legal certainty for all parties are key determinants in attracting worthwhile foreign direct investment. Therefore, Ecuador has established a domestic law to protect investments. Ecuador now signs investment contracts with regional (i.e. Latin American) arbitration allowed, so long as it is based on national laws and regulations, excludes regulatory and tax policy space from the ambit of arbitration, and requires that domestic jurisdiction be exhausted. These contracts also include performance requirements for the investors and are balanced. They include rights and duties for both parties - unlike BITs that are blank checks for the investor.

6. Conclusion

The geopolitical pressures that developing countries have faced regarding investment treaties and arbitration will soon be a thing of the past. But this can only be if the Global South collectively seizes the moment of internal contradictions in the hegemonic North.

End notes

- ¹ <http://www.oxy.com/Pages/default.aspx>. More details on the case raised by Occidental against Ecuador are included in the following sections of the brief.
- ² ITA Law (2014g)
- ³ Tempone (2003: 30)
- ⁴ The President of the World Bank, as Chairman of the Administrative Council of ICSID also designates arbitrators when one of the parties refuses or omits to do so. See ICSID (2006a: Art. 5).
- ⁵ ICSID (2006b: Rule 4.1)
- ⁶ ICSID (2006b: Rule 52)
- ⁷ Parks (2013)
- ⁸ US Department of State (2013)
- ⁹ There are only three known cases, but because the information is not public, it is not possible to determine whether the BITs themselves constituted consent for this type of arbitration: Republic of Equatorial Guinea v. CMS Energy Corporation and others (ICSID Case No. CONC(AF)/12/2); Gabon v. Société Serete S.A. (ICSID Case No. ARB/76/1); Republic of Peru v. Caravelí Cotaruse Transmisora de Energía S.A.C. (ICSID Case No. ARB/13/24).
- ¹⁰ According to ICSID (2014: 30), 48% declined jurisdiction and 24% dismissed all of the investors' claims.
- ¹¹ Save from a harsh response from Honduras, none of these countries protested. CAITISA (2014).
- ¹² El Telégrafo (2013)
- ¹³ Sosa and Zeas (2013); Vela (2013).
- ¹⁴ Allix (2013)
- ¹⁵ European Commission (2014b)
- ¹⁶ Khor (2014)
- ¹⁷ Assemblée Nationale (2014a)
- ¹⁸ "[...] the European Commission had suspended negotiations and had organized a public consultation on this matter. Any decision about the inclusion of such a clause [dispute settlement between investors and States] with the United States was suspended. What is then the legitimacy of laying down such provisions in the agreement with Canada, prejudging the outcome of the consultation the results of which will not be known before the end of October? And if the European Union accepts this precedent how can it defend something else during the transatlantic negotiations? [...] the definition of indirect expropriation is like the sword of Damocles for public authorities and can jeopardise the capacity of States to regulate; [...]"
- ¹⁹ Assemblée Nationale (2014b)
- ²⁰ "5. Is opposed to any kind of arbitration mechanism for disputes between the States and investors and therefore requests the substantial revision of chapters 10 and 33 on the protection of investments".
- ²¹ According to Euractiv.fr (2014).
- ²² European Court of Justice (2009a, 2009b, 2009c)
- ²³ European Parliament and Council of the European Union (2014)
- ²⁴ Micula et al. v. Romania in Tietje and Wackernagel (2014).
- ²⁵ European Commission (2014a)
- ²⁶ See ITA Law (2014c, 2014h, 2014i).
- ²⁷ ITA Law (2014d)
- ²⁸ Ministerio de Economía y Finanzas Públicas (2013)
- ²⁹ A point highly indicative of the asymmetries of the "reciprocal" bilateral investment treaties is that in the US-Ecuador BIT, there is a section reserved for financial services and the energy sector, but on the US side only.
- ³⁰ ITA Law (2014)
- ³¹ ITA Law (2014a)

³² OECD (2008)

³³ ITA Law (2014b)

³⁴ Another interesting threat of a case was that notified by the Ecuadorean indirect owners of an Ecuadorean newspaper "El Universo" (itself established in tax haven Cayman Islands), who have lived and worked in Ecuador, but who apparently have a US passport and thus could consider the local newspaper a "foreign investment". See Procuraduría General del Estado (2014).

³⁵ CAITISA (2014)

³⁶ ITA Law (2014f)

³⁷ Procuraduría General del Estado (2014)

³⁸ ITA Law (2014g)

³⁹ Ecuador has since filed for annulment of the award at ICSID. See ITA Law (2014g).

⁴⁰ ITA Law (2014g), para 273.

⁴¹ Wikileaks (2004)

⁴² Wikileaks (2005)

⁴³ Secretary of the Senate (2007)

⁴⁴ Security Intelligence Review Committee (2014)

⁴⁵ gwynmorgan.ca (2014)

⁴⁶ ITA Law (2014e, 2014j, 2014k)

⁴⁷ Business and Human Rights Resource Centre (2014)

⁴⁸ Brazil recently signed investment agreements with Mozambique, Angola, Malawi and Mexico and is negotiating with several other countries based on a new 'Cooperation and Facilitation of Investments' model.

⁴⁹ Boltenko (2014)

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