PROCURADURÍA GENERAL DEL ESTADO
ECUADOR

A CRITICAL VIEW OF INVESTMENT ARBITRATION BASED ON ECUADORIAN EXPERIENCE

• MANAGEMENT 2008 - 2016 • DIEGO GARCÍA CARRIÓN

FOR THE LEGAL DEFENSE OF
THE REPUBLIC OF ECUADOR

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This edition is a product of the Attorney General's Office, directed and supervised by Dr. Diego García Carrión, Attorney General, coordinated by Dra. Blanca Gomez de la Torre, Director of International Affairs and National Arbitration and Dra. Christel Gaibor, Deputy Director of International Affairs, with the support of the legal team of the Department of International Affairs and Arbitration.

Quito, August 2016

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http://www.pge.gob.ec

Prologue

On the eighty eighth anniversary of the creation of the State Attorney General's Office, we hereby present this new publication: "A Critical View of Investment Arbitration Base on Ecuadorian Experience." This publication shows our citizens and the international community a particular perspective of the Investment Dispute Settlement System, pursuant to our analysis of the elements in the system and our cumulative experience during these 8 years of efforts. An era precisely characterized by the fact that international disputes arising from Bilateral Investment Treaties underwent their greatest evolution.

This book is part of the trilogy of institutional investment dispute settlement publications, in hand with the 2014 publication "Oxy Case: The Defense of a Sovereign and Legal Decision of the Ecuadorian State" and the 2015 publication "Chevron Case: Ecuador's Defense on the Claimants Abuse of Process in International Investment Arbitration."

While the two previous publications addressed specific investment arbitration cases to which Ecuador was a party, this new publication addresses the analysis of the system from the perspective of the State of Ecuador's defense and its particular experience defending cases over the past 8 years.

When I took office as State Attorney General, Ecuador had 7 pending investment arbitration cases. Oxy I and Encana had already ended. Oxy II and Chevron II were in their initial stages, and MCI, Duke Energy, and Emelec were further along. The Burlington and Perenco arbitration cases had just begun. Subsequently, Merck, Unete (Globalnet), Ulyseas, Chevron III, Copper Mesa and Murphy were brought.

Since then, both Oxy II and Chevron II ended and the other arbitration cases progressed to the point of having concluded or being in their last stages of discussion. The gained experience by the State Attorney General's Office through Ecuador's defense in these investment arbitration cases is – then – substantially different to the institution's experience before April 2008. In fact, in no other stage during these 88 years of existence, has the Office of the Attorney General's docket ever had

cases of such complexity or cases that involved such immense monetary amounts in dispute as those that we had to manage during recent years. We achieved important results during this stage, such as the dismissal of the annulment request in the MCI Award, brought by the investor after the award favored Ecuador; dismissal of EMELEC's arbitration claims, presented by Miguel Lluco, claiming U.S. $ 1,072,694,359.17 or Ullyseas, in which the claimant sought a compensatory award in the amount of U.S. $ 56,100,000.00.

The discussion and final decision issued by the Arbitral Tribunal in Chevron II were important steps and results for Ecuador's defense. The Arbitral Tribunal reduced the partial award from U.S. $698'621.904,84 to U.S. $ 96,355,369.00, a 86% decrease as a result of the embracement of Ecuador's thesis regarding the impact of tax legislation on the compensation amount; as well as the presented arguments against the award in Oxy II, which were adopted by the Annulment Committee when it partially annulled the award by reducing the compensation from U.S. $1,769,625,000.00 to U.S. $ 1,061,775,000.00, equal to 40% - up until then, the greatest reduction of an award by an annulment.

Equally important were the initiatives of Ecuador's legal defense when demanding an interpretation of the United States - Ecuador Bilateral Treaty concerning the Encouragement and Reciprocal Protection of Investment, to determine the scope of the effective means standard in the administration of justice. It is worth noting that this occured after the Chevron II award, which the Tribunal did not resolve and was the subject of a strong dissenting opinion submitted by Prof. Vinueza; as well as the submission of environmental counterclaims in the Perenco and Burlington arbitration cases – companies that created a consortium to operate two oil blocks in the Ecuadorian Amazon. In these cases, the Arbitral Tribunal found signs of the consortium operator's liability of the damages found in the area. Through these cases, Ecuador has lived and suffered the consequences of the system's issues, including: inconsistencies, disrespect for Ecuadorian laws, and disregard of the State's regulatory power.

Furthermore, during this period, two Arbitral Tribunals conducted site visits to Ecuador in the Chevron III and Burlington cases, in order to confirm the environmental harm caused by the oil operators during their presence in Ecuador.

The gained experience and strength of the Ecuadorian State legal defense,, have now achieved an excellent reputation and the respect in the arbitration system. Ecuador's cases have been presented in various academic centers of renowned global prestige, such as Yale, Georgetown or Columbia in the United States, University Paris 1 Pantheon Sorbone, UCL, Oxford, Cambridge

and Utrecht in Europe, and Universidad de Chile, Católica de Chile and Universidad Externado de Colombia.

Two equally successful events were organized along with the defense teams of a series of Latin-American countries, with the presence of State Attorney Generals and attorneys from 14 countries in the region, sharing experiences to strengthen the structures and legal defense teams in fellow countries. This is added to the close collaboration with Bolivia's State Attorney General's Office, with whom we have exchanged administrative and legal information to defend our cases.

The State of Ecuador's defense team has been subject to great professional growth through its defense work. Despite its budgetary limitations and the fact that it cannot compete with private attorney salaries, it has trained attorneys who are able to face the enormous challenges that we must endure, with sufficient professional capacity.

In this context, the experience is a plus point in favor of Ecuador's defense that we cannot overlook and should lead to results beyond the management of specific cases to our mandate and beyond the limits of the Ecuadorian territory. The cases and arguments that we have set forth in defense of the State and their effect on the decisions adopted by Arbitration Tribunals will continue to be quoted in other future cases at a global level. Other countries will support their positions on our arguments and the awards issued in Ecuador's cases. Academics and researches will cite them.

Two aspects motivated the State Attorney General's Office to share its knowledge and experience in international litigation through this publication: The first, the need to expose Ecuadorian citizens to the system's operation, so that they can understand how the State's defense had to defend the State's interests in this complex world of international arbitration; and, the second, Ecuador's need to impart this knowledge and experience as a contribution, as part of the international community, to propose changes to investor-State dispute settlement mechanism, so that this system becomes a proper justice system, with greater balance and compliance to the law and the parties' agreements, consistently resolving the disputes submitted thereto.

Ecuador has long been making observations and comments regarding the system's operation and deficiencies. Personally, I have been making observations and proposals regarding system reforms at various international events during the last 4 years. The State of Ecuador's isolated voice, however, has long ceased to be alone,

to the point that international conferences no longer discuss whether the system has problems instead they now address the changes that it requires. Some countries and international bodies have made similar criticisms over the past few years. One has merely to look at reports issued by UNCTAD and its initiative to reform the system or the European Union's observations in its discussion of the various international instruments that have yet to be signed.

This makes a lot of sense if we consider that the problems faced by Ecuador over the past 8 years are now starting to be experienced by capital-exporting countries. The new disputes that states of the European Union are currently facing– disputes that others may face tomorrow – show that international discussion on this subject is necessary. Many are concerned at how tribunals address domestic laws, the State's regulatory powers or the actions of domestic judiciaries, when these are analyzed in the context of an investor claim.

Others will show similar concern regarding arbitrators' actions and their omnipotent power to resolve without any possibility to challenge their awards and given the absence of case law addressing contradictory decisions on the same facts or the ambiguous application of insufficient and unclearly defined protection standards.

This publication seeks to focus on the main criticisms and observations made by Ecuador's legal defense, international practice and academia's work, with specific examples and references to cases that Ecuador has been entrusted to manage, in hands with comments and proposals to improve the investment dispute settlement system.

Dr. Diego García Carrión

Attorney General of the Republic of Ecuador
Quito, August 2016

CHAPTER I

INTRODUCTION

The investor-State dispute resolution mechanism

The majority of International Investment Agreements (IIA's) provide a series of dispute resolution mechanisms between investors and host States, either through direct negotiation, resorting to *"the courts or administrative tribunals of the Party that is party to the dispute," "in accordance with any applicable, previously agreed dispute settlement procedure,"*[1] or by resorting to a managed or ad-hoc arbitration.

However, although the other alternatives are available, arbitration was chosen as the main means of dispute resolution. Given its unusual features, investor-State arbitration is perhaps the only case where an investor can use an arbitration agreement signed by a third party, its State of nationality, against another State, the investment's recipient. In contrast to judicial decisions, arbitration resolves a dispute brought by an investor, through a tribunal that issues a final, single and un-appealable decision, subject to the limitations determined by annulment.[2]

Many Investor-State disputes have been settled through this mechanism – and this number increases significantly each year. According to UNCTAD, the number of cases processed increased from 608 to 696 between 2014 and 2015 alone, according to the most recent information on its website on the date of publication of this piece.[3]

In turn, since 2004, the State of Ecuador has faced 27 investment arbitration cases, as per the following list:

STATE ATTORNEY GENERAL'S OFFICE – INVESTMENT ARBITRATIONS

	PLAINTIFF	RESULT	BEGINNING	END
1	Encana	Favorable End	14-mar-03	03-feb-06
2	OXY I	Partially Favorable End	11-nov-02	04-jul-07
3	IBM	Ended Friendly Settlement	06-sep-02	22-jul-04
4	Unete	Ended Friendly Settlement	10-jun-09	12-jun-13
5	Quiport	Ended Friendly Settlement	12-ago-09	11-nov-11

1• Article 6, Treaty between the Republic of Ecuador and the United States of America for the promotion and reciprocal protection of investments, August 27th, 1993.
2• Foreign Trade Information System, OAS, http://www.sice.oas.org/default_p.asp; last visit on July 27th, 2016.
3• See http://investmentpolicyhub.unctad.org/ISDS?status=1000. Last visit on July 27th, 2016.

6	Machala Power	Ended Friendly Settlement	17-mar-05	20-may-09
7	City Oriente	Ended Friendly Settlement	10-oct-06	12-sep-08
8	Repsol II	Ended Friendly Settlement	05-oct-01	08-ene-07
9	Ulysseas	Favorable End	08-may-09	12-jun-12
10	Murphy I	Favorable End	15-abr-08	15-dic-10
11	Murphy II	Favorable End	30-dic-10	19-ago-11
12	MCI	Favorable End	16-dic-02	19-oct-09
13	Emelec	Favorable End	13-dic-04	02-jun-09
14	Técnicas Reunidas S.A.	Ended Withdrawal	31-oct-06	13-may-08
15	Chevron II	Unfavorable End	21-dic-06	26-sep-14
16	TBI Ecuador - EUA	Unfavorable End	28-jun-11	29-sep-12
17	OXY II	Partially Favorable End	17-may-06	02-nov-15
18	Duke Energy	Partially Favorable End	30-ago-04	18-ago-08
19	Merck Sharp & Dohme	Active	29-nov-11	
20	RSM Company	Active	13-may-10	
21	COPPER MESA	Active	21-ene-11	
22	Zamora Gold	Active	11-jul-11	
23	Chevron III	Active	09-oct-07	
24	Burlington	Active	21-abr-08	
25	Perenco	Active	30-abr-08	
26	Murphy III	Active	30-sep-11	
27	GLP	Active	01-jul-15	
28	ALBACORA	Active	04-abr-16	

There are a series of characteristic features of Investor-State international disputes:

- *"In a dispute between an investor and a State – whether it is the central government itself or subnational entities – the sovereign State participates as the defendant (Muchlinski, 2007; Sornarajah, 2004). Thus, the parties are different from other types of arbitration where all parties are commercial entities, as in the case of commercial arbitration. The dispute can arise from a series of measures or acts adopted by lower levels of government or by public bodies that must respect the provisions of the IIAs, despite not having singed them. This can lead to interagency differences at the core of government, and lead to difficulties for a timely State response to the problem and to the investor's proper identification of the appropriate defendant.*

- *The foreign investor will challenge the sovereign State's acts and measures or those of its state entity, (or the omission of appropriate actions), in their sovereign capacity. Thus, the challenged measures or acts are specific. The dispute will often cover matters of public policy and will turn on the State's ability to regulate for the public interest – even when it can harm private interests such as those belonging to a foreign entity. A dispute can turn easily into a political matter for the State, even at an international level – for example, when environmental or emergency measures are challenged to address a financial crisis. This is further criticized when there are many public funds at issue. Further, the recent trend in the framework of IIAs and SCIE rules of increasing investment policy transparency makes it easier for civil society and other groups to review SCIE cases and voice their concerns.*

- *Applicable law is also specific, as the dispute is governed by international law and based on a violation an international instrument, which also constitutes one of the sources of international law – that is, an investment treaty.*

- *It also has different available resources. Contrary to the principles of international law and ordinary legal disputes, the Investor-State dispute resolution mechanism is based on international arbitration as the main option for the injured foreign investor. The great majority of IIAs offer the foreign investor – as main protection body – the ability to resort to international arbitration with ICSID or ad hoc arbitration pursuant to UNCITRAL's Rules. On occasion, IIAs do not even require resorting to the domestic courts of the host country. Similar dispute resolution provisions can be found in concession contracts, privatization plans, stabilization agreements, or ordinary public contracts, pursuant to which purported violations are not required to be submitted with*

domestic courts, but international tribunals instead.

- *The long-term relationship of the litigants is yet another distinctive feature of disputes among investors and States, and it often involves a complex relationship between the two parties, derived from a mutual dependence. For example, a country's population could depend on a private foreign investor to provide public services, while the investor likely contributed substantial capital to a company, whose performance will only be feasible after a series of years. As a result, the investor and the State may be forced to maintain a good working relationship, despite the dispute (UNCTAD, 2008a; Salacuse, 2007).*

- *Lastly, the amounts at issue in investor and State disputes are usually very large, on average, much larger than those in commercial arbitration. Thus, the large sums of money involved in investor and State arbitration often constitute a considerable burden for the relevant governments (Salacuse, 2007)."* [4]

1.2 Historical development

International arbitration as a dispute resolution mechanism arose as an alternative given investors' mistrust of domestic courts in host countries and the ineffectiveness – as they claimed -- of diplomatic protection. Until 1959, when the Bilateral Investment Protection Treaty was signed between Germany and Pakistan, these were the only two choices for an investor.

As one of their justifications, the investors used the results obtained in the *Barcelona Traction* case[5], in which the International Court of Justice rules on a claim presented by the Government of Belgium for the compensation of harm caused to Barcelona Traction, Light and Power Company Limited, for acts committed by the Spanish State in violation of international law. In this case, the court denied Belgium's claim because it held that because

4• UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT, *Disputes between investors and states: Prevention and Alternatives to Arbitration,* United Nations, New York and Geneva, 2010. pp. 9-11.

5• International Court of Justice, Barcelona Traction, Light and Power Company Limited - Belgium vs. Spain, 1970, ICJ, February 5th, 1970, paragraph 33. English Text:

> "When a State admits into its territory foreign investments or foreign nationals, whether natural or juristic persons, it is bound to extend to them the protection of the law and assumes obligations concerning the treatment to be afforded them. These obligations, however, are neither absolute nor unqualified. In particular, an essential distinction should be drawn between the obligations of a State towards the international community as a whole, and those arising vis-a-vis another State in the field of diplomatic protection. By their very nature the former are the concern of all States. In view of the importance of the rights involved, all States can be held to have a legal interest in their protection; they are obligations *erga omnes*."

the company was Canadian, the government of Canada should have protected its national and refused to accept Belgium's appearance to claim the protection of the company's shareholder rights.

Therefore, the tribunal considered the following:

- **Access to international justice can only be obtained through the State's discretional decision of the claimant's National state. -** Diplomatic protection can be exercised by a State through any means and with the coverage that it deems adequate, because it is the State that is exercising its right. If natural or legal persons on behalf of whom the State intervenes consider that their rights have not been adequately protected, they have no recourse under international law. The State is the only judge to decide whether it shall provide protection and when it will be interrupted. It has, at that point, the discretionary power to exercise it.

- **Corporate entities are subject to domestic jurisdiction. –** The source of diplomatic protection is closely linked to international trade. However, the economic lives of nations have undergone profound changes that have given rise to national institutions that transcend borders and have started to exercise considerable influence in foreign affairs. Corporate entities constitute one of these phenomena. Thus, international law has had to recognize corporate entities as State-created institutions within a scope that is essentially covered by their domestic jurisdiction. Therefore, when international law must address matters that involve them, it must refer to the relevant domestic law.

- **The companies have a distinctive legal personality, different to that of their shareholders. –** The idea and structure of the companies is based and determined by a firm distinction between the individual nature of the company and the shareholder, each with a distinct set of rights. The separation of the rights to property among the company and the shareholder is an important expression of this distinction.

- **The shareholder cannot exercise the company's right to claim damages. –** Despite the separation in corporate persons, harm to the company often harms the shareholders. However, although the harm affects both the company as well as the shareholder, this does not imply that both have the power to claim compensation. From a legal perspective, the question is whether it is lawful to identify an attack on the company's rights, and the ensuing harm to shareholders, with the direct violation of their rights.

- **Only the State of which the company is a national can trigger diplomatic protection.** –Traditional law grants diplomatic protection to a company from the State under whose laws it incorporated and in which it has registered its domicile. If an unlawful act is committed against a company with foreign capital, the general rule of international law solely authorizes the State of whom the company is a national to submit the claim.

- **Shareholder protection requires an express agreement between a State and its investors.** – In the present development of the law, shareholder protection requires an existence of specific provisions in treaties or special agreements signed by the investor and the State where the investment is made.

- **Providing diplomatic protection to shareholders of a company will create legal insecurity.** - The Court considers that the adoption of the theory of giving diplomatic protection to shareholders as such opens the door to parallel diplomatic claims and could create an atmosphere of confusion and insecurity in international economic relationships. The danger would be greater to the extent that companies with international activities are broadly dispersed and frequently change ownership.

The history of investor-State[6] dispute resolution can be depicted with greater accuracy at the following times:

1. **Diplomatic protection (Gunboat diplomacy):** Given a dispute in the territory of a host State, the States of origin would intervene in favor of their investors,[7] as held by the Permanent Court of International Justice, the defense of one of its citizens constituted the defense of the State in itself: "By taking up the case of one of its subjects and by resorting to diplomatic action or international judicial proceedings on his behalf, a State is in reality asserting its own rights-its right to ensure, in the person of its subjects, respect for

6• BISHOP Doak, CRAWFORD James and REISMAN Michael, *Foreign Investment Disputes - Cases, materials and commentary*, Kluwer Law International, 2005. pp. 2-7.

7• UNCTAD, Center for Settlement of Investment Disputes, *Course On Dispute Settlement International,* New York and Geneva, 2003. "Diplomatic protection is a frequently used method to settle investment disputes. It requires the espousal of the investor's claim by his home State and the pursuit of this claim against the host State. This may be done through negotiations or through litigation between the two States before an international court or arbitral tribunal. But diplomatic protection has several disadvantages. The investor must have exhausted all local remedies in the host country. Moreover, diplomatic protection is discretionary and the investor has no right to it. Also, diplomatic protection is unpopular with States against which it is exercised and may lead to tensions in the relations of the States concerned."

8• Permanent Court of International Justice, Mavrommatis Palestinian Concessions, Greece vs. UK, August 30th, 1924, Series A, No. 2, pp. 12.

the rules of international law…"[8] This diplomatic protection disturbed the international affairs between States. Usually, developing countries were pressured by industrialized countries that defended their investors. This pressure was exercised both on a bilateral and a multilateral level, through economic reprisals and other intimidation practices, commonly referred to as "cannon diplomacy."

2. **The Calvo Doctrine (1868):** Argentine commentator, Carlos Calvo, defended a proposal that the host State should reduce the protection for foreign property, rejecting special treatment for foreign property and thereby denying the right to diplomatic protection. The Calvo Doctrine considered the latter *"an undesirable and even inadmissible interference in a State's internal affairs."*[9] Calvo advocated for maintaining a standard of treatment for foreign property associated with a State's national laws, such that if the State reduced protection for domestic private property, it could also reduce protection for foreign property. The Calvo Doctrine achieved great popularity in Latin America towards the end of the 19th century and beginning of the 20th century, as a reaction to coercive and intimidation measures, as well as threats of the use of force from industrialized countries.[10] Until the mid-20th century, the Calvo Doctrine held an important place as an international legal standard and many States invoked it in their disputes with foreigners. This is the case of the Soviet Union after the 1917 Russian Revolution, when it expropriated the property of its nationals and foreigners and as this led to a series of international lawsuits, including the arbitration brought against it by British company Lena Goldfields, Ltd. In this case, the idea of domestic treatment to foreigners, as conceived by the Calvo Doctrine, was used as one of the Soviet State's defense arguments.

3. **Drago-Porter Convention (1907):** Imposed restrictions on the use of military force to collect on public debt.

4. **Post World War I:** after the creation of the Permanent Court of International Justice, three important investment arbitration cases were submitted with this Court: Oscar Chinn,

9• DOLZER Rudolf and SCHREUER Christoph, *Principles of International Investment Law,* Oxford, 2012, pp. 233.

10• TAMBURINI, Francesco, *Historia y Destino de la "Doctrina Calvo":¿Actualidad u obsolencia del pensamiento de Carlos Calvo?,* Valparaiso, Rev. estud. hist.-juríd. n.24, 2002, http://dx.doi.org/10.4067/S0716-54552002002400005, last visited on July 27th, 2016.

11• Permanent Court of International Justice, Complaint against Belgium for the Belgian government subsidies to Belgian companies to the detriment of Oscar Chinn's river transport business, Oscar Chinn – British citizen, Britain vs. Belgium. Ser. A / B No. 70, December 12th,1934. Chorzow Factory: Germany vs. Poland, (1927) P.C.I.J., Ser. A, No. 9. Permanent Court of International Justice. Mavrommatis Palestine Concessions: Greece vs. UK; Permanent Court of International Justice, 1924.

Chorzow Factory and Mavrommatis Palestine Concessions. [11]

5. **Post World War II:** Investment disputes arose from the imposition of socialist models in Eastern Europe, the independence of ancient colonies and nationalization proceedings embarked on by a series of countries both in Western Europe as well as the Middle East and the Americas. There were many unsuccessful attempts to regulate foreign investments through international agreements, such as the Habana Charter or the Bogota Economic Convention. During the 50s, many countries, including Ecuador,[12] were involved in the signature of Bilateral Friendship, Commerce and Navigation Treaties that, as suggested by their names, regulated a series of matters including human rights, commerce and investment protection. During this decade and the next, the International Court of Justice (ICJ) declared that it did not have jurisdiction on a series of investment cases submitted therein.

6. The Convention on the Settlement of Investment Disputes between States and Nationals (known as the Washington Convention) entered into force in 1966, and created the International Centre for Settlement of Investment Disputes (ICSID), in order to manage disputes regarding investments that exist among States party to the Convention and nationals of other States. ICSID processed the first investor- State dispute based on BIT in 1987.

7. At the same time, during the 60s and 70s, a new investment protection era began, as parties began signing international investment agreements, essentially motivated by an increase of oil concessions in developing countries. Thus, the first bilateral investment treaty (BIT) was signed between Germany and Pakistan in 1959. The other European capital exporting countries followed Germany. The first treaties that were signed were essentially with African and Asian counties. During the 80s, this extended to countries in Southeast Asia, Central and Eastern Europe. In the 90s, a series of Latin American countries entered this list.[13]

A series of investment agreement arose during the 90s:

- The Lome Convention signed between

12• Ecuador signed Bilateral Friendship, Commerce and Navigation Treaties with: Mexico, Brazil, Belgium, Colombia, Spain, New Granada, Peru, Bolivia, Chile, United States, Britain, Costa Rica, France, Guatemala, Netherlands, Italy, Japan, Nicaragua, Switzerland, West Germany, Poland, El Salvador and Venezuela.

13• GRANATO Leonardo, *Protección del Inversor Extranjero en los Tratados Bilaterales de Inversion*. Argentina, edited by Juan Carlos Martínez Coll.

the European Community and African, Caribbean and Pacific.

- The North American Free Trade Agreement **(NAFTA)** signed between the Government of Canada, the Government of the United Mexican States and the Government of the United States of America to create a free trade zone.
- The Treaty on the Energy Charter ratified by the European Community and its Member States.

In its 2015 Annual Investments Report, UNCTAD disclosed that the 3,276 Investment Agreements were in force.

1.3 International Investment Law

Since inception, International Investment Law (IIL) was considered a "systematic package' convened by developing and developed states that had sought to promote economic law.

From a teleological perspective, the protection of foreign investors has always been justified as a key reason to promote economic development. Foreign international investment law rules can be accepted as principles of international law, provided that they are based on an accepted source of public international law. These sources of public international law are included in article 38(2) of the Statute of the International Court of Justice:[14]

Treaties

Multilateral treaties are a source of international law. And, within the subject of investment, a series of treaties have referenced this matter, although with limited success.

Created in 1995, the World Trade Organization set a precedent for foreign investments that was not adopted by every State, as they contained principles that were favorable only to capital-exporting countries to the detriment of developing countries.

In the 90s, the Organisation for Economic Co-operation and Development (OECD) attempted to create a Multilateral Investments Agreement that was not adopted by developed countries and caused the rejection of certain NGO's that argued that the project only considered the interests of multinational corporation.

To date, the 1965 Washington Convention has been the most widely accepted treaty, although its nature is mostly procedural, as it institutionalizes the investment dispute resolution mechanism through arbitration.

14• SORNARAJAH M., *The international law on foreign investment,* Cambridge University Press, 2004. p. 87.

On a regional level, the North American Free Trade Agreement (NAFTA) among the United States, Mexico and Canada is worth mentioning, as it created a framework for the free movement of investments among its member states. The treaty provides for a dispute resolution mechanism for disputes between investors and States.

The ASEAN Treaty is another important multilateral agreement (Association of Southeast Asian Nations) for the protection and promotion of foreign investments, which solely protects approved investments and thus creates a strong regulation of foreign investment.

In Latin America, MERCOSUR has embarked on a series of efforts geared towards protecting promoting investments. In 1994, the Protocols of Colonia for the Reciprocal Promotion and Protection of Investments and the Protocol of Buenos Aires on the Promotion and Protection of Investments Coming from Non-Mercosur State Parties were adopted, however none of them entered into force. In 2010, via Decision 30/10 of the Common Market Council, the Guidelines on the Conduct of an Investment Agreement in Mercosur were approved, annulling the Protocols of Colonia and Buenos Aires. As part of this decision, Subgroup No. 12 "Investment" submitted a proposal which reflected the following guidelines:

1. The scope of application would be foreign investment in goods;
2. Among the main obligation, the parties must establish rules regarding national treatment, transparency, national and personal regulations;
3. The scope of disciplines regarding protection in matters of expropriation must be determined;
4. The modality of consignment of commitments must be defined;
5. The parties must establish a modality of lifting of the restrictions that will be detailed by a list;
6. The parties shall agree on a common classification to consign commitments;
7. The dispute resolution mechanisms must be based on the State- State model, based on the *Olivos Protocol*;
8. The conditions for the free transfer of capital must be established, and
9. With respect to the entry into force, bilateral validity shall be provided.

Further, the Andean Community of Nations has issued regulations regarding investment, as follows:

> *"The Andean Community includes a* ***Common Investment Regime*** *approved through* ***Decision 291****, that ensures equal and non-discriminatory treatment for foreign investment and grants Member States the freedom to define their investment policies through their respective domestic laws.*
>
> *Thus, a special regime was established for* ***Empresas Multinacionales Andinas*** *[Andean Multinational Companies]* ***(EMAs for short)***

*that, according to **Decision 292** are defined as such pursuant to which at least 60% of the corporate equity belongs to investors of two or more countries of the Andean Community. These companies were granted national treatment in matters of public acquisitions of goods and services; the right to freely convertible remission of all the dividends distributed currencies; national treatment in tax matters and the right to establish branches in other member countries.*

***Decision 578** is another important contribution to the promotion of Andean Community Investment. It establishes a **Regime to avoid Double Taxation and Prevent Tax Evasion.** This regime applies to persons who are domiciled in any of the Member Countries, regarding taxes on income and estate. The purpose of the rule is to avoid double taxation on the same income or estates at the community level. In this sense, the income shall only be taxable in the Member Country in which the income was produced and the other countries with power to tax these revenues must exempt them."*[15]

However, the most common investment treaty practice has been at the bilateral level and most recently, on multilateral and regional treaties.

According to the Global Investment Report, edited by UNCTAD, there are 3276 signed investment agreements.[16]

During the 90s, Ecuador signed 29 Investment Protection Treaties, and 16 are in force today. A closer look shows that they have served as the basis for the arbitration cases brought against Ecuador, as well as the petition that was made by the Tribunals and which will be addressed by chapter III of this publication.

Customary International Law

Opinio juris, accepted as obligatory by the international community, constitutes a source of international law.

Thus, this category includes the resolutions issued by the General Assembly of the United Nations that constitute "instant customary law" as they show the *opinio juris* of the international

15• http://www.comunidadandina.org/Seccion.aspx?id=91&tipo=TE&title=inversiones; last visit on July 27th, 2016.
16• http://unctad.org/en/PublicationsLibrary/wir2015_en.pdf, last visit on July 27th, 2016.
17• The most well-known UN resolutions have been: (i) Resolution of permanent sovereignty over natural resources in the Charter of Economic Rights and Duties of States (resolution 1803 (XVIII) of the General Assembly of 14 December 1962; and (ii) Charter of Economic Rights and Duties of States, Resolution 3281 (XXXIX) of December 12th, 1974.

community, which is adopted in areas not addressed by domestic laws – in other words, it is auxiliary.[17]

The opinions of individual experts and arbitrators also constitute a subsidiary source of (IIL).

General Principles of Law

The scope of these principles is more limited than previous sources. The general principles are based on general principles of law (IIL), such as the notions of unjust enrichment in expropriations, of acquired rights, and equity. Although these general principles of law make a positive contribution to legal framework, one must recall the high degree of subjectivity that they involve, when used a priori to demonstrate the arguments set forth by the parties.

Arbitration Tribunals commonly tend to use general principles of law applicable to investment agreements. The general principles have acquired a formative role for the rules in the area of the protection of foreign investments.

Case law

Judicial decisions are subsidiary sources of international law. Despite their subsidiary nature, the decisions of the International Court of Justice and its predecessors have had, throughout time, great influence on the creation of the general principles of law.

Arbitration awards issued for disputes and settlements of foreign investments also contribute to the framework, especially awards that are issued by institutional tribunals, which provide evidence of possible rules that could be used to build IIL rules, although they are not strictu sensu, binding case law.

CHAPTER II

International Investment Agreements (IIAs)

Historical development

Prior to the birth and expansion of IIAs and Bilateral Investment Protection Treaties in particular, investor protection stemmed almost exclusively from customary international law, marked by a series of eras that span the prevalence of diplomatic protection and national treatment, the application of the Calvo doctrine and end with the application of the minimum international standard.

The latter was a reaction by industrialized countries to the application of the Calvo document. Its fundamental criticism held that a standard tied to domestic law could suddenly change from a regime with strong guarantees to a regime having no protections for the investor, who is also vulnerable to local law reforms as it does not participate in the internal politics of the host country, either through elections, popular referenda, or participation in legal reform proceedings, among other matters.[18]

Thus, the international courts of the time have slowly recognized that minimum international standards include are rules that are independent from the internal rules of the host State, and that protect foreigners.[19] In matters of investment protection, these rules were found in international custom.

International custom provided the fundamental rules that would be subsequently picked up by bilateral investment treaties (BITs) as of the second half of the XX century.

The "Hull formula" for expropriation cases is one of the clearest examples of a minimum international standard, which has been incorporated in the majority of BITs worldwide.

The Hull formula was developed in 1938 by then U.S. Secretary of State, Cordell Hull. In the context of the nationalization of the Mexican oil industry that was promoted by president Lázaro Cárdenas, Secretary Hull sent a famous diplomatic letter to his Mexican counterpart in which he held that the rules of international law allowed the expropriation of foreign property, though subject to a prompt, adequate and effective compensation. Since then, the Hull formula has been generally accepted in international law as one of the requirements for a State to have the ability to expropriate an asset without incurring international liability.

Although regional treaties with investment chapters are increasingly common today; in general, the rules that govern relationships between investors and host states receiving foreign investment have developed at a bilateral level.

18• European Court of Human Rights, James et al. vs. United Kingdom, Application no. 7601/76; 7806/77, 1986, par. 63.

19• United Nations, *Reports of International Arbitral Awards*, L.F.H. Neer and Pauline Neer (U.S.A.) vs. United Mexican States, U.S. vs. Mexico, Mexico General Claims Commission, 4 R.I.A.A. 60 (1926), October 15th, 1926.

From 1959 (until 1999) bilateral investment treaties (BITs) emerged as the first international agreements that were exclusively focused on the treatment of foreign investment and the main source of regulation of Investor-State relationships.

The attention of industrialized countries that promoted their signature during this period (1959-1999) (Germany, United States, Switzerland, France, among others) was focused on including all the standards of protection gleaned from customary international law.

Since that time, until now, much road has been covered and many changes made to IIAs as a result of the circumstances and economic, political, social and technological challenges faced throughout the world.

In its 2015 World Report on Investment, in referencing this evolution, UNCTAD identifies four stages:

1950 – 1964 Era of Infancy	1965-1989 Era of Dichotomy	1990-2007 Era of proliferation	2008- to date Era of reorientation
New IIAs: 37 Total IIAs: 37 New ISDS cases: 0 Total ISDS cases: 0	New IIAs: 367 Total IIAs: 404 New ISDS cases: 1 Total ISDS cases: 1	New IIAs: 2663 Total IIAs: 3067 Total ISDS cases: 291 Total ISDS cases: 292	New IIAs: 410 Total IIAs: 3271 Total ISDS cases: 316 Total ISDS cases: 608
Emergence of IIAs (weak protection no ISDS)	• Enhanced protection and ISDS in IIAs • Codes of conduct for investors	• Proliferation of IIAs • Liberalization components • Expansion of ISDS	• Shift from BITs to regional IIAs • Decline in annual IIAs • Exit and revision
GATT (1947) Draft Havana Charter (1948) Treaty establishing the European Economic Community (1957) New York Convention (1958) First BIT between Germany and Pakistan (1959) OECD Liberalization Codes (1961) UN Resolution on Permanent Sovereignty over Natural Resources (1962)	CSID (1965) UNCITRAL (1966) First BIT with ISDS between Netherlands and Indonesia (1968) Draft UN Code of Conduct on TNCs (1973–1993) UN Declaration on the Establishment of a NIEO (1974) Draft UN Code of Conduct on Transfer of Technology (1974–1985) OECD Guidelines for MNEs (1976) MIGA Convention (1985)	World Bank Guidelines for treatment of FDI (1992) NAFTA (1992) APEC Investment Principles (1994) Energy Charter Treaty (1994) Draft OECD MAI (1995–1998) WTO (GATS, TRIMs, TRIPS) (1994) WTO Working Group on Trade and Investment (1996–2003)	EU Lisbon Treaty (2007) UN Guiding Principles on Business and Human Rights (2011) UNCTAD Investment Policy Framework (2012) UN Transparency Convention (2014)
Independence movements	**New International Economic Order (NIEO)**	Economic Liberalization and globalization	**Development paradigm shift**
UNDERLYING FORCES			

Figure IV.1 – Evolution of the IIA regime
Source: UNCTAD
Note: the years in parenthesis refer to the adoption and/ or signature of the instrument at issue.

2.1.1 Era of Infancy (end of the Second World War until mid-1960s)[20]

This era begins with a paradigmatic change in international relations, developed on a series of fronts. On one hand, significant promotion of arbitration as a dispute settlement formula that is reflected by the signature of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention) on 10 June 1958; on the other hand, the treaty that establishes the European Economic Community in 1957 and a series of independent movements in the former European-African colonies, which demonstrates the problems related to the protection of their investments under new non-European regimes to investors in said countries.

> *In the first half of the 20th century, customary international law (CIL) was the primary source of international legal rules governing foreign investment. The emergence of a number of major investment disputes between foreign investors and their host countries after 1945 showed the significant limitations of protection afforded under CIL and through the system of home- State diplomatic protection, and triggered a move towards international investment treaty making.*

Given this context, the international investment protection regime thus begins with a new type of instrument – a sui generis BIT, as it is illogical that parties would create treaties that bind States to certain obligations but only States can claim a violation thereof; thus, a third party is added (the investor) that can support its claims without having to resort to its country of origin for this purpose.

> During this period, the first BIT was signed between Germany and Pakistan in 1959, as well as the *"1957 Treaty establishing the European Economic Community included the freedom of establishment and the free movement of capital as core pillars of European integration. Other early examples include the OECD Code of Liberalization of Capital Movements and Code on Current Invisible Operations of 1961.*
>
> *(…). In terms of content, the BITs (or IIAs) had a focus on protection against expropriation and nationalization, as investors from developed countries perceived expropriation and nationalization as the main political risks when investing in developing countries. To a considerable extent, these first-generation BITs resembled the 1959 Abs-Shawcross Draft Convention on Investments Abroad, a private initiative, and the 1962 OECD Draft*

20• United Nations, World Investment Report 2015, Reforming International Investment Governance, New York and Geneva, 2015, Chapter IV [Era of infancy (end of World War II until mid-1960s], pp. 121 - 125, http://unctad.org/en/PublicationsLibrary/wir2015_en.pdf; last visit on July 28th, 2016.

> *Convention on the Protection of Foreign Property (revised and adopted in 1967 but never opened for signature) (Vandevelde, 2010).*[21]
>
> During this period, *the International Centre for Settlement of Investment Disputes (ICSID) was created. It has become the most visible face in Investor-State investment resolution. This Center was created pursuant to a Convention that entered into force on 14 October 1966 and which includes 144 countries as members.*

Bolivia, Ecuador and Venezuela have denounced this Convention.

On 2 May 2007, Bolivia sent a written notice of its denunciation of the Convention. Ecuador denounced the Convention on 6 July 2009 and Venezuela on 24 January 2012.

And, although strictly speaking, ICSID is an arbitration management institution, it has been subject to a series of criticisms and challenges that undoubtedly reflect these denunciations. These denunciations are contemplated by international law and the Convention itself.

2.1.2 Era of Dichotomy (mid-1960s until mid-1980s)

> *Investment protections in BITs are enhanced, including by adding ISDS provisions. At the same time, multilateral attempts to establish rules on investor responsibilities fail.*[22]

This period was characterized by an expansion of IIAs, reaching 400 BITs by the end of the 1980s. The international instruments were mainly signed between Europe and countries of Africa, Asia and Latin America. The Soviet Union, countries in Central and Eastern Europe, China, India and Brazil chose not to keep out of the IIA regime altogether.

From a political and economic perspective, two fundamental systematic factors explain the increase of IIAs during this period:

First: the decolonizing movement caused investors and entrepreneurs to feel pressure from no longer being able to count on the legal protection of colonizing countries, but this pressure was also exacerbated by nationalist movements headed by the new economic elites of the former colonies.

21• Id. p. 122 Original text: "(…) Another landmark development was the establishment of the International Centre for Settlement of Investment Disputes (ICSID) in 1965, providing a specialized facility for the resolution of investment disputes between investors and host States. In 1958, the New York Convention on the cognition and Enforcement of Foreign Arbitral Awards was concluded, facilitating the enforcement of international arbitral awards (...)."

22• Id., p. 122.

Second: The investment is concentrated in extractive activities and processing of raw materials.

These factors lead to IIAs being conceived of as instruments for the protection of the private property of investors, mainly protecting them from nationalization or expropriation of their investments.[23]

IIAs during this period increasingly incorporated arbitration provisions to solve disputes between investors and States until this became a standard provision in BITs since the 1990's on.[24]

The first ICSID arbitration case under a Bilateral Investment Protection Treaty was filed in 1987, Asian Agricultural Products Limited v. Socialist Democratic Republic of Sri Lanka.[25]

2.1.3 Era of Proliferation (1990's until 2007)

As a result of the previous era, the IIA system grew exponentially, as did investor-State arbitration. This growth showed the practical scope of these international instruments, as their provisions ceased to be mere declarations and became State obligations – in many cases, with unforeseen or imagined scope and content.

The number of IIAs grew rapidly and they became public policy tools that, in the opinion of many States, gave them access to global markets and allowed them to receive the flow of international investment. And although, this was not necessarily true in practice, countries such as China and India

23• YANNACA, Katia, *Arbitration Under International Investment Agreements,* A guide to the key Issues, Oxford University Press, 2010.

24• United Nations, *2015 World Investment Report,* New York and Geneva 2015. pp. 121 – 125.

25• El *arbitraje según los tratados bilaterales de inversión y tratados de libre comercio en América Latina*. Journal Nº 1 June - Dec. 2004:

Unofficial translation

> "In 1983, Asian Agricultural Products Ltd. (AAPL), a corporation incorporated in Hong Kong, became the shareholder of a shrimp farm in Sri Lanka. On January 28, 1987, that country's army launched a military offensive against any facility that it believed was used by the rebel Tamil group, causing significant collateral damage to the farm. As a result of this attack, AAPL argued that the Government was responsible for the total loss of its investment.
>
> Previously, in 1980, Sri Lanka had signed a BIT with the United Kingdom – including the territory of Hong Kong-, the Treaty between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of Sri Lanka for the Promotion and Protection of Investments, that provided, in its article 8.1: "each Contracting Party hereby consents to submit to the International Centre for the Settlement of Investment Disputes for settlement by conciliation or arbitration […] of any legal disputes arising between that Contracting Party and a national or company of the other Contracting Party concerning an investment of the latter in the territory of the former.
>
> Based on this provision, AAPL successfully brought an arbitration case against the Republic of Sri Lanka, before ICSID. In that way, the company became the pioneer in arbitrations based on BIT as it was the first plaintiff claiming protection under the arbitration clause of this type. The award issued ordered Sri Lanka to payment of compensation for failing to assure "full protection and security" to the investment, as part of the protections contemplated in the BIT."

multiplied the signature of IIAs, as did many Latin-American countries, including Ecuador.

> In referring to this state, in its world investment report, UNCTAD states that *"[a] landmark event was the establishment of the WTO in 1994, with several WTO agreements containing rules applicable to foreign investment (GATS, TRIMs, TRIPS). In the same year, the Energy Charter Treaty was concluded; today it comprises more than 50 contracting parties from Europe, Asia and Oceania, and contains detailed investment provisions as one of its pillars. At the regional level, countries concluded the North American Free Trade Agreement (NAFTA) (1992) and adopted the APEC Non-Binding Investment Principles (1994).*
> *(…)*
>
> *While the vast majority of BITs concluded in this period covered only the post-establishment phase of investment, many free trade agreements (FTAs) went one step further and included in their investment (and/or services) chapters commitments on non- discriminatory treatment of establishment by foreign investors as a means to facilitate market access. The 1990s also witnessed the start of a move towards renegotiating first-generation BITs with the objective of further enhancing investment protection by including protection elements hitherto missing. In 1990, the first award in a treaty-based case was issued. This was followed by a number of new cases during the 1990s and a rapid increase in the 2000s."*

As historical milestones during this era, the following are worth mentioning:

- In 1997, the first arbitration case under the Regulations of the Complementary Mechanism, Metalclad Corporation v. United Mexican States.
- In 2001, the first ICSID arbitration case was brought under the Treaty on the Charger of Energy, AES Summit Generation Limited v. Republic of Hungary.

During this era, a series of arbitration claims were brought under these treaties, which would then be a factor in creating a movement to reform IIA's. The signing countries became aware of the fact that if the Treaty provisions were not well defined or if their content was overly broad, they created obligations that were not originally contemplated at the execution of these international instruments. In turn, the investors were not satisfied with plain investment protection, but demanded an adjustment in light of the globalization of the world's economy, where commerce and investment complement each other to compete in a globalized international market.

The BITs signed by Ecuador belong to this second generation. Thus, until 2007, Ecuador had twenty-seven bilateral investment agreements. In 2008, Ecuador decided to terminate ten of those agreements, as it decided that they did not fulfill their objective of

promoting bilateral investment. It then filed cases to denounce the remaining treaties. To date, only one has completed the entire internal proceedings, including the respective notice to the counterparty and 16 are pending completion of internal proceedings, in order to denounce the treaties. Through the exercise of its state's defense in investment arbitration Ecuador has identified the following problems in the BITs that it has already signed:

- Ambiguous provisions that have led to varied interpretations – even contradictory interpretations – that, in many cases, have departed from the intent of the signing parties regarding concepts such as investment, investor, full protection and security, among others.
- Excessively long proceedings, with excessively long timelines, to the point of being unreasonable in some cases.

Quito, December 3 - 8, 2012, Dr. Diego Garcia Carrion during the conference "Concerns of Ecuador regarding the Investor-State dispute settlement system", within the advanced course about "The new generation of Investment Policies and Investor-State dispute resolution", organized by the Organization of America States (OAS) General Secretary and the United Nations Conference on Trade and Development (UNCTAD), with the support of the Attorney General's Office of Ecuador.

- Absence of a mechanism to review awards, the annulment recourse is insufficient as arbitration involves matters that go beyond commercial interests.

2.1.4 Era of Reorientation (2008 through present)

This era is characterized by two trends: the first refers to the increasing addition of investment chapters in regional trade agreements and the liberalization of investments. And the second, refers to the incorporation of more detailed descriptions of protection standards, transparency clauses, health, security and environmental protections incorporated in Investment Protection Treaties, among others; as well as innovation to the investor-State dispute resolution mechanism.

With respect to the first trend. –
According to the UNCTAD's[26] report for the end of February 2016, over 350 regional trade agreements have been signed that include chapters on investment that not only protect investment, but also strongly promote the right to foreign investment in the host country's economy. While investment protection treaties are generally "post-establishment", i.e. the rights and guarantees derived from the treaty shall only be granted and can be claimed by the foreign investor after it has established its investment pursuant to the national legislation of the host Country and party to the treaty; the investment chapters in regional commercial agreements are "pre-establishment" agreements, i.e. that certain rights and guarantees derived from the treaty are granted and can be claimed by the foreign investor even prior to establishing the investor pursuant to the national legislation of the host State and party to the treaty.[27]

The new generation of investment agreements involves granting national treatment and most favorable treatment standards to foreign investors with respect to their right to establish themselves in the host State. This right is regulated through negative lists, in which the terms of the agreement apply to all sectors and subsectors, except for such cases where the state sets forth reservations that seek to maintain regulations and rules that do not agree with the agreement's provisions. This mechanism includes two appendices: one which records non-conforming measures– i.e. a list of existing laws that are inconsistent with one or many of the agreement's provisions (so that only conforming laws apply and in the event of amendment of a non-conforming measure, the amendment should benefit the investor). The second appendix includes future measures. It includes a list of economic activities or industries in which contracting parties can hold or adopt measures that do not conform to one or many of the agreement's obligations.[28]

26• United Nations Conference on Trade and Development, *Investment Policy Monitor,* No. 15, March 2016, http://unctad.org/en/PublicationsLibrary/webdiaepcb2016d01_en.pdf; last visit on July 28th, 2016.

In this regard, UNCTAD provides as follows:

"Although bilateral treaty making lost much of its dynamism, regional IIA making accelerated (see chapter III). This is partially a reaction to the failure to establish multilateral investment rules, leaving regional approaches as a "second best solution". In addition, the entry into force of the Treaty of Lisbon in December 2009 triggered a trend towards intensifying and upscaling regional IIA treaty making. By transferring competence in FDI from the EU member States to the EU, with potential implications for almost half of the IIA universe, the Treaty of Lisbon enables the EU to negotiate IIAs with post- establishment provisions (earlier, EU treaties only covered pre-establishment). Examples are the Canada–EU Comprehensive Economic and Trade Agreement (CETA, draft 2014), the EU–Singapore Free Trade Agreement, and negotiations for the EU–United States Transatlantic Trade and Investment Partnership (TTIP). Outside the EU, megaregional negotiations are ongoing for the Trans- Pacific Partnership (TPP), the Regional Comprehensive Economic Partnership Agreement (RCEP), and negotiations for the COMESA-EAC-SADC Tripartite Agreement

27• CÁRDENAS, Andrés, *La Peculiar Estructura del Tratado Bilateral de Inversión celebrado entre Colombia y Japón: Seguridad jurídica para la inversión extranjera,* 20 Octubre 2015, http://dernegocios.uexternado.edu.co/controversia/la-peculiar-estructura-del-tratado-bilateral-de-inversion-celebrado-entre-colombia-y-japon-seguridad-juridica-para-las-inversion-extranjera/; last visit on July 27th, 2016.

Unofficial translation:

"Pre-establishment agreements" are structured in a more complex manner than "post establishment" agreements, which can be summed up in the following aspects:

- "Pre-establishment" agreements provide a greater number of rights and guarantees to the investor and its investment as compared to post establishment agreements.

Both "post-establishment" as well as "pre-establishment" agreements grant general protection guarantees to foreign investments. These are: National Treatment, Most Favored Nation Treatment, Fair and Equitable Treatment, Full Protection and Security, Prohibition against Expropriation without Compensation, Compensation for Losses, Freedom to make transfers; while "pre-establishment" treaties additionally grant the guarantees of: Prohibition against Performance Requirements, and, Senior Executives and Boards of Directors.

- "Pre-establishment Agreements" provide non-conforming measures, with the exception of the rights granted prior to establishing the investment, while "post-establishment" agreements do not provide these.

The non-confirming measures concrete the advance statements of States regarding exclusions to the application of National Treatment, Most Favored National Treatment, Prohibition against Performance Requirements, or Senior Executives and Board of Directors during the "pre-establishment" stage and in economic sectors and specific industries. The non-conforming measures are specified in the appendices to the main investment protection treaty text, which provide a detailed list of these exclusions.

- "Pre-establishment" Agreements establish an Administrative Body for the treaty, while this is not contemplated in "post – establishment" Agreements.

The Administrative Body for a "pre-establishment" Agreement is composed of representatives of State Parties and its duty is to resolve inquiries regarding the treaty's interpretation and scope that are brought by States party. The notions of Administrative Body, as a general rule, are binding for the international investment arbitration tribunals, created pursuant to the treaty."

28• The negative lists were initially proposed in the framework of the U.S. model BIT, but they have been used in other agreements in Latin 2wAmerica and Asia, such as the chapter on investments between Chile and South Korea.

(chapter III). For IIA treaty making, regionals and, even more so, megaregionals offer opportunities to consolidate today's multifaceted and multilayered treaty network. However, without careful drafting, they can also create new inconsistencies resulting from overlaps with existing agreements (WIR14)."[29]

With respect to the second trend. –
The significant increase in the number of investor – State disputes has affected the procedures involved with the creation of investment treaties. Thus, the decisions issued by Arbitration Tribunals have cast doubt on the legitimacy of the investor-State dispute resolution mechanism and international investment law. These criticisms have specifically concentrated on the following:

- A vague and broad formulation of the idea of investment. – Cases such as S.D. Myers v Canada[30] or Chevron v. Ecuador[31] show the broad interpretation that Tribunals have given to this concept. In the first case, by determining that the establishment of sales offices and the time required to do so constitutes an investment, and, in the second, when holding that, despite the fact that the plaintiffs had what was considered an investment in Ecuador in its oil exploration and extraction activities since 1960 until early 1990's, the lawsuits brought by Chevron in Ecuador were part of an investment because they were related to the liquidation and settlement of investment claims and thus, the BIT signed with U.S. was applicable to them, despite the fact that the BIT entered into force in 1997.

- Ambiguous formulation of protection standards for investor rights. – The drafting of these clauses is so ambiguous that it almost any circumstance that involves an investment could apply.

- Overlapping of various control mechanisms and arbitration institutions. The existence of frivolous claims brought by investors, parallel cases and investors' search for the most convenient forum.

- Inconsistency of the various decisions issued by Tribunals. Unforeseeability and inconsistency of the investor-State dispute resolution system, as there are contradictory decisions on similar legal and factual points, such as the decisions in the Lauder cases.[32]
- Inequality in the regime when defending investment above and beyond States' regulatory interests, as well as non- economic interests.

29• United Nations, 2015 *World Investment Report,* New York and Geneva 2015.

30• S.D. Myers, Inc. vs. Canada ("SD Myers I"), UNCITRAL Rules, First Partial Award, November 13th, 2000.

31• Permanent Court of Arbitration, Chevron Corporation (EE.UU.) and Texaco Petroleum Corporation (EE.UU.) vs. Ecuador, Interim Award, December 1st, 2008, pars. 180-189.

32• These cases involve a series of facts and measures that are common underlying claims of inappropriate interference by the Czech Republic. In one, the investor lost the case, but in another, the investor obtained an award in its favor of over US$300 million.

- Imbalance between State obligations designed to protect the public interest and the rights of investor that seek protection of their property and investment.
- An option for the investor to bring international arbitration by itself.

A smaller list of arbitrators that could be chosen in comparison with other international dispute resolution mechanisms.

Geneva, Switzerland, March 16, 2016, Palace of Nations. Dra. Blanca Gomez de la Torre, National Director of International Affairs and Arbitration (Attorney General's Office of Ecuador) in the Multi-year Expert Meeting on Investment, Innovation and Entrepreneurship for Productive capacity-building and Sustainable Development) Forth Session.

In this regard, UNCTAD stated the following in its report:

The "IIA rush" of the 1990s gradually slows down. Many countries refine treaty content. States' increased exposure to ISDS cases, the global financial crisis, a paradigm shift towards "sustainable development" and important changes at regional levels mark the beginnings of a concerted move towards IIA reform.

(…)

The experience of Canada and the United States as respondents in NAFTA investment arbitrations, prompted them to create, already in 2004, new Model BITs aimed at clarifying the scope and meaning of investment obligations, including the minimum standard of treatment and indirect expropriation. In addition, these new models included specific language aimed at making it clear that the investment protection and liberalization objectives of IIAs must not be pursued at the expense of the protection of health, safety, the environment and the promotion of internationally recognized labour rights. Canada and the United States also incorporated important innovations related to ISDS proceedings such as open hearings, publication of related legal documents and the possibility for non-disputing parties to submit amicus curiae briefs to arbitral tribunals. Also included, following on from NAFTA, were special regimes of substantive protection and dispute resolution for investments in the financial services industry, as well as specialized mechanisms for disputes by investors

based on host-country tax measures. The United States Model BIT was slightly revised in 2012.

The global financial and economic crisis that broke out in September 2008 – following the Asian and Argentine financial crises a number of years before – emphasized the importance of solid regulatory frameworks for the economy, including for investment. Growing dissatisfaction with the existing IIA regime and its impact on contracting parties' regulatory powers to pursue public interests and to enhance sustainable development led countries to reflect on, review and reconsider their policies relative to IIAs.

The rise in ISDS cases, from 326 in 2008 to 608 known cases at the end of 2014, involving both developed and developing countries as defendants, contributed to this development (UNCTAD, 2015).

In addition, investment disputes became more complex, raising difficult legal questions about the borderline between permitted regulatory activities of the State and illegal interference with investor rights for which compensation has to be paid. At the same time, as the number of ISDS cases began to rise sharply, so did the amount of compensation sought by investors in their claims and awarded by arbitral tribunals in a number of high-profile cases.

Accordingly, governments have entered into a phase of evaluating the costs and benefits of IIAs and reflecting on their future objectives and strategies as regards these treaties. Mounting criticism from civil society plays a role as well. As a result, several countries have embarked on a path of IIA reform by revising their BIT models with a view to concluding "new generation" IIAs and renegotiating their existing BITs. This move is based in part on UNCTAD's Investment Policy Framework for Sustainable Development (IPFSD), which was developed to provide guidance to the reform of investment policies at the national and international levels and which is increasingly being used by developing and developed countries (box IV.1 and chapter III). Countries have started to clarify and "tighten" the meaning of individual IIA provisions and to improve ISDS procedures, with the objective of making the process more elaborated, predictable and transparent and of giving contracting parties a stronger role therein. Improved transparency is also the outcome of the recently adopted UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration and the UN Transparency Convention.

Other countries, by far a smaller group, have announced a moratorium on future IIA negotiations, while still others have chosen a more radical approach by starting to

33• United Nations, *2015 World Investment Report,* New York and Geneva 2015.

terminate existing IIAs. A few countries have also renounced their membership in ICSID (UNCTAD, 2010a).[33]

These criticism have led to a trend among new IIAs that focuses on:

- Detailing, in a more accurate manner, the meaning of the term investment.
- Clarification of the meaning of key obligations such as the ideas of fair and equitable treatment, full security and protection and indirect expropriation.
- Preservation of the States' right to regulate through a limitation of the objectives of promotion and liberalization of investments given public policy objectives such as health, safety, cultural identity, environment and workers' rights.
- Greater transparency among the parties in the process of elaboration of domestic legal frameworks.
- A reform of the dispute resolution mechanisms that emphasizes greater State party control on the interpretation of Treaty terms and the ability to create Permanente Dispute Resolution Tribunals, as well as appellate mechanisms.
- Guaranteeing responsible investment including specific responsibilities of investors to contribute positively to the country's development and to avoid adverse impacts caused by their activities.

2.2 New Trends

2.2.1 IIA's and Sustainable Development

The international policy agenda is a milestone in terms of the need to ensure states' sustainable development; this has caused increasing scrutiny on investor behavior with respect to this objective. In this regard, investors are increasingly required to satisfy international parameters for their behavior, such as the United Nations' "Guiding principles on business and human rights," the revised version of the "OECD Guidelines for Multinational Enterprises," the "Principles for Responsible Investment in Agriculture and Food Systems" created by the FAO, the World Bank, UNCTAD and the International Fund for Agricultural Development (IFAD). Further, this scrutiny extends to the parameters developed by other international organizations and businesses' corporate policies themselves.

This, in addition to the environmental and human rights criticisms regarding the actions of investors in countries where they develop their investments,[34] etc. has marked a trend that requires that investments promote sustainable development; therefore, IIAs can only promote and protect the investments that follow this line.

34• Ecuador's emblematic cases are: Chevron III where the contamination caused by the oil company constitutes one of the greatest environmental tragedies in history or the Copper Mesa case, which shows investment management against the settlers' human rights.

This implies expanding the current scheme; in other words, not only protecting investors and their investors, but also setting obligations for the State receiving the investment.

> *"Put another way, it will assign obligations, as well as rights to investors. It is not unreasonable to demand, in exchange for the extraordinary protection provided by IIAs and their investor-state dispute mechanisms, that investors follow certain basic minimum standards of acceptable conduct, such as full disclosure of past practice, conduct of consultations and environmental impacts assessments and other widely-practiced expressions of corporate social responsibility. It is also conceivable that IIAs should assign obligations to home states—the states from which the investment originates—such as to ensure that investors can ultimately be held accountable at home for their actions abroad."*[35]

In this regard, in May 2008, the Working Group on Development and the Environment in the Americas, founded in 2004 and organized by the Global Development and Environment Institute at Tufts University, already held:[36]

> *"Hence, it comes as no surprise to find that virtually all newly elected governments in Latin America are rethinking the role of FDI in their economies. While some countries are simply at the stage of starting to debate the issue, others are going so far as to nationalize foreign firms. Yet, most governments are looking for a more balanced approach. What this report makes clear is that new policies are needed. Based on the research mentioned above, three broad lessons can be drawn out as principles for policy-making in this field:*
>
> *FDI is not an ends but a means to sustainable development. Simply attracting FDI is not enough to generate economic growth in an environmentally sustainable manner. The report shows that even in the nations that received the lion's share of FDI in the region— Brazil, Argentina, and Mexico—FDI fell short of generating spillovers and sustained economic growth. FDI needs to be part of a comprehensive development strategy aimed at raising the standards of living of the nation's population with minimal damage to the environment.*
>
> *FDI policy needs to be conducted in parallel with significant and targeted domestic policies that upgrade the capabilities of national firms and provide a benchmark of environmental protection. There are numerous country specific policies that are either being implemented or debated regarding ways in which LAC nations can*

35• COSBEY,Aaron, MANN, Howard, PETERSON, Luke Eric, VON MOLTKE, *Konrad, Investments and sustainable development*, IISD, International Institute for Sustainable Development, p. 7.

36• https://ase.tufts.edu/gdae/Pubs/rp/FDI_WG_May08_Span_Full.pdf; last visit on July 25th, 2016.

overcome information and coordination externalities, access to credit problems, and competitiveness issues on the part of their domestic firms. In this regard, parallels or lessons from Asia may be drawn, since many nations in that region have put in place targeted industrial policies to link domes- tic firms to foreign firms to the extent that the domestic firms develop into competitive ex- porters themselves.

International agreements, whether at the WTO or at the level of regional or bi-lateral trade and/or investment treaties (RBTIAs), need to leave developing nations the "pol- icy space" to pursue the domestic policies necessary to foster sustainable development through FDI. The emerging international regime of international investment rules is restricting the ability of developing nations to pursue some of the policy instruments that have been successful at channeling FDI for development in Asia and elsewhere. When acting collectively under the auspices of the WTO developing nations have largely succeeded in blocking proposals that would further restrict such policy space. However, slower movement in global trade talks has led to a proliferation of RBTIAs between developed and developing countries where developing countries have much less bargaining power and end up exchanging policy space for market access."

Other countries have also reoriented their investment policies to sustainable development. One of these countries is India, which has a Model Investment Treaty that states the following in its preamble:

"Preamble
The Government of the Republic of India and the Government of the Republic of ---------- (hereinafter referred to as **"the Party"** individually or **"the Parties"** collectively);
(…)
Seeking to align the objectives of Investment with sustainable development and inclusive growth of the Parties;[37]

2.2.2 Greater Accuracy In The Definition of Investment

In order to avoid the ambiguous and general definition that exists in IIA's, the following choices have been suggested:
On one hand, use a "closed list" definition, which consists of a broad but finite list of tangible and intangible assets to be protected, instead of a general definition. This option originated in NAFTA and was reflected by other countries, such as, for example, the free trade agreement between Japan and Mexico, or Canada's model BIT.

Another alternative proposed qualifying the general definitions in auxiliary economic terms. In other

37• Model BIT India.

words, the investment must include the concept of an expectation of an earning, or profit or assumption of risk. This is complemented by the explicit exclusion of a certain quantity of assets. This is the case, for example, of the agreement executed by South Korea and Chile.

2.2.3 Greater Accuracy In The Concepts Of Fair And Equitable Treatment, Full Security And Protection, And Indirect Expropriation

With respect to the concepts of fair and equitable treatment, the trend is to define the terms specifically, in some cases, even creating a list.

For example, the agreement negotiated between the United States and Australia defines fair and equitable treatment as such treatment that includes the obligation not to deny justice in civil, criminal or administrative proceedings according to the principles of due process in force in legal systems around the world. With respect to full protection and security, the agreement provides the obligation to ensure the level of police treatment required under international customary law, which is also defined expressly.

With respect to the term expropriation, the new IIAs clarify two specific aspects: first, they specify that obligations related to expropriation must reflect the level of treatment granted by international customary law and, in second place, complement the first with guidelines and criteria in order to determine whether a particular situation has given rise to indirect expropriation. This has been the case, for example, of the free trade agreement signed between United States and Chile.

2.2.4 Preservation Of States' Right To Regulate By Limiting The Objectives Of Promotion And Liberalization Of Investments

The new IIAs specifically refer to the protection of health, the environment, the cultural identity, security and workers' rights through specific language that clearly defines that these objectives cannot be sacrificed in order to promote and liberalize investment. Some countries such as Canada and the United States have included a series of exceptions in their model BITs to preserve their public policy objectives in these areas. Other States have chosen to include explicit language to protect these public objectives, such as the BIT between Japan and Vietnam, which specifically mentions this reservation in its preamble. In cases such as the Pacific strategic economic partnership agreement and NAFTA, ancillary agreements have been negotiated on environment and labor rights. Others have reserved specific articles within the treaties to establish such reserves as in the case of the United States with Chile and with Peru, or South Korea with Chile.

2.2.5 Greater Transparency Among The Parties In The Creation Of Domestic Laws

Another trend among new IIAs involves incorporating clauses in which States not only commit to being transparent on laws in force in the country, but also involving investors in the discussion of laws that would be promulgated by the host country. These provisions are incorporated, for example, in the model BIT of the United States and Canada.

2.2.6 Dispute Resolution Mechanism Reform

IIAs have proposed two alternatives: the first addresses a reform of the current dispute resolution mechanisms in international arbitration, conserving its basic structure; and the second is related to replacing the actual investor-State arbitration system.

The first alternative, which began in 2000, presents a series of variables. Thus, the proposal attempts to improve transparency in arbitration proceedings such as the one adopted by Canada in its model BIT; mechanisms to avoid frivolous claims such as the one included in the investment chapter for the free trade agreement signed by the United States and Chile; the ability to accumulate arbitration proceedings as included in the investment chapter of the free trade agreement between Mexico and Japan; reducing matters submitted for arbitration and provided that matters such as financial services or tax measures will be interpreted by a Commission that is comprised of authorities appointed by contracting States as proposed by the agreement between South Korea and Chile; the insertion of the requirement to first resort to domestic courts, such as the BIT signed between Peru and Germany; the inclusion of the possibility of appealing as contemplated by the chapter on investment in the free trade agreement signed between the United States and Peru, which provides that in three years from the validity of the agreement, the parties shall consider the possibility of creating an appellate body to review awards; and finally, the intervention of third parties, as in Canada's model BIT.

The second alternative involves creating an international permanent investment court, as proposed by the European Union within the framework of the EU-Canada Comprehensive Economic and Trade Agreement (CETA) and the Free Trade Agreement between the European Union and Vietnam.

2.2.7 Recent Agreements

2.2.7.1 CETA Agreement

On September 26, 2014, the European Union and Canada completed the negotiation of the EU-Canada Comprehensive Economic and Trade Agreement (CETA); however, this Agreement has yet to be ratified.

This Agreement includes significant innovation, guaranteeing many protections for investors, simultaneously preserving the States' right to regulate and apply their lawful public policy objectives, such as the protection of health, safety or the environment.

The CETA Agreement seeks, by defining and limiting protection standards, to eliminate such ambiguities that allowed excessive abuses or interpretations. Thus the agreement contains new factors such as omitting the umbrella clause, provisions that limit the Most Favored Nation Standard, among others.

Regarding the dispute resolution mechanism, an independent arbitration system was created, that includes a permanent tribunal and an appellate tribunal, designed to process disputes in a transparent and impartial manner. Thus, under the CETA Agreement, a permanent tribunal will hear cases with members who will no longer be appointed ad hoc by the investor and the State involved in a dispute, but in advance, by the Parties to the Agreement. CETA also creates an appellate system that is similar to the one in domestic legal systems. This means that the tribunal's decisions will be reviewed and reversed in the event of an error of law.

Further, CETA provides clearer rules regarding the development of proceedings, including transparency of all documents, which will be publicly available and the hearings will be open to the public. It also includes significant innovations by introducing strict qualification requirements and ethical norms designed so that the Tribunal embers have the necessary impartiality, experience and knowledge to hear and rule on cases.

In sum, this Agreement is designed to promote and protect investment, emphasizing the right to regulate in the public interest within their territories.[38]

2.2.7.2 TRANSPACIFIC STRATEGIC ECONOMIC PARTNERSHIP AGREEMENT

This Agreement has negotiated been since 2006, originally by Chile, Brunei, New Zealand, Singapore. Nonetheless, over the passage of time, the seven countries were interested in forming a partnership and negotiation rounds were held to promote signature of a macro agreement.

On October 5, 2015, the rounds of negotiation ended and finally, on January 26, 2016, the Agreement was signed by: Japan, Australia, Brunei, Malaysia, New Zealand, Singapore, Canada, United States, Mexico, Peru and Chile.

38• CETA - Summary of the final negotiating results: February 2016, http://trade.ec.europa.eu/doclib/docs/2014/december/tradoc_152982.pdf; MEYER, Nils, Comments on Investment Protection under CETA: Good or bad; new or old? http://ecologic.eu/sites/files/publication/2014/comments-on-investment-protection-under-ceta-2014-meyer-ohlendorf.pdf; last visit 28 July 28th, 2016.

The Agreement includes three chapters, and its object is to create a platform to integrate the economies of the Asian and Pacific regions. It is worth noting that various countries have signed the agreement, i.e. they hold cultural, linguistic, geographic differences and, most importantly, economic differences. However, they hope to take benefit from the advantages of international trade with an inclusive participation of member countries.

Although it is true that the majority of countries that are members of the TPP have previous agreements amongst themselves, the Agreement was designed so that it could coexist with other commercial agreements.

The TPP mainly covers trade matters, seeking to update and generate a new vision as compared to the traditional approaches of treaties that were previously executed on the subject.

One of the novelties that the TPP included, in contrast to the other international agreements, is that it includes new visions of trade. Thus, it includes "issues related to the Internet and the digital economy, the participation of state-owned enterprises in international trade and investment, the ability of small businesses to take advantage of trade agreements, and other topics."[39] Moreover, it seeks to provide uniform intellectual property and environmental regulation rules.

With respect to investment matters, the TPP member states adopt a market approach that is completely open to foreign investment. The TPP includes definitions of applicable standards to protect investments, including: national treatment, most favoured nation treatment, minimum level of treatment, prohibition on expropriation without due process and fair compensation, free transfer of funds related to an investment,[40] among other matters.

For example, when referencing fair and equitable treatment in its article 9.6(2)(a) it "includes the obligation not to deny justice in criminal, civil or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world."

This Agreement adopts the perspective of many IIAs with respect to the "definition of investment". It contains an indicative list to determine the types of investment protected by the TPP. In any case, the investment of an investor from a State party to the TPP made in the territory of another country must hold certain features such as a commitment of capital or other resources in the territory of the host country; the expectation of obtaining or generating earning or profits; or the assumption of risk.

39• Executive Summary of the Trans-Pacific Partnership Agreement. http://www.sice.oas.org/TPD/TPP/Negotiations/Summary_TPP_October_2015_s.pdf; last visit July 27th, 2016

40• http://www.sice.oas.org/Trade/TPP_Final_Texts/English/Chapter9.pdf, last visit July 27th, 2016

The TPP also corrects something that has affected international arbitration (such as the case brought by Chevron against Ecuador) and that involves the term of the Treaty, by including the following text in article 9.2. (3):

> "3. For greater certainty, this Chapter shall not bind a Party in relation to an act or fact that took place or a situation that ceased to exist before the date of entry into force of this Agreement for that Party."

Surely, as a result of the trend of seeking balance between investor and State rights and obligations, the TPP contains subrogation provisions,[41] links investment to measures on health and other regulatory objectives and matters relative to corporate social responsibility. Further, it includes appendices on concepts of customary international law and direct and indirect expropriation.

In the investment chapter, TPP also includes international arbitration as a dispute resolution mechanism, through the following alternatives:

- ICSID Convention and the ICSID Rules of Procedure.
- Rules for ICSID's complementary mechanism.
- UNCITRAL Rules of Arbitration; or
- Any other arbitration institution or any other rules of arbitration, provided that there is an agreement among the parties.

The arbitration rules provided by the TPP establish, except for an agreement to the contrary, that the Tribunal shall be conformed by three arbitrators and that it must decide pursuant to the provisions of the Agreement and applicable rules of international law. As to the arbitration proceedings, the TPP includes procedural safeguards that provide the ability to submit amicus curiae briefs, that the defendant State can countersue, briefs from parties who are not parties to the suit. It also sets up a procedure to review a provisional award, rules to avoid claims in parallel proceedings, among others.

In sum, the TPP is considered an agreement that sets a new standard as to international trade, as it includes provisions related to situations that are proper to the new generation and technology. It regulates them in order to ensure commercial and economic integration of state parties.

41 • Article 9.13 provides that:

> "If a Party, or any agency, institution, statutory body or corporation designated by the Party, makes a payment to an investor of the Party under a guarantee, a contract of insurance or other form of indemnity that it has entered into with respect to a covered investment, the other Party in whose territory the covered investment was made shall recognize the subrogation or transfer of any rights the investor would have possessed under this Chapter with respect to the covered investment but for the subrogation, and the investor shall be precluded from pursuing these rights to the extent of the subrogation.

2.2.7.3 EU - UNITED STATES TRANSATLANTIC TRADE AND INVESTMENT PARTNERSHIP

In June 2013, the members of the European Union authorized the European Council to begin negotiating a commercial and investment agreement with the United States. The following facts highlight the background of the authorization: 1) maintenance of the North Atlantic Treaty Organization – NATO- and ii) the creation, under its sponsorship, in 2007 of an Economic Transatlantic Council[42] which would issue the recommendations of a group of experts in February 2011 regarding opening negotiations for a commercial and investment agreement.[43]

Subsequently, the parties issued political declarations supporting the agreement; thus, in his Speech on the State of the Union of February 12, 2013[44] President Obama, addressed the possibility of this agreement; the following day, then President of the European Council, José Manuel Barroso announced the beginning of negotiations,[45] which, despite significant progress in draft agreements, have yet to be completed.

> In this regard, the public referendum at the European Community that was carried out between March and July 2014, showed an almost unanimous opposition to the investor-State arbitration mechanism, "… *perceived as biased, not transparent and as restrictive of State liberty to adopt policies that they judge appropriate in fundamental matters, particularly in matters of health and the environment.*"[46]

In this climate of mistrust towards the international arbitration mechanism, as well as the fact that large companies both in Europe and the United States have expressed their reticence to the agreement, the European Parliament demanded a reform of the current investor-State arbitration system via a resolution dated July 8, 2015, in the following terms:

"XV: to ensure that foreign investors are treated in a non-discriminatory fashion, while benefiting

42• European Commission, EU-US: Transatlantic Economic Council, http://ec.europa.eu/enterprise/policies/international/cooperating- governments/usa/transatlantic-economic-council/index_en.htm>; last visit, June 8th, 2014.

43• http://www.hispaniccouncil.org/wp-content/uploads/PolicyPaper2THC.pdf.; last visit, July 25th, 2016.

44• http://www.bbc.com/news/business-21439945.; last visit, July 27th, 2016.

45• http://www.reuters.com/article/us-eu-us-trade-idUSBRE91C0OC20130213.; last visit, July 26th, 2016.

46• Les Echos, Critiques de l'árbitrage TTIP: de la transparence à la vacuité, 28 January 2015. http://www.lesechos.fr/idees-debats/cercle/cercle-121643-critiques-de-larbitrage-ttip-de-la-transparence-a-la-vacuite-1087723.php, last visit on July 28th 2016. Original text:

"Elle révèle une méfiance persistante envers le mécanisme d'arbitrage envisagé pour résoudre les litiges entre investisseurs et États, qui est soupçonné de partialité, d'opacité et d'interférer avec la liberté des États d'adopter les politiques qu'ils jugent appropriées dans des domaines fondamentaux, en particulier en matière de santé et d'environnement."

from no greater rights than domestic investors, and to replace the ISDS system with a new system for resolving disputes between investors and states which is subject to democratic principles and scrutiny, where potential cases are treated in a transparent manner by publicly appointed, independent professional judges in public hearings and which includes an appellate mechanism, where consistency of judicial decisions is ensured, the jurisdiction of courts of the EU and of the Member States is respected, and where private interests cannot undermine public policy objectives;…"[47]

If it were ratified, this Agreement would have undeniable economic importance, not only because it is a broad agreement that covers both commercial matters as well as investments, but also because its participants have enormous influence on the global economy. Together, the United States and the European Union globally represent 45% of GDP; they receive 32% of all imports and effect 26% of all exports.[48] And their importance increases even further in the economic arena and would be relevant to all the subjects that it addresses, including investment protection, and its proposal with respect to investment-State dispute resolution mechanisms. Today, this is telling because it shows the "European fear of arbitration" and it unveils that the criticism of the system, that was thought to arise from developing countries subject to lawfuits, are not simple assumptions, but palpable realities instead. If dispute resolution mechanisms were implemented under this treaty, the tribunals that were created would be considered among the most important at a global level.

The chapter on investments in the draft agreement proposes that the plaintiffs, i.e. the investors, must fulfill a series of previous steps to submit their claims. These preliminary steps cannot be compared to the traditional "cooling off period"; instead, the defendant must show more initiative. The proposal not only requires a period intended to negotiate settlement of a dispute as a preliminary requirement to bring a claim, but, according to the agreement, prior to bringing a case, the parties must engage in a direct negotiation process, identified as "friendly settlement." After this inquiry, which is similar to the "cooling period", and once six months have transpired from its beginning, summons could be served, but there once the consultation process has begun, if the affected party has not filed its claim within 18 months, the claim shall be understood as waived.

In turn, it contemplates establishing a "System of investment tribunals" that departs from the conceptual idea of arbitration because, although

47• Resolution of the European Parliament, 8 July 2015. Available at: http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P8-TA-2015-0252+0+DOC+XML+V0//EN; last visit on July 28th, 2016.

48• http://ec.europa.eu/priorities/publications/eu-us-free-trade-one-year_es.; Last visit on July 25th, 2016.

the bodies that hear the claim are appointed as "Arbitration Tribunals", in reality, they are trial courts and their decision can in turn be reviewed by an Appellate Tribunal. The text of the Agreement responds to two of the most frequent investor criticisms of the State dispute resolution system: i) an absence of a clear definition of the term investment; and, ii) inconsistent decisions issued by Arbitration Tribunals.

With respect to the form, considering that the United States or the European Union have never attempted to include elements of the Salini test in their agreements, it is at least eloquent that today, the draft Agreement includes a definition of "investment" that contemplates certain elements mentioned by this Test. The draft agreement states:

'investment' means all types of assets with investment features, which include certain terms and other features such as commitment of capital or other resources, the expectation to obtain profits or benefits, or assumption of risk."[49]

With respect to the latter, this inconsistency among arbitration decisions occurs when, despite interpreting similar terms and even similar facts, tribunals reach completely different conclusions; the draft transatlantic partnership agreement addresses this problem in an innovative fashion, since it contemplates the constitution of two Tribunals, one of first instance and another appellate tribunal, with permanent judges who are exclusively dedicated to the Tribunal. This would ensure the homogeneity of opinions and interpretations, which would in turn lead to that desired consistency and formation of jurisprudence.

2.3 Model BITs

The above-mentioned evolution has led to changes that states have implemented into their "Model BITs" and their review can show global trends.

2.3.1 United States

This country created its Bilateral Investment Treaty program in 1977 and its first model was developed in 1982. This model was reformed in 1994 and introduced provisions regarding transparency.

Between 2003 and 2004, the U.S. government sought to review its model and it published the draft of a new model BIT on February 5, 2004, that included 36 articles and 4 appendices.

The American Journal of International Law (2004)

49• Draft text of the TPP – Investment. Chapter II Investment. Specific definitions for investment protection. http://ec.europa.eu/trade/policy/in-focus/ttip/index_es.htm; last visit on July 28th, 2016.

explained that this model contained more detailed provisions on procedural matters such as access to the investor – State dispute resolution mechanism (arts. 23, 24), transparency in domestic laws (art. 11) and on certain protection standards such as: minimum protection standard (art. 5 and annex A) and the standard of application on expropriations (art. 6 and Annex B). Finally, articles 12 and 13 recognized that promoting investments through weakening or reducing protection under national legislation in labor and environmental matters was inappropriate.

The last review of the model took place in 2012 and it contains provisions regarding a future possibility of appellate mechanisms and requires that the Parties ensure that any mechanism includes provisions regarding transparency and public participation. This model seeks to find a balance between interests, facilitate and protect investments; and in turn, protect the state's ability to regulate for the public interest (UNCTAD, 2016).

2.3.2 India

KAVALJIT Singh & BURGHARD ILGE (2016)[50] explain that a working group of the central government started to review the 1993 model BIT in July 2012. They questioned the nature and convenience of investment treaties. The intent was not only to make investment treaties instruments to protect the investor, but also, to create a useful tool to promote development goals, transparency in corporate agreements and prevent unethical business practices, and promote good corporate conduct.

The preamble of the new model BIT recognizes the promotion and protection of investments conducive to stimulating mutually beneficial business activities, a mutual development of economic cooperation and promotion of sustainable development.

As to dispute resolution, it contains exhaustive provisions and clearly provides what disputes can be heard through arbitration; picks up the State's right to submit counterclaims; regulates the exhaustion of internal resources and the mechanism for inquiries. It provides that the Tribunals do not have jurisdiction to reexamine administrative or judicial decisions made by authorities of the host State; it provides the times pursuant to which investors can sue; contains provisions regarding conflicts of interest and disqualifications.[51]

2.3.3 Brazil

During the 90s, Brazil signed BITs with 14 countries but, because of Congress and the Judicial Power's strong political opposition, they were not

50• KAVALJIT Singh & BURGHARD ILGE, *Rethinking Bilateral Investment Treaties: Critical Issues and Policy Choices*, Holland, 2016.
51• Model BIT India, Chapter 14.

ratified nor did they enter into force. Thus, Brazil became one of the few economies without BITS and without a model investment agreement.

Nevertheless, the model Agreement on Cooperation and Facilitation of Investments (ACFI) was approved in 2013. In March 2015, Brazil signed the first ACFI and the agreements signed with Angola, Chile, Colombia, Malawi, Mexico, and Mozambique are currently in force.

This Agreement seeks to cover the needs of capital importing and exporting. It provides that foreign investment must establish the transfer of technology and training as benefits. It seeks to generate a general impact through the investments of the source country in the host State, such as employment, or local labor – all through special agreements, additional programs and agreements that are complementary to the main treaty. It seeks to mitigate risks and prevent disputes through the periodic exchange of information. In contrast to traditional BITs, ACFs forbid investors to initiate arbitration proceedings against a State; to the contrary, they contemplate State – State arbitration.

> *"The treaties signed by Brazil contemplate three stages sine qua non for dispute resolution; in the first place, Parties are ordered to resort to non-judicial mechanisms for friendly settlement of the dispute, in which they must appoint an Ombudsman in each State so that he or she acts as mediator. In the second place, if friendly settlement fails, the situation must be forwarded to a joint Committee created by both Parties. In third place, if the dispute is not resolved by this Committee, the parties may submit it to an ad hoc Tribunal or an permanent arbitration institution if they were to mutually decide this.*
>
> *It is interesting that these agreements did not foresee a specific procedure or rules for international arbitration, which confers a greater degree of autonomy and flexibility on the mechanism oriented towards the recovery of the State's prominent role, proper to the decade of the seventies. The latter fact generates – in the author's opinion—two consequences that are the reason for the title of this commentary: first, the State – State dispute resolution mechanism constitutes a readaptation of the rule of diplomatic protection, to the extent that, as a prerogativeof the State and not an investor right, a violation of the BIT has been breached or one of its strategic interests. Second, although BITs seek the protection of direct foreign investment (DFI) through a series of legal guarantees, private actors have a series of impediments to resorting to arbitration and this leaves investment protection to voluntariness and national interest. This has resulted in a series of debates regarding the legal efficacy of these agreements".*[52]

52• ACCOLD, Academia Colombiana de Derecho Internacional, *Debate Global, Brasil y los recientes Acuerdos de Cooperación y Facilitación de las Inversiones: ¿un resurgimiento de la protección diplomática?*, 20 December 2015, https://debateglobal.wordpress.com/; last visited on July 28th, 2016.

Further, the agreements contain corporate social responsibility clauses (CSR), encouraging foreign investors to respect the host State's legislation, with respect to the environment and human rights.

In conclusion, ACF's not only seek investment and investor protection, but also seek to coordinate agencies and facilitate investments pursuant to thematic agendas on cooperation and observance of internal legislation.

2.3.4 Colombia

Colombia has developed a model BIT that includes interesting innovations.

> *"The first is that it grants a greater degree of discretion to the State to develop public polices, by establishing that the sole fact that a measure causes adverse effects to the economic value of a certain investment does not automatically imply expropriation. Moreover, once a dispute has arisen, a term of 12 months is set prior to being able to resort to arbitration. The idea is to encourage mutual resolution of the dispute and avoid the recourse to jurisdictional mechanisms; moreover, when arbitration is inevitable, it allows a more adequate preparation of the State's defense."* [53]

According to information provided by the Colombian Ministry of Commerce (http://www.tlc.gov.co/publicaciones.php?id=6126), a series of International Investment Agreements with México, Chile, Guatemala, El Salvador, Honduras, EFTA States, Canada, United States, Spain, Japan, Switzerland, Perú, China, India and the United Kingdom are in force.

2.3.5 Belgium

Belgium has signed investment treaties with over 90 countries, mostly developing countries or countries in transition. It signed its first BIT with Tunisia, and then signed with other Asian and African developing countries. During the 80s, after the collapse of communism and the fall of the Soviet Union, Belgium began to sign BIT's with countries in Western Europe and in the 90s it expanded even to Central and South America.

The model BIT that continued unmodified until 2002 followed the traditional European model. It was short and did not include many details, contained a broad definition of investments, and a prohibition for governments against discriminating foreign investments in favor of domestic investments or third party States. It required that governments provide

53• TANZI, Attila, ASTERITI, Alessandra, POLANCO, Rodrigo, TURRINI, Paolo, *International Investment Law in Latin America,* p. 127.

fair and equitable treatment. It also demanded that the host state allow foreign investors to transfer funds and repatriate capital. It required prompt and fair compensation for expropriations of property and allowed investors to seek protection for claimed harm through the submission of direct claims against host States via international arbitration.

Belgium's 2002 model BIT included provisions regarding labor and environmental rights and set the previous traditional European model aside.

In practice, the BIT signed with Madagascar in 2005 contains provisions regarding the relationship between investment protection and protection of labor[54] and environmental[55] rights (BERNASCONI-OSTERWALDER & JOHNSON, 2010)[56]; references to labor and environmental protection have also been included in the renegotiations of BITs with Korea in 2006 that replaced the 1976 BIT and the one signed with Democratic Republic of Congo in 2005, that replaced the 1977 BIT.

2.4 Structure of the BIT

In general, the current IIAs and, BITs specifically, provide obligations for host States and rights to investors.

> *"The provisions of IIAs are not uniform; while some of the key countries in the OECD have their own preferred templates for such agreements, these are constantly evolving,*

54• Art. 6. Agreement on Reciprocal Protection of Investments between Madagascar and Belgium, 2005:

Original text

1. Reconnaissant que chaque Partie contractante a le droit de fixer ses propres normes de protection du travail et d'adopter ou de modifieren conséquence ses lois ad hoc, chacune des Parties contractantes veillera à ce que sa législation fixe des normes de travail conformes aux droits universellement reconnus des travailleurs énoncés au paragraphe 6 de l'Article 1 et n'aura de cesse d'améliorer lesdites normes.
2. Les Parties contractantes reconnaissent qu'il n'est pas approprié d'assouplir la législation nationale du travail aux fins d'encourager les investissements. A cet égard, chacune des Parties contractantes veillera à ce qu'il ne soit pas accordé d'exemption ni dérogé d'aucune autre façon à ladite législation, pas plus qu'il ne soit offert de possibilité d'exemption ou autre dérogation aux fins d'encourager la constitution, l'entretien ou l'expansion d'un investissement sur son territoire.
3. Les Parties contractantes réaffirment leurs obligations en tant que membres de l'Organisation internationale du Travail ainsi que leurs engagements en vertu de la Déclaration de l'OIT relative aux principes et droits fondamentaux du travail et de son suivi. Les Parties contractantes veilleront à ce que lesdits principes et droits universellement reconnus des travailleurs énoncés au paragraphe 6 de l'Article 1 soient reconnus et protégés dans leur législation nationale.
4. Les Parties contractantes reconnaissent que la coopération mutuelle leur offre des possibilités accrues d'amélioration des normes de protection du travail. A la demande de l'une des parties, l'autre partie cceptera que les représentants de leurs gouvernements se réunissent à des fins de consultations sur toute matière tombant dans le domaine d'application du présent article.

such that the "standard" agreement of the mid-twentieth century is markedly different from the "standard" agreement today. The result is a complex web of agreements, with provisions that differ even among parties to agreements with the same third country."[57]

In many countries, this evolution has been recorded through the adoption of a series of model BIT's, especially in developed countries such as the United States or Canada. Nevertheless, certain common provisions are picked up by the standards of protection for foreign investors and these constitute obligations for host States.

The majority of IIAs include "definitions" that limit the scope of these agreements and establish dispute resolution mechanisms both between contracting parties in the Agreement as well as investors, nationals of the other contracting State.

Unofficial Translation

5. Recognizing that each Contracting Party has the right to set its own rules of labor protection and to adopt or modify its ad hoc laws accordingly, each Contracting Party shall ensure that its legislation sets labor standards in accordance with universally recognized labor rights set out in paragraph 6 of Article 1 and will not fail to improve those standards.
6. The Contracting Parties recognize that it is inappropriate to relax domestic labor laws in order to stimulate investment. In this regard, each of the Contracting Parties shall ensure that there are no exemptions or any laws repealed regarding such legislation; they will ensure that there is no possibility of exemption from or other derogation for the purposes of stimulating the creation, maintenance or expansion of an investment in its territory.
7. The Contracting Parties reaffirm their obligations as members of the International Labour Organization pursuant to the principles and fundamental rights to work and its enforcement. The Contracting Parties shall ensure that the principles and universally recognized rights of workers set out in paragraph 6 of Article 1 are recognized and protected in their national legislation.
8. The Contracting Parties recognize that mutual cooperation gives them a greater chance of improving labor protection standards. At the request of one party, the other party will accept the meetings of their government representatives for the purpose of the inquiries on any matter that is left within the domain of application of this article.

55• Art. 5. Agreement on Reciprocal Protection of Investments between Madagascar and Belgium, 2005, Article 5. Environment:

Original Text

1. Reconnaissant que chaque Partie contractante a le droit de fixer son propre niveau de protection de 'environnement et de définir ses politiques et priorités en matière d'environnement et de développement, ainsi que d'adopter ou de modifier en conséquence ses lois ad hoc, chacune des Parties contractantes vei llera à ce que sa législation garantisse un hautniveau de protection de l'environnement etmettra tout en œuvre en vue d'améliorer constamment ladite législation.
2. Les Parties contractantes reconnaissent qu'il n'est pas approprié d'assouplir la législation nationale en matière d'environnement aux fins d'encourager les investissements. A cet égard, chacune des Parties contractantes veillera à ce qu'il ne soit pas accordé d'exemption ni dérogé d'aucune façon à ladite législation, pas plus qu'il ne soit offert de possibilité d'exemption ou autre dérogation aux fins d'encourager la constitution, l'entretien ou l'expansion d'un investissement sur son territoire.
3. Les Parties contractantes réaffirment les engagements auxquels elles ont souscrit dans le cadred'accords internationaux en matière d'environnement. Elles veilleront à ce que lesdits engagements soient pleinement reconnus et appliqués dans leur législation nationale.
4. Les parties reconnaissent que la coopération mutuelle leur offre des possibilités accrues d'amélioration des normes de protection de l'environnement. A la demande de l'une des parties, l'autre partie acceptera que les représentants de leurs gouvernements se réunissent à des fins de consultations sur toute matière tombant dans le domaine d'application du présent article.

BITs generally hold more or less a common structure and they are relatively short instruments.

2.4.1 PREAMBLE

In the preamble, the parties state their intent and the objectives that they wish to achieve by executing the treaty. Despite being a section that notes the parties' aspirations and that omits substantive rights or obligations, the preamble is important when determining the agreement's context. According to general rules of interpretation established in Article 31 of the Vienna Convention on the Law of Treaties ("the Vienna Convention"), treaties must be interpreted *"in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose."*[58]

In fact, many tribunals have resorted to preambles to shed light on the substantive content of the obligations assumed through BITs or to determine the precise scope of jurisdictional provisions; although they have not always done so in the best possible manner.[59]

In some cases, nonetheless, Tribunals have transformed policies disclosed in the preambles of investment treaties into principles of law that could shape the substantive application of investment protection standards, in violation of the Vienna Convention.[60]

Unofficial Translation

5. Recognizing that each Contracting Party has the right to set their own level of environmental protection and define their policies and priorities for the environment and development, as well as the right to adopt or amend its laws on an ad hoc basis, each Contracting Party shall ensure that its legislation ensures a high level of environmental protection and will make every effort to achieve continuous improvement of the legislation
6. The Contracting Parties recognize that it is inappropriate to relax the national legislation on the environment in order to stimulate investment. In this regard, each of the Contracting Parties shall ensure that no one is exempt from these laws and that such legislation is not repealed in any way; it shall also ensure that there are no offers whatsoever regarding a possibility of exemption or other derogation for the purposes of stimulating the creation, maintenance or expansion of an investment in its territory.
7. The Contracting Parties reaffirm the commitments that have been signed within the framework of international environmental agreements. The Parties shall ensure that such commitments are fully recognized and that they are applied in their national legislation.
8. The Contracting Parties recognize that mutual cooperation provides them a greater chance of improved standards of environmental protection. At the request of one party, the other party accepts that representatives of their governments meet for the purpose of consultations on any matter that is within the domain of application of this article.

56• BERNASCONI, Nathalie & JOHNSON Lise, *Belgium's Model Bilateral Investment Treaty: A review, International Institute for Sustainable Development,* DesLibris, March 2010, p. 20, http://deslibris.ca.ezproxy.library.ubc.ca/ID/227320, last visit on 28th July 2016.

57• COSBEY, Aaron, MANN, Howard, PETERSON, Luke Eric, VON MOLTKE, *Konrad,. Investments and sustainable development,* IISD, International Institute for Sustainable Development. p. 9.

The investment treaty tribunal's mandate is nothing more and nothing less than the resolution of a concrete dispute between two or more litigants. A claimant seeks to establish an individuated right to compensation for acts of the host state causing prejudice to its investment, whereas the respondent host state may assert an individuated right to regulate that investment without paying compensation for that prejudice in the circumstances of the particular case. Both litigants maintain that their arguments are consistent with the concepts of 'fair and equitable treatment' or 'expropriation' found in the treaty. The collective goals that motivated the contracting states to conclude an investment treaty, as articulated in its preamble, cannot be decisive in the tribunal's resolution of the conflicting assertions of individuated rights. Where there is no specific rule of decision to apply, which is invariably the case in investment treaty arbitration, the tribunal should search for principles of law. For instance, a tribunal would be on safer ground by making reference to the principle of estoppel or legitimate expectations to give content to the fair and equitable standard of treatment, rather than appealing to the policy of achieving 'greater economic cooperation' between the contracting states to the treaty. Such an appeal is, more often than not, disingenuous: the tribunal is not equipped to assess whether a particular interpretation of the fair and equitable standard will achieve 'greater economic cooperation' between the contracting state parties and thus to invoke a policy based upon the preambular statements to resolve a concrete dispute is often to substitute speculative discourse for principled arguments."[61]

2.4.2 Definitions

The second section of BITs contains definitions, in particular, of the concepts of investor and investment. Some BITs contain clauses that define the scope of application of the treaty. Such is the case of the U.S. Model BIT (2012), which uses concepts such as "covered investment"[62] and defines aspects such as the treaty's temporal jurisdiction (*rationae temporis*) and the degree of parties' discretion in the admission of certain types of investments.

2.4.3 Investment Protection Standards

The third section of a BIT typically contains substantive investment and investor protection

58• Bilateral Investment Treaties 1995-2006, *Trends in investments rulemaking*, United Nations, New York and Geneva, 2007.

59• DOUGLAS Zachary, *The International Law of Investment Claims*, Cambridge University Press. 2009. pp. 82-84.

60• Ibid, pp. 83.

61• Ibid. pp. 84.

standards. The standards typically included in this section are: fair and equitable treatment, protection and security, national treatment, most favored nation, guarantees against arbitrary and discriminatory measures, guarantees in cases of expropriation and guarantees for the free transfer of payments. Some BITs include an "umbrella clause" that extends the protection granted by the treaty even to transactions that are not properly characterized as an "investment" according to the definition of the term in the treaty (for example, a contractual difference).

2.4.4 Dispute Resolution Rules

The fourth part of a BIT typically includes a section on dispute resolution rules. The majority of BITs establish two types of proceedings separate from conflict resolution.

The first is applicable to disputes between investors and States receiving the investment, one of its alternatives is ad – hoc arbitration or under the rules of the ICSID Convention. This method of Investor-State arbitration includes an offer to arbitrate or advance consent from the host country that perfects when the investor with respective legitimacy bring a case to arbitration.

The second resolution method establishes an arbitration process for disputes that arise between States party to the BIT with respect to the interpretation of any section of the treaty.

62• Article 2, Scope and Coverage, U.S. Model Bilateral Investment Treaty, Treaty Between the Government of The United States of America and The Government of [Country] Concerning the encouragement and reciprocal protection of investment, 2012.

CHAPTER III

THE APPLICATION AND INTERPRETATION OF BIT'S AND IIA'S WITHIN INVESTOR-STATE DISPUTE RESOLUTION SYSTEMS

Ecuador's experience

Over the passage of time, the application and interpretation of IIA's and, BIT's in particular, has become one of the most controversial issues of the investment dispute resolution system, on account of the fact that tribunals contradict each other when interpreting or applying these instruments; and because of inaccurate obligations related to each and every one of the protection standards; few certainties as to content; and, even discouraging criticism from academics.

It is true that this uncertainty is also a consequence of the fact that the majority of the texts in each one of the Agreements are completely curt and do not reflect the intent or limits that States include in international instruments.

We continue on to analyze the most representative and most frequently applied standards, especially in Ecuador's cases, as well as the most relevant arbitration decisions in each. The conclusion, nevertheless, seems to always be the same: the IIA's text must be clearer and include more detail, establishing when and under what circumstances State parties incur liability so that it can be attributed by a Tribunal pursuant to a Treaty.

Certain measures should be adopted in practice:

- Depending on the standard at issue, the parties should establish who bears the burden of proof and the value that should be given to the Defendant State's administrative or judicial resolutions.
- Include an exhaustive list of host State obligations for each of the standards.
- Include the obligations that investors must fulfill to be able to claim the protection of a certain standard.
- Include the form of redress that should be applied when each standard is breached.
- List what acts and the public institutions or dependencies that cause the State's international liability.
- Include an exhaustive list of the industries or aspects that the State excludes from protection.
- Fortunately, it appears that this is the general trend today, because, as stated, new texts include specifications and definitions for each one of the standards.

3.1 Treaty Interpretation and the Perspective of Arbitration Tribunals

The specific Treaty interpretation rules are found in Section 3 of the Vienna Convention on the Law of Treaties. *"At first glance, these provisions are not ambiguous, but rather, they are clear as to application. The International Court of Justice (ICJ), which is the principal judicial organ of the United Nations, has recognized that the Vienna rules are in principle applicable to the interpretation of treaties."*[63] *In its judgment "[it] is now well established that the provisions on interpretation of treaties contained in Articles 31 and 32 of the Convention reflect pre-existing customary international law, and thus may be (unless there are*

particular indications to the contrary)"[64] applied to treaties, even to such Treaties that entered into force even prior to the Vienna Convention or regardless of whether State parties to a dispute have signed it or not.

To date, we cannot speak about the existence of one single opinion or a "particular pattern"[65] defined to interpret Treaties, much less given the existence of a large number of bilateral, regional or multilateral agreements, as well as endless decisions issued by arbitration Tribunals and by the ICJ itself.

Many Tribunals have chosen to apply the general rules of interpretation set forth by article 31 of the Vienna Convention.[66] "Good faith", "in accordance with the ordinary meaning to be given to the terms," "context," "object and purpose" of the treaty as general guides for interpretation.

This context includes "[a]ny instrument which was made by one or more parties in connection with the execution of the treaty and accepted by the other parties as an instrument related to the treaty."[67]

On other occasions, Tribunals have resorted to the complementary interpretation mechanism established by article 32 of the Vienna Convention. This article allows Tribunals to investigate the treaty's travaux preparatoires and the circumstances under which it was negotiated, but only (i) to confirm the meaning yielded by interpretation of the treaty under the rules of article 31 (not to contradict the result) or (ii) to determine the meaning of the treaty when the application of article 31 yields an ambiguous or obscure result that leads to an absurd or unreasonable result.[68]

Without a doubt, there are two currents:

- An excessively extensive interpretation of the BIT, that applies investors rights with all their force and in a broad and unrestrictive manner and that leads to the limitation of the State's sovereignty to regulate its affairs, as in *Methanex* v. *United States*; and,
- An excessively restrictive interpretation that reduces the force and the assurances of investors under the BIT; applied by the Tribunal in *SGS v. Pakistan*.

63• NWAIGBO, Onyeka. *Vienna Convention On The Law Of Treaties And Interpretation Of Treaty In Investment Dispute Arbitration*. pp. 4.

64• United Nations, *Report of International Arbitral Awards*, The Iron Rhine ("Ijzeren Rijn") Railway between the Kingdom of Belgium and the Kingdom of the Netherlands, May 24th, 2005. par. 45.

65• Ibid.

66• Art. 31. Vienna Convention on the Law of Treaties, U.N. Doc A/CONF.39/27 (1969), 1155 U.N.T.S. 331, entry into force on January 27th, 1980, Vienna, signed on May 23th,1969.

67• Ibid, Art. 31(2)(b)

68• Ibid, Art. 32(a)(b)

This situation has led to legal insecurity when considering the application of Treaties. Tribunals are inclined to apply one or another method on many occasions, in an unpredictable and willy-nilly manner, without an objective reason to do so. They have even arrived to the absurdity of interpreting one same rule, using the method established by article 31 of the Vienna Convention as a basis and obtaining different conclusions.

However, the result of these interpretations is the most serious matter: They are mostly (and sometimes unreasonably) in favor of investors.[69]

Let's look at some examples of this willy-nilly interpretation:

- *In Enron v. Argentina*, the application of article 31 of the Vienna Convention was given exclusive priority

  32. The Tribunal's interpretation is, in addition, fully consistent with the rules on the interpretation of treaties laid down in the 1969 Vienna Convention on the Law of Treaties. Article 31.1 of this Convention provides that "A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose". Also Article 32 indicates the recourse to supplementary means of interpretation, including the "preparatory work of the treaty and the circumstances of its conclusion…". That the Treaty was made with the specific purpose of guaranteeing the rights of the foreign investors and encouraging their participation in the privatization process, is beyond doubt. In view of the explicit text of the Treaty and its object and purpose, it is not even necessary to resort to supplementary means of interpretation, such as the preparatory work, a step that would be required only in case of insufficient elements of interpretation in connection with the rule laid down in Article 31 of the Convention..[70]

- In *Plama v. Bulgaria*, the investor sought to expand the scope of the most favored nation clause in the Bulgaria – Cyprus BIT to use an arbitration procedure established in another BIT signed by Bulgaria, the Tribunal used the preamble to the Bulgaria – Cyprus BIT as the basis for its interpretation:

  "192. The "context" may support the Claimant's interpretation since the MFN provision is set forth amongst the Treaty's provisions relating to substantive investment protection. However, the context alone, in light of the other elements

69• DOLZER Rudolf and SCHREUER Christoph, *Principles of International Investment Law,* Oxford, 2012, p. 30.

70• ICSID, Enron Corporation and Ponderosa Assets, L.P. vs. Argentina, ICSID Case No. ARB/01/3, Decision on Jurisdiction, August 2nd, 2004, par. 32.

of interpretation considered herein, does not persuade the Tribunal that the parties intended such an interpretation. And the Tribunal has no evidence before it of the negotiating history of the BIT to convince it otherwise.

193. The object and purpose of the Bulgaria-Cyprus BIT is: "the creation of favourable conditions for investments by investors of one Contracting Party in the territory of the other Contracting Party." (Preamble, see also title which refers to "mutual encouragement and protection of investments"). The Claimant places much reliance on the foregoing and on the Report of the Executive Directors on the ICSID Convention of 1965, according to which: "the creation of an institution designed to facilitate the settlement of disputes between States and foreign investors can be a major step toward promoting an atmosphere of mutual confidence and thus stimulating a larger flow of private international capital in those countries which wish to attract it" (Exhibit C60, at paragraph 9). The Claimant further relies on UNCTAD's study "Bilateral Investment Treaties in the Mid-1990s" which contains language to the same effect (Exhibit C104 at p. 5). The Claimant also points to the Maffezini decision in which it is observed: "dispute settlement arrangements are inextricably related to the protection of foreign investors, as they are also related to the protection of rights of traders under treaties of commerce." Such statements are as such undeniable in their generality, but they are legally insufficient to conclude that the Contracting Parties to the Bulgaria-Cyprus BIT intended to cover by the MFN provision agreements to arbitrate in other treaties to which Bulgaria (and Cyprus for that matter) is a Contracting Party. Here, the Tribunal is mindful of Sir Ian Sinclair's warning of the "risk that the placing of undue emphasis on the 'object and purpose' of a treaty will encourage teleological methods of interpretation [which], in some of its more extreme forms, will even deny the relevance of the intentions of the parties"

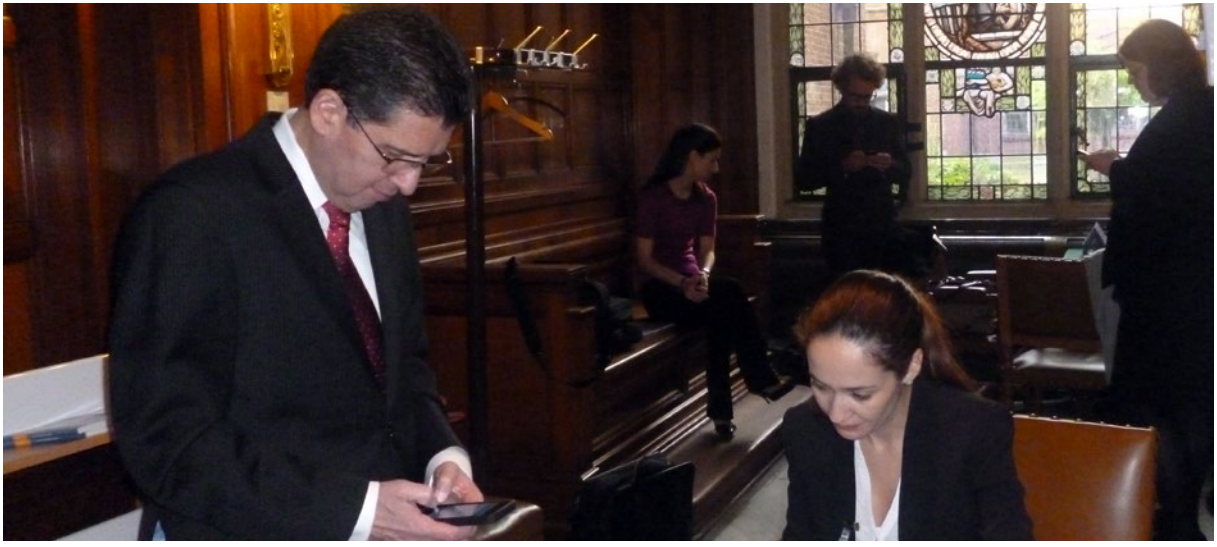
194. The Tribunal finds no guidance in the provisions of paragraphs 2 and 3 of Article 31 of the Vienna Convention, as there are no facts or circumstances that point to their application. The same goes for paragraph 4 of Article 31 of the Vienna Convention ("A special meaning shall be given to a term if it is established that the parties so intended")."[71]

71 • ICSID, Plama Consortium Ltd vs. Bulgaria, ICSID Case No. ARB/03/24, Decision on Jurisdiction, February 8th, 2005, par. 192, 193 y 194.

3.1.1 Ecuador's experience

Ecuador has also been both a "witness" and a "victim" of this interpretive pendulum.

3.1.1.1 The Perenco Case: travaux préparatoires



The Hague, September 10, 2013, Peace Palace. Before the hearing on Perenco's Counterclaim, Dr. Diego Garcia Carrion with Dra. Maria Claudia Procopiak (Dechert LLP).

During the Jurisdictional Phase, Ecuador's defense argued that the Tribunal had no jurisdiction, as Perenco was not "French" within the meaning of Article 1(3)(ii) of the Treaty signed between Ecuador and France, which was claimed by the company. Ecuador argued that, in light of the text of Article 1(3)(ii), a company could benefit from the BIT provided that it was:

"Art.1.-*For the application of this agreement 3. The term "company" designates: ii) Any legal person controlled by the nationals of one of the Contracting Parties, or by legal persons with domicile in the territory of one of the Contracting Parties and incorporated pursuant to their legislation.*

In application of article 31 of the Vienna Convention on the Law of Treaties and, as it does not provide a distinction between indirect and direct control, it was clear that a company could only benefit from protection under the BIT if the control was direct.

This conclusion was supported by the BIT's *travaux preparatoires*. Indeed, the model used as a basis for the 1986 negotiations distinguished control as indirect or direct.[72] The text was the following:

3.- El término "sociedades" designa; i) A toda persona jurídica constituída en el territorio de una de las Partes Contrantes, conforme a su legislación y que tiene en el mismo, su domicilio social; o, ii) Toda persona jurídica controlada directa o indirectamente, por nacionales de una de las Partes Contrantes, o por personas jurídicas que tengan su domicilio en el territorio de una de las Partes Contratantes y constituídas conforme a su Legislación.

> *3. - The term "corporations" designates: i) Any legal person incorporated in the territory of one of the Contracting Parties, pursuant to its legislation and with social domicile in this territory; or, ii) Any legal person controlled by nationals of one of the Contracting Parties, or by legal persons with domicile in the territory of one of the Contracting States and incorporated pursuant to its legislation.*[73]

Per the above image, the reference to "direct and indirect" was eliminated and the above was the final version of Article 1(3)(ii).

Moreover, when one of the parties decided to extend the benefits of the BIT to indirect control, they did so expressly, when defining investments and expressly stipulating that this considered "all assets belonging [*possédés*], (owned) direct or indirectly by the nationals or corporations of one of the Contracting Parties […]."[74]

On September 12, 2014, the Arbitration Tribunal decided that, in referencing control, the text used by the Contracting States is plain: "controlled", which, in its opinion, it referenced direct and indirect control.

It is impossible to understand, to say the least, how the Tribunal concluded something different based on the literal sense of the terms and the *travaux preparatoires*, which, clearly, and as established by Art. 32 of the Vienna Convention, could only confirm the conclusion obtained in light of the ordinary meaning of the terms.

Given its decision, the Tribunal forced Ecuador to litigate a case that clearly should not have existed and one regarding which, on the date of this publication, the Tribunal had already

72• Article 1.Travaux prèparatoires (Perenco Case: The travaux preparatoires) submitted by the company in the arbitration in Spanish and French versions, with a translation identified within the arbitration as CE 188 (Claimant's Exhibit), pp. 6.

73• Unofficial translation. "3. The term "corporations" designates: i) Any legal person incorporated in the territory of one of the Contracting Parties, pursuant to its legislation and with social domicile in this territory; or, ii) Any legal person controlled XXXXXXXXX by nationals of one of the Contracting Parties, or by legal persons with domicile in the territory of one of the Contracting States and incorporated pursuant to its legislation."

74• Ibid. par. 26.

concluded the State's liability for the violation of a BIT that does not even protect the Plaintiff.

3.1.1.2 Ecuador – United States Case. BIT Interpretation

The majority of IIA's and, specifically, BIT's contain dispute resolution mechanisms among contracting parties, with a structure that is similar to the mechanism contemplated by investor – State disputes; in other words, they provide for a period of negotiation, prior to being able to file for arbitration.

This mechanism shows the disputes that arise between parties, the signing States, with respect to the application and interpretation of the Treaty. It is worth saying that these disputes have not arisen, except in the case brought by Ecuador against the United States of America for the interpretation of the BIT signed between both States.

In general, treaty interpretation cases have been scarce such as NAFTA; or, when the parties do not obtain positive results, they have not continued or, perhaps, as in many other matters, when there are no clear rules regarding State-State disputes, it is possible that many actors do choose not to risk getting an unforeseeable result. Based on Ecuador's experience in the dispute regarding the interpretation of a provision of the BIT with U.S., at this time, we can categorically say that these fears do exist and that they are justified.

Given the award issued in an arbitration brought by Chevron-Texaco in which the Tribunal applied article II (7) of the BIT, the State of Ecuador informed the U.S. of its intent to interpret this article in order to define its scope and the limits of application because it did not agree with the Tribunal's interpretation of the effective means standard, under Article VII (2) of the BIT.

In Ecuador's opinion, this interpretation was necessary because investment treaties, as well as treaties in general, reflect the obligations that States acquire and their texts must faithfully reflect the parties' intent to ensure that the treatment afforded to their respective nationals and properties is not inferior to the minimum international standard.[75]

In essence, this experience could be classified as frustrating for Ecuador. After Ecuador informed the United States of America, in writing, of its intent to begin this interpretive process, and when it did not receive an answer to its communication stating its interpretation of the treaty, it began an arbitration case under UNCITRAL's rules, on 28 June 2011.

75• J.C. Thomas, *Reflections on Article 1105 of NAFTA: History, State Practice and the Influence of Commentators*, 17 ICSID R. - FOREIGN INVESTMENT L. J. 21 (2002), p. 26.

Quito, April 15, 2015, Meeting Room. The International Affairs and Arbitration team working meeting.

After the Tribunal had been constituted and if the procedural schedule were to have been fulfilled, in which the U.S. objected to the Tribunal's jurisdiction, barely two days prior to holding the hearing on the Merits, the Tribunal suddenly issued its jurisdictional award, declaring that it had no jurisdiction to hear the dispute filed by the Tribunal.

In a disappointing manner, in its award dated September 29, 2012, a majority of the Tribunal concluded that Ecuador's claims had no practical relevance and that there was no dispute between Ecuador and the U.S. because the latter's interpretation was no different than Ecuador's interpretation.

For the majority of the Tribunals, the problems in the case were between Ecuador and U.S. Company Chevron, and not between Ecuador and the U.S., because neither of the parties had accused the other of a violation of article II (7) of the BIT. In the majority opinion, the Tribunal's jurisdiction could very well exist in the event of a specific dispute between the parties.

Nevertheless, in a contradictory fashion, the Tribunal also stated that if the U.S. had opposed Ecuador's arguments regarding Article II (7) or had actively supported the Chevron Tribunal's perspective, the "result could well have been different."

The Tribunal held that Ecuador could not conclude that it disagreed with the U.S., due to the U.S.'s silence to its request for interpretation, because, in its opinion, this silence had a different explanation; that the U.S. preferred not to interfere with a tribunal's decision in the framework of a BIT, regardless of whether it was correct or not.

These are also matters that should be regulated by the framework of IIAs because the possibility of an interpretation becomes somewhat ethereal. The dissent issued by Arbitrator Raul Vinuesa is the best criticism of this decision; in an arbitration proceeding, in which a Tribunal adhered to the U.S.'s position – a party that was not interested in entering a debate on the scope of the effective means standards because of its situation as a defendant State, but also because of its nature as an exporter of investment capital.

In paragraphs 36, 37 and 38 of his dissent, Professor Vinuesa clearly stated that if one of the parties "deliberately refused to clarify the Treaty's meaning" this "gives another State the opportunity to resort to the mechanism of Article VII of the Treaty, in other words, to resort to arbitration."

Clearly, in this case, the Tribunal adopted a comfortable position by simply accepting the U.S.' position without much explanation, that if one of the parties to a Treaty wishes to clarify its meaning, they must reach an agreement among them through an inquiry in advance. By accepting the U.S.'s position, the Tribunal refused to consider what would happen if one of the parties did not access the inquiry mechanism such as the U.S. The dissent references this point and questions the majority's position.

3.2 Coverage of BITs and Definitions

Despite the reservations that IIA's can give rise to today, it is clear that they are tools used by States (not all states, today, and perhaps, with greater judgment and knowledge than in previous decades as well as, of course, with the specificities of each) within their economic development policy in order to regulate foreign investment.

The scope of application of these agreements is largely defined by the definitions of "investment" and "investor."

3.2.1 Definition of Investment

> *"Investment agreements often define "investment" in a way that is both broad and open-ended. The broadest definitions embrace every kind of asset. They include in particular movable and immovable property, interests in companies (including both portfolio and direct investment), contractual rights (such as*

service agreements), intellectual property, and business concessions."

"Each of these types of investment has different economic and development implications for home and host countries. The parties to an investment agreement thus may not wish to liberalize, promote, protect or regulate all investment flows in the same manner or to the same extent. For example, the economic development policies of treaty parties may call for excluding certain assets from coverage by a particular investment agreement or for treating certain assets differently under the agreement."[76]

When reviewing investment agreements (multilateral or bilateral) and commercial agreements with investment chapters, we conclude that there are four ways to address this subject:

i) The definition based on assets, i.e., a broad definition of investment is included: "any type of assets", generally followed by a non-exhaustive list of examples of "investments";
ii) A tautological definition: "investment is any investment";
iii) An exhaustive list of whatever constitutes an investment; and,
iv) Adopting any of the above methods, subject to exclusions for anything that is not considered an investment.

This definition is fundamental when a dispute arises, because, to the extent that an economic activity, a transaction, a good, a contract, etc. is considered an "investment" it will be protected by the protection standards under a BIT and the arbitration tribunals created by virtue of the dispute resolution clause; thus, they can assume jurisdiction and will have subject matter jurisdiction to hear the dispute. "Accordingly, whether a transaction qualifies as an investment can mean the difference between having to litigate a breach of contract claim against a foreign government in the host country's courts and bringing a claim under a governing IIA and having the dispute settled by an international arbitration tribunal in a neutral forum."[77]

As noted previously, BITs and IIAs are not necessarily explicit when conceptualizing an investment and, in practice, this has given Tribunals great discretion and ability to consider certain specific circumstances of a case when determining if a transaction at issue is protected as an investment. This discretion has led to inconsistent interpretations of the concept of investment.

76• UNCTAD, *Series on issues in international investment agreement. Scope and definition*. New York and Geneva, 1999, p. 1.

This discretion is aggravated even further if it addresses arbitration under the ICSID Convention or if this is arbitration brought before another institution and under other Regulations or if it is ad-hoc arbitration.

> *"In order to accept jurisdiction under the ICSID Convention, Tribunals have usually adopted a double barrel approach: they consider an "investment" both under Article 25 (1) of the Convention as well as under the relevant investment agreement-designated by some "double barrel approach" or "double barreled test."*[78] Certainly, under the ICSID Convention, there are two filters that an investor must pass when determining whether a Tribunal, created under its rules, can hear a dispute. In fact, in certain cases, the Tribunals have rejected their jurisdiction if the plaintiffs do not fulfill the criteria set forth in Article 25 of the ICSID Convention. For example, *in Malaysian Historical Salvors, SDN, BHC v. Malaysia*, the methodology employed by the tribunals in Salini and in Joy Mining required that a claimant in ICSID arbitration prove to the tribunal that: *"Under the double-barreled test, a finding that the Contract satisfied the definition of "investment" under the BIT would not be sufficient for this Tribunal to assume jurisdiction, if the Contract failed to satisfy the objective criterion of an "investment" within the meaning of Article 25."*[79]

In the other cases, ad-hoc arbitrations or arbitration under other Regulations, the issue is somewhat simpler, as the BIT becomes the only element to determine whether the transaction, the contract, the company, the assets, etc., are an investment or not.

And at first sight this could be harmless; it might even be used by an investor with a certain acuity and if there are doubts regarding whether its investment falls into the concept contemplated by the ICSID Convention, it could attempt ad-hoc arbitration, as surely, the options for an arbitration Tribunal to declare its own jurisdiction are greater. Neither doctrine nor arbitration decisions have been able to set forth even minimum criteria to use in order to

77• MASLO, Paul B., *Definition of Investment: Gatekeeper to Investment Treaty Arbitration,* 2011, Publicist, online Publication of Berkeley Journal of International Law.

78• YANNACA, Katia, *Definition of Investment: An open-ended search for a Balance Approach,* Oxford University Press Inc., 2010, pp. 249.

79• ICSID, MALAYSIAN HISTORICAL SALVORS SDN, BHD vs. MALAYSIA, ICSID Case No. ARB/05/10, Award on Jurisdiction, May 10th, 2007, par. 55.

define an "investment." The opinion set forth pursuant to the *Salini Test (Salini v. Morocco)*, despite giving some guidance regarding the requirements for an investment, have not resolved the problem and, although certain Tribunal have adopted this text, many others have not.

However, even among ICSID Tribunals, two positions exist with respect to the definition of an investment. On one hand, certain Tribunals believe that one must first identify that certain features exist, and if they do, conclude on the existence of an investment. On the other hand, other Tribunals believe that creating a definition for investment pursuant to the Washington Convention is unnecessary, because it does not include one. This is because when the agreement was being debated, the definition was expressly withdrawn so that states would have absolute freedom when defining the term in their IIAs.

The following list summarizes the situation:

SALINI TEST – INCONSISTENCIES IN THE INTERPRETATIONS OF TRIBUNALS [80]

Salini v. Morocco: The investment requirement must be respected as an "objective criterion." There are 4 factors that characterize an investment: **(i)** an economic contribution; **(ii)** a certain duration of the implementation of the project or contract; **(iii)** sharing in the risks of the transaction; **(iv)** contribution to the host State's economic development.

CASES THAT ADOPTED / CONSISTENT WITH THE SALINI TEST

Joy Mining v. Egypt: The Tribunal highlighted that the extent to which each case fulfills the Salini test is specific to each case, as it depends on the specific circumstances of each situation.

Certain Tribunals, either in ICSID cases or in other fora, have followed the Salini Test, namely:

- Patrick Mitchell v. Congo;
- Bayindir v. Pakistan;
- Saipem v. Bangladesh;
- Noble Energy v. Ecuador;
- Kardassopoulos v. Georgia;
- Jan van de Nul v. Egypt;
- Helnan v. Egypt;
- Milicom v. Senegal;
- Ulysseas v. Ecuador.

CASES THAT HAVE ADOPTED A MODIFIED FORMULA OR A FORMULA OTHER THAN THE SALINI TEST:

Abaclat v. Argentina: Considering that the Salini test was never included in the ICSID Convention and that its application is controversial, as tribunals have differed in its application and it has been applied to a different extent, this tribunal does not find sufficient justification to follow and copy the Salini criterion. The Salini criterion can be used to describe the features that certain contributions could or should have. However, it should not be used to create a limitation that neither ICSID nor the contracting parties to a specific BIT attempted to create.

80• Excerpts by SABAHI, Borzu y DUGGAL, Kabir Notion of *"Investment"*, 2014.

Alpha Projecktholding v. Ukraine: The ICSID Convention does not define the term "investment." Given the absence of a definition, both parties refer to illustrative criteria developed in various arbitration cases, most notably, the award in Salini v. Morocco, the elements of the so-called Salini test, which some tribunals have applied as mandatory and on a cumulative basis (i.e., if one feature is missing, a claimed investment will be ruled out of ICSID jurisdiction), are not found in Article 25(1) of the ICSID Convention. In applying the criteria in this manner, these tribunals have sought to apply a universal definition of "investment" under the ICSID the fact that the drafters and signatories of the Convention decided that it should not have one. This Tribunal will not follow that approach and will not impose additional requirements beyond those expressed on the face of Article 25(1) of the ICSID Convention and the UABIT.

Phoenix v. Czech Republic: The Tribunal notes that there are six elements in an investment: (1) a contribution in money or other assets; (ii) a certain duration; (iii) an element of risk; (iv) an operation performed in order to develop the economic activity of the host State; (v) assets invested according to the laws of the host State; and (vi) assets invested in good faith. [Contrast to the approach of the Tribunal in Fakes)

Saba Fakes v. Turkey: (the formula of three objective criteria) The Tribunal considers that there are three elements in an investment: (i) a contribution, (ii) a certain duration, and (iii) an element of risk. It rejects the element of contribution to the development of the host State (based on the preamble to the ICSID Convention) because an investment that is expected to be fruitful can become an economic disaster but such investments cannot fall outside of the scope of application of the Convention for that reason. It also rejects the element of good faith (since it is not contemplated in the text of the ICSID Convention) and the legality of the investment (since these conditions must be included in the BIT). This approach was also adopted for the cases KT Asia v. Kashakhstan and Deutsche Bank v. Sri Lanka.

Pantechniki v. Albania: a single arbitrator tribunal noted that two of the elements characterize an investment under the Salini Test ("a certain duration" and a "contribution to the development of the Host State" are unacceptably subjective. Despite the fact that Salini makes a respectable attempt to define the features of an investment, it includes subjective elements that: (a) transform arbitrators into public policy developers; and (b) increase the unforeseeability of ICSID to resolve these disputes.

Quiborax v. Bolivia: "The Tribunal believes that the element of contribution to the development of the host State is generally considered to be one of the four parts of the Salini Test. However, this contribution could be a consequence of a successful investment, not a requirement for one. If the investment fails, it may not contribute to the development of the host State. This does not mean that it is not an investment.

Biwater Gauff v. Tanzania / Annulment of Malaysian Historical Salvors v. Malaysia: Both the Biwater Tribunal as well as the Annullment Committee in Malaysian Salvors noted that there is no basis to apply the Salini Test to all cases and that it does not arise from the ICSID Convention. A rigid application of the Salini Test is problematic, since one runs the risk of excluding certain types of transactions. These tribunals recommended that the focus for the meaning of "investment" must be determined by reference to the agreement among the parties instead of an autonomous and strict definition as in the Salini Test.

Inmaris v. Ukraine: Despite the fact that a series of tribunals have adopted some or all of the features of the Salini Test as a mandatory and restrictive definition for purposes of the ICSID Convention, this Tribunal considers that it is appropriate to give deference to the articulation of State Parties in the instrument of consent (e.g. the BIT) on which the investment was constituted.

MCI v. Ecuador: The Tribunal notes that the requirements that were taken into account in certain arbitration precedents for purposes of determining the existence of an investment protected by a treaty (such as elements of duration and risk of a purported investment) must be considered as mere examples and not necessarily as elements required for an investment to exist.

SGS v. Paraguay: "Would go as far as to suggest that any definition of investment agreed to by the States in a BIT (or by a State and an investor in a contract) must constitute an investment for the purposes of Article 25(1). The States Party to a BIT agree to protect certain types of economic activity, and, when they note that the disputes and investors and States regarding these types of activities can be resolved through, among others, ICSID arbitration; this means that [the States] believe that these economic activities constitute an "investment" also in the context of the ICSID Convention. […] A Tribunal must have strong reasons to hold that a mutually-decided definition of investment should not be considered."

Phillip Morris v. Uruguay: In the Tribunal's view, the four constitutive elements of the Salini test do not constitute jurisdictional requirements to the effect that the absence of one or the other of these elements would imply a lack of jurisdiction. They are typical features of investments under the ICSID Convention, not "a set of mandatory legal requirements." As such, they may assist in identifying or in extreme cases excluding the presence of an investment but they cannot defeat the broad and flexible concept of investment under the ICSID Convention to the extent it is not limited by the relevant treaty, (…)."

Tribunals also exist that, despite not being subject to the ICSID Convention, have adopted the criteria of the Salini Test or consider it in some way. For example, in the case brought by American company Ulysseas against the Ecuadorian State, the Tribunal, in its 12 June 2012 award, stated that:

> *"251. The Tribunal shares Respondent's view.* ***As held by many ICSID tribunals, the ordinary conception of an investment includes several basic characteristics, essentially: (a) it must consist of a contribution having an economic value; (b) it must be made for a certain duration; (c) there must be the expectation of a return on the investment, subject to an element of risk; (d) it should contribute to the development of the economy of the host State.*** *Regardless of the definition of an "investment" under Article I(1)(a) of the BIT, these factors inform the determination of the moment when Claimant "invested" in Ecuador in the ordinary sense and began relying on any legitimate expectations that it may have formed.*
>
> ***252. In order for an "investment" to arise in this sense, there must be an actual transfer of money or other economic value from a national (whether a physical or a judicial person) of a foreign State to the host State through the assumption of some kind of commitment ensuring the effectiveness of the contribution and its duration over a period of time…"***

And there are other non-ICSID Tribunals that instead have clearly established that the criteria set forth based on the ICSID Convention are not applicably, for example, in *GUARACACHI AMERICA, INC. et.al. v. The Plurinational State of Bolivia*, in which the Tribunal stated:

> *"350. The Respondent cited the case of Quiborax v. Bolivia in support of the contention that no investment exists through a shareholding if there is no payment for those shares. The Tribunal notes, however, that Quiborax v. Bolivia was an ICSID case where the tribunal decided to analyze whether the "investor" had an investment under Article 25 of the Washington Convention. In fact, as regards the applicable BIT, the Quiborax tribunal concluded without further*

elaboration that "Bolivia does not contest that the Claimants have made an 'investment' within the meaning of the BIT".[81]

3.2.1.1 Ecuador's experience

The ample choices that Tribunals have when defining an investment also derive from a series of interpretations that can be considered foolish. Ecuador has experienced this folly because, under the pretext of defining whether an investment is or is not covered by a BIT, another principle that governs International Treaties such as non-retroactivity has been violated.

This occurred specifically with the definition of investment in the BIT signed between Ecuador and the United States of America.

The definition of investment is found in article 1 (1) of the Treaty

> ***1. For the purposes of this Treaty,***
> ***(a)*** *"investment" means every kind of investment in the territory of one Party owned or controlled directly or indirectly by nationals or companies of the other Party, such as equity, debt, and service and investment contracts; and includes:*
> ***(i)*** *tangible and intangible property, including rights, such as mortgages, liens and pledges;*
> ***(ii)*** *a company or shares of stock or other interests in a company or interests in the assets thereof;*
> ***(iii)*** *a claim to money or a claim to performance having economic value, and associated with an investment;*
> ***(iv)*** *intellectual property which includes, inter alia, rights relating to:*
> *literary and artistic works, including sound recordings;*
> *inventions in all fields of human endeavor;*
> *industrial designs;*
> *semiconductor mask works;*
> *trade secrets, know-how, and confidential business information; and trademarks, service marks, and trade names; and*
> ***(v)*** *any right conferred by law or contract, and any licenses and permits pursuant to law;*[82]
> *Thus, the definition is quite broad; and this has given way for arbitration Tribunals in cases MCI, Chevron II and III to assume jurisdiction, in violation of every legal principle, despite the fact that the investments terminated prior to the entry into force of the BIT.*

The Tribunal in MCI made the following interpretation:

81• Permanent Court of Arbitration, GUARACACHI AMERICA, INC. y RURELEC PLC vs. Bolivia, PCA CASE No. 2011-17, January 31st, 2014, par. 350.

82• Treaty between Ecuador and the United States of America on the Promotion and Protection of Investments, August 27th, 1993.

> *164. **The Tribunal concludes that Article I(a) of the BIT gives a broad definition of investment** and that the rights and interests alleged by the Claimants to have subsisted as a consequence of the Seacoast project, after the entry into force of the BIT—such as the intangible assets of accounts receivable, the existence of an operating permit—would fit that definition.*[83]

In other words, for the Tribunal, an investment exists when there is a consequence of investment, regardless of its nature (such as accounts receivable) or when a permit is valid even if it has no effect because the associated project and investment no longer exist and ceased to do so prior to the entry into force of the BIT pursuant to which the investor claims protection.

Thus, the Tribunal assumed jurisdiction over the Plaintiff's claim.

Subsequently, in 2008, the Tribunal that heard the arbitration case brought by Chevron against the Republic of Ecuador, a case that was designated "Chevron II", confirmed the position of the American oil company, in the sense that:

> *181. The Claimants highlighted in their submissions that the definition of "investment" in the BIT is a broad one that covers "every kind of investment." Beyond being broad in its general terms, the definition enumerates a myriad of forms of investment that are covered. It first specifies that it covers investment forms "such as equity, debt, and service and investment contracts." It then gives a further non-exhaustive list of forms that an investment may take. The list covers, among other things, multiple further incorporeal assets and speaks of a variety of rights, claims, and interests that an investor may hold in them. In addition, Article I(3) of the BIT provides that "[a]ny alteration of the form in which assets are invested or reinvested shall not affect their character as investment."*
>
> ***183. Taken together, the above-mentioned provisions indicate to the Tribunal that once an investment is established, the BIT intends to close any possible gaps in the protection of that investment as it proceeds in time and potentially changes form. Once an investment is established, it continues to exist and be protected until its ultimate "disposal" has been completed – that is, until it has been wound up.***
>
> *184. The Claimants' investments were largely liquidated when they transferred their ownership in the concession to PetroEcuador and upon the conclusion of various Settlement Agreements with Ecuador. Yet, those investments were and are not yet fully wound up because of ongoing*

83• ICSID, M.C.I. Power Group L.C. and New Turbine INC. vs. Ecuador, ICSID Case No. ARB/03/6, Arbitration Award, July 31st, 2007, par. 164.

claims for money arising directly out of their oil extraction and production activities under their contracts with Ecuador and its state-owned oil company. These claims were excluded from any of the Settlement Agreements (R II, para. 169; C II, para. 40). The Claimants continue to hold subsisting interests in their original investment, but in a different form. Thus, the Claimants' investments have not ceased to exist: their lawsuits continued their original investment through the entry into force of the BIT and to the date of commencement of this arbitration."[84]

In other words, the Tribunal accepted jurisdiction despite the fact that it recognized that Chevron's investment had ended on the date of entry into force of the Ecuador – U.S. BIT and despite recognizing that the company had interrupted its activities in Ecuador because of this event. The Tribunal's reasoning is foreign to any logic: an investment that has ended cannot subsist, nor change shape, and much less, be an object of protection.

Similarly, in February 2012, the Tribunal in charge of arbitration, known as Chevron III, in its award on jurisdiction, and based on the definition of investment

Washington D.C., May 8, 2015, Conference Room at the World Bank. The Attorney General of Ecuador, Dr. Diego Garcia Carrion and part of Ecuador's defense team on the Chevron III case: Eric Bloom (Winston & Strawn LLP) , Eduardo Silva R. (Dechert LLP) and Ricardo Ugarte (Winston & Strawn LLP), during the closing hearing.

84• Permanent Court of Arbitration, Chevron Corporation (USA) and Texaco Petroleum Corporation (USA) vs. Ecuador, Interim Award, December 1st, 2008, par. 184

under the Ecuador – U.S. BIT interpreted the treaty broadly by assuming jurisdiction over a purported dispute that arose after the company ended its investments in Ecuador and moreover, with the aggravating factor that these investments were never protected by this BIT because it entered into force after the company ended its operations in Ecuador.

"4.32 n the Tribunal's view, having already decided above upon the broad interpretation of "investment" under Article I(1)(a) of the BIT, there is an inextricable link between the 1973 Concession Agreement and the 1995 Settlement Agreement, to which TexPet and the Respondent were named and signatory parties. Again, the latter would not have come into existence without the former; and, accordingly, the Tribunal similarly determines that, for the purpose of applying Article VI(1)(a), it is not possible to divorce one from the other. In the Tribunal's view, the 1995 Settlement Agreement must be treated as a continuation of the earlier concession agreement, so that it also forms part of the overall "investment agreement" invoked by TexPet under Article VI(1)(a) of the BIT.

4.33 The Tribunal rejects the Respondent's argument that the 1995 Settlement Agreement came too long after the expiry of the 1973 Concession Agreement, some three years later (in 1992). In the Tribunal's view, there could be no doubt that if the 1995 Settlement Agreement had been made during the contractual term of the 1973 Concession Agreement (say in 1975), it could only have been regarded as an elaboration of that agreement and thus clearly forming part of one overall investment agreement. A long-term oil concession must inevitably involve extensive clean-up costs and related responsibilities to others for the environmental consequences of its activities, particularly at or after the end of such activities. It is also well known scientifically that the consequences of environmental pollution caused by oil production are generally measured over many years, if not several decades. As the Claimants' Counsel rightly submitted at the Jurisdictional Hearing: "Environmental remediation is a normal and natural part of an oil concession project" (D1.129).

4.34 The Tribunal therefore dismisses any chronological distinction between remedial agreements made the day before and the day after the expiry of a concession agreement; and there is equally no logical reason to treat differently a much longer period after the concession's agreement expiry, so long as the same link remains between them (as is the case here).

4.35 Moreover, the requirement for an "investment dispute" under Article VI(1)(a) of the BIT (which introduces the Arbitration Agreement) is broadly defined to mean a dispute "arising out of or relating to" an investment agreement. In the Tribunal's

view, such wording would not limit an investment dispute to one only arising under a particular investment agreement but would include a wider range of disputes "relating to" the investment agreement. In the Tribunal's view, TexPet's claims under the BIT do "relate" to the 1973 Concession Agreement, even if (contrary to the Tribunal's decision above) the 1973 Concession Agreement were to be isolated from the 1995 Settlement Agreement and the Parties' dispute did not arise under or even "out of" that concession agreement at all.

The Tribunal's conclusion in these cases is unjustifiable, because the decisions flagrantly contravene two specific provisions of the BIT: the definition of investment and Art. XII.1, which refers to the term of the Treaty.

"Article XII

1. *This Treaty shall enter into force thirty days after the date of exchange of instruments of ratification. It shall remain in force for a period of tan years and shall continue in force unless terminated in accordance with paragraph 2 of this Article. It shall apply to investments existing at the time of entry into force as well as to investments made or acquired thereafter."*

Nothing in the definition of the Treaty addresses the meaning of an "investment," any consequence derived therefrom, regardless of what it could be. However, worse yet, can there be any "consequence of an investment" when it has ended? The immediate answer appears to be no.

That, precisely, is Chevron's case. Texpt's investment ended in 1992 when the company expressly ended is operation and withdrew from Ecuador. How is it that, if the investment ended, the lawsuits that are pending in the country can still be classified under that category? Again, the answer is no: there is no way that a judicial case can revive an investment.

The purported connection that the arbitration found between the investment and the lawsuit does not exist, because the Contracts that the company had in Ecuador ended prior to the entry into force of the BIT in the same way that the lawsuits were begun prior to the entry into force of the Treaty.

A BIT cannot protect an investment that ended prior to its entry into force. The text of Article XII is clear in determining that the BIT governs the future investments THAT EXIST at the time that it enters into force. This was not the case of the American oil company.

3.2.2 Definition of an investor

The investment regime developed through BITs is based on the premise that its protection is applicable only to natural or legal persons (investors), who are nationals of a contracting State that performs investments in another contracting State. BITs usually, and IIAs generally include a definition for investment. When addressing legal persons, the

majority of BITs adopt the place of registration as criteria to define their nationality. Further, the definitions for investors include the subsidiaries of a foreign investor that are registered in the host State and that are subject to its control (direct or indirect).

In other words, one of the fundamental assumptions of host States is that the protections established in these treaties are not applicable to (i) citizens and / or nationals of the State receiving the investment, or (ii) citizens and/or nationals of a third State that is not party to the treaty. The realization of the object and purposes established in the BIT (attracting *foreign investment of the other contracting Party* to promote economic development) depends, to a great extent, on the precise and equitable application of these concepts.

However, the practical application of the concept of "investor" in the system of investment arbitration has been characterized by inconsistency, abysmally different results and interpretations that expand the limits of the scope of protection beyond what was determined by the contracting Parties to a BIT, usually to the detriment of the Host State's interests.

The problems related to the concept of investor begin with the approach used to define the term in the majority of BITs. One of the most severe criticisms that the investment system has received is related to the open and ambiguous definitions in BITs, both for substantive protection standards as well as to define the conditions that "an investor" must meet to enjoy this protection. A lack of accuracy in these concepts, has led tribunals to reach completely different conclusions on apparently similar matters.[85] The definitions of the concept of investor in the majority of BITs, as can be appreciated in the following paragraphs, do not escape this generalized problem.

3.2.2.1 Determination of the Nationality of an Investor

The concept of investor is a specific development of the concept of "nationality" in the context of the investment treaty regime. Prior to the development of the private dispute resolution system in the subject of investments, the nationality of an individual or entity was the first requirement to be able to request diplomatic protection from his or her state of origin. The State's decision to bring a claim in representation of its citizen was, as noted by the ICJ in Barcelona Traction, completely discretionary. In this context, the ICJ developed ample case law regarding the jurisdictional question as to the cases in which the State had the right to adopt a claim as representative of a private, natural or legal person, under international law.[86]

In the current investment protection regime, the

85• UNCTAD, World Investment Report, 2014, http://unctad.org/es/PublicationsLibrary/wir2014_overview_es.pdf; last visit on July 28th, 2016.

nationality of the investor has two important implications. First, the substantive protections set forth in a BIT are only applicable to nationals of the respective contracting States. If an individual or entity attempts to invoke the benefits of a BIT, he or she must demonstrate that he or she holds the nationality of one of the contracting States (not the Host State). And second, the personal jurisdiction (or lack thereof) of a tribunal constituted by virtue of a BIT is determined based on the claimant's nationality. An extension of consent granted by the Host State of the investment in a BIT is limited to the nationals of the other State that have made an investment in the Host State. These implications highlight the importance of a precise definition that could be subject to consistent interpretation.

3.2.2.1.1 Natural Persons

In the case of natural persons, BIT's usually establish that the nationality of an individual is determined pursuant to the laws of citizenship and immigration of contracting States. Some BITs demand permanent residency in addition to citizenship. The BIT signed between Germany and Israel, for example, requires that the nationals of Israel are permanent residents of Israel to be considered investors.[87] In contrast, in application of the definition of investor contained in NAFTA, the Tribunal in *Feldman v. Mexico* concluded that it had personal jurisdiction over a claim brought by a U.S. citizen despite the fact that the claimant had his or her permanent residency in Mexico.[88]

In the case of natural persons with double nationality of State Parties to a BIT, the treatment granted to this fact largely depends on whether the arbitration was ad-hoc or was under rules other than the ICSID Convention and the arbitration brought under the latter.

In non-ICSID arbitration, the critical factor for determining nationality or double nationality is found in the relevant BIT. Tribunals focus on this analysis when making this determination. For example, the Tribunal that heard the claim brought by Serafin García Armas and Karina García Gruber against the Bolivarian Republic of Venezuela, set forth the following when the plaintiffs claimed double nationality, invoking the BIT signed by the latter with Spain:

> *199. The Tribunal considers that, based on the rules of interpretation established in article 31 of the CVDT, the reading that the Defendant makes of article 1 of the APPRI does not correspond to common sense regarding the*

86• CAMPBELL MCLACHLAN QC, SHORE, Laurence, and WEINIGER, Matthew, International Investment Arbitration Substantive Principles, par. 5.08, 2007, Oxford University Press.

87• Art. 1(3)(b). Treaty Concerning the Encouragement and Reciprocal Protection of Investments between Germany and Israel, June 24th,1976.

88• DOLZER Rudolf and SCHREUER Christoph, *Principles of International Investment Law,* Oxford, 2012, pp. 47.

terms of this article and it is inconsistent with the object and purpose of the APPRI. The Tribunal considers that the term "one" does not, in this case, operate as a numeral, but rather, it is an adjective and it opposes "another" not any other number. In this sense, the literal text of article 1(a) includes the nationals of one party, but without excluding them in the event that they were also simultaneously nationals of another party. In accordance with international rules that apply to treaty interpretation, the Tribunal concludes that it cannot add a condition to APPRI that did not exist as to the restriction of nationalities of investors protected by this treaty.

200. Therefore, the Tribunal considers Venezuela's "merely procedural" characterization of the Spanish nationality of the Claimants as irrelevant. For the purposes of the APPRI, it is enough that they hold Spanish nationality. Its text does not impose any limitations to persons with double nationality and it is not possible to deprive the effects of nationality freely granted by a State and accepted by another as valid.[89]

This scenario changes in ICSID arbitration cases. Its Convention denies and makes the jurisdiction of the Center impossible to persons under these circumstances:

> *(2) "National of another Contracting State" means: (a) any natural person who had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration as well as on the date on which the request was registered pursuant to paragraph (3) of Article 28 or paragraph (3) of Article 36,* ***but does not include any person who on either date also had the nationality of the Contracting State party to the dispute;*** *(emphasis added)*

89• Permanent Court of Arbitration, Serafin García Armas and Karina Garcia vs Venezuela, Case No 2013-3, December 15th, 2014. Unofficial translation. Original text in Spanish:

> "199.- A juicio del Tribunal, basado en las reglas de interpretación establecidas en el artículo 31 de la CVDT, la lectura que hace la Demandada del artículo 1 del APPRI no corresponde al sentido común de los términos de ese artículo y es inconsistente con el objeto y propósito del APPRI. Entiende el Tribunal que el vocablo "una" no tiene, en este caso, una función de numeral, sino de pronombre adjetivo, y se opone a "otro", no a cualquier otro número. En ese sentido, el texto literal del artículo 1(a) incluye a los nacionales de una parte, pero sin excluirlos en el caso de que fuesen simultáneamente nacionales de la otra parte. De conformidad con las reglas internacionales que se aplican a la interpretación de los tratados, el Tribunal concluye que no puede adicionarse al APPRI una condición no existente en cuanto a la restricción de la nacionalidad de los inversores protegidos por ese Tratado (…)""(…) 200.Por consiguiente, el Tribunal considera irrelevante la caracterización que efectúa Venezuela de la nacionalidad española de los Demandantes como "meramente formal". A los fines del APPRI, es suficiente con que posean la nacionalidad española. Su texto no impone ninguna limitación a los dobles nacionales y no resulta posible privar de efectos a la nacionalidad otorgada libremente por un Estado y aceptada como válida por el otro (…)"

Certainly, the investor could invoke the BIT's protection in his capacity as Spain's national if he enjoyed that nationality at two times: on the date that the parties consented to the jurisdiction of ICSID and the date of submission of the arbitration.

3.2.2.1.2 Legal persons

In the case of legal persons, the determination of their classification as investors and their nationality is much more complex.

> *"Companies today operate in ways that make it very difficult to determine nationality because of the several layers of shareholders, both natural and legal persons themselves, operating from and in different countries. […] Investment treaties specifically define the objective criteria which make a legal person a national, or investor, of a Party for purposes of the agreements and specify any additional requirements that the contracting States wish to see applies to determine the standing of claimants.*[90]

One of the criticisms of the investment treaty protection system lies in the flexible and liberal interpretation by arbitration tribunals of the notion of investor; above all, in situations pursuant to which the alleged beneficiary of a BIT has obtained the nationality of the Contracting State from which it requests protection but holds a tenuous or artificial relationship to it. This interpretive liberality has been used for many economic actors to obtain undue advantages and abuse the investment protection system.

The complex nature of global commercial and financial transactions creates incentives for economic actors to seek competitive advantages through corporate and organizational restructurings. Certain initiatives that seek financial efficiency from a corporate perspective constitute, from the perspective of the public interest, questionable actions that could cause great harm to society. An example is a phenomenon named the "race to the bottom" in which certain developing countries compete to attract foreign private investment through reforms that reduce or eliminate regulation standards in environmental, labor, or tax aspects, among others. In the investment regime, the permissiveness in interpreting the concept of investor has stimulated a practice called 'forum-treaty-shopping' that consists of designing and planning organizational and corporate structures with many levels of property, in order to obtain the greatest possible amount of BIT protection.

> *"[…]Some arbitration tribunals have shown concern over treaty shopping and the dangers that investment claims can pose to public policy space.*

90• YANNACA-SMALL Katia. *Who is Entitled to Claim? Nationality Challenges in Arbitration Under International Investment Agreement*. p. 219.

[6] At the same time, however, they have conceded that while BITs are being used in a way that may be perceived as morally doubtful, they also consider themselves bound by the wide definitions that the signatories to BITs have agreed to.

In the case of Saluka Investment BV v. the Czech Republic the tribunal expressed "some sympathy for the argument that a company which has no real connection with a State party to a BIT, and which is in reality a mere shell company controlled by another company which is not constituted under the laws of that State, should not be entitled to invoke the provisions of that treaty." The tribunal worried that "Such a possibility lends itself to abuses of the arbitral procedure, and to practices of 'treaty shopping' which can share many of the disadvantages of the widely criticized practice of 'forum shopping'."Nonetheless, the tribunal remained of the opinion that the provisions of the treaty should guide its decision, and that it could not impose a narrower definition of "investor" than that which the state parties to the agreement had concluded.

In Mobil v. Venezuela – a dispute that centred on the nationalisation of oil and gas projects by the state of Venezuela – the tribunal noted that Mobil restructured its investments through the Netherlands with the sole purpose of gaining access to ICSID arbitration to contest Venezuela's new energy policy through the Netherlands-Venezuela BIT. The tribunal concluded that this was "a perfectly legitimate goal as far as it concerned future disputes." However, the tribunal took exception to this approach with regard to pre-existing disputes, stating that "to restructure investments only in order to gain jurisdiction under a BIT for such disputes would constitute […] an abusive manipulation of the system of international investment protection under the ICSID Convention and the BITs.[91]

In investment treaties, the nationality of corporations and legal persons is typically defined by (i) the place of incorporation; (ii) the company's headquarters; (iii) the nationality of the shareholder who controls the company; or (iv) a combination of the three factors.[92]

In the case of Ecuador, the definitions of investors included in the treaties take various shapes. The BIT's signed with Spain and Canada are a few examples. And, as Ecuador, the rest of the world's countries have variations as to the definition for investor.

The Ecuador – Spain BIT contains a definition of the term based on the domestic legislation of each

91• KNOTTNERUS, Roeline & VAN OS, Roos, *The Netherlands: A Gateway to 'Treaty Shopping' for Investment Protection*, 12 January 2012, https://www.iisd.org/itn/2012/01/12/the-netherlands-treaty-shopping/, last visit on July 26th, 2016

State and the criteria of "headquarters." Article 1 of its text notes:

> *" 1. The term "Investor" shall be construed to mean:* ***a)*** *natural persons that, in the case of the Kingdom of Spain, are considered its nationals under its legislation and, with respect to the Republic of Ecuador, natural persons that, in accordance with Ecuadorian legislation, are considered nationals of Ecuador,*
> ***b)*** *Legal persons, including companies, associations of companies, commercial corporations and other organizations that are* ***incorporated****, or in each case,* ***duly organized according to the law of such Contracting Party and are headquartered*** *in the territory of that same Contracting Party."*[93]

The definition of investor in the Ecuador – Canada BIT is different for the case of Canadian nationals and for Ecuadorian nationals, in the case of natural persons. However, the definition of investor for Canadian companies and for Ecuadorian companies reflects a relevant difference. In this regard, article 1(h) states that *"investor"* means:

In the case of Canada:

> ***(ii)*** *any enterprise incorporated or duly constituted in accordance with applicable laws of Canada,*

In the case of Ecuador:

> ***(ii)*** *any enterprise organized in accordance with the laws and regulations of Ecuador,* ***with domicile*** *in the territory of Ecuador who makes the investment in the territory of Canada and* ***who does not possess the citizenship of Canada;***

Moreover, at the same time that BITs use the referenced criteria, they establish that companies or legal persons registered in the Host State shall be protected as long as companies or legal persons that are registered or incorporated in the other State

92• THORN, Rachel & DOUCLEFF, Jennifer *"Disregarding the Corporate Veil and Denial of Benefits Clauses: Testing Treaty Language and The Concept of "Investor"*, p.6, quoted in The Backlash against Investment Arbitration: Perceptions and Reality, 2010, Kluwer Law International, 2010.

93• Agreement for the Promotion And Reciprocal Protection Of Investments Between Spain And Ecuador, 1996. Texto original en español:

"1. Por «inversionistas» se entenderá: a) Personas naturales que, en el 'caso del Reino de España, son considerados sus nacionales con arreglo a su legislación y, con respecto a la República del Ecuador, las personas naturales que, de, conformidad con la legislación ecuatoriana, son considerados nacionales del Ecuador,

b) Personas jurídicas, incluidas compañías, asociaciones de compañías, sociedades mercantiles y otras organizaciones que se encuentren **constituidas** o, en cualquier caso, **debidamente organizadas según el derecho de esa Parte Contratante y tengan su sede** en el territorio de esa misma Parte Contratante."

control them. Certain Treaties expressly establish the type of required control, either direct or indirect, but there are others that simply refer to control in a general manner, opening the door for Tribunals to specify the scope that their control should have as well as the definition of an investor in their judgment.

In ICSID arbitration, when defining whether a legal person is protected by the Convention, an additional element comes into play, as a party is considered a national pursuant to article 25 (2) (b).

> *(b) any juridical person which had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration and any juridical person which had the nationality of the Contracting State party to the dispute on that date and which, because of foreign control, the parties have agreed should be treated as a national of another Contracting State for the purposes of this Convention.*

Tribunals have adopted various positions applying the referenced criteria.
For example, in *Tokios Tokelés vs. Ukraine*, the Tribunal held that a company incorporated in Lithuania based on the BIT signed between both States, when considering that the company was, for the purposes of the Treaty, a Lithuanian investor despite being 99% controlled by Ukrainian nationals.

The Tribunal concluded that:

> *"According to the ordinary meaning of the terms of the Treaty, the Claimant is an "investor" of Lithuania if it is a thing of real legal existence that was founded on a secure basis in the territory of Lithuania in conformity with its laws and regulations. The Treaty contains no additional requirements for an entity to qualify as an "investor" of Lithuania."*[94]

From a public interest perspective, the State is in charge of ensuring that the BIT's objectives are satisfied; therefore, such Tribunal's decisions that only consider that the investor is the national of a State or the legal person organized according to the host State's legislation and domiciled in that place, do not necessarily add to that state objective, and on occasion, allow unlawful or even illegitimate forum – shopping practices that could succeed on account of the Tribunal's lax reasoning.

94• ICSID, Tokio Tokelès vs. Ukraine, Case No. ARB/02/18, Decision on Jurisdiction, April 29th, 2004, par. 28.

3.2.2.2 Ecuador's experience

Murphy International's third case against Ecuador is one of the cases that discuss the definition of an investor, for the purposes of determining whether he or she is a beneficiary of the BIT's protection.

This arbitration was brought based on the BIT signed by Ecuador and the U.S., its Article VI(1) expressly limits the jurisdiction of an arbitration tribunal to "investment disputes."

The claim originated by the application of Law 42-2006, through which Ecuador regulated the windfalls obtained by its Contractors in the exploration of crude oil, under the mode of Participation Contracts. Once the law was applied, Murphy Ecuador (member of an oil consortium that operated a block in the Amazon Region) decided not to continue in Ecuador by selling its share of this consortium. The Complaint was submitted by Murphy International, a U.S. company, and not by Murphy Ecuador, the company that held the contract with the State of Ecuador.

According to Article I(1)(b) of the BIT, for a "company" to be classified as an "investment in [Ecuador's territory] it must be "lawfully incorporated under Ecuador's laws and regulations. Murphy Ecuador was not lawfully incorporated under the laws and regulations of Ecuador, therefore, it could not be considered an investment in Ecuadorian territory and it did not give its parent company the ability to file a claim.

New Haven, Connecticut, November 7, 2013, Yale University. The Attorney General, Dr. Diego García Carrión, offered a conference on the case Chevron-Texaco v. Ecuador, before an audience conformed by postgraduate students, lecturers and legal professionals all related to the prestigious education community.

Even when Ecuador revealed that Murphy Ecuador was not a protected "investment" within the meaning of the BIT and that its contractual rights under the Participation Contract did not qualify as an investment and, therefore, the element necessary for the umbrella clause to apply did not exist, the Tribunal did not refer to this argument, indicating that because of its findings, it was not required to resolve this matter. Thus, it assumed jurisdiction over the claim brought by Murphy and forced the State to get involved in an arbitration that should never have succeeded and handed down an award concluding that it was responsible for the violation of the BIT. We have yet to see, in this case, if the award annulment mechanism is sufficient to reverse the decision of a Tribunal without jurisdiction.

3.3 Treatment and Protection Standards

States assume a series of obligations to investors and their investments through IIAs and therefore BITs. They also agree not to incur in conduct that arbitrarily or discriminatorily limits the operation, maintenance, expansion or disposition of the investment, as well as providing investors access to the judicial system in order to resolve their disputes.

> *"Investment agreements contain obligations specifying the treatment that the contracting parties are required to provide to the investment once it has been established. One can distinguish between general treatment standards, that is standards relating to all aspects of the existence of a foreign investment in a host country, and specific treatment standards addressing particular issues (Vandevelde, 1992).*
>
> *Within the category of general standards of treatment, a further differentiation can be made. First, there are "absolute standards" of treatment, so called because they are non-contingent. They establish the treatment to be accorded to the investment without referring to the manner in which other investments are treated. Examples of absolute standards are the provisions on fair and equitable treatment, full protection and security, expropriation and the transfer of funds.*
>
> *A second category relates to "relative standards" of treatment. They define the required treatment to be granted to investment by reference to the treatment accorded to other investment. National treatment and MFN treatment are the relative standards par excellence. Thus, in the case of national treatment, reference must be made to the treatment of nationals of the host country. Similarly, in determining the content of the MFN standard, reference must be made to the treatment granted to investments from the "most favoured nation."*[95]

Beyond the doctrinal content or Tribunals' application of each of these standards, their existence within investment agreements has generated more than one criticism on account of its "abstract content", especially in such States

with a civil tradition, because these figures are more commonly found in the common law system. In fact, this criticism even extends to procedural matters in investor-State arbitration, which frequently includes legal mechanisms such as counter-interrogatories for witnesses and experts.

Furthermore, we must accept that, for attorneys educated under the continental law system, it is not always easy to assimilate the interpretation or the variable content of each of these standards. This surely contributes to our increasing mistrust in the investment protection system that is currently in force.

> *"A standard is a tool imported from sociology that represents a characteristic that is able to absorb the changing circumstances in a society, preserving thereby the security that the law must provide. It is a unit of measurement, a criterion, an ideal that must be sought. A guideline from the "legislator" to the "adjudicator."*
>
> *In order to clarify, we will compare it to the figure that we are most familiar with: the rule.*
>
> *While the rule contains a hypothesis that, if realized, in accordance with the principle of causality, it demands a "penalty", the standard contains two elements: one objective and one subjective element. The objective element is normative. It is the core of the concept itself, what it wants to achieve. The subjective element is the ingredient included by the adjudicator. His or her experience and intuition."*[96]

Given the territory covered in the application of these standards, the solution could be the application of "rules" and not standards, since the former provides greater certainty and uniformity of application and content as compared to the limits that investment protection standards imply. It appears that it is the time to prove, using factors of the civil system that the common law figures have not been effective in matters of investment.

95• Bilateral Investment Treaties 1995-2006, *Trends in investment rulemaking,* United Nations, New York and Geneva, 2007. pp. 28.

96• GONZALEZ DE COSSIO, Francisco, *Estándares en arbitraje de inversión: ¿Choque de tradiciones?,* Biblioteca Jurídica Virtual del Instituto de Investigaciones Jurídicas de la UNAM, México, http://biblio.juridicas.unam.mx/libros/6/2815/6.pdf last visit 27 July 2016. Free Translation.

Original text in Spanish:

"Un estándar es una herramienta importada de la sociología que representa una característica que logra absorber las circunstancias cambiantes de una sociedad, preservando la seguridad que el derecho debe dar. Es una unidad de medición, un criterio, un ideal que debe buscarse. Un lineamiento del "legislador" al "juzgador".

Para esclarecerlo, lo compararé con aquél con el que estamos más familiarizados: la regla.

Mientras que la regla contiene una hipótesis que, de realizarse, de conformidad con el principio de causalidad, exige una "sanción", el estándar contiene dos elementos: uno objetivo y uno subjetivo. El objetivo es normativo. Es el núcleo del concepto mismo, lo que desea lograr. El subjetivo es el ingrediente que el juzgador le incluye. Su experiencia e intuición."

3.3.1 Fair and Equitable Treatment

This is the most invoked protection standard in Investor – State disputes and it is included in the majority of investment treaties as well as in commercial treaties with investment chapters, although, in general, without greater detail as to its content or meaning.

For example, the Ecuador – France BIT notes:

> *"Art. 4. - Each of the Contracting Parties commits to ensure fair and equitable treatment, pursuant to the principles of International Law to the investments of nationals and corporations of the other Contracting Party and, to do as necessary so that the exercise of this right, recognized in this way, is not obstructed either in fact or in law."*[97]

Given the wave of arbitration that started in the 90s, arbitration tribunals have started to give content to this standard and have established certain obligations derived therefrom in countless situations, making it too broad and flexible.

Therefore, some tribunals have concluded that the FET standard operates as a general principle that regulates the application of the other standards contained in a BIT.[98] However, the majority opinion seeks to distinguish the FET standard from the other protections.

Perhaps the main discussion around this standard is whether it should limit itself to customary international law (CIL). While countries such as the U.S. and Canada believe that it should, the European Union has a different opinion.

> An overbroad interpretation, alien to the limits of CIL is not the way. *"[…] In theory, linking FET to CIL results in a standard of protection that is more deferential to the regulatory authority of governments than the EU's "autonomous" standard. A CIL-linked standard should also have greater legitimacy given that it is rooted in the actual practice of states that they believe to reflect their international legal obligations rather than simply the pronouncements of investment tribunals.*
>
> *In practice, however, investment tribunals continue to construe even CIL-based FET provisions to impose broad limits on government authority by accepting, without*

97• BIT France between Ecuador, Unofficial translation. Original text in Spanish: "**Art. 4.-** Cada una de las Partes Contratantes, se compromete a garantizar un trato justo y equitativo, conforme a los principios del Derecho Internacional a las inversiones de los nacionales y sociedades de la otra Parte Contratante y, a hacer lo necesario para que el ejercicio del derecho así reconocido no se vea obstaculizado ni en derecho ni de hecho."

98• ICSID, Noble Ventures Inc. vs. Romania, Award, 12 October 2005, par. 182; Impregilo vs. Argentina, ICSID case No. ARB/07/17, Award, June 29th, 2011, par. 333.

> *any evidence of state practice or opinio juris, the pronouncements of previous tribunals as definitive evidence of the standard under CIL. The award in Railroad Development Corp. v. Guatemala[3] (RDC) is an example of this approach, which renders the linkage of FET to CIL largely meaningless. The reluctance of investment tribunals to base their interpretations of CIL on actual state practice and opinio juris suggests that more aggressive approaches may be necessary to deter tribunals from adopting increasingly broad interpretations of FET."*[99]

It is likely that the discussion regarding CIL has led to one of the main criticisms of this standard: ambiguity. In various arbitrations *(CMS v. Argentina; Sempra v. Argentina; Suez v. Argentina; Rumeli v. Kazakstán; Total v. Argentina)*, the tribunals have noted that the ambiguity and lack of specific definition of the FET standard has caused problems when delineating the range and scope of obligations stemming thereof and to what extent the obligations that the parties have not consented to in an express manner can be inferred. There is no consensus regarding whether the FET language incorporated in the majority of BITs includes standards of customary international law regarding the international minimum treatment standard to nationals of other States.

The decisions of tribunals have shed light to some extent on the obligations derived from the FET: (i) the State's obligation to grant stability and protection to an investor's legitimate expectations; (ii) obligations of transparency; (iii) obligation of compliance with contractual obligations (which should not be confused with the umbrella clause of a BIT); (iv) the guarantee of access to justice and prohibition of denial of justice; (v) guarantee of access to effective means to submit claims and exercise rights; (vi) non-arbitrariness; and, (vii) proportionality. This of course does not mean that other obligations will not be added in the future or that their content will be even more extensive. What could prevent this? Only a reform of the investment protection system could limit these broad and extensive interpretations.

3.3.1.1 Denial of Justice

As stated previously—and it appears that the consensus with respect to this is quite

99•PORTERFIELD, Matthew C., *A Distinction Without a Difference? The Interpretation of Fair and Equitable Treatment Under Customary International Law by Investment Tribunals*, 22 March 2013. https://www.iisd.org/itn/2013/03/22/a-distinction-without-a-difference-the-interpretation-of-fair-and-equitable-treatment-under-customary-international-law-by-investment-tribunals/. Last visit on July 27th, 2016.

widespread— one of the obligations derived from FET is the prohibition to deny justice.

> *"Denial of justice lies at the heart of the development of international law on the treatment of aliens and of foreign investment. At the same time this notion is inextricably linked to the broader concept of access to justice, understood as the individual's right to obtain the protection of the law and the availability of legal remedies before a court or other equivalent mechanism of judicial or quasi-judicial protection. Intuitively, this type of protection is a sine qua non for any type of constitutional democracy, where the rule of law and the independence of the courts, rather than the benevolence of the ruler, provide the fundamental guarantees of individual rights and freedoms."*[100]

Denial of Justice is configured as a "floor"; in other words, it is a minimum standard of International Law, pursuant to which an investor has a right to a "minimum" level of treatment. When breached, State responsibility is created.

There is certain ambiguity regarding the interpretation and factors of this standard that, in some way, has been resolved by the decisions of arbitration Tribunals.

There are three elements to consider in the evaluation of a State's conduct with respect to the denial of justice standard: 1) Denial of justice is always procedural. 2) the State's obligation is not to create a perfect justice administration system, but rather, one in which the errors that are committed are corrected. 3) the determination of the act of denial of justice cannot be established in purely predictable or objective elements.[101]

3.3.1.1.1 The procedural nature of denial of justice

This element defines the scope and essence of the standard that can be understood based on the words of the Tribunal in Lowen Group and Raymond Lowen v. U.S. In other words, denial of justice is always procedural and not substantive.[102]

This procedural nature, according to a series of international arbitration tribunals[103] does not only assume that cases will be guaranteed access to

100• FRANCIONI, Francesco. *Access to Justice, Denial of Justice and International Investment Law,* The European Journal of International Law Vol. 20 no. 3(C) EJIL, 2009http://www.ejil.org/article.php?article=1862&issue=92, last visit on July 27th, 2016.

101• PAULSSON, Jan, Denial of Justice in International Law, Cambridge, International Law Journal, Cambridge University Press, 2005.

102• ICSID, The Loewen Group, Inc. and Raymond L. Loewen vs. United States "[m]anifest injustice in the sense of a lack of due process leading to an outcome which offends a sense of judicial propriety."

103• See e.g.: Mondev vs. United States, Azinian vs. Mexico; Elettronica Sicula S.p.A. (ELSI) United States of America vs. Italy.

the courts, but rather, it also involves other types of conduct (1) the refusal to admit a claim, or (2) undue delay, or (3) administration of justice in an essentially inadequate manner. Based on this, it is possible to conclude that the procedural element of the denial of justice is not limited to merely procedural matters, but rather, the state obligation to guarantee due process.

Further, other tribunals have admitted that occasions may exist in which there is evidence of an improper case through a manifest incorrect decision that could never be made by an honest or competent judge. This explains the addition of a fourth reason for denial of justice in *Asinina v. Mexico*:[104] clear and malicious misapplication of the law.

Although this has not been widely accepted by courts, Latin-American doctrine has traditionally held that denial of justice exclusively consists of conduct that prevents access to judicial services. In other words, if foreigners have had the means and venue available to bring their case before a competent domestic court in the respective states, there is no denial of justice.[105]

3.3.1.1.2 A State does not have an obligation to create a perfect justice administration system, but rather, it must create a system with the ability to correct any errors that are committed.

In other words, we cannot speak about denial of justice until one exhausts the recourses that the judicial system offers to correct mistaken acts. Jan Paulsson holds: "[a]ccording to the premise that a denial of justice requires that the plaintiff show that the entire legal system of a country, the rule of exhaustion requires that [a party] not only seek to file appeals, but also, while the previous cases are underway, that the (plaintiff) takes advantage of the existing procedural mechanisms (such as subpoenaing witnesses and documentary discovery), that are fundamental to process a case."[106] In other words, in addition to exhausting existing recourses the claimant must act diligently in its defense.

In Loewen Group, Inc. v. United States, the tribunal, at the time of issuing its decision on the general principles of exhaustion and irrevocableness of domestic recourses, observed that: "No instance

104• PAULSSON, Jan, *Denial of Justice in International Law, Cambridge,* International Law Journal, Cambridge University Press, 2005, pp. 98.

105• INTER- AMERICAN JUDICIAL COMMITTEE, Contributions of the American Continent to the principles of international law that govern the responsibility of the State, Washington D.C., Pan American Union document CIJ-61, in OAS Official Records, OEA/Ser.I/VI.2, 1962, pp.7-8.

106• Unofficial translation. PAULSSON, Jan, *Denial of Justice in International Law,* Cambridge, International Law Journal, Cambridge University Press, 2005. pp. 126 (D.P. O'Connell, DERECHO INTERNACIONAL.)

has been drawn to our attention in which an international tribunal has held a State responsible for a breach of international law constituted by a lower court decision when there was available an effective and adequate appeal with in the State's legal system."[107]

Further, the State's obligation to provide a system that corrects errors not only implies that this system exists, but the recourses provided by the state must be effective. This was the core of the Tribunal's decision in *Saipem v. Bangladesh*, which references Duke *Energy v. Ecuador*, providing that: "The requirement of exhaustion of local remedies imposes on a party to resort only to such remedies as are effective. Parties are not held to "improbable remedies"[108]

3.3.1.1.3 A DETERMINATION OF A DENIAL OF JUSTICE CANNOT BE ESTABLISHED BASED ON PURELY PREDICTABLE OR OBJECTIVE ELEMENTS.

This implies that the circumstances surrounding each case must be the ones that lead to a belief of the existence or not of a denial of justice.
On this point, it is useful to take into account the considerations made by the Tribunal in Tot Costruzioni v. Lebanon, which discusses the facts of the case and analyzes them in order to determine whether, in light of the case's circumstances, a denial of justice existed. Thus, this Tribunal (in sum) considered that in order to determine whether a court's delay is a violation, one must weight: the difficulty of the matter, whether the claimants had means available to accelerate the case; whether harm was caused by the delay. It held, further, that a determination of whether justice was made in a reasonable time depends on the circumstances and context of the case; thus, each case should examine the complexity of the subject, the need for an expedited decision and the claimant's diligence in driving its case.

Under the Denial of Justice standard, in accordance with Customary International Law, a State and its judiciary are subject to the following obligations: 1) accepting a claim provided that it satisfies the requirements necessary for admission and validity; 2) ensuring that there are no undue delays in the case; 3) providing a justice administration system with effective domestic recourses and remedies to correct errors; and 4) to have access to an independent justice system.

3.3.1.2 ECUADOR'S EXPERIENCE

The exercise of the State of Ecuador's defense in the cases filed against it, where the investors have

107• ICSID, Loewen Group, Inc. and Raymond L. Loewen vs. United States ,Case Nº ARB(AF)98/3, June 26th, 2003. Par. 154.
108• ICSID, Saipem S.p.A. vs. The People's Republic of Bangladesh, ICSID Case No. ARB/05/07, Award, June 30th, 2009, par. 182.

invoked the violation of this standard, has allowed us to reach certain conclusions regarding its content and limits.

As mentioned previously, the texts of the IIA's and BIT's, including Ecuadorian ones, are lax and do not include a definition or guidelines for FET; nonetheless, it appears to be the most controversial interpretation. In light of the general objective of these international instruments, it should be, pursuant to the words of the Tribunal in Mondev v. U.S., to provide a degree of significant protection.[109] This means that the FET is not a higher standard of treatment in customary international law. Certain Tribunals have thus accepted it.

For example:
In *CMS v. Argentina*, the Tribunal held that:

> *In fact, the Treaty standard of fair and equitable treatment and its connection with the required stability and predictability of the business environment, founded on solemn legal and contractual commitments, is not different from the international law minimum standard and its evolution under customary law.*[110]

Adopting the position of the Waste Management Tribunal, the type of serious misconduct required to violate the minimum treatment standard is:

> *[…] that the minimum standard of treatment of fair and equitable treatment is infringed by conduct attributable to the State and harmful to the claimant if the conduct is* ***arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial propriety****—as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candour in an administrative process. In applying this standard it is relevant that the treatment is in breach of representations made by the host State which were reasonably relied on by the claimant.*[111]

Fair and equitable treatment does not mean that a BIT is an insurance policy against changes in the Host State's legal and regulatory changes. The lofty limits of this standard assigns the responsibility of acting "with awareness of the regulatory situation"[112] to the investor. Thus, an investor who wishes to install itself in a certain country has an essential requirement. It is almost naive to believe

109• ICSID, Mondev International Ltd. vs. United States of America, Award, ICSID Case No. ARB (AF)/99/2, October 11th, 2002, par. 127.
110• ICSID, CMS vs. Argentina, Award, ICSID Case No. ARB/01/8, May 12th, 2005, par. 284
111• ICSID, Waste Management Inc. vs. United Mexican States, Award, ICSID Case No. ARB(AF)/00/3, April 30th, 2004, par. 98.

that an investor who would risk making a decision without adequate knowledge of the country in which it will invest and it is even more naive to assume that a large, global corporation that puts billions of dollars at risk would even think about doing that.

An investor must, therefore, consider the totality of the "legal order of the State receiving the investor, as determined by the Host State, according to the principles of territorial sovereign and economic self-determination."[113] The Tribunal in *Duke v. Ecuador* held precisely this:

> *340. The stability of the legal and business environment is directly linked to the investor's justified expectations. The Tribunal acknowledges that such expectations are an important element of fair and equitable treatment. At the same time, it is mindful of their limitations. To be protected, the investor's expectations must be legitimate and reasonable at the time when the investor makes the investment.* ***The assessment of the reasonableness or legitimacy must take into account all circumstances, including not only the facts surrounding the investment, but also the political, socioeconomic, cultural and historical conditions prevailing in the host State. In addition, such expectations must arise from the conditions that the State offered the investor and the latter must have relied upon them when deciding to invest.***[114]

Departing from this criteria and notwithstanding that the Tribunal in Occidental v. Ecuador accepted the relationship of this standard to customary international law, it inexplicably arrived at the conclusion that this standard requires a framework of legal and business stability.

> *183. Although fair and equitable treatment is not defined in the Treaty, the Preamble clearly records the agreement of the parties that such treatment "is desirable in order to maintain a stable framework for investment and maximum effective utilization of economic resources." The stability of the legal and business framework is an essential element of fair and equitable treatment.*
>
> *189. The issue that arises is whether the fair and equitable treatment mandated by the Treaty is a more demanding standard than that prescribed by customary international law…*
>
> *190. The Tribunal is of the opinion that in the instant case the Treaty standard is different from*

112• ICSID, Grand River Enterprises et al. vs. United States of America, Award, January 12th, 2011, par. 144

113• DOLZER Rudolf, *Fair and Equitable Treatment: A Key Standard in Investment Treaties,* 39 Int'l Law 87 (2005), p. 103.

114• ICSID, Duke Energy vs. Ecuador. ICSID Case Nº ARB 04/19, Award. August 18th, 2008. par. 340

> *that required under international law concerning both the stability and predictability of the legal and business framework of the investment. To this extent, the Treaty standard can be equated with that under international law…* [115]

This Tribunal also concluded that the standard is objective and therefore, it is irrelevant whether the host state acts in good faith or not- a conclusion that cost Ecuador something more than US$ 100 million dollars – when, instead, good faith is a factor that one must necessarily take into account when determining the liability of a State. From a strictly legal perspective, if a State is proven to act in good faith, there is no penalty that could apply; in a system made for investors, this is not necessarily appropriate.

Paris, April 5, 2014, Offices of Dechert LLP. Preparatory meeting for the hearing on annulment in the Oxy II case, Dr. Diego Garcia Carrion, Dr. Jose Manuel Garcia Represa (DECHERT LLP), George Von Mehren (SQUIRE PATTON BOGGS LLP).

115• LCIA, Occidental Exploration and Production Co. vs. Ecuador, Final Award, LCIA Case No. UN3467, July 1st, 2004, par. 183, 189-190.

Logically, the legal and business stability referenced by the OXY tribunal as an element of FET cannot be subjected exclusively to the "foreign investors' subjective motivations and considerations. Their expectations, in order for them to be protected, must rise to the level of legitimacy and reasonableness in light of the circumstances."[116]

This was not the opinion adopted by the Tribunal in Murphy III. In this case there is no doubt that the Tribunal only took the "circumstances" of the purported investor into account and did not stop to analyze the state environment or the motivations that led the State to act as it did. If it had, it would have perhaps considered that, despite its previous efforts, the State of Ecuador's hands were tied because the oil contractor's refusals to include the State in the windfall profits generated by the unprecedented oil prices, despite owning the natural resource.

> *"292. The Tribunal holds that the enactment and enforcement of Law 42 at 99% constituted a violation of Claimant's legitimate expectation that the basic terms of the Participation Contract would not change except within the confines of the law and pursuant to a negotiated, mutual agreement between contractual partners. Claimant's legitimate expectation that it would be treated fairly in a business-like manner as a contractual business partner was also breached by Ecuador's coercive conduct in negotiations.*
>
> *293. The Tribunal thus finds that Ecuador breached the FET standard at Article II(3)(a) of the Treaty when it enacted Decree 662 on 18 October 2007 and when it took actions subsequently to enforce it."*[117]

Certain tribunals have included proportionality as part of FET, but subject to a deference to a State's domestic law and as a lock, in order to preserve the regulatory law of these States.

> *"In view of the concern that has been expressed about possible abusive claims by investors of violations of their legitimate expectations and, consequently, the potential for abusive interpretation by tribunals- which might have a chilling effect on the governments` exercise of regulatory power, it is worth looking at the balanced positions taken by some recent tribunals, which accompanied their interpretation with a proportionate clarification.*
>
> *A number of tribunals have followed the S.D. Myers reasoning that the determination of a breach of the obligation of "fair and equitable treatment" must be made in the light measure*

116• Permanent Court of Arbitration, Saluka Investment vs. Czech Republic. Partial Award. 17 March 2006. par. 304. See also, ICSID, Duke vs. Ecuador, ICSID Case ARB04/19, Final Award, August 18th, 2008. par. 340.

117• Permanent Court of Arbitration, Murphy Exploration vs. Ecuador, Partial Final Award, May 6th, 2016, par. 292 - 293.

of deference that international law generally extends to the right of domestic authorities to regulate matters within their own borders. Therefore, it should not be handled as an inflexible yardstick."[118]

Despite the perception regarding proportionality, and departing completely from it, the Tribunal in OXY II, proceeding in a completely contrary fashion, penalized Ecuador for its violation of the FET standard; considering that, in its opinion, the declaration of caducidad used to terminate the contract with Occidental was disproportionate.

> *"It follows that even if OEPC, as the Tribunal found earlier, breached Clause 16.1 of the Participation Contract and was guilty of an actionable violation of Article 74.11 (or Articles 74.12 or 74.13), the Caducidad Decree was not a proportionate response in the particular circumstances, and the Tribunal so finds. The Caducidad Decree was accordingly issued in breach of Ecuadorian law, in breach of customary international law, and in violation of the Treaty. As to the latter, the Tribunal expressly finds that the Caducidad Decree constituted a failure by the Respondent to honour its Article II.3(a) obligation to accord fair and equitable treatment to the Claimants' investment, and to accord them treatment no less than that required by international law."*[119]

Not only did the Tribunal fail to show proper deference to Ecuadorian law, but it also turned the BIT into OXY's insurance for its own inappropriate or imprudent commercial decisions,[120] such as assigning its rights under the contract without the State's proper authorization, breaching Ecuadorian legislation thereby, and, worse yet, attempting to deceive the authorities.

The denial of justice claims have not been unusual to Ecuador and, in fact, up to the date of publication of this book, two cases claiming denial of justice as the main arguments are pending resolution. Previously, in the arbitration case brought by Chevron – Texaco (Chevron II), although the main accusation was originally denial of justice, at the end of the Tribunal's procedure, after a new argument regarding article II (7) of the Ecuador – United States BIT was submitted, invoked by the oil company to support its denial of

118• YANNACA-SMALL Katia. *Fair and Equitable Treatment Standard in Arbitration under International Investment Agreement*. p. 403.

119• ICSID, Occidental vs. Ecuador, Case Nº ARB 06/11, Award. October 5th, 2012. par. 452. .

120• ICSID, MTD Equity Sdn. Bhd. and MTD Chile S.A. vs. Chile, Award, ICSID Case No. ARB/01/7, May 25th, 2004, par. 167.

"[t]his conclusion of the Tribunal does not mean that Chile is responsible for the consequences of unwise business decisions or for the lack of diligence of the investor. Its responsibility is limited to the consequences of its own actions to the extent they breached the obligation to treat the Claimants fairly and equitably.")

justice claims, the Tribunal found that Ecuador had violated the effective means standard.

Although there is no clear definition regarding the effective means standard, the few Tribunals that have referenced it have done so in different ways and it can be found in a series of BITs signed by the United States.

Thus, it may be useful to review these in the 1983 State Department's Report to the U.S. President, with respect to the BIT signed with Senegal. It explains that keeping an environment that is favorable to investment is one of the BIT's objectives; therefore, each party must establish effective means in order to enforce their claims and rights regarding investment agreements, investment authorizations and property. Further, each party shall grant the nationals of the other party access to courts of justice, tribunals and administrative bodies, as well as any forum that exercises jurisdictional authority, in terms and conditions not less favorable than those granted to its own nationals in similar situations.

Similarly, in 1984, the language of the United States – Congo BIT ratified that the effective means clause translated into an obligation of the parties to provide investors a right of access to tribunals and justice.

The text of clause II (7) was first used in the U.S. – Turkey 1985 BIT (entry into force in 1990). Other BITs used this clause, such as the BITs signed by the Czech Republic, Slovakia, Estonia, Sri Lanka and Tunisia.

In *Duke Energy v. Ecuador*, when discussing article II (7) of the BIT signed with the United States, the Tribunal stated the following: "Such provision guarantees the access to the courts and the existence of institutional mechanisms for the protection of investments. As such, it seeks to implement and form part of the more general guarantee against denials of justice."[121]

In other words, according to the Tribunal in Duke, article II (7) is not a special law, nor does it contain an independent standard; it is merely a guarantee of access to justice.

On March 30, 2010, the Arbitral Tribunal assigned to Chevron II issued a partial award finding Ecuador liable for the violation of Article II (7) of the BIT, for the unjustified delay in its administration of justice, because Ecuadorian courts did not issue a ruling in the seven lawsuits filed by a subsidiary of the defendants in the years prior to the plaintiffs bringing arbitration under the Treaty.

121• ICSID, Duke Energy vs. Ecuador, ICSID case ARB 04/19, Award, August 18th, 2008, para. 391.

The tribunal in Chevron II based its decision on a violation of the effective means standard provided by Article II (7) of the BIT signed by Ecuador and the United States:

> "Each Party shall provide effective means of asserting claims and enforcing rights with respect to investment, investment agreements, and investment authorizations."

The Tribunal considered that Article II (7) stated an "effective means" standard, constituted lex specialis and not a mere reformulation of the law on denial of justice.[122]

The Tribunal's classification of Art. 11 (7) as special law had a very serious consequence for Ecuador; by demanding evidence that was different and less stringent than the standard applicable as compared to denial of justice under customary international law,[123] it determined State responsibility that does not exist.

Another effect of the determination of lex specialis, or a tribunal's independent standard – which is the same – is that the plaintiffs did not demonstrate, and in fact, they could not demonstrate, a strict exhaustion of the domestic resources so that a Tribunal determines a violation of Article II (7).[124]

In other words, the Tribunal clearly distinguished the requirements necessary to demonstrate a violation of the denial of justice standard under Customary International Law and the independent standard established in article II (7). In the words of the Tribunal itself:

> *"Although the Tribunal is amply satisfied that a requirement of exhaustion of local remedies applies generally to claims of denial of justice, the Plaintiffs' claims of BIT violations and Article II(7) in particular are not subject to that same strict requirement of exhaustion."*[125]

On the contrary, under the scheme set forth by the Tribunal, the burden of proof regarding exhaustion of resources, under the parameter of "effective means" shifts and, in this case, it is the State who has to demonstrate that the recourses exist, prior to demanding that a plaintiff demonstrate their ineffectiveness or that resorting to them is useless.[126]

Under the accusations of denial of justice pursuant to International Law, the Tribunal was going to judge the entire Ecuadorian judicial system; however,

122• Permanent Court of Arbitration, CHEVRON Corp. y TEXACO vs. Ecuador, Case Chevron II, Partial Award, March 30th, 2010, par. 242.
123• Ibíd., par. 244.
124• Ibíd. par. 268.
125• Ibíd. par. 321.
126• Ibíd., par. 329.

when establishing an independent standard under Article II (7), the Tribunal did not have to carry out that analysis; it only had to judge Chevron's case.[127]

In any case, neither under the effective means standard nor under the denial of justice standard, could the Tribunal take the place of domestic judges and resolve the cases pending in Ecuador, as it did in *Chevron II*. There is no BIT that is applicable to a provision that would give it that power, nor did the parties agree to it during the proceedings. This conduct ignores the difference in principle between international law and domestic law and turns international arbitration into an appellate body able to review domestic judgments. This is a complete violation of the nature of international investment protection.

3.3.2 Expropriation

The protection of foreign property and foreign investment has been one of the particularities of international law. This has been picked up by the majority of IIA's and BIT's, considering that the latter have contributed to the development of international law.

> The majority of BITs *"recognize the right of host countries to expropriate or nationalize foreign private property subject to certain conditions. Most expropriation clauses apply to expropriations and nationalizations, and they generally avoid defining these terms as well as clarifying the distinction between the two.*
>
> *"Although the specific wording may vary, most expropriation clauses have continued with the traditional approach of extending protection to those measures of the host country that may have an effect equivalent to expropriation or are tantamount to expropriation. Other agreements use the term indirect expropriations."*[128]

Officially, an expropriation implies the State's forcible appropriation of tangible or intangible property that belongs to private parties through administrative or legislative acts. As it is a power that is recognized by the State, it does not necessarily carry responsibility; it arises when "an expropriation and other measures take place under conditions or circumstances that contravene international standards that govern the State exercise of the right or, in other words, when they are contrary to the rules that protect the rights acquired by foreigners or the State's "arbitrary" omissions."[129]
As stated earlier, two types of expropriations are acknowledged: direct and indirect expropriations, and, although defining them is not easy, we can make a highly accurate approximation.
Direct expropriation is caused by measures that

127• Ibíd., par. 332.

128• UNCTAD, *Bilateral Investment Treaties 1995-2006: Trends in investments rulemaking*, United Nations. New York and Geneva 2007. p. 44.

cause immediate deprivation of property or the loss of control of an owner's property/investment.

Indirect expropriation (also named de facto or creeping expropriation) is caused when conduct or acts deprive the private party of his or her use and enjoyment of the property, even when he or she continues to hold legal title crediting him or her as its owner.

> In this regard, the Tribunal in *Marvin Roy Feldman Karpa v. United Mexican States held that: "governments must be free to act in the broader public interest through protection of the environment, new or modified tax regimes, the granting or withdrawal of government subsidies, reductions or increases in tariff levels, imposition of zoning restrictions and the like. Reasonable governmental regulation of this type cannot be achieved if any business that is adversely affected may seek compensation, and it is safe to say that customary international law recognizes this.*
>
> *Drawing the line between expropriation and regulation has proved difficult […]*
>
> *A state is responsible as for an expropriation of property under Subsection (1) when it subjects alien property to taxation, regulation, or other action that is confiscatory, or that prevents, unreasonably interferes with, or unduly delays, effective enjoyment of an alien's property or its removal from the state's territory...*[130]

Unlawful expropriation has, as a corollary to it, indemnification. In the words of the Tribunal in *Técnicas Medioambientales Tecmed S.A. v. United Mexican States:*

> *"119. The principle that the State's exercise of its sovereign powers within the framework of its police power may cause economic damage to those subject to its powers as administrator without entitling them to any compensation whatsoever is undisputable. Another undisputed issue is that within the framework or from the viewpoint of the domestic laws of the State, it is only in accordance with domestic laws and before the courts of the State that the determination of whether the exercise of such power is legitimate may take place. And such determination includes that of the limits which, if infringed, would give rise to the obligation to compensate an owner for the violation of its property rights. […] That the actions of the Respondent are legitimate or lawful or in compliance with the law from the standpoint of the Respondent's domestic laws does not mean that they conform to the Agreement or to international law."*[131]

With respect to the expropriation or nationalization

129• BISHOP, Doak, CRAWFORD, James and REISMAN W. Michael, *Foreign Investment Disputes,* Kluwer Law. 2005. p. 838.

130• ICSID, Marvin Roy Feldman Karpa vs. United Mexican States, Case Nº ARB (AF)/99/1; December 16th, 2002, par. 103.

of foreign investment, BITs generally provide that a host State can only take these types of measures when they: i) respond to the orders of a public utility, security or national interest; ii) when they are adopted pursuant to the proper legal procedure; iii) when they are not discriminatory; iv) when they are accompanied by provisions that provide for payment of an adequate, effective and timely indemnification.

This is where perhaps the most interesting questions arise with respect to the State's police power; in other words, determining when state regulation can imply indirect or de fact expropriation of foreign investment.

In practice, another of the problems related to expropriation is the calculation method or the variables that must be used to set the amount of compensation. In this regard, it appears that there is no consensus either in doctrine or among the Tribunals.

Therefore, a method may exist for each situation, although it is true that States prefer certain methods and investors prefer others.

The Hague, September 10, 2013, Peace Palace. Hearing on Perenco's Counterclaim, Dr. Diego Garcia Carrion, Dr. Eduardo Silva (DECHERT LLP).

131• ICSID, Técnicas Medioambientales Tecmed, S.A. vs. United Mexican States, ICSID Case No. ARB (AF)/00/2). Award, May 29th, 2003. pars. 119 y 120.

3.3.2.1 Ecuador's experience

Expropriation has been object of pronouncements by the Tribunals in the three following cases that involve Ecuador: *OXY II, Perenco, and Burlington*.

Regarding the first, the Tribunal, departing from international law, concluded that Ecuador had violated its obligation to provide fair and equitable treatment to OXY's investments and did so by considering that the State of Ecuador's conduct was disproportionate, and that its termination of the oil company's contract was tantamount to an expropriation.

This absurd conclusion ignores that contractual termination, through the legal figure of caducidad, was a punishment contemplated by the law for the unlawful conduct of an investor; thus, it could never cover the elements for an expropriation. The Tribunal's conclusion also ignored that caducidad was contemplated by the contract and was accepted by the contractor; thus, any conclusion regarding disproportionality is baseless.

The other two cases that include a discussion of expropriation are the arbitration proceedings brought separately by companies Perenco and Burlington against the State of Ecuador. Both companies were partners in the Consortium that operated Blocks 7 and 21 of the Amazon Region, and they had signed two participation contracts for this purpose. The dispute originated after Ecuador promulgated Law 42 – 2006 pursuant to which it established that the contractors would pay a percentage (first 50% and then 99%) of windfalls from the high oil prices. In July 2009, they abandoned the operations in the Blocks, initiating investment arbitration under the Bilateral Treaties in France and U.S.

In turn, Ecuador, pursuant to the Hydrocarbons Act, assumed the operation of the Blocks on account of the risk posed to oil production by the Contractor's abandonment of the wells. The operation, however, was carried out on behalf of these companies, expressly recognizing their ownership in exploration and exploitation contract. On July 20, 2010, then Minister of Non Renewable Natural Recourses, after the required procedure, declared the caducidad of the Block 7 and 21 contracts.

In other words, both arbitration cases were filed by two partners of one same Consortium, under the same factual and contractual framework, under similar provisions in their BITs, and despite this, the conclusions of the Tribunals are different. In particular, on the matter of expropriation, the differences are notorious, regarding the determination of what conduct or facts give rise to it. See below:

BURLINGTON Award December 14, 2012	PERENCO Award September 12, 2014
REGARDING PETROECUADOR'S INTERVENTION According to the Tribunal, the evidence did not convincingly establish that the suspension of the operations would have created a risk of significant damage. Ecuador's entry and occupation of Blocks 7 and 21 deprived Burlington from Blocks 7 and 21 and its oil deposits. This conduct not only deprived Burlington of its share in the oil production, and therefore, its revenues, but it also deprived it of the means of production that would make those revenues possible. The Tribunal concluded that the physical occupation of Blocks 7 and 21 effected by Ecuador expropriated Burlington's investment as of August 30, 2009 (Paragraphs 519 – 537).	**REGARDING PETROECUADOR'S INTERVENTION** For the Tribunal, although Perenco could lawfully suspend the operations without its actions incurring into breach, this should not lead to the conclusion that given the suspension of the operations, the State did not have a right to intervene and that said intervention constituted an expropriation. The Tribunal accepts that when the Consortium announced its intent to suspend the operations, there were justified and valid reasons for the State to intervene in order to operate the Blocks; to ensure continuity and maintain its productivity. AS a result, the Tribunal accepts that the State had the right to operate and maintain the Blocks after the Consortium had withdrawn. This intervention – which did not interfere with the Consortium's right to manage and control the Blocks did not constitute an expropriation and cannot be considered a part thereof (paragraphs 704 and 705).
REGARDING THE "CADUCIDAD" OF THE CONTRACTS The Burlington Tribunal, in considering Ecuador's intervention as an expropriation of the Blocks, determined that the Caducidad Decree did not have to be analyzed and omitted any consideration in this regard.	**REGARDING THE "CADUCIDAD" OF THE CONTRACTS** For the Tribunal, while Perenco could lawfully suspend the operations given a breach without its actions being considered a breach themselves, this should not lead to the conclusion that, given the suspension of operations, the State did not have a right to intervene and that said intervention constituted an expropriation.

We continue on to address each of the arbitration decisions in further detail.

As stated previously, in the Award on liability in the Perenco case, the Tribunal found that Ecuador was responsible for expropriation based on the following reasoning:

671. It appears that although the Claimant saw Law 42 at 50% as the first of a series of measures that culminated in the expropriation of the investment, it did not press the point that at 50% Law 42 was itself an expropriation. The Tribunal agrees that at 50%, Law 42 did not constitute a deprivation within the meaning of Article 6.

680. In the Tribunal's view, although it contravened Article 4 of the Treaty for the reasons previously explained, Decree 662 did not amount to an indirect expropriation. The Tribunal's reasons are threefold.

706. The Tribunal now turns to the Respondent's decision to initiate caducidad proceedings. This too can be dealt with summarily. While it accepts that the State had the right to intervene and operate the blocks, the Tribunal does not accept that the State was bound to bring the Claimant's contracts to an end by means of a caducidad declaration. The Tribunal notes in this regard that under Chapter IX of the Hydrocarbons Law, Article 74, the Ministry "may declare the caducidad of contracts, if the contractor" engages in any of thirteen different types of acts including suspending operations "without cause justifying it, as determined by PETROECUADOR." The Tribunal attaches particular importance to the fact that the opening phrase of Article 74 is expressed in permissive rather than mandatory terms. That is, the Ministry is empowered to declare the caducity of contracts in any of the specified circumstances, but it is not obliged to do so.

707. The Tribunal accepts Ecuador's submission that this was not done without fair warning to the Consortium. The Ministry and Petroecuador wrote to the Consortium on four occasions requesting it to resume operations and warned that a failure to do so could lead to the termination of their Contracts.

708. But in all the circumstances of the case, the Tribunal considers that the Ministry should have stayed its hand and awaited the outcome of this arbitration. It was not contrary to Article 6 for Ecuador to have continued to operate the oilfields in the face of the Claimant's refusal to return until the coactiva matter had been addressed to its satisfaction. But the decision to initiate caducity proceedings and thereby bring Perenco's contractual rights to an end during the midst of this arbitration leads the Tribunal to find a breach of Article 6.

709. In this regard, the Tribunal notes that when Ecuador first indicated its inability to comply with the Decision on Provisional Measures, it stated that it had no intention to terminate the Participation Contracts:

...Nevertheless, Ecuador is committed to furthering the central goal of the Decision, namely to avoid any actions that would undermine the effectiveness of any potential award that might be issued (should the Tribunal ultimately affirm its jurisdiction and proceed to the merits). To that end, Ecuador intends to carry out the enforcement of Law 42 in such a way as to avoid any disruption of Perenco's business. In particular, Ecuador does not intend to seize any assets of the Consortium beyond oil equivalent in

value to the outstanding debt. Nor does Ecuador intend to terminate the relevant Participation Contracts, or take legal action against Perenco representatives."

710. The Tribunal recognises that this statement of intention was made prior to the Consortium's suspension of its operations and the ensuing correspondence between the Parties. Be that as it may, the Ministry had the discretion not to commence caducidad proceedings and it is the Tribunal's judgment that this discretion should have been exercised in favour of not pursuing caducidad while the Parties' respective rights and obligations were being determined in this proceeding. ***Accordingly, the Tribunal finds that as of the date of caducidad having been declared and the Consortium's interests were finally brought to an end, the Respondent effected an expropriation of Perenco's contractual rights contrary to Article 6 of the Treaty.*** *This is the date of the expropriation; for the reasons given above, the Tribunal rejects the creeping expropriation argument advanced by Perenco.*

711. This declaration of caducity was for the same reason equally a breach of the Block 21 Contract because, having occupied the blocks in order to safeguard the oilfields, it was unnecessary for the Ministry to then bring the Contract to an end.

This conclusion overlooks certain objective facts:

- As any other levy on windfall profits, Law 42 reduced Perenco's profitability; it did not deprive the Plaintiff of its rights to manage and control its investment in Ecuador, nor did it reach the level required for a substantial decrease in value of said investment. The Tribunal, as others have done, should have distinguished between a partial deprivation of value, which is not expropriation and a *"total or almost total deprivation of value,"* which may constitute en expropriation.

And it failed to make this fundamental distinction, despite the evidence filed and despite the fact that the declaration of the contract's caducidad was based on the company's abandonment of the country. The Tribunal did not stop to consider whether this matter and the consequences for the country, surely because the arbitrators (and this could be generally attributable to all arbitrators) are quite unaware of the State's dynamic – not only in its operating portion but also with respect to the interests that it represents.

In the Burlington case, the Tribunal also declared the State of Ecuador liable for a purported expropriation, but through a different justification.

In its Award on Liability, the Tribunal stated that:

519. […]The Tribunal is not persuaded that

the suspension posed such a significant risk of damage as to justify Ecuador's immediate intervention.

528. Therefore, the evidence does not persuasively establish that the suspension of operations would have created a significant risk of damage. Accordingly, the Tribunal finds that Ecuador's immediate intervention in the Blocks may not be justified on the ground that it was necessary to prevent serious and permanent damage to the Blocks.

529. For these reasons, the Tribunal deems that Ecuador's entry and taking of possession of the Blocks was not justified under the police powers doctrine because (i) At the time of the taking of possession of the Blocks, Burlington's decision to suspend operations was legally justified as a matter of Ecuadorian law and (ii) the evidence does not show that Ecuador's immediate intervention in the Blocks was necessary to prevent serious and significant damage to the Blocks. The next question is to gauge the effects of Ecuador's occupation of the Blocks on Burlington.

530. As a purely factual matter, Ecuador's entry into and occupation of Blocks 7 and 21 dispossessed Burlington of the oil fields. Such dispossession deprived Burlington not only of its oil production share – and thus of its revenues – but also of the means of production that made those revenues possible. In a nutshell, the occupation of the Blocks deprived Burlington of all the tangible property embodying its investment in Ecuador. While Burlington still had its subsidiary's rights in the PSCs as well as the subsidiary's shares, these rights and shares had no value without possession of the oil fields and access to the oil.

535. On this basis, the Tribunal deems that, by the end of the 10-day period mentioned in Minister Pinto's letter of 19 August 2009, the possibility that the Consortium could resume operations, and hence that Burlington could regain control of the Blocks, had vanished altogether. Accordingly, the Tribunal considers that Ecuador's takeover of the Blocks became a permanent measure on 30 August 2009. As of this date, Ecuador deprived Burlington of the effective use and control of Blocks 7 and 21 on a permanent basis, and thus expropriated its investment.

536. Ecuador argues that the takeover of the Blocks did not affect the rights of Burlington's subsidiary under the PSCs. Even though these contract rights were still nominally in force after the takeover – as caducidad would not be declared until almost a year later, in July 2010 –, they were bereft of any real value from the moment Burlington permanently lost effective use and control of its investment. The termination of the PSCs for Blocks 7 and 21

through the caducidad process in July 2010 merely formalized an already prevailing state of affairs, but is otherwise irrelevant for purposes of the expropriation analysis. As a result, the Tribunal will dispense with reviewing the specific submissions and arguments made in relation to caducidad.

537. For the foregoing reasons, the Tribunal concludes that Ecuador's physical occupation of Blocks 7 and 21 expropriated Burlington's investment as of 30 August 2009. This being so, the next question that arises is whether this expropriation was unlawful. But prior to the examination of this question, the Tribunal will briefly address Burlington's submission that this is a case of creeping expropriation."

This Tribunal also ignored essential matters:

- Ecuador's intervention in the Blocks was not an expropriation. On the contrary, Burlington's unlawful decision to suspend the operations was part of a strategy, designed to force Ecuador to intervene and, therefore, create the appearance of direct expropriation. Specifically, Ecuador established (i) that Burlington's threat to suspend the operations of the Blocks was unlawful and had no economic justification, (ii) that Burlington's decision threatened Ecuador with significant economic loss and other serious damages at the Blocks, and (iii) that the intervention was not expropriation, but rather, it was a temporary measure adopted in response to Burlington's unlawful conduct; as such, it was necessary, adequate and proportion in accordance to the circumstances.
- Burlington's decision to suspend the operation of the Blocks did not comply with Ecuadorian law or the Contract with Ecuador. In an express manner, the Hydrocarbons Act provides that a suspension of operations is cause for *caducidad*. In turn, the Constitution of the Republic expressly provides that the State's natural non-renewable resources are part of its strategic sectors. Therefore, these resources should be protected. The Constitution forbids the suspension of public services that include, among others, the production of hydrocarbons.
- The Participation Contracts also establish that suspending operations is in violation of the obligations assumed by the Contractors, because they must *"begin […] and continue enforcing the operation in the Contract Area," according to the Block 21 Contract and "fulfill and demand that the subcontractors comply with all the laws, regulations and other applicable provisions"* according to the Block 7 Contract.
- Burlington did not have just cause to suspend the operations at the Blocks. Whether it is a question of Ecuadorian law or international law, it cannot invoke the principle *exception non adimpleti contractus*. Although Article 1568 of the Ecuadorian Civil Code ratifies this principle and allows a party to suspend the performance of its obligations if the other ceases to perform

his or hers, this is incompatible with the general interests protected through administrative contracts.
- Burlington's decision to suspend the operation at the Blocks threatened Ecuador with a significant economic loss and other serious and permanent damages to the Blocks.

3.3.3 National Treatment

The objective of clauses that ensure national treatment is granting equal conditions between foreign investors and their respective local competitors. Pursuant to this clause, the host State has an obligation not to adversely differentiate a local investor from a foreign investor, both in the application of existing laws as well as the promulgation of new laws or regulations.

While a negative differentiation is forbidden under the BIT, a positive differentiation is permitted and, in some cases, is mandatory under the current investment regime. The language of the BITs anticipates the possibility that national law can be modified in the context of an economic or social reform and that this would derive in laws that grant lesser protection to private property of nationals of the Host State (and consequently, the investor) than that established by the general rules of international law.[132] This precaution is included in BITs when they provide that the State will provide *"no less favorable"* treatment than the treatment granted to a national of the Host State. In this manner, we recognize that rules of international law may exist that are more favorable than national rules and that, in these cases, the state would be forced to make a positive differentiation and grant preferential treatment to a foreign investor.[133] The possibility of a certain degree of discrimination between foreigners and nationals is permitted under customary international law.[134]

The practical application of this concept in specific cases has caused varied and questionable results in certain cases. In order to determine the measure for compliance of the standard, one must perform a comparison. First, we must determine whether the foreign and the local investor are in a comparable situation, in similar circumstances (for example, whether they are competitors in a common market, in common territory, etc.). Second, one must determine whether the treatment granted to the investor is at least as favorable as the treatment granted to a domestic investor. Third, in the case of less favorable treatment, one has to determine whether the distinction was justified. The analysis of these parameters includes an intense factual investigation that combines complex commercial, economic and legal factors.[135]

132• VINUESA Raul, *'National Treatment, Principle'* in R. Wolfrum (editor), Encyclopedia of Public International Law, volume II, 2012.

133• DOLZER Rudolf and SCHREUER Christoph, Principles of International Investment Law, Oxford, 2012, p. 198.

134• MCLAHLAN Campbell et al, *International Investment Arbitration,* 2007, p. 251.

In the first step of this methodology, the determination of equality of circumstances has led arbitration tribunals to considerably inconsistent results. In cases such as *Feldman v. Mexico*, the tribunal interpreted that "equal circumstances" meant that the investor must find him or herself in the same type of business or market as the alleged local investors that have received an advantage, in this case, the business of cigarette exports.

3.3.3.1 Ecuador's experience

In contrast to the above, in *Occidental v. Ecuador* (OXY I), the tribunal adopted a much more questionable approach when it concluded that to search for a basis for comparison, it did not have to limit itself solely to oil producing companies, but rather, it could expand its comparison to any type of business, local producer or producer in general. In this way, the tribunal concluded that a violation did occur of the obligation of national treatment related to the application of VAT to Occidental's oil exports, since the application of the VAT rules to producers in other economic industries (other than the oil industry) was more permissive.

The Tribunal rejected the State's argument that the relevant basis for comparison to determine whether less favorable treatment existed toward the investors was based on the local oil producers and the actors in the oil industry.[136] The Tribunal inexplicably held that this comparison could not be carried out, solely by taking as a reference the actors and particular activities of the oil industry. In reaching this determination, the OXY I Tribunal clearly ignored the WTO's case law (that is more developed in matters of national treatment), without referencing the precedent of the investment regime that supports this departure.[137] The legislation of the English courts that reviewed this dispute does not allow entering into a discussion regarding the details of the merits of the award.

The basis for comparing activities between local and foreign investors is a matter that continues to be controversial.

3.3.4 The Umbrella Clause

The designated "umbrella clause" is a provision that requires a Contracting State to respect the contractual commitments assumed as to an investor of the other Contracting State. Around 40% of the total BIT's that exist globally contain an umbrella clause.[138]

135• DOLZER Rudolf and SCHREUER Christoph, *Principles of International Investment Law,* Oxford, 2012, pp. 199.
136• LONDON COURT OF INTERNATIONAL ARBITRATION, Occidental Exploration and Production vs. Ecuador, July 1st, 2004, par. 173.
137• LONDON COURT OF INTERNATIONAL ARBITRATION, Occidental Exploration and Production vs. Ecuador, July 1st, 2004.

For example, article 3.C of the Ecuador – United States BIT notes that *"[e]ach Party shall observe any obligation it may have entered into with regard to investments."*

In the interpretation of these types of investments, numerous tribunals have question whether the umbrella clause "elevates" a contractual breach or "puts it on the same level" to the level of an international obligation contained in a treaty.

From the perspective of public companies, autonomous agencies of the central government, or other legal persons with activities that are not originally attributable to the State under international law *(Articles on the responsibility of the State of international unlawful acts adopted in 2001 by the Commission of International Law)*, an excessively broad interpretation of the umbrella clause represents a factor of uncertainty that, in certain situations, the contracts signed by these entities could lead to the State's international responsibility. Moreover, when the objectives of the creation of certain public commercial entities, such as public companies, is their active participation in critical sectors of the economy, their capacity to execute transactions and contracts as a legal person with limited liability and that they can resolve any dispute that arises in the performance of a contract, in the manner and within the parameters agreed to by the parties.

The application of the umbrella clause in arbitration practice has caused a series of discrepancies – primarily with respect to their jurisdictional function and the potential extent of attribution of international State responsibility. For these reasons, the scope of the umbrella clause is a controversial matter within the investment regime.

The source of these discrepancies is found in the traditional distinction between 'investment disputes' and 'merely contractual or commercial disputes.' This distinction, in turn, is one of the bases for separation between the Investor – State arbitration (that is based on a multilateral investment treaty, BIT, or investment contract) and the commercial arbitration (with legal basis in a settlement clause that is usually included in a contract). Given the effect that arbitration tribunals have given umbrella clauses, this distinction has been virtually eliminated, permitting, on many occasions, disguising merely contractual/commercial claims as investment claims.

The majority of BITs and International Investment Agreements include contractual rights in their broad definitions of investment.

138• MEREMINSKAYA Elina, *"La Cláusula Paraguas: Lecciones de Convivencia para los Sistemas Jurídicos"*, Revista Internacional de Arbitraje, 2009, p. 13.

Article 1.a.v. of the Ecuador – United States BIT provides that for the purposes of the treaty, "investment" means, among other matters:

> *"**(v)** any right conferred by law or contract, and any licenses and permits pursuant to law." The rights that arise by virtue of a contract are considered an asset and, consequently, they are protected against any type of actions established in the BIT (expropriation, fair and equitable treatment, etc.)."*

This is a traditional notion in international law. In Impregilo v. Pakistan, the tribunal noted that investment case law is consistent in considering that the seizure of contractual rights can potentially constitute an expropriation or a measure with equal effects.[139]

Other tribunals have noted that certain state actions produce the effect of terminating or annulling contractual rights/ obligations constitute a violation of the fair and equitable treatment standard.[140]

It could be said, in general, that the rights granted by virtue of a contract are subject to BIT protection.

3.3.4.1 Ecuador's Experience

The application of the umbrella clause was a matter discussed in the arbitration filed by Burlington, with positive results for Ecuador. The Tribunal, applying the Vienna Convention, reached the conclusion that the umbrella clause does not protect commitments resulting from participation contracts because, for the "commitment" described in the treaty to operate, a direct contractual relationship must exist. This case did not fulfill this premise, as the plaintiff in the investment arbitration was not simultaneously the signatory of the Participation contract. As a result, the plaintiff could not invoke the Treaty's umbrella clause to enforce its subsidiary's contractual rights against Ecuador.

139• ICSID, Impregilo SPA vs. Pakistan, ICSID Case No. ARB/03/3, Decision on Jurisdiction, April 22nd, 2005, par. 274.

140• YANACCA SMALL Katia, *Arbitration under International Investment Agreements: A guide to Key Issues,* 2010, p. 326.

Santiago de Chile, July 3, 2013, Great Hall of the Universidad de Chile School of Law. Dr. Diego García Carrión presented on: "The Investor-State dispute settlement system: a propositive vision".

CHAPTER IV

CRITICISMS OF THE INVESTOR-STATE DISPUTE RESOLUTION SYSTEM— PROPOSALS

Throughout this publication, we have discussed the problems inherent to an absence of definitions, ambiguities and the broad provisions in IIAs and how this has been reflected in the decisions of Arbitral tribunals and has led to a investor-dispute resolution system that is subject to many criticisms and subject to serious efforts towards its reform.

Of course, each of these criticisms is important, but there are some that merit special attention. These are detailed below with the respective proposal to overcome the underlying problems.

4.1 Inconsistent Tribunal decisions

The diversity of international investment agreements,[141] the broad and vague definitions that are constant therein, a dispute resolution system that is both scattered and isolated, with absolute discretion and free from any subsequent control, except by a limited annulment action, has caused, as we have seen, a series of inconsistent decisions and interpretations that deeply question its legitimacy and that have led to proposals such as the one made by the European Union, which suggest establishing an International Court that would ensure consistency, legal security and impartiality of the investor-State dispute resolution mechanisms.

Although each dispute must be evaluated individually, taking into account the elements that make it unique, we must also consider that certain circumstances make it similar to other cases and it could very well be subject to application of previous interpretations and resolutions. Tribunals should even be aware of the very differences that should force them to review prior decisions to depart from the resolution in certain cases in a well-reasoned manner.

International law and investment arbitration do not recognize the *stare decisis* doctrine. As a result, investment arbitration tribunals are not forced to follow past decisions. The statute of the International Court of Justice is even more explicit when it rejects *stare decisis* in international law, by establishing, in its article 59 that "The decision of the Court has no binding force except between the parties and in respect of that particular case." In fact, when it enumerates the sources of international law, it mentions judicial decisions in fourth place, that the court must apply "as an auxiliary means to determine the rules of law."

141• There are over 3271 IIAs in force, many of them contain similar provisions and others that are completely different; the scope and text of their provisions have led to various interpretations.

Nonetheless, in the law of investments, the need for binding precedent is imperious because:

- In contrast to commercial cases, a review of investment cases is not limited to technical aspects that are determined by the contract or trade practice, but rather, they go beyond this, since the adjudicator examines a State's administrative acts, and these often involve decisions that cover public policy, such as health and the environment.
- IIAs often have relative ambiguity of rules and principles, vague and general substantive standards and the tribunals that "fashion" investment law almost exclusively determine their scope. This should be compounded by the poor knowledge held by Tribunals regarding the law involved in the dispute and the fact that it is common that professionals with backgrounds in Common Law systems must decide matters resolved under Civil Systems or vice versa.
- The results of investment arbitration cases yield important economic consequences for the States involved, and exercise pressure on them regarding the States' decision-making on matters of public policy. One tangible example of this pressure was evident in the case involving tobacco company Phillip Morris. It filed investment arbitration cases against Uruguay[142] and Australia[143] because of the laws issued by these States ordering that cigarette boxes carry health warnings covering 80% of the packet. As a result, Philip Morris pressured countries such as Canada and Norway, interrupting their discussion on their relevant laws, and caused the European Union not to make significant progress on the subject. The company went even further, as it warned the United Kingdom's Government that if it adopted similar decisions it would risk owing the company indemnification in the millions.
- Cases are subject to greater public scrutiny because they must address matters involving important state policies and decisions that involve essential elements regarding the population's general wellbeing – any State's main obligation.

142• ICSID, Philip Morris Brand Sàrl (Switzerland), Philip Morris Products S.A. (Switzerland) and Abal Hermanos S.A. (Uruguay) vs. Uruguay (Case No. ARB/10/7). Award dated 8 July 2016, the Tribunal rejected the tobacco company's claim, concluding that Uruguay did not violate the BIT invoked for the claim. The award is on the following web site: www.pge.gob.ec. Last visited on July 25th, 2016.

143• Permanent Court of Arbitration, Philip Morris Asia Limited (Hong Kong) vs. Australia, PCA Case No. 2012-12. Via award dated December 17th, 2015, the arbitral Tribunal declared its lack of jurisdiction over the dispute because the tobacco company changed its corporate structure to obtain protection of the BIT signed between Australia y Hong Kong. The award is on the following web site: www.pge.gob.ec., last visited on July 25th, 2016.

This has led arbitrators such as Prof. Kaufmann Kohler to declare that developing consistency in investment arbitration is necessary to strengthening the rule of law. In her judgment, this is rule of law. Adjudicators' roles become important to rule of law only if precedent is consistently applied in such a way that it is predictable and decision-makers have an obligation – it is irrelevant whether the obligation is moral or legal – to seek consistency and foreseeability.[144]

Arbitration tribunals also hold inconsistent perspectives as to this point. Thus, certain tribunals have firmly rejected the application of precedent and others have accepted it. In *Vivendi v. Argentina*, the adjudicators attached another eighteen decisions to the award in which the same objection had been rejected. While in *Sgs v. Philippines*, the Tribunal noted that precedent should not be followed, because, by definition, every BIT is different. Further, it held that there is no reason for the tribunal intervening in a previous case to decide the result of subsequent cases.

Bogota, May 22, 2014, Externado University of Colombia. Dr. Diego García Carrión presented on "Legal uncertainty in the Investor-State dispute settlement system" during the Sixth Seminar on International Investment Arbitration called "The costs of legal uncertainty in investment arbitration: State and Investor perspective".

144• KAUFMANN-KOHLER, Gabrielle, *Is Consistency a Myth?* http://www.arbitration-icca.org/media/4/92392722703895/media01231914136072000950062.pdf; last visited on July 25th, 2016.

145• ICSID, Noble Energy & Machalapower Cia. Ltd. vs. Republic of Ecuador and National Electricity Council, ICSID Case No. ARB/05/12, Decision on Jurisdiction, March 5th, 2008, par. 50.

146• ICSID, Burlington Resources vs. Ecuador, Case No. ARB 08/5, Decision on Jurisdiction, June 2nd, 2010. par. 100.

In the Ecuadorian case, we can cite to the decision on jurisdiction in *Machala Power v. Ecuador,* in which the Tribunal noted that ICSID tribunals, "should seek to foster the harmonious development of investment law and thereby to meet the legitimate expectations of the community of States and investors towards certainty of the rule of law."[145]

> Further, in the award on jurisdiction in Burlington v. Ecuador, the Tribunal affirmed the concept that, *"the Tribunal considers that it is not bound by previous decisions. At the same time, it is of the opinion that it must pay due consideration to earlier decisions of international tribunals. The majority believes that, subject to compelling contrary grounds, it has a duty to adopt solutions established in a series of consistent cases. It also believes that, subject to the specifics of a given treaty and of the circumstances of the actual case, it has a duty to seek to contribute to the harmonious development of investment law, and thereby to meet the legitimate expectations of the community of States and investors towards the certainty of the rule of law.Arbitrator Stern does not analyze the arbitrator's role in the same manner, as she considers it her duty to decide each case on its own merits, independently of any apparent jurisprudential trend"*[146]

The risk of inconsistency is more obvious when we face any of the following scenarios:

- The existence of different tribunals that can adopt different decisions regarding the application of one same treaty or regarding the scope and meaning of a standard of protection.
- Different tribunals under different treaties adopting different decisions on similar facts.
- Different tribunals under different treaties adopting different decisions regarding disputes that involve the same facts or even reach the same conclusions with different reasoning.

Two Ecuadorian cases fall into the first case, by way of example. They were examined in the previous chapter. These types of inconsistencies and different decisions occurred in these cases, Ulysseas and Emelec, in which article I(2) of the Ecuador – United States Investment Protection Treaty was interpreted in a different manner.

Awards such as *CMS v. Argentina* and *LG&E v.*

147• The various conclusions found in the matter of state of necessity in the CMS and LG&E awards provide a clear illustration of the destructive effects of this contradiction. As a reaction to the Argentine economic crisis that started in 1999, the government decided to suspend the semester rate adjustment for IPP and freeze the gas distribution rates. These measures led to a number of American investors in the gas industry, including CMS Gas Transmission Company (CMS) and LG&E Corporation to file arbitration cases under the ICSID rules. Both in CMS as in LG&E, the Argentine government claimed that it was in a state of necessity as a defense to exempt it from State responsibility under Argentine law, international law and in the BIT itself between Argentina and the United States. In both cases, the law that was argued was the same. Both tribunals reached, however, different conclusions. While the CMS award rejected the argument, the LG&E award partially admitted it.

Argentina fall into the second scenario, related to the state of necessity,[147] or the paradigmatic *CME v. Czech Republic y Lauder v. Czech Republic*[148] denominated by Prof. August Reinish as the "last fiasco in investment arbitration."[149]

The cases brought by companies Burlington Resources and Perenco fall into the third scenario. Both arbitration cases deal with the same facts; both cases involve the same oil blocks: 7 and 21; and both cases concern the same participation contracts.

In these cases, the matters addressed and resolved differently are: Law 42 at 50% and 99%, the intervention of the blocks and the declaration of caducidad of the participation contracts.

Both Tribunals concluded that Law 42 did not imply a violation of the protections established by the treaties, but they used different reasoning in order to reach these decisions.

In Burlington's decision on liability dated December 14, 2012, using economic calculations and based on the company's conduct to continue with its development plans, the Tribunal concluded that Law 42 did not substantially deprive Burlington's investment.[150]

The Perenco Tribunal, in its decision dated September 12, 2014, justified its conclusion that Law 42 at 50% did not violate the contract on the absence of evidence. Perenco did not demonstrate the economic impact of the law, within the framework of the provisions of the contract and through the negotiation clauses.[151]

Regarding the application of Law 42 at 99%, the Tribunals differed in their conclusions.

148• The problem of inconsistency was clearly visible in the awards issued in CME v. Czech Republic and Lauder vs. Czech Republic, where, despite similar facts, the results were different. These UNCITRAL cases referred to state measures related to a local company that owned a television concession. The claims that were almost simultaneously brought under the agreements of the Czech Republic and the United States (LAUDER) and the one signed with the Netherlands (CME). In the case brought by Lauder, the Czech Republic obtained a favorable result, while in CME, the Czech Republic was ordered to pay US300 million. In the second case, the annulment recourse filed by the Czech Republic did not yield a favorable result.

149• REINISCH August, *"The Proliferation of International Dispute Settlement Mechanisms: The Threat of Fragmentation v. the Promise of a More Effective System? Some Reflections From the Perspective of Investment Arbitration"*, in International Law between Universalism and Fragmentation – Festschrift in Honour of Gerhard Hafner, pp. 107-125 (Leiden – Boston, Martinus Nijhoff Publishers 2008).

150• ICSID, Burlington Resources vs. Ecuador, Case No. ARB 08/5, Decision on Liability, December 14th, 2012, par. 431.

"This conclusion is reinforced by the following facts. First, despite the enactment of Law 42 at 50%, the Consortium submitted a plan for additional investments of USD 100 million in the Oso field, which according to Burlington's own description was the "largest field in Block 7 and the center of the Block's development plans." As Ecuador noted, in submitting the Oso plan, the Consortium implicitly conceded that Block 7 was economically viable even with Law 42 at the 50% rate. Second, Burlington's allegation that Block 21 was "not viable" with Law 42 at 50% is not supported by the record. As Fair Links pointed out, Burlington's financial statements for Block 21 do not show a loss but a "positive figure." Third, Burlington acknowledged that there were bidders willing to acquire its interest in the Blocks despite the effects of Law 42 at 50%".

To the Burlington Tribunal, the company was unable to make a reliable showing of its affectation. Therefore, the Tribunal considered that there was no violation of the BIT.[152]

The Perenco Tribunal, on the contrary, concluded that Law 42 violated the BIT with France, because, from its implementation, the participation contracts were de *facto* transformed into services agreements.[153]

However, two examples best highlight the contradictions: the first, the intervention in the blocks and the second, the declaration of *caducidad* of the participation contracts. In 2009, Perenco and Burlington decided to abandon the operations and as a result, given their breach, the State was forced to assume operation of the bocks and declare the *caducidad* of the contracts. On these facts, both Tribunals ruled differently.

As to the intervention in the blocks, the Burlington Tribunal was not convinced of the risks implied by abandonment of the blocks; it thus concluded that the State's intervention constituted an

151• IICSID, Perenco vs. Ecuador. ICSID Case No. ARB 08/6. Decision on Remaining Issues on Jurisdiction and Liability, September 12th, 2014, par. 400. "In sum, the Tribunal holds that: (i) Law 42 fell within the taxation modification clauses of both Contracts; (ii) as the party claiming that the law had an impact on the Contracts' economy, it was incumbent upon Perenco to pursue negotiations with the new administration at least until they were shown to be futile; and (iii) Perenco did not do so, preferring instead to adopt a 'wait and see' approach with the new Correa Administration. In these circumstances, the Tribunal does not find a breach of clauses 11.12 and 11.7 of the two Contracts."

152• ICSID, Burlington Resources vs. Ecuador, ICSID Case No. ARB 08/5, Decision on Liability, December 14th, 2012, par. 456 "Having considered all the evidence, the Tribunal is not persuaded that Law 42 at 99% substantially deprived Burlington of the value of its investment. While Law 42 at 99% diminished Burlington's profits considerably, Burlington's allegations that its investment was rendered worthless and unviable have not been substantiated. Rather, the evidence shows that, notwithstanding the enactment of Law 42 at 99%, the investment preserved its capacity to generate a commercial return. Finally, although the evidence shows that Ecuador passed Law 42 without intending to comply with the tax absorption clauses, there can be no expropriation in the absence of substantial deprivation".

153• ICSID, Perenco vs. Ecuador, ICSID Case No. ARB 08/6. Decision on Remaining Issues on Jurisdiction and Liability, September 12th, 2014, par. 606. "The Tribunal has already made a finding to this effect (at paragraphs 407 to 410). It agrees with Perenco's argument that the application of the law at 99% rendered a participation contract essentially the same as a service contract. Moreover, Decree 662 marked the beginning of a series of other measures in breach of Article 4 taken in relation to the Participation Contracts, namely: (i) demanding that the contractors agree to surrender their rights under their participation contracts and migrate to what for a considerable period of time was an unspecified model, such that the contractors were unable to discern precisely what they were being asked to move to; (ii) escalating negotiating demands, in particular in April 2008 when the President unexpectedly suspended the negotiations and rejected what had recently been achieved in a Partial Agreement in respect of one of the blocks; (iii) making coercive and threatening statements, including threats of expulsion from Ecuador; and (iv) taking steps to enforce Law 42 against Perenco (and Burlington) for non-payment of dues claimed to be owing, a portion of which has been held to be in breach of Article 4, and when no payments were made, forcibly seizing and selling the oil produced in Blocks 7 and 21 in order to realise the claimed Law 42 debt. This set the stage for the Consortium's suspension of operations and ultimately the declaration of *caducidad* which formally terminated the Consortium's rights in the two blocks."

expropriation.[154] For the Perenco Tribunal, the intervention was not an expropriation because it was fully justified by the State.[155]

Finally, with respect to the declaration of *caducidad*, for the Burlington Tribunal, after the intervention of the blocks, the contract's termination only formalized the events that actually occurred.[156] However, in the judgment of the Perenco Tribunal, *caducidad* led to a violation of the BIT.[157]

154• ICSID, Burlington Resources vs. Ecuador, ICSID Case No. ARB 08/5, Decision on Liability, December 14th, 2012, par. 529.
"For these reasons, the Tribunal deems that Ecuador's entry and taking of possession of the Blocks was not justified under the police powers doctrine because (i) At the time of the taking of possession of the Blocks, Burlington's decision to suspend operations was legally justified as a matter of Ecuadorian law and (ii) the evidence does not show that Ecuador's immediate intervention in the Blocks was necessary to prevent serious and significant damage to the Blocks. The next question is to gauge the effects of Ecuador's occupation of the Blocks on Burlington."

155• ICSID, Perenco vs. Ecuador, ICSID Case No. ARB 08/6. Decision on Remaining Issues on Jurisdiction and Liability, September 12th, 2014, par. 705.
"Here the Tribunal accepts the Respondent's argument that when the Consortium announced its intention to suspend operations, there were good and valid reasons for the State to intervene in order to operate the Blocks, thereby ensuring their continuity and maintaining their productivity. The Respondent has demonstrated the potential production losses and other technical problems that could have ensued had operations been suspended. The Tribunal therefore accepts that the State had the right to operate and maintain the Blocks after the Consortium withdrew. This intervention – which cannot be said to have interfered with the Consortium's rights of management and control over the Blocks because the Consortium had voluntarily surrendered such rights on a temporary basis – did not amount to an expropriation and cannot be counted towards one."

156• ICSID, Burlington Resources vs. Ecuador, ICSID Case No. ARB 08/5, Decision on Liability, December 14th, 2012, par. 536.
"Ecuador argues that the takeover of the Blocks did not affect the rights of Burlington's subsidiary under the PSCs. Even though these contract rights were still nominally in force after the takeover – as *caducidad* would not be declared until almost a year later, in July 2010 –, they were bereft of any real value from the moment Burlington permanently lost effective use and control of its investment. The termination of the PSCs for Blocks 7 and 21 through the *caducidad* process in July 2010 merely formalized an already prevailing state of affairs, but is otherwise irrelevant for purposes of the expropriation analysis. As a result, the Tribunal will dispense with reviewing the specific submissions and arguments made in relation to *caducidad*."

157• ICSID, Perenco vs. Ecuador, ICSID Case No. ARB 08/6. Decision on Remaining Issues on Jurisdiction and Liaiblity, September 12th, 2014, par. 706
"The Tribunal now turns to the Respondent's decision to initiate caducidad proceedings. This too can be dealt with summarily. While it accepts that the State had the right to intervene and operate the blocks, the Tribunal does not accept that the State was bound to bring the Claimant's contracts to an end by means of a caducidad declaration. The Tribunal notes in this regard that under Chapter IX of the Hydrocarbons Law, Article 74, the Ministry "may declare the caducidad of contracts, if the contractor" engages in any of thirteen different types of acts including suspending operations "without cause justifying it, as determined by PETROECUADOR." The Tribunal attaches particular importance to the fact that the opening phrase of Article 74 is expressed in permissive rather than mandatory terms. That is, the Ministry is empowered to declare the caducity of contracts in any of the specified circumstances, but it is not obliged to do so."

COMPARATIVE TABLE – INTERNATIONAL ARBITRATION BURLINGTON – PERENCO		
	Burlington Liability Decision December 14, 2012	**Perenco Liability Decision July 18, 2014**
CONTRACTUAL CLAIM	Declare that there is no jurisdiction over Burlington's claims under the umbrella clause pursuant to Article II(3)(c) of the Treaty. Paragraph 546 B(1)	The Tribunal has jurisdiction over all claims of contractual breach under the form of technical and/or economic disputes, with the exception of the claim regarding the declaration of ***caducidad*** relative to the Block 7 Contract. This claim is not covered by the Tribunal's contractual jurisdiction. Paragraph 713 (1)
CADUCIDAD DECREE	Declares that it has jurisdiction over the ***caducidad*** decrees with respect to the CPs of Blocks 7 and 21. Paragraph 546 B (2)	Declares that it has jurisdiction over the Treaty Violation claims. Paragraph 713 (2)
	Declares that Burlington's claims with respect to the declarations of ***caducidad*** are not admissible. Paragraph 546 B(3)	
	Termination of the oil contracts for Blocks 7 and 21 via the ***caducidad*** proceedings dated July 2010 merely formalized an emergency, but it is irrelevant for the purposes of the analysis of the expropriation. As a result, the Tribunal will omit the rest of the claims and the specific arguments effected with respect to ***caducidad***	The claim regarding the declaration of ***caducidad*** constituted a violation of Article 6 of the Treaty. Paragraph 713 (12).
LAW 42 at 50%	Law 42 with a rate of 50% did not substantially deprive Burlington of the value of its investment and, therefore, was not a measure tantamount to expropriation. Paragraph 433.	The contractual breach claim regarding Law 42 at 50% is dismissed. Paragraph 713 (3)
		The breach claim regarding Article 4** of the Treaty, with respect to Law 42 at 50% is dismissed. Paragraph 713 (7)

LAW 42 at 99%	The Tribunal concludes that the effects of Law 42 at a rate of 99% were not a measure tantamount to expropriation and, therefore, that Law 42 at a rate of 99% does not constitute an expropriation of Burlington's investment. Paragraph 457.	The contractual breach claim regarding Law 42 at 99% is admitted.
		The breach claim regarding Article 4 of the Treaty with respect to Law 42 at 99% is admitted. Paragraph 713 (8)
DISCRIMINATORY TREATMENT	Does not apply	The claim regarding contractual breach of the Block 7 Contract regarding allegedly discriminatory treatment against Perenco as compared to Andes Petroleum is dismissed. Paragraph 713(5)
COACTIVA SUITS	Burlington has not demonstrated that the *coactiva* suit was an expropriation. Paragraph 468.	The claim that the enforcement of *coactiva* measures was a violation of Article 6 of the Treaty is dismissed. Paragraph 713(10)
DECREE 662	Does not apply	The claim that Decree 662 constituted a violation of Article 6 of the Treaty is dismissed. Paragraph 713(9)

As another inconsistency, we can also cite to the differences that exist between one Tribunal and the next regarding the scope and content of the IIA's protection standards. In order to depict this matter, it is worth citing the SGS arbitration cases, two ICSID cases brought by Swiss company SGS against Pakistan[158] and the Philippines,[159] respectively, in which the Tribunals arrived at entirely different decisions regarding the meaning of the umbrella clause.

In the *SGS v. Pakistan* award dated August 6, 2003, in determining the scope of the BIT's umbrella clause, the tribunal held that the broad wording used in the general protection clause could not be interpreted in such a way as to cover contractual

158• ICSID, SGS Société Générale de Surveillance S.A. vs. Pakistan, ICSID Case No. ARB/01/13, August 6th, 2013.

159• ICSID, SGS Société Générale de Surveillance S.A. vs. Philippines, ICSID Case No. ARB/02/6, January 29th, 2004.

obligations. In other words, according to the tribunal's opinion, the general protection clause did not transform contractual obligations into obligations under international law in the absence of unequivocal text to show this intent.

In *SGS v. Philippines*, the arbitral tribunal decided that an umbrella clause that provided that *"Each Contracting Party shall observe any obligation it has assumed with regard to specific investments in its territory by investors of the other Contracting Party,"* turns all contractual obligations regarding investments into international obligations. The tribunal interpreted the terms 'any obligations' included in the umbrella clause in the sense of covering all obligations that arise from the contract executed between the parties. In the opinion of the tribunal, its jurisdiction was assured by the fact that, the umbrella clause, *"makes it a breach of the BIT for the host State to fail to observe binding commitments, including contractual commitments, which it has assumed with regard to specific investments."* In this case, the Tribunal justified its disagreement by waiving any binding precedent under the ICSID Convention or international law in general[160].

In the context of investment arbitration, the development of a system of mandatory precedent would lead to constant jurisprudence, and would consequently develop and harmonize the law. Consistent jurisprudence would help develop the scope of the obligations set forth by the treaties and the procedural rules that the tribunals must apply.

The inconsistencies in the Tribunals' decisions have delegitimized arbitration as a means for investor-State conflict resolution. This lack of legitimacy, as previously observed, has caused States negotiating new IIAs to adopt a series of positions, from modifying the IIAs to control the system, to completely rejecting treaties and causing the break-down of the system.

4.1.1 The inadequacy of the annulment action as a means to correct Tribunals' inconsistent decisions

Over the past few years, the number of investment arbitration awards has not only increased, but annulment actions have also increased, either within the mechanism provided by ICSID, either using the laws of the country that hosts the arbitration.

With respect to the disputes resolved under the ICSID Convention, the annulment mechanisms is based on specific justification determined in article 52 of the Contention, which expressly states the following:

160• Ibid.

1) Either party may request annulment of the award by an application in writing addressed to the Secretary-General on one or more of the following grounds:

(a) that the Tribunal was not properly constituted;
(b) that the Tribunal has manifestly exceeded its powers;
(c) that there was corruption on the part of a member of the Tribunal;
(d) that there has been a serious departure from a fundamental rule of procedure; or
(e) that the award has failed to state the reasons on which it is based.

In practice, these subsections have not been exercised in a proportional manner; thus, the greatest number of annulments have been ordered mostly as functions of manifest excess of power (b), failing to state the reasons on which the award is based (e) and serious departures from the rule of procedure (d); while the other two subsections have not been relevant to practice.

In this manner, the scope of review by the ICSID Annulment Committees[161] is exclusively limited to these subsections and this is reflected by issued awards themselves, which expressly clarify that the Committees are not appellate bodies.

This position was ratified by the Annulmen Committee in *M.C.I. v. Ecuador*,[162] which held as follows:

"24. It appears clearly from Article 53 of the Washington Convention that the only permissible remedies against an award are those provided for in the Convention, which include a request for annulment but not an appeal. Ad hoc committees are therefore not courts of appeal. Their mission is confined to controlling the legality of awards according to the standards set out expressly and restrictively in Article 52 of the Washington Convention. It is an overarching principle that ad hoc committees are not entitled to examine the substance of the award but are only allowed to look at the award insofar as the list of grounds contained in Article 52 of the Washington Convention requires. This was

161• Pursuant to article 52, numeral (3) of the ICSID Convention:

"(3) On receipt of the request the Chairman shall forthwith appoint from the Panel of Arbitrators an ad hoc Committee of three persons. None of the members of the Committee shall have been a member of the Tribunal which rendered the award, shall be of the same nationality as any such member, shall be a national of the State party to the dispute or of the State whose national is a party to the dispute, shall have been designated to the Panel of Arbitrators by either of those States, or shall have acted as a conciliator in the same dispute. The Committee shall have the authority to annul the award or any part thereof on any of the grounds set forth in paragraph (1)."

162• ICSID, M.C.I. Power Group L.C. and New Turbine, Inc. vs. Ecuador, ICSID Case No. ARB/03/6, Annulment Decision, October 19th, 2009.

reaffirmed by many committees, whose decisions are relied upon by the parties. Consequently, the role of an ad hoc committee is a limited one, restricted to assessing the legitimacy of the award and not its correctness. The committee cannot for example substitute its determination on the merits for that of the tribunal and, as the Lucchetti v. Peru Committee emphasized: "[...] it is no part of the Committee's functions to review the decision itself which the Tribunal arrived at, still less to substitute its own views for those of the Tribunal, but merely to pass judgment on whether the manner in which the Tribunal carried out its functions met the requirements of the ICSID Convention." The annulment mechanism is not designed to bring about consistency in the interpretation and application of international investment law. The responsibility for ensuring consistency in the jurisprudence and for building a coherent body of law rests primarily with the investment tribunals. They are assisted in their task by the development of a common legal opinion and the progressive emergence of "une jurisprudence constante", as the Tribunal in SGS v. Philippines declared."[163]

In certain cases such as *CMS v. Argentina*, this trend of limiting the annulment action as much as possible to avoid turning into an appellate body has caused the Committee to establish that, despite finding and clearly establishing legal errors in the

163• The decision's cites are the following: [14] in Klöckner (I) Committee already explained that Article 52 "is in no sense an appeal against arbitral awards" and that "[t]his provision permits each party in an ICSID arbitration to request annulment of the award on one or more of the grounds listed exhaustively in the first paragraph of Article 52 of the Convention." Klöckner (I), Decision on Annulment, May 3, 1985, 2 ICSID Reports 97, para. 3 (emphasis in the original). CMS Gas Transmission Company vs. Argentine Republic (ICSID Case No. ARB/01/8), Decision on Annulment, September 25, 2007, paras. 43, 135-136 (hereinafter referred to as CMS vs. Argentina); Compañía de Aguas del Aconquija S.A. and Vivendi Universal vs. Argentine Republic (ICSID Case No. ARB/97/3), Decision on Annulment, July 3, 2002, para. 62 (hereinafter referred to as Vivendi vs. Argentina); Amco Asia Corporation and others vs. Republic of Indonesia (ICSID Case No. ARB/81/1), Decision on Annulment, May 16, 1986, 1 ICSID Reports 509, para. 23 (hereinafter referred to as Amco I); Maritime International Nominees Establishment vs. Republic of Guinea (ICSID Case No. ARB/84/4), Decision on Annulment, December 22, 1989, 4 ICSID Reports 79, paras. 5.04-5.08 (hereinafter referred to as MINE); Wena Hotels Limited vs. Arab Republic of Egypt (ICSID Case No. ARB/98/4), Decision on Annulment, February 5, 2002, paras. 34-37 (hereinafter referred to as Wena vs. Egypt); Patrick Mitchell vs. Democratic Republic of the Congo (ICSID Case No. ARB/99/7), Decision on Annulment, November 1, 2006, para. 19 (hereinafter referred to as Patrick Mitchell vs. Congo); MTD vs. Chile, supra note 10, paras. 31, 52; Hussein Nuaman Soufraki vs. United Arab Emirates (ICSID Case No. ARB/02/7), Decision on Annulment, June 5, 2007, para. 20 (hereinafter referred to as Soufraki vs. UAE); Industria Nacional de Alimentos, S.A. and Indalsa Perú, S.A. (formerly Empresas Lucchetti, S.A. and Lucchetti Perú, S.A.) vs. Republic of Peru (ICSID Case No. ARB/03/4), Decision on Annulment, September 5, 2007, para. 101 (hereinafter referred to as Lucchetti vs. Peru). [16] Lucchetti vs. Peru, supra note 15, para. 97. See also MTD vs. Chile, supra note 10, para. 54. [17] SGS Société Générale de Surveillance S.A. vs. Republic of the Philippines (ICSID Case No. ARB/02/6), Decision of the Tribunal on Objections to Jurisdiction of January 29, 2004, para. 97 (hereinafter referred to as SGS vs. Philippines).

treatment of a state of necessity, that these errors are not enough to constitute reason for annulment. Thus, the Committee, in examining the parties' arguments, concluded as follows:

> *"135. These two errors made by the Tribunal could have had a decisive impact on the operative part of the Award. As admitted by CMS, the Tribunal gave an erroneous interpretation to Article XI. In fact, it did not examine whether the conditions laid down by Article XI were fulfilled and whether, as a consequence, the measures taken by Argentina were capable of constituting, even prima facie, a breach of the BIT. If the Committee was acting as a court of appeal, it would have to reconsider the Award on this ground.*
>
> *136. The Committee recalls, once more, that it has only a limited jurisdiction under Article 52 of the ICSID Convention. In the circumstances, the Committee cannot simply substitute its own view of the law and its own appreciation of the facts for those of the Tribunal. Notwithstanding the identified errors and lacunas in the Award, it is the case in the end that the Tribunal applied Article XI of the Treaty. Although applying it cryptically and defectively, it applied it. There is accordingly no manifest excess of powers."*[164]

Annulment as such is a limited revision recourse that solely applies under certain circumstances, and is limited to exclusively analyzing the legitimacy of the proceedings, not their merits. It therefore differs from an appeal, which implies a comprehensive review of the decision under review to the extent that it reviews the justice of the decision and its legitimacy; the review is performed by one sole appellate body and, because this is a single appellate body, it can assure the consistency of decisions and their consequent coherence.

The effect of an annulment is not to correct a mistaken decision, but rather, to void the original decision, thus making it necessary for the parties to begin arbitration anew. The Committee, therefore, cannot modify the annulled award or replace it by another, and it's reasoning does not bind the Tribunal created to resolve the case. Therefore, it could be feasible for the new Tribunal to adopt a decision that is similar to the one subject to annulment.

With respect to the scope of decision of the Committees, it is important to keep in mind that annulment is not an "all or nothing" process. According to article 52(3) of the ICSID Convention, Annulment Committees can annul certain parts of an award, leaving the rest as valid. This is the case in OXY II, in which the Committee partially

164• ICSID, CMS Gas Transmission Company vs. Argentina, ICSID Case No. ARB/01/8 Decision on Annulment, Decision Of The Ad Hoc Committee On The Application For Annulment Of The Argentine Republic, September 1st, 2006.

annulled the award that was issued by the Arbitral tribunal in charge, with manifest excess of power.

Given the award that triggered one of the strongest dissenting votes in the history of ICSID cases, and, especially given the manifest excess of power and a majority decision that lacks justification, the Ecuadorian State applied for annulment. The *ad hoc* Committee partially accepted this application on November 2, 2015. This annulment is a milestone in the reduction of awards, especially taking into account the originally claimed amount (US$ 3.37 billion plus interest), the amount of the award (US$ 1.7 billion plus interest) and the amount that was finally granted by the Annulment Decision (US$ 1.061 billion plus interest). This annulment is framed within the small percentage of 7% of annulment cases accepted by the ICSID system.[165] Further, this annulment opened the door for more of these types of decisions, because the Centre had not issued any annulments since 2010.

Despite having vindicated some of Ecuador's arguments in the annulment stage, *Occidental* is an example of the lack of reasoning of decisions adopted in the award, the breach of essential rules that ensure the right to a defense or the limited or non-existent knowledge of the law that governs the disputes that lead to incorrect an unfair awards which cannot be reviewed on account of the limitations of article 52 of the Convention.

In its annulment, Ecuador focused its arguments on three prongs: i) jurisdiction; ii) liability; and, iii) damages.

Ecuador argued that the claims regarding *caducidad* were not subject to arbitration under Ecuadorian law as well as the participation contract itself. However, the Committee did not accept Ecuador's claim on the basis that it could not apply the law to avoid performing its international obligations. Neither the Tribunal, nor the Committee analyzed Ecuador's argument based on the correct assumptions; they did not evaluate the fact that the contract between the parties expressly excluded *caducidad* from matters that were subject to arbitration. If they had done so, the arbitration brought by Occidental should have ended years before in a decision on jurisdiction that was in accordance with the Treaty's provisions.

Another of Ecuador's arguments addressed the "principle of proportionality." Ecuador's defense showed the Tribunal that the penalty agreed to by the parties in the participation contract for cases of unauthorized assignments of rights would lead to the *caducidad* of the contract. On account of the parties' decisions, both the State as well as Occidental recorded their acceptance of *caducidad* and its effects. Despite the evidence, the Tribunal

165• ICSID, *Background Paper on Annulment For the Administrative Council of ICSID*, World Bank, August 10th, 2012.

overstepped its powers, overlooked an essential principle of law such as *pacta sunt servanda* and applied the principle of proportionality, thereby distorting its nature, by classifying conduct that the parties had previously accepted as disproportionate.

For Ecuador, this misapplication of the principle creates an inevitable conflict with the principle of *pacta sunt servanda* and represents a typical example of a Tribunal acting as a friendly settler. Despite all of the arguments that the State filed, the Committee concluded that the Tribunal did justify its decision and that given the Tribunals' appreciation of the evidence, such evidence could not be reviewed by the ad hoc Committees.

Another relevant matter in the State's defense was related to Occidental's negligence and its liability in the acts that gave rise to the declaration of *caducidad* for the Block 15 Participation Contract. Occidental knew of the consequences implied by an unauthorized assignment of the rights under the contract; the Arbitral tribunal warned that Occidental's conduct gave rise to the disputes; nonetheless, it only issued frivolous reasoning, concluding that it was a "minor" violation and that, notwithstanding this fact, Ecuador had acted in a disproportionate manner against the company. Despite the Tribunal's limited reasoning, the Committee supported the Tribunal's actions and affirmed that its power did not extend to questioning the appreciation of the evidence.[166]

Despite this support, the flagrant contradictions, the lack of justification, the manifest excess of power and the dissenting vote of Professor Brigitte Stern, the *ad hoc* Committee only recognized the Arbitral tribunal's excess of power by granting 100% of the compensation in favor of Occidental, extending its competence to a Chinese company that was obviously outside the Tribunal's jurisdiction and partially annulling the majority's award; thereby supporting the position that Ecuador always rejected – the fact that the Tribunal's majority granted the Plaintiffs 100% of Block 15's fair market value despite a unanimous finding that the Plaintiffs had assigned the rights under the Participation Contract to AEC / ANDES. The Committee could do nothing else but affirm the facts: OXY only retained 60% of the contract's rights.[167] The actions of the Tribunals' majority were so ridiculous that the Annulment Committee had no other option but to annul that section of the award.

166• ICSID, Occidental Petroleum Company. vs. Ecuador, Case No. ARB/06/11, Decision on Annulment, November 2nd, 2015, par. 367.
"It is worth noting that in this summary of facts, the Tribunal drops the expression "negligent", and substitutes it with "imprudent". The use of this synonym shows that the Tribunal never gave a precise legal meaning to the concepts "negligent" or "imprudent" – they were used as convenient adjectives to describe Claimants' conduct. Contrary to Respondent's allegation, the Tribunal never had the intention of creating a new kind of violation of the HCL – a merely negligent one."

Paris, April 6, 2014, Offices of Dechert LLP. Preparatory meeting for the hearing on annulment in the Oxy II case. Comprehensive review of Ecuador's opening statement presentation for the hearing on annulment.

In that same line, the Committee should also have recognized the interpretive error regarding the Ecuadorian framework and, specifically, article 79 of the Hydrocarbons ACT. As noted by Ecuador, the definition of an automatic or a non-existent annulment does not apply in the country, the annulment contemplated by article 79 can only be declared by a judge,[168] demonstrating that it is possible for an Arbitral tribunal to commit flagrant errors when interpreting a State's domestic laws and that these errors must be corrected.

In *Occidental's* proceedings, the Tribunal pinpointed the deficiencies of the investor-State arbitration system. The annulment decision shows an imperative need for a change in the system; one that allows the review of arbitration awards and prevents unfairness that can affect the parties to the arbitration. The system is not infallible; thus, a body must exist with the power to: i) review the awards, and even analyze the facts; not limiting itself to reviewing the law as applied[169] - this has been the generalized practice of Annulment

Committees in recent years, and; ii) review and analyze the evidence submitted by the parties in arbitration proceedings.

However, the legal nature of the recourse itself – the ineffectiveness of the annulment to correct and ensure the system's consistency – does not limit itself to ICSID cases; rather, it can be observed in the decisions on annulment adopted in countries with centers of investment arbitration under UNCITRAL's rules. Such is the case of the proceedings brought against Ecuador, known as Chevron II.

This case, brought on account of the existence of 7 commercial complaints against Texaco – a company that emerged with Chevron in 2001 – was presented in the 90's, a few years prior to the entry into fore of the Bilateral Investment Promotion and Protection Treaty signed between the United States and Ecuador (1997). In this case, the Arbitral tribunal not only declared its jurisdiction despite the fact that Texaco abandoned Ecuador in 1992 – in other words, it did not have any investment in the country at the time of the entry into force of the Treaty – but it also considered that article II(7) of the Treaty was *lex specialis* that provided a guarantee other than denial of justice, and therefore, a evidentiary standard that was lower than the one required for Denial, according to Customary International Law, as analyzed in the previous chapter.

There is no doubt that given this award, Ecuador faced two circumstances that constitute serious errors of interpretation. The first circumstance faced by Ecuador was the fact that the Tribunal believed that the 1997 Investment Protection Treaty

167• ICSID, Occidental Petroleum Company. vs. Ecuador, Case No. ARB/06/11, Decision on Annulment, November 2nd, 2015, par. 201: "Summing up: upon the execution of the Farmout Agreements in 2000, OEPC retained a 60% interest in the Farmout Property (which included OEPC's legal position under the Participation Contract), and for good consideration transferred to AEC ownership over a 40% interest in the Farmout Property. The transfer was never authorized by the Ecuadorian Minister of Mines, as required by Article 79 HCL. However, OEPC and AEC duly complied with the terms and conditions agreed upon in the Farmout Agreements".

168• ICSID, Occidental Petroleum Company. vs. Ecuador, Case No. ARB/06/11, Decision on Annulment, November 2nd, 2015, par. 236: "The majority of the Tribunal's interpretation is incorrect: Article 79 does not mention the concepts of "inexistence" or "automatic nullity", it simply states that the transfer or assignment *"serán nulas y no tendrán valor alguno si no procede la autorización del Ministerio"*, and this nullity clearly fits into the definition of a *"nulidad absoluta"* under Article 1698 of the Civil Code. The words *"y no tendrán valor alguno"* are a simple reiteration of the main effect produced by nullity."

169• Regarding the subject, the international conference, especially Mr. Borzu Sabahi, has referred to the Occidental decision and noted that "The decision shows that an Annulment Committee does not hesitate to review the facts and the law when the existence of material to determine a manifest excess of powers is evident."

protected an investment that had ended in 1992, which gives rise to cause for annulment given that there was no arbitration award contemplated in the legislation of the arbitration center. The Tribunal's second mistake was its misinterpretation of article II (7) of the Treaty, which, although it did form a part of the basis for Ecuador's annulment action, the Dutch Court did not perform an exhaustive review of it when it indicated that there was no reason that would allow a review of an annulment action. The Court's ruling that said review was impossible is expressly noted in the District Court's judgment:

> *The District Court states first and foremost that the possibility of challenging arbitral awards is limited and that the Court should observe restraint in its investigation of whether there are grounds for setting aside. Setting-aside proceedings may not be used as a covert appeal...*[170]

This shows the inefficiency of the annulment action to correct serious matters such as the lack of jurisdiction of an Arbitral tribunal, a misinterpretation of the concept of investment, or a Tribunal's manifest excess of power when it stepped into the shoes of Ecuador judges and decided on each one of the 7 commercial lawsuits underlying the investment dispute.

4.1.2 The appellate mechanism as a proposal to overcome an inconsistency.

As noted previously, a series of reasons justify implementing an appellate mechanism:

i) The system is plagued with inconsistent decisions: there are many cases in which, despite many similarities, the arbitral tribunals reach conflicting decisions;[171]

ii) The subjects of international law involved in investment arbitration discuss acts related to public policy and public law before the tribunals; these require a system with the greatest possible legitimacy, given the consequences of the arbitration awards in State economies and their citizens.

iii) The States and investors need the legal security that they will be able to depend on uniform interpretations of investment law; these can hardly be reached if contradictory cases exist, such as Duke and Chevron II, or Encana and Occidental[172] and all those mentioned throughout this publication.

However, above all, an appellate system would be geared towards preventing arbitrary rulings that could cause effects. The decision on annulment

170• Court of The Hague, Trial Judgment, Ecuador vs. Chevron Corporation and Texaco Petroleum Company. Case No.: 386934/HA ZA 11-402 y 408948 / HA ZA 1-2813, January 20th, 2016, par. 4.3. Unofficial Translation.

171• FRANCK, Susan D., *"The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law through Inconsistent Decisions."* Fordham Law Review, Available at: http://ssrn.com/abstract=812964, last visited on July 28th, 2016, pp. 113 - 117.

in *Yukos*, is a concrete example of this.[173] This case was widely known because it constituted the largest award in the world of investment arbitration: approximately 50 billion dollars. It is not relevant for the purposes of our critique to determine the claims that the investor made against the Russian Federation, but the reason why the award was annulled is relevant. The reason was that-- in the words of Dutch courts --the Russian Federation never ratified the Energy Treaty, which constituted the international agreement used to file the arbitration claim. It is logical to think therefore that the arbitration should never have been filed. The Arbitral tribunal's decision, beyond the dispute on the merits, should have considered this specific detail a*b initio* and declare its lack of jurisdiction and much less order a damages award. If a case involving an invalid international Treaty can get to the point of an award being issued, what credibility can a Tribunal have under these circumstances?

However, States must have access to an appellate body to review the awards that are issued, and this appellate body must not only be limited to reviewing procedural matters; it should focuses on an exhaustive review of the litis; in other words, the

Quito, October 17, 2012, Dr. Diego Garcia Carrion, Attorney General, in the opening of "The Fifth Annual International Arbitration Seminar". Important jurists of the region participated in this event.

positions of the parties, the evidence, the law and the conclusions of the arbitral tribunal.

Until this appellate body exists, States and its investors are at the mercy of Tribunals that, although conformed by top professionals in the world of the law, they are not exempt from political or economic visions, personal or corporate interests or making mistakes. In many cases, these Tribunals forget the serious effects of their decisions, especially for States.

These inconsistencies have given rise to a proposal to provide for an appellate body in the new treaties that are signed. Even more eloquently, the Transatlantic Partnership Agreement for Trade and Investment of the EU-US that is soon to be signed between the United States and the European Union includes – not a possibility – but a complete commitment to establish a tribunal that would review, as in an appeal, the awards issued by first instance courts.[174]

4.1.2.1 Appellate Mechanisms in Treaties

There are a series of treaties that generally include the possibility of eventually creating an appellate body. According to ICSID, in 2005, approximately 20 countries had signed agreements with clauses that contained the creation of appellate mechanisms for awards issued in investor-State arbitration.

The Free Trade Agreement between the United States, Central America and the Dominican Republic, hereinafter CAFTA-DR, addresses complementary matters such as environmental protection, the protection of intellectual property rights and respect for workers' rights. Article 10(20) of the Treaty provides for an Appellate Body created

172• In *Encana* and *Occidental*, the respective tribunals considered that Ecuador did not violate the Bilateral Treaty with Canada when the former refused to return the VAT to oil company Encana and, on the contrary, in Occidental, the tribunal concluded that Ecuador did violate the Treaty signed between Ecuador and the United States when it refused to reimburse the VAT to said company. As noted, under these completely contradictory decisions, Ecuador cannot know whether it would violate a BIT in the future if it refused to return a levy, according to its laws, such as VAT.

173• Court of The Hague, Decision on Annulment in Cases Nos. C/09/477160 / HA ZA 15-1. Russian Federation vs. VETERAN PETROLEUM LIMITED; C/09/477162 / HA ZA 15-2 Russian Federation vs. YUKOS UNIVERSAL LIMITED; y C/09/481619 / HA ZA 15-112 Russian Federation vs. HULLEY ENTERPRISES LIMITED, April 20th, 2016.

174• The draft Agreement between the United States and the European Union provides as follows: *"Either disputing party may appeal Tribunal a provisional award, within 90 days of its issuance. The ground to appeal are:*

(a) That the Tribunal has erred in the interpretation or application of applicable law;

(b) That the Tribunal has manifestly error in its appreciation of the facts, including the appreciation of the relevant domestic law; or,

(c) Those provided for in Article 52 of the ICSID Convention, in so far as they are not covered by (a) and (b)."

through a separate multilateral treaty that can review the awards issued in arbitrations brought after the multilateral agreement entered into force between the Parties.[175]

Annex D of the 2004 model U.S. Bilateral Treaty proposes the possibility of a Bilateral Appellate Mechanism to review the awards issued in arbitrations filed after the appellate mechanism was established.[176] Thus, article 20(10) of the 2012 Model provides that, in the event that an appellate mechanism is created under future institutional agreements, the Parties will decide whether to submit awards under this Treaty. Pursuant to the Model Treaty, this new procedure must comply with the provisions established therein regarding transparency.[177] Since there is no need to keep a permanent institutionalized bureaucratic apparatus, the reduction of costs is one of the advantages of including provisions regarding appellate mechanisms in IIAs that provide for ad-hoc tribunals.

Nonetheless, although it may be more feasible to create an appellate body through a bilateral convention, because each appellate body created under each bilateral convention could issue different decisions, ISDS would not reach its objective of promoting consistent and predictable awards.

4.1.2.2 The Creation Of An Appellate Mechanism

Although certain IIAs already contemplate creating appellate bodies to reexamine awards issued by arbitration tribunals, at the same time, the creation of a "unique complementary unit" is necessary. It prevents the emergence of a scattered series of appellate structures created by different agreements.

Thus, we propose the creation of an appellate proceeding through the creation of a Permanent Court of Investment Arbitration that would act as an appellate body. This initiative would be

175• Art. 10(20) of the CAFTA-DR: *"If a separate multilateral agreement enters into force as between the Parties that establishes an appellate body for purposes of reviewing awards rendered by tribunals constituted pursuant to international trade or investment arrangements to hear investment disputes, the Parties shall strive to reach an agreement that would have such appellate body review awards rendered under Article 10.26 in arbitrations commenced after the multilateral agreement enters into force as between the Parties."* https://ustr.gov/sites/default/files/uploads/agreements/cafta/asset_upload_file328_4718.pdf. Last visited on July 28th 2016.

176• Annex D, US Model Bilateral Investment Treaty 2004: "Within three years after the date of entry into force of this Treaty, the Parties shall consider whether to establish a bilateral appellate body or similar mechanism to review awards rendered under Article 34 in arbitrations commenced after they establish the appellate body or similar mechanism."

177• Art. 28 (10) US Model Bilateral Investment Treaty 2012: "In the event that an appellate mechanism for reviewing awards rendered by investor-State dispute settlement tribunals is developed in the future under other institutional arrangements, the Parties shall consider whether awards rendered under Article 34 should be subject to that appellate mechanism. The Parties shall strive to ensure that any such appellate mechanism they consider adopting provides for transparency of proceedings similar to the transparency provisions established in Article 29."

feasible in multilateral agreements such as ICSID. Specifically, the ICSID Secretariat described a possible appellate mechanisms in a document issued in October 2004[178] where it proposes establishing Tribunals with permanent arbitrators in charge of hearing the appeals filed by claimants.

The Comprehensive Economic and Trade Agreement[179] between Canada and the European Union (CETA) that was executed in 2013 and which, on the date of this publication, was yet to be ratified by the European Union, changes the traditional dispute resolution system by creating a permanent investment tribunal and an appellate tribunal with the competence to review the tribunal's decisions.

This change implies institutionalizing the dispute resolution system. The investor or the State involved in the dispute would not appoint the members, but rather, they would be appointed in advance by the parties to the Agreement.

The Tribunal would be composed of 15 competent members to address claims on the violation of protection standards set forth in the agreement for the investments. These members, of notorious integrity, must meet the same standards required for Judges of the International Court of Justice and would be appointed by the European Union and Canada.

Furthermore, CETA's text establishes that an Appellate Tribunal may modify or revoke an award in the following cases:[180]

> **(a)** errors in the application or interpretation of applicable law;
> **(b)** manifest errors in the appreciation of the facts, including the appreciation of relevant domestic law;
> **(c)** the grounds set out in Article 52(1) (a) through (e) of the ICSID Convention, in so far as they are not covered by paragraphs (a) and (b).

The European Union and Canada will adopt a decision based on a Joint CETA Committee to include the necessary technical elements regarding the operation of the Appellate Tribunal.

This mechanism has been subject to criticism on account of an increase in processing times for arbitrations and secondly, the inherent costs thereof. In this regard, the European Commission has stated

178• ICSID, Possible Improvements of the framework for ICSID Arbitration, October 22, 2004, https://icsid.worldbank.org/apps/ICSIDWEB/resources/Documents/Possible%20Improvements%20of%20the%20Framework%20of%20ICSID%20Arbitration.pdf Last visited on July 28th, 2016.

179• European Commission. Investment provisions in the EU-Canada free trade agreement (CETA). http://trade.ec.europa.eu/doclib/docs/2013/november/tradoc_151918.pdf Last visited on July 28th, 2016.

180• Final CETA Agreement: http://www.sice.oas.org/TPD/CAN_EU/Texts/Final_CETA_Text_e.pdf, Last visited on July 28th, 2016.

the following in its proposal to negotiate a similar agreement with the United States:[181]

- An investment dispute resolution system with more efficient costs and faster processing times

- The system has clear procedural terms in order to assure that dispute resolution is expeditious and in order to keep costs low. In investment disputes, outside attorneys' fees (legal advisors) are the main costs for the parties involved; they represent approximately 80% of the total costs of a dispute. Here, clear substantive rules would help control claims – and thus, the amount of litigation.
- The general cases under ICS, **including the appeal**, would be limited to 2 years (the Tribunal of First Instance must decide within 18 months and the Appellate Tribunal must do so within 6 months).

By way of comparison, the average duration of proceedings under the existing investment treaties is between 3 and 4 years, and the annulment (due to procedural reasons) could add about another 2 years; this means that the total duration is frequently about 6 years (and many take much longer).

- Compensation for members of the Appellate Tribunal would be exclusively borne by the EU and the U.S.; there would be a daily limit to the judges' rates, instead of letting this be negotiated by the litigating parties, as in the case of the current ISDS system.

It is evident that there are a series of specific reasons to appeal for the purposes of ensuring that the appellate system is not subject to abuse by the unsuccessful party. These are: (a) errors in the application or interpretation of applicable law in the TTIP agreement; (b) manifest errors in the appreciation of the facts, including the appreciation of relevant domestic law; and procedural reasons (in other words, reasons comparable to annulment proceedings).

- Clear rules applied by impartial judges through a transparent and neutral process that is in the interest of States and investors

- The EU's proposal clarifies the content of substantive protection rules and how to fully preserve the right to regulate in the public interest. This represents greater legal security for investors and governments. Governments can regulate in the public interest. Investors also benefit from clearer rules, since they are protected against possible abuse (for example, expropriation without compensation, harassment, etc.) and they will avoid wasting

181• Press release issued by the European Commission on 12 November 2015. *Why the new EU proposal for an Investment Court System in TTIP is beneficial to both States and investors*. http://europa.eu/rapid/press-release_MEMO-15-6060_en.htm_. Last visited on July 28th, 2016.

time and resources in processing cases that are not within this legal framework.

- As with international arbitration, the Investment Court System (ICS) contemplates a neutral center for investment dispute resolution.

Another option would be to replicate the appellate body of the World Trade Organization (WTO), which was set up in 1995 in Geneva pursuant to article 17 of the Understanding on Rules and Procedures Governing the Settlement of Disputes.[182] It reviews the appeals from the reports issued by special groups based on disputes brought by WTO members.[183] This body affirms, modifies or revokes the findings and legal conclusions of a special group through its reports; the appellate review report is then accepted or rejected (by consensus) by the Dispute Settlement Body within a 30-day term; if the Dispute Settlement Body adopts it, the parties must accept it.

Appeals may be brought for legal disputes, such as legal interpretations; but the Body may not examine the evidence in the record or review any new issues. The appellate proceedings last between 60 and 90 days.

From its creation, the WTO's Appellate Body has generated a coherent and consistent line of jurisprudence regarding the WTO's Agreements; thereby positioning itself as interpretive authority for the WTO's Agreements. Similarly, we suggest creating an appellate body with the power to issue more coherent and consistent arbitration awards that could reduce the expense of an entire dispute resolution system.

Introducing an appellate mechanism would imply the following advantages:

1) Development of a coherent and consistent line of arbitration awards.

The WTO should review legal issues and the interpretations of the arbitral tribunals, and has the power to modify or replace an award in its entirety. Furthermore, the Appellate Body may carry out an analysis of issues that were not reviewed or resolved by the first instance arbitral tribunal.

A permanent appellate body would be able to ensure coherent arbitration practice. This body would be composed of permanent judges appointed by the States, upon their fulfillment of requirements

182• Art. 17, numeral 14 of the Understanding regarding the rules and procedures governing the WTO's dispute settlement: "An Appellate Body report shall be adopted by the DSB and unconditionally accepted by the parties to the dispute unless the DSB decides by consensus not to adopt the Appellate Body report within 30 days following its circulation to the Members (8).This adoption procedure is without prejudice to the right of Members to express their views on an Appellate Body report."

183• World Trade Organization, https://www.wto.org/english/tratop_e/dispu_e/appellate_body_e.htm., Last visited on July 28th, 2016.

that ensure their impartiality and technical ability. These requirements would again ensure that the judges "are authorities capable of issuing consistent and balanced opinions, and that they would correct any challenges to the legitimacy of the current alternative dispute resolution regime" (UNCTAD b, 2015, p. 150-). Further, judges would benefit from having permanent positions and would avoid any uncertainty regarding continued appointments.

Since the ICSID Convention currently provides that arbitration awards are binding for the parties and are not subject to appeal, it would have to be amended in order to incorporate this change. In turn, this amendment would require the consent of all the State Parties to the Convention.

2) Monitoring procedural times and costs. Implementing clear procedural terms and ensuring that appellate body act pursuant to clear rules regarding fees would also control costs. Any costs that were indeed incurred would be justified by the system's certainty and legitimacy.

The creation of a court with permanent members who are exclusively dedicated to acting impartially

Cochabamba, Bolivia, November 26, 2015. The Attorney General's Office launched the book "Chevron Case: Ecuador's Defense on the Claimants Abuse of Process in International Investment Arbitration" during the International Seminar: Economic Development and State Legal Defense. In the board, Luis Inacio Lucena Adams, Chief Minister of the Attorney General's Office of Brasil (Advocacia-Geral da União), Dr. Diego Garcia Carrion, Attorney General of Ecuador, Dr. Hector Arce, State Attorney General of Bolivia, Ricardo Ulcuango Farinango, Ecuadorian Ambassador in Bolivia.

and free from the pressure created by the various roles performed by arbitrators –attorneys, arbitrators, academics, and experts— would be ideal.

The proposal of creating a permanent appellate body presupposes institutionalizing a mechanism that would provide coherence and consistency in arbitration decisions on a global level; it would generate case law for the entire international investment arbitration system, which would promote its credibility.

4.2 Mechanisms with limited actors (Arbitrators that can be attorneys or experts).

One of the particularities of creating Arbitral tribunals lies in that their respective appointments come from each of the parties. In turn, the appointment of arbitrators must take into account any possible sympathies and antipathies that each arbitrator could have towards the case, the parties and even the attorneys. This obviously affects the system, since arbitrators will of course hope to be appointed again in future cases. We have seen the creation of a closed community created by expert arbitrators. A recent study performed by Sergio Puig reveals a dense network that reinforces predominant standards and behaviors that isolate the more important members from external influence.[184] As this is a closed community, and one not subject to ex post control, it faces the challenge of controlling itself and ensuring that it does not commit any abuse of power.

The close relationship between law firms and arbitrators is another criticism. This phenomenon, known as DOUBLE HATTING arises when attorneys who represent a party to a dispute before an arbitration institution or center are also arbitrators for disputes administered by the same institution.

With respect to double hatting "The International Institute for Sustainable Development (IISD)" stated the following regarding this duality of roles: "that attorneys or their partners act as attorney in certain cases, by definition created a conflict of interest (actual or apparent) that contradicts their participation as arbitrators."[185]
This situation has led to great controversy; while a sector speaks of an appearance of bias that should not lead to disqualification or recusal; other sectors voice a need for roles to be exclusive and that they should never be mixed.

Currently, only the Arbitration Regulations of the Court of Arbitration of Sports (CAS) expressly recognize double hatting. The regulations of the

184• PUIG, Sergio, *Social Capital in the Arbitration Market*, The European Journal of International Law, Volume 25, No. 2, p. 390.
185• FIERRO VALLE, Estefanía. *Conflicto de Intereses en el arbitraje internacional: El fenómeno del double-hatting*.

Arbitration Center, in force as of January 1, 2010, introduced a new rule that provides that arbitrators and mediators are forbidden from practicing as attorneys in CAS cases.

The IBA's Guidelines also contemplate situations that could be related to double hatting. For example: a) the arbitrator advised one of the parties or its subsidiary, or issued a resolution regarding the dispute prior to previous arbitrations; b) the arbitrators are attorneys in the same law firm.

> In turn, in October 2001, the International Court of Justice adopted the Practice Directions for States appearing before it: "*The Court considers that it is not in the interest of the sound administration of justice that a person who until recently was a Member of the Court, judge ad hoc, Registrar, Deputy-Registrar or higher official of the Court (principal legal secretary, first secretary or secretary), appear as agent, counsel or advocate in a case before the Court. Accordingly, parties should refrain from designating an agent, counsel or advocate in a case before the Court a person who in the three years preceding the date of the designation was a Member of the Court, judge ad hoc, Registrar, Deputy-Registrar or higher official of the Court.*"[186]

In reality, this should be the trend: introduce, either in Center regulations, whether in the IIAs themselves or through a global Convention, limitations to the parallel exercise of professionals as arbitrators, attorneys or experts. This should go even further, as bodies should regulate the positions adopted by professionals in their capacities of experts, attorneys, or judges, because we should seek consistency and prevent changes in positions that imply going to a complete opposite side or abandoning theories for a particular case, despite having defended them over years.

4.2.1 Disqualification to ensure the impartiality of arbitration decisions

The disqualification of one or all of the members of a tribunal is an extreme measure available to parties to restore their confidence in the tribunal. The duty of every arbitrator or judge is to be impartial and independence, as set forth by General Principle No. 1 of the Guidelines on conflicts of interest of the International Bar Association:

> *"Every arbitrator shall be impartial and independent of the parties at the time of accepting an appointment to serve and shall remain so until the final award has been rendered or the proceedings have otherwise finally terminated."*[187]

186• Practice Direction VII of the International Court of Justice, available at http://www.icj-cij.org/documents/index.php?p1=4&p2=4&p3=0.

Disqualification is not a measure that parties adopt without great deal of caution, as it involves inherent risks. We can imagine the following scenario: a party perceives that one of the arbitrators acts with bias and finds out that said arbitrator has a relationship or has made an observation that reveals that he or she is not neutral. And however, despite proving the existence of that fact, there is no guarantee that the parties will succeed in disqualifying the arbitrator, with the aggravating factor that he or she will surely have a biased opinion against the party who tried to disqualify him or her.

The results of disqualifications vary; for example, the disqualifications in the following cases had negative results:

- **TELKOM Malaysia co. Republic of Ghana.** The most emblematic case about double hatting. After a disqualification, Telekom nominated Emmanuel Gaillard and the Court's Secretary General appointed Robert Layton as substitute arbitrator. During the hearings, the investor based its defense on *RFCC v. Morocco*. Once the plaintiff referenced the decision, Professor Gaillard revealed to the parties that he had participated in this arbitration as an attorney. Ghana recused the arbitrator, who refused to renounce. The request for disqualification was submitted before the Court's General Secretariat, but it was denied. Finally, on September 27, 2004, Ghana filed a request for provisional measures with the District Court of The Hague in order to obtain the recusal of arbitrator Gaillard. The Court decided to maintain the disqualification against the arbitrators' bias if, within 20 days following the decision, he did not inform the parties that he had renounced as attorney in the case *RFCC v. Morocco*.[188]

- **Eureka v. Republic of Poland.** The Brussels Court of Appeals resolved this case. After the parties were informed of the partial award issued in August 2005, Poland requested that arbitrator Stephen Schwebel excused himself, who had been appointed by EUREKO. The State based its petition on the fact that this arbitrator had represented an investor in another case against Poland, which addressed similar claims. Arbitrator Schwebel refused to decline his appointment and the State filed a claim with the Brussels Trial Court, who dismissed the action. The Court held that this fact was not enough to create suspend the arbitrator on account of his independence and impartiality. The Belgian Court of Appeals affirmed the decision.

187• General Principle No. 1 Guidelines of the IBA on Conflicts of Interest in International Arbitration, approved on May 22nd, 2004.

188• DISTRICT COURT OF THE HAGUE, Civil Law Section- Provisional Measures Judge, Case Nº HA/RK 2004.667. 18 OCTOBER 2004. http://www.italaw.com/sites/default/files/case-documents/ita0857_0.pdf; last visited on July 28th 2016.

Ecuador, in turn, has prevailed in some of its disqualification petitions. Thus, it succeeded in disqualifying an arbitrator in the case brought by Burlington, because the arbitrator had made negative comments regarding the ethics of Ecuador's attorney.[189] In contrast, Ecuador was unsuccessful in an attempt to disqualify one of the arbitrators assigned to the arbitration case brought by pharmaceutical company Merck,[190] despite the fact that the reason for disqualification was quite similar: the arbitrator was the author of an editorial that suggested, without mentioning any basis therefor, that one of the attorneys in charge of Ecuador's defense had been associated, either directly or indirectly, with the plaintiff in a case with a different client. This was classified as a "fraud on the court."[191]

The system does not currently provide clear reasons for disqualification, or it could also be said that the reasons are insufficient.

Thus, for example, the UNCITRAL Regulations determine that the existence of circumstances that give rise to justified doubts regarding arbitrators' impartiality or independence are reasons for disqualification; and that if an arbitrator does not fulfill its objective or is prevented from doing so by fact or law.[192] The ICSID Convention, instead, is more ambiguous. It states that any arbitrators who do not meet the substantive requirements may be disqualified. In other words, an arbitrator must have a well-known reputation as an ethical person, recognized ability in the field of Law, of commerce, of the industry or finance, and he or she must inspire full confidence in the impartiality of his or her judgment.[193]

And it is not that we are trying to increase the number of reasons for disqualification, to the point that an arbitrator cannot act or feels threats from the parties. It is healthy, for any judicial or arbitration system, that the control remains in the authority, in such a way that parameters exist to which the arbitrator can publicly refer a case or rules exist that regulate the frequent appointment by a part of the same law firm. Further, the periods used by Tribunals to issue their decisions should also be regulated, given that they can have a great impact on investors' economies and transcendental economic consequences for the States and their populations.

189• ICSID, Burlington Resources Inc. vs. Republic of Ecuador, ICSID Case No. ARB/08/5, Decision on the Proposal for Disqualification of Professor Francisco Orrego Vicuña, December 14th, 2012; Ecuador also successfully disqualified arbitrator Charles Brower in Perenco Ecuador Ltd. V. Republic of Ecuador & Empresa Estatal Petróleos del Ecuador Case No. IR-2009/1; the Disqualification decision was adopted on 8 December 2009 on the basis of comments made about Ecuador in an interview given by the arbitrator.

190• Permanent Court of Arbitration, Merck Sharp & Dohme (I.A.) Corp. (U.S.A.) v. The Republic of Ecuador, Case No. AA442, August 8th, 2012.

191• M. Schwebel, Stephen. Editorial Commentary, *Celebrating a Fraud on the Court*, 106 (1) American Journal of International Law (AJIL) 102 (2012).

192• Article 12 of the UNCITRAL Arbitration Rules (reviewed in 2010).

4.3 Elevated costs and excessive delays

The cost of arbitration proceedings is high; thus, States must bear the burden of these costs to exercise their own defense. This is compounded by the fact that an investment arbitration proceeding can span much longer than a domestic case. If one also takes into account that there is no appellate phase, these factors strip the process even more legitimacy. By way of example and using a method of calculation available on the network,[194] the cost of an ICSID arbitration case regarding a sum at issue of US$ 500 million, with a Tribunal composed of three arbitrators, with a medium level of complexity and U.S. corporate lawyers, can cost each of the parties US$3'964.456,90 and can take four years.

The defense team's work includes disbursing large sums of money in attorneys' fees, expenses, costs associated with the logistics of appearing before Tribunals and expenses.

IIAs should regulate fees, costs and expenses. Many IIAs and arbitration regulations already do provide these details, We suggest expressly adopting the principles of "loser pays" or "the prevailing party has a right to demand that the losing party pay the costs." Of course, this goes hand in hand with establishing terms of duration for arbitration proceedings and penalties for Tribunals who cannot meet them.

Naturally, the parties could have the power to agree to different terms and they would surely do so taking into account their own convenience.

Excessive delays in arbitration proceedings cast doubt on one of the underlying advantages of arbitration – that is, a faster solution in terms of time and therefore, costs and expenses. That was precisely one of the reasons why arbitration has traditionally been the preferred choice over an ordinary judicial system. However, the long timelines makes arbitration no different from the ordinary judicial system and parties might as well resort to the latter, especially given that it has clearer rules as to the consistency of decisions and the possibility of their review.

Excessive delays are a reality. In the case of Ecuador, for example, the average duration of an investment

193• Article 14, provision No. 1, International Convention of the International Centre for Settlement of Investment Disputes, which provides in article 57 that: "A party may propose to a Commission or Tribunal the disqualification of any of its members on account of any fact indicating a manifest lack of the qualities required by paragraph (1) of Article 14. A party to arbitration proceedings may, in addition, propose the disqualification of an arbitrator on the ground that he was ineligible for appointment to the Tribunal under Section 2 of Chapter IV."

194• International Arbitration Attorney Network, https://www.international-arbitration-attorney.com/es/icsid-arbitration-cost-calculator-2/. Last visited on July 25th, 2016.

arbitration is 1410 days; that is, four years (2012 – 2015 period). These terms, by themselves, demonstrate that the system is ineffective of and cast doubt on whether, given these long timelines, it can truly provide redress for damages in the case of investors or how great the harm is to a State. Surely, until a dispute is decided, a State is unable to grant a concession to a port, oil block or a highway, or environmental harm went unremediated, or power was not generated, or perhaps a construction work went unfinished.

4.3.1 Disparity of reasoning given a monetary judgment

A disparity of reasoning, or ambiguity in the reasoning of arbitrators to establish a monetary judgment is another defect of the arbitration system. In sum, in certain cases, tribunals give exaggerated deference to investors, despite their submission of illegitimate claims or even in cases when the investors have lost certain claims. In turn, contrary to what a subject of international law would expect, in certain cases, arbitral tribunals issue unclear reasoning to explain a monetary judgment awarded against a State.

Specifically, on three occasions, Ecuador has been subject to an award that shows this defect.

The first began in 2004. This year, the ICSID Secretariat received a notice of arbitration from Empresa Eléctrica del Ecuador EMELEC,[195] filed by Mr. Miguel Lluco, an Ecuadorian citizen who claimed to have the legal power to represent the company.

After the exchange of memorials during the jurisdictional phase, the Tribunal accepted Ecuador's first objection and concluded that Mr. Lluco was unable to prove that he was the company's attorney-in-fact. In this manner, Ecuador avoided an award of almost $1.7 billion.

Of course, the State of Ecuador was only partially satisfied with the award, because the Tribunal decided, without any justification therefor, that it would divide the procedural costs among the two parties.[196] This decision was mistaken in light of the Tribunals' conclusion: Mr. Lluco was not EMELEC's representative; therefore, he did not have the legitimacy to submit an arbitration claim against a State.

This may seem trivial; everyone assumes that a State will have sufficient funds to pay for its defense against arbitration, but one must at least consider three factors: i) international investment litigation does not come cheap; ii) States' wealth varies, and some economies cannot withstand the cost of an

195• ICSID, Empresa Eléctrica del Ecuador, Inc. (Emelec) vs. Ecuador, ICSID Case No. Arb/05/9, Award, June 2nd, 2009, Par. 129, 130,134, 135, 136, 137.

international defense, aggravated further if there is no possibility to recover; and iii) it is possible, especially for developing countries, that a State that must divert resources for a defense by sacrificing certain of its objectives, such as providing education or healthcare to its own people.

In contrast to the above, in the arbitration brought by Murphy against Ecuador, the Arbitral tribunal awarded 75% of the costs to the Ecuadorian State. The following was the Tribunals' justification for this:

> *In light of the fact that Claimant has prevailed in full or in part on jurisdiction, liability, and damages, the Tribunal determines that it should be awarded a significant portion of the costs of arbitration enumerated under Article 38(a), (b), (c), (d) and (f) as well as its costs of legal representation and assistance under Article 38(e). The Tribunal orders Respondent to bear 75% of the costs of arbitration under Article 38(a), (b), (c), (d) and (f) as well as 75% of the costs of legal representation and assistance under Article 38(e) for a total amount of EUR 3,756,550.68 (i.e., USD 4,316,770).*[197]

Nonetheless, we must say that the reason given to Murphy during the liability and damages phase does not correspond to 75% of its claim, but rather, less than 10% since the amount of its claim was US$ 633 million and the Tribunal granted compensation in its partial award of US$ 20 million.

This leads us to highlight the absence of the reasoning necessary to order Ecuador to pay costs. It appears, given the Tribunal's opinion, which cites to article 40, numeral 1 of the UNCITRAL Rules,[198] that it is enough to be successful in the suit in order to be awarded fees and expenses. We would be remiss to consider this an absolute rule, since the same article provides that the award will be borne by the unsuccessful party, *in principle*. Thus, we would expect that the Tribunal's reasoning would support this decision, especially when there are many other cases in which tribunals deciding under the same rule have not ordered the unsuccessful party to pay legal fees, as in the *Occidental*[199] or in certain other cases in which, despite the fact that Ecuador was successful, the costs award has been issued against the State, such as in Encana.[200]

196• Empresa Eléctrica del Ecuador, Inc. (Emelec) vs. Ecuador, ICSID Case No. Arb/05/9. Award. June 2nd, 2009. par. 137:

> "COSTS. In accordance with Article 61(2) of the Convention and Rule 28 of the Arbitration Rules, the Tribunal decides that, in view of the particular circumstances of the present case, each Party shall pay an equal portion of the costs and expenses incurred in this arbitration proceeding related to the competence of the Tribunal. Likewise, each Party shall assume its own costs and expenses of representation during this arbitration proceeding."

197• Permanent Court of Arbitration, Murphy Exploration v. Ecuador, Partial Final Award, May 6th, 2016, par. 546.

Quito, February 16, 2016, team meeting, Dr. Christel Gaibor, Deputy Director of International Affairs, Dr. Blanca Gomez de la Torre, Director of International Affairs, and Fausto Albuja, Deputy Director of National Arbitration.

20I. Article XIlI (9) of the BIT permits the Tribunal to award costs in accordance with the applicable arbitral rules. Article 40 of the UNCITRAL Arbitration Rules states:
[…]

2. With respect to the costs of legal representation and assistance referred to in article 38, paragraph (e), the arbitral tribunal, taking into account the circumstances of the case, shall be free to determine which party shall bear such costs or may apportion such costs between the parties if it determines that apportionment is reasonable…"

According to the general principle expressed in

198• UNCITRAL Rules, 1976, "Article 40.1. Except as provided in paragraph 2, the costs of arbitration shall in principle be borne by the unsuccessful party. However, the arbitral tribunal may apportion each of such costs between the parties if it determines that apportionment is reasonable, taking into account the circumstances of the case."

199• LCIA, Occidental Exploration and Production vs. Ecuador, LCIA Case No. UN 3467, July 1st, 2004, Numeral 13, dispositive section.

article 40(1), as the prevailing party Ecuador is in principle entitled to the costs of the arbitration. However, this is not an inflexible rule and the Tribunal has a discretion to order otherwise.

202. In view of the events giving rise to this proceeding, the Tribunal considers that it would not be equitable to require EnCana to pay Ecuador's costs of arbitration. Indeed, the Tribunal has considered whether Ecuador should be required to meet EnCana's costs, despite the fact that the limitations on its jurisdiction under the Treaty prevent the Tribunal from addressing most of EnCana's complaints and despite its having found that no expropriation was effected by the Respondent. In the circumstances, the Tribunal considers that it would be just and equitable for Ecuador to bear the costs of the arbitration. Accordingly, Ecuador shall be responsible for reimbursing EnCana for all sums that it has deposited with the LCIA as deposit-holder in connection with the costs of the arbitration.

As you can see from these cases, Tribunals issue completely different opinions, even on the application of one single rule regarding the criteria to order payment of the costs of arbitration. And the fact that one of the parties is a subject of international law is not part of the analysis.

4.4 Unlimited access to the dispute resolution system and / or arbitration

A series of the cases brought before arbitral Tribunals, many of which we have referenced in the previous chapter, show that investors have unlimited access to investment arbitration. Again, the reason is the ambiguous treaties and the absence of preliminary requirements for an investor to access the system. While it is true that certain current IIA's do include preliminary requirements, such as exhaustion of domestic resources, even this lacks sufficient clarity.

As mentioned in the previous chapter, a description of each standard must include a list of conducts that imply its violation; this is essential, because the investor would have the right to resort to arbitration only to the extent that these preliminary requirements were met. In turn, even if an investor fulfills the first stage, Tribunals should be required to resolve objections to jurisdiction in advance. This contradicts the current global trend in which tribunals can resolve the merits as well as jurisdiction at the end, but it is unreasonable. It is unacceptable

200• LCIA, EnCana Corporation vs. Ecuador, Award and Partial Dissenting Opinion, LCIA Case No UN3481, IIC 91 (2006), par. 201

when a case is dismissed for lack of jurisdiction when the entire case has been litigated. In any case and given any doubt, tribunals should have the power to order all procedural actions that allow them to resolve an objection to jurisdiction rather than wait for the entire case's litigation in order to do so.

Of course, IIAs should include other provisions that limit access to arbitration that could include the following, according to UNCTAD:

- *Excluding certain types of claims from the scope of ISDS. This could apply, for instance, to certain sectors considered particularly sensitive (e.g. for claims relating to financial institutions and real estate), specific treaty provisions (e.g. pre- establishment obligations) or sensitive policy areas (e.g. measures adopted on national-security grounds). Exclusions can be party-specific or apply to all contracting States.*
- *Limiting admissible claims to treaty breaches only. [...]*
- *Prohibiting recourse to [arbitration] after a certain time period has passed from the events giving rise to the claim ("limitations period"), e.g. three years. This introduces a time factor that fosters certainty and predictability with regard to the assumed treaty obligations. Without it, claims could be filed any time, exposing States to uncertainty. It may be useful to clarify whether the limitation period includes the time that the investor spends pursuing its claims in domestic courts.*
- *Preventing "abuse" of the treaty by denying ISDS access to investors who engage in "treaty shopping" or "nationality planning" through "mailbox" companies that channel investments but do not engage in any real business operations in the home State.*
- *Providing for State consent to international investment arbitration on a case-by-case basis.*[201]

201• UNCTAD 2015 World Investment report, p. ix, available at: following web site: www.pge.gob.ec., last visited on July 25th, 2016.

China, September 7, 2010. UNCTAD. World Investment Forum. Dr. Diego Garcia Carrion, Attorney General was part of the Ministerial Round Table on Investment Policy Reviews.

4.5 Comprehensive system reform

As this book has demonstrated, it appears that the system has an dire need for comprehensive reform. However, the change must come from the source of the problem. In other words, it must be directed towards creating IIAs that focus on specific points such as sustainable development as well as clear and specific definitions regarding standards of protection or investors as well as the concepts of investment and investor, fair and equitable treatment, indirect expropriation, nation most favored treatment, as well as the exceptions based on public policy, national security, crisis in the balance of payments, human rights, the rights of indigenous communities, the environment, among others.

The innovative proposals of investment agreements seek to answer to public order considerations. We should attempt to perfect substantive standards in such a way as to reaffirm the States' regulatory power regarding matters related to sustainable development, such as public health, safety and the environment, without this being a violation of the protection granted by IIAs.[202]

This proposal involves new negotiations of valid treaties; negotiations that, in many cases, involve aggressive political confrontations to execute the treaties. Furthermore, this proposal requires that certain investors with great capacity to lobby politically must waive the rights that they have already obtained in signed treaties.

> As noted by the UNCTAD in its 2015 World Investment Report, *"In terms of process, IIA reform actions should be synchronized at the national, bilateral, regional and multilateral levels. […]In the absence of a multilateral system, given the huge number of existing IIAs, the best way to make the IIA regime work for sustainable development is to collectively reform the regime with a global support structure."* [203]

202• Annex B of the 2012 US Model BIT, Concerning The Encouragement And Reciprocal Protections Of Investments, 2012, http://www.state.gov/documents/organization/188371.pdf, last visited July 25th, 2016.

Each country should establish its own plan; however, without a doubt, the first step is deciding how to proceed with respect to IIAs that are already in force and establish whether these shall be denounced in order to enter a new negotiation process to adopt a completely new Treaty; or embark in a process of reforming existing treaties. However, as stated previously, this depends on each country's circumstances. The least traumatic way might be to embark on a reform of existing treaties. And the reason is that foreign investor protection continues and does not cause any type of concern or hesitation for investors who have already settled in a country or those who have considered entering others. Of course, this requires managing the investors. However, the new scenario, one in which both developing and investment exporting countries are subject to claims surely entails the least complicated approach.

The reform should focus on a series of aspects:

- Eliminating ambiguous and overbroad provisions; making the intent of each of the contracting parties clear. Once the progress is made, details are necessary.
- Related to the greater detail in IIAs, the state institutionalism and its internal frameworks must be adjusted as a function of these instruments.
- Countries should resort to these reform proceedings, regardless of the way they have chosen to do so, with clear investment politics regarding the investment that they need and wish to receive. Only then will the treaty reform as well as reform of the domestic framework have a clear objective and coherent guidelines, which will be reflected in each provisions. This cannot be an isolated thing. The investment protection policy in a country is everything and affects everything. And the formulation of a clear internal policy regarding investments must consider a series of elements, including, *"It may be noted here that not all FDI is desirable from a sustainable development—or even a narrower economic—perspective. In some cases, FDI simply crowds out domestic investment, offering no net gain in investment overall, or it may erode the domestic economy's ability to innovate or engage in R&D. In other cases, FDI's impacts on the environment and human health may leave long-term costs that are higher than the short-term economic benefits. And it is possible that the wealth generated by FDI in the host country will intensify income inequality. Thus, an IIA should promote investment that addresses the economic requirements of sustained growth and development, and the environmental requirements that ensure the protection and inter-generational viability of resource bases. The idea of quality investment may be*

203• UNCTAD 2015 World Investment report, p. ix, available at: following web site: www.pge.gob.ec. last visited on July 25th, 2016.

useful as a shorthand here, as long as it is understood to include both the development and sustainability halves of the sustainable development paradigm."[204] The design of a state investment policy must take into account each country's position in the world and whether that framework, when and under what circumstances, that state should sign bilateral, regional or multilateral investment agreements or whether it should negotiate or sign trade agreements with investment chapters.

- The reform must take into account that the world has changed and that certain subjects today are fundamental despite their absence in the past.

"Given that the opinions of the global community on development have changed, societies' expectations regarding the function of foreign investment have become more stringent. Currently, it is not enough for investment to create jobs, contribute to economic growth or generates currency exchange. Countries increasingly seek investments that do not harm their environment, that produce social benefits, promote gender equality and that help them climb the global value chain."[205]

In particular, IIAs must provide obligations to States party to IIAs, but also to investors.

"[…]it should be recognized that investors do become economic citizens of the host state. They acquire extensive rights through private contracts, host state legislation and international investment agreements. The first and most obvious obligation that they also acquire is to respect the laws and regulations of the host state. But beyond this most basic obligation, a common floor of pre- and post-establishment obligations or duties can also be foreseen, […]. Areas of minimum standards could include environmental impact assessments of proposed investments, anti-corruption obligations, and full investor disclosure requirements. All of these tools exist and are applied in various forms today."[206]

204• COSBEY, Aaron, MANN, Howard, PETERSON, Luke Eric, VON MOLTKE Konrad. *Investment and sustainable development*. p. 29 - 30. https://www.iisd.org/pdf/2004/investment_invest_and_sd.pdf. Last visited on August 5th, 2016.

205• Ibid.

206• Ibid.

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