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ECUADOR RETURNS TO INVESTMENT-ARBITRATION: A step which may be replicated by others in the region, like Venezuela

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Ecuador's anti-arbitration stances, taken during the last decade, portrayed this South American nation as one of the most visible 'poster children' of the so-called backlash against investment arbitration.[1] Indeed, Ecuador --like Argentina, Bolivia and Venezuela-- was a 'repeat player'[2] in the general arena of investment arbitration, but became particularly visible, with Venezuela, in the oil, gas and mining sectors.[3]

This anti-arbitration depiction should not be based merely on the number of claims brought against Ecuador before ICSID and other international arbitral venues or for their impact and media coverage.[4] Ecuador's active (and in some instances 'vocal') stand against conventional international dispute-resolution mechanisms and treaty-based arbitration must also be considered. The country engaged in issuing ideology-driven public policies and passed legislation based on the premise of jurisdictional immunity for sovereign nations, as enshrined in the international-law classic Calvo doctrine.

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1 M. Waibel, *The Backlash against Investment Arbitration: Perceptions and Reality* (Kluwer Law International, 2010). C. Schreuer, *Why Still ICSID*? 9 Transnational Dispute Management (2012).

2 G. Guerrero-Rocca, *Praising Calvo and Wearing Investors' Robes: A Case Study of Venezuela and its Strategy in Investment Treaty Arbitration in the Oil, Gas and Mining Sectors*. Stanford University, 2013.

3 In 13 out of the 26 investment-arbitration claims sought against Ecuador, the subject matter was oil (CAITISA report, p. 32).

4 For many years now, the case of Chevron (Texaco Petroleum Company) v. Ecuador ("Lago Agrio") has attracted the attention of major media outlets, environmentalists, practitioners and scholars and two resonant awards have been rendered against Ecuador by arbitral tribunals (*infra).* Another 'landmark' arbitral award against the nation was rendered in Occidental v. Ecuador (ICSID Case No. ARB /06/11).

Ecuador's anti-investment-arbitration measures included withdrawing from international bilateral investment treaties and the ICSID Convention, promoting the creation of sub-regional unconventional arbitral venues,[5] drafting an anti-investor 'model' for prospective bilateral treaties and even enacting a new constitution[6] which supposedly bars the nation from adopting any international instruments that contemplate treaty-based arbitration. In sum, Ecuador in a way flew in the face of all the recommendations prescribed by the orthodox playbook[7] for attracting foreign direct investment (FDI).[8]

Background

Major adverse awards (like, for instance, in the *Occidental* case)[9] are thought to have been a triggering factor for Ecuador embarking in a long journey against treaty-based arbitration (in general). That may have been the last straw for former President Correa, who issued an executive decree creating an interdisciplinary commission (CAITISA)[10] to undertake a comprehensive audit of all the BITs in force at the time.

The Ecuadorian Government systematically filed petitions requesting constitutional interpretation (in effect, challenges) by the Constitutional Court, as a prerequisite for denouncing international treaties. All of the Court's opinions (*dictámenes*) found that the BITs (under scrutiny) had become unconstitutional by virtue of Article 422 of the 2008 Constitution.

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[5] M. Gómez, *The South American way: Sub-regional integration under ALBA and UNASUR and international dispute resolution*. Hungarian Journal of Legal Studies 58.4 (2017): pp. 449-457.

[6] Article 422 of the Ecuadorian Constitution of 2008 states that "*Treaties or international instruments where the Ecuadorian State yields its sovereign jurisdiction to international arbitration venues in disputes involving contracts or trade between the State and natural persons or legal entities shall not be entered into.*"

[7] K. Sauvant *et al. The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows*. eds., Oxford University Press 2009.

[8] See G. Guerrero-Rocca, *In Case of Fire Please Denounce the ICSID Convention: The Socio-Legal Risks of Adopting a Pro State Approach Towards Articles 71-72 Dealing with Sovereign Repeat Players*, p. 129, World Arbitration & Mediation Review (WARM) Vol 11: No.2. 2017. Albeit important, prospective investors' option of seeking redress through treaty-based arbitration should not be seen as the main factor when deciding whether to proceed with FDI.

[9] In Occidental v. Ecuador (Oxy II, CIADI No. ARB/06/11/), claimants were awarded with USD 2.3 billion becoming the largest ever rendered by any ICSID panel. Eventually the value of the compensation was dramatically reduced by 40% by an ICSID-appointed committee which partially granted Ecuador's petition for annulment (Nov. 2015).

[10] On May 6, 2013, by issuing decree No. 1506 President Correa created the CAITISA (The Ecuadorian Citizens' Commission for a Comprehensive Audit of Investment Protection Treaties and of the International Arbitration System on Investments) to assess the costs and benefits of the remaining BITs in force

In 2017, based on the recommendations of the CAITISA Report (p. 99),[11] Ecuador finally terminated the last group of BITs (Argentina, Bolivia, Canada, Chile, China, Italy, Netherland, Spain, Peru, Switzerland, United States and Venezuela),[12] excluding the investor-State dispute settlement mechanism from any future treaty and, on the other, providing legal certainty to investors in national courts (p. 104).[13] Moreover, the CAITISA Report not only targeted investment-arbitration (in general), it also provided Ecuador with guidelines for drafting substantive provisions to be included in prospective bilateral investment treaties. In this way, the Report shaped the presumptive 'Ecuadorian model' for bilateral investment agreements (pp.100-104).

These 'guidelines' reflected both an anti-arbitration sentiment and a criticism of the substantive provisions generally contained in the vast majority of the BITs. Thus, it would appear that like other nations, Ecuador intended not only to diminish treaty-based investment arbitration as an alternative legal proceeding, but also to narrow the scope of investors' legitimate safeguards and guarantees.

A new beginning?

Amid a new wave of economic and political reforms led by the administration of recently-elected President Lenin Moreno, it seems that Ecuador is now leaning toward a more friendly 'pro-business' and 'pro-foreign investment' legal framework. In August 2018, Ecuador's National Assembly passed a few but significant amendments to the investment protection law, whereby new investors will receive tax incentives, features of the stock market's regulation have been eased and disputes arising out contracts and investments exceeding USD 10 million can be settled by investment arbitration. Moreover, according to the media, there has been speculation that Ecuador might be seeking a return to the ICSID Convention and that the government would continue negotiating new BITs with 30 countries.[14]

[11] http://caitisa.org/index.php/home/enlaces-de-interes
[12] http://caitisa.org/index.php/home/enlaces-de-interes
[13] According to the CAITISA Report "The Ecuadorian judicial branch is able to hear and to settle potential investment-related claims sought by foreign investors with transparency and impartiality" http://caitisa.org/index.php/home/enlaces-de-interes
[14] https://globalarbitrationreview.com/article/1173443/ecuador-gives-go-ahead-to-arbitration-of-investment-disputes

In June 2018, high-ranked members of both the executive and legislative branches have expressed their desire to pass an amendment to the constitution, by allowing treaty-based arbitration to attract FDI. Furthermore, the National Assembly approved the filing of a motion for interpretation of the constitution before the Constitutional Court[15] as to whether bilateral investment treaties are consistent or not with the general restriction prescribed in Article 422.[16]

The challenges ahead

Despite the promising 'pro-investor' willingness displayed by the new administration of President Moreno, its polices have brought widespread criticism from leftist politicians, who are still thought to be a very influential faction. Just recently, as has occurred before elsewhere in the region, Moreno's 'pro-business' policies have been labeled *"neoliberal"* and *"pro-imperialistic."*[17] At the time of writing, it is uncertain whether this new governmental trend ('pro-investment' and 'treaty- based arbitration'), as described above, will last in the midst of the newly rendered award against Ecuador by a state-investor arbitral tribunal in connection to the infamous *Lago Agrio (Chevron III)* case.

The award (PCA Case No. 2009-23, Aug 30, 2018, *Chevron III*) was rendered by an *ad-hoc* (UNCITRAL) international arbitral tribunal in The Hague (Permanent Court of Arbitration (PCA)), whereby Ecuador was found liable under the US-Ecuador Bilateral Investment Treaty. This is the second investment dispute in connection with this particular case. Ecuador was previously found liable (*Chevron II*) in an award rendered on August 31, 2011 (PCA Case No. 34877) for the 'undue delay' of the Ecuadorian courts in deciding seven pending court cases regarding the *Lago Agrio* dispute, and Ecuador had unsuccessfully sought a strategic inter-state arbitration before PCA (Case No. 2012-5, *Ecuador v. USA*) based on the interpretation of Article II (7) of the same BIT, subject to which the award in *Chevron II*' had been rendered.

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[15] This, despite the fact that the Ecuadorian Constitutional Court has decided this legal issue in the past (among other decisions, *Dictámen No. 26-10-DTI-CC case BIT Finland-Ecuador* rendered on July 29, 2010*; Dictámen No. 20-10-DTI-CC case BIT UK-Ecuador* and *Dictámen No. 23-10-DTI-CC case BIT Germany-Ecuador* all rendered on June 24, 2010). It seems that current political actors are seeking to reverse this approach. In the case of Venezuela, this hard-fought legal battle was settled by the landmark decision rendered by its Constitutional Chamber in October 2008 (Ruling No. 1541/2008) favoring the legality of treaty-based arbitration and Venezuela's adoption of international treaties providing alternative dispute resolution mechanisms.

[16] http://www.ecuavisa.com/articulo/noticias/politica/394076-prohibicion-acudir-arbitrajes-internacionales-sera-reformada

[17] https://cnnespanol.cnn.com/video/ecuador-marcha-apoyo-expresidente-rafael-correa-contra-lenin-moreno-live-ana-maria-canizares/

Specific steps

The recently implemented legal reforms, as described above, -in spite of not reestablishing ICSID investment arbitration as an available option- provide a self-imposed mandate on Ecuador to agree upon arbitral clauses governed by the rules of ICC, UNCITRAL *(ad hoc)* and the InterAmerican Commission for Commercial Arbitration. It is important to highlight here that according to the wording in the newly-enacted statute, where the Spanish word "*deberá*" (which translates to "shall" or "must")[18] is used, choosing between litigation and arbitration is not an alternative and therefore arbitration is the only valid option or settling investment-related disputes.

Accordingly, based on the mandatory nature of the legal term chosen by the statute as mentioned above, that provision must be deemed a 'functional equivalent' to (or at least a variation of) a 'unilateral offer' to opt for investment arbitration according to the accepted standards in the field of international arbitration and that is, by far, a nice way of snubbing Calvo's doctrine.[19] In fact, this Ecuadorian statute-based compulsory adoption of arbitral clauses must be applied regardless of consent-related external governmental procedures, such as the attorney-general's mandatory approval of public bidding processes.[20]

This type of statute-based compulsory arbitration is a useful feature for explaining different sources of investment arbitration (*i.e.*, treaty-based investment arbitration and investment agreement arbitration claims), and also for drawing a distinction between, on the one hand, contract-claims for breach of investment agreements (including stabilization clauses) and, on the other hand, claims for violation of both investment treaty provisions (treaty-claims) and international customary law.

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[18] "Shall. - As used in statutes, contracts, or the like, this word is generally imperative or mandatory. In common or ordinary parlance, and in its ordinary signification, the term "shall" is a word of command, and one which has always, or which must be given a compulsory meaning; denoting obligation. The word in ordinary usage means "must" and is inconsistent with a concept of discretion." Black's Law Dictionary, Sixth Edition. p. 1375. West Publishing CO. 1990.

[19] C. Schreuer, *Calvo's Grandchildren: The Return of Local Remedies in Investment Arbitration*, 4 Law & Prac. Int'l Cts. & Tribunals (2005). R. Shea, *The Calvo clause: a problem of inter-American and international law and diplomacy* (University of Minnesota Press. 1955). J. Alexander & D. Krishan, *Venezuelan Investment: Locating a Safehouse and Achieving a Reverse Calvo* 6 OGEL (2008).

[20] Article 190 of the Ecuadorian constitution of 2008 states that "*In public bidding processes, legal arbitration shall be accepted after a favorable ruling by the Attorney-General's Office, pursuant to the conditions provided in the law."*

Ecuador's offer of arbitration will awaken a new interest (in that country) and revisit to a wide range of contractual-type provisions to protect investors' legitimate expectations by obliging the state and state-owned companies to enter into formal and unambiguous assurances and undertakings. This is particularly relevant in the oil, gas and mining sectors where risks of volatility and unpredictability are far more significant.

The most frequent stabilization clauses are: i) those where the host-state or the state-owned company bears the fiscal risks ('allocation and exemption' clauses); ii) freezing clauses whereby the applicable law is 'frozen'[21] (also called 'stabilization clause *stricto sensu'*);[22] iii) 'intangibility clauses' which freeze contract terms; iv) clauses that 'contractualize' governing laws by repeating their provisions in the contract as an obligation of the host-state or the state-owned-company; v) 'renegotiation/adaptation'[23] clauses which provide contractual mechanisms to modify contracts in response to changes in the domestic legal framework or to face sudden economic variations; vi) 'mixed clauses' which combine features of more than one type of undertaking, and vii) 'good faith' clauses requiring both parties to perform the agreement in good faith and precluding unilateral modification or termination.

Regional benchmarking

As for regional benchmarking, in the case of Bolivia, that country passed its new law on the promotion of investments (Law No. 516, April 4, 2014) and issued Supreme Decrees (No. 2156 of October 23, 2014 and No. 2220 of December 17, 2014) to settle two relevant investment-arbitration claims filed by Red Eléctrica Internacional and Pan American Energy LLC, respectively. In 2015, Bolivia also passed its new Arbitration and Conciliation Law, whereby the State could adopt bilateral investment treaties and trade agreements providing investment dispute mechanisms but excluding similar settlements for contracts to be entered into with international entities for external financing.

[21] "In other words, it prevents any new or changed laws from having a detrimental effect on the rights guaranteed in the investor-state contract." C.E. Stewart (ed.), Commentary I.1 in *Transnational Contracts* (Oceana Publications, Inc. 1997). p. 293 in *Foreign Investment Disputes. Cases, Materials and Commentary*. Kluwer Law International. 2005.
[22] C. Curtis, *The Legal Security of Economic Development Agreements*, 29 Harv. Int'l L.J. 317 (1998). p. 295, footnote 164 *supra*.
[23] D. Bishop, J. Crawford, W. Reisman, *Foreign Investment Disputes*, footnote 164 *supra*, p. 303.

In the case of Venezuela, unlike that of Ecuador and Bolivia, the controversial and government-controlled National Constituent Assembly (which has been questioned as illegitimate) enacted a new investment law in December 2017 entitled "*Constitutional Law for Productive Foreign Investment.*" In general terms, this Law replicates the Decree-Law of 2014, by insisting on ordering that foreign investments be registered with the Foreign Investment Register as a pre-condition for obtaining the already reduced catalog of protections enshrined in that Law. Not surprisingly, its Article 6 replicates the previous Venezuelan Government's stance towards international dispute-resolution mechanisms by re-writing a *Calvo Clause*, introducing a minor mitigation by prescribing that "Venezuela may also participate in other dispute-resolution mechanisms" as long as they were "drafted (based) on the Latin-American and Caribbean integration process, and other integration mechanisms."

UNASUR's proposal - led by Ecuador - to create a venue to settle investment claims, is difficult and challenging for multiple reasons.[24] Sensitive subject matters such as health, environment, education and energy are excluded from settlement by arbitration unless member-states expressly agree to include them. Draft Rules also contain a provision allowing member-states to require the exhaustion of local remedies as a precondition for submitting the dispute to arbitration, which is *per se* a classical Calvo-doctrine premise. These signs certainly take the shine off the proposal for prospective investors, leading us to predict that its impact may be ineffective.

Conclusion

In sum, broad, positive and lasting results from these promising new Ecuadorian reforms will have to overcome some serious challenges: (i) potential political unrest generated by a recent arbitral award (*Chevron III*) against Ecuador in the litigation headache of the *Lago Agrio* case; (ii) political pressure by opponents of President Lenin Moreno; (iii) the question as to whether the Constitutional Court will reverse its 'anti investment-arbitration' approach, thus unblocking the adoption of new BITs; and/or (iv) the possibility of a constitutional amendment being passed by the National Assembly in order to revisit Constitution Article 422.

Until Ecuador re-embarks on an effective process of adoption of new BITs, investment agreements containing stabilization clauses, undertakings and assurances, seem to be the more plausible means of protecting investors' legitimate expectations.

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[24] M. Gomez, *The South American way*, supra note 5.