Tipping Point?: What Does the Perenco case say about Fair and Equitable Treatment?

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The case of *Perenco Ecuador Limited v Republic of Ecuador*, ICSID Case No. ARB/08/6 (Decision, 12 September 2014), is one of a number of investor-state disputes to arise from the Ecuadoran government's policies on the so-called "extraordinary income" of oil companies operating in its territory in the mid to late 2000s. Keen followers of international arbitration will recall three previous cases concerned with the same issues:

• *Murphy Exploration & Production Company – International v. Republic of Ecuador*, (UNCITRAL, PCA Case No. AA434 / ICSID Case No. ARB/08/4), which is now proceeding in an UNCITRAL arbitration after the ICSID proceedings were dismissed for lack of jurisdiction;
• *Repsol YPF Ecuador, S.A. and others v. Republic of Ecuador and Empresa Estatal Petróleos del Ecuador (PetroEcuador)*, (ICSID Case No. ARB/08/10) which was discontinued; and
• *Burlington Resources Inc. v. Republic of Ecuador* (ICSID Case No. ARB/08/5), which has been delayed at the quantum stage following Ecuador's successful application to disqualify one of the arbitrators.

In its decision, the tribunal in *Perenco* found Ecuador to be in breach of a number of its obligations, both under the underlying exploration contract, and of its obligations under the France-Ecuador BIT. As regards whether Ecuador was in breach of its fair and equitable treatment obligations ("FET"), the tribunal found that it was, but that the breach occurred later than Perenco had alleged. This is of potential broader significance, given what the tribunal said about the current state of international law with regards to FET.

The two key measures that were the focus of the case on FET were (i) Ecuador's introduction of 'Law 42' in June 2006, which introduced a windfall tax of 50% on the revenue Perenco derived from the increase in oil prices in the mid-2000s (as measured against the original 'reference price' in Perenco's exploration contract); and (ii) 'Decree No. 662', issued in October 2007, which increased Ecuador's share of revenue from such sales from 50% to 99%.

When considering the FET issue, the tribunal recited and considered the oft-quoted passages in *Waste Management Inc v Mexico, Biwater Gauff (Tanzania) Ltd v United Republic of Tanzania* and *Saluka Investments BV v Czech Republic*. The tribunal then noted that the adjectives used in Waste Management such as 'arbitrary', 'grossly', 'unfair, unjust or idiosyncratic' and 'manifest' *"implies a search for the 'something more' that distinguishes an act in violation of international law from the perceived unfairness occasioned by many governmental actions that do not rise to a breach of international law. The challenge is to discern between the two."*

The tribunal held that the 50% adjustment in Law 42 did not fulfil this 'something more' requirement. The tribunal's reasoning for this was that the increase in oil prices had been "*extraordinary*" and similar measures were taken at around the same time by other states to harness some of the extra oil dollars being generated by the exploration in their territory. The tribunal noted the increase in price had not deprived Perenco of its anticipated revenue but rather only reduced the upside it stood to gain as a result of the higher prices. The tribunal also placed weight on the fact that the contract (and the law upon which the contract was based) envisaged future re-negotiation of the distribution of revenues. The fact that such negotiations were eventually subsumed by later developments did not mean that at the time of Law 42 Ecuador was in breach of its FET obligations.

Conversely, the tribunal found that Decree No. 662 fundamentally changed the contract from a 'participation' model to a service-type contract. The tribunal was perturbed also by the lack of transparency from Ecuador regarding how the contracts were to be further altered thereafter.

On one level, it is difficult to see a fundamental difference between a windfall tax set at 50% and a windfall tax set at 99%. Both could be seen as confiscatory and both (at least according to Perenco) frustrated Perenco's legitimate expectations. Perenco argued that the participation nature of the contract entitled it to expect both that (i) it would be able to retain all of the upside on the back of increased oil prices; and (ii) that its contract would not be unilaterally amended. However, the tribunal was clearly persuaded that given the "profoundly different" state of the oil market in 2006-2007 as against when the exploration contract was first agreed, negotiations to amend the contract might well have been successful.

When deciding whether a state has breached FET standards, investment tribunals have tended to face greater challenges in relation to determining how criteria should be applied to the divergent factual backgrounds that turn up at ICSID, than in establishing the criteria against which a state's conduct should be judged. The Perenco case reinforces the notion that FET is best viewed as a spectrum, with the tribunals ultimately having to decide where on the spectrum of state behaviour to draw the line of culpability; and then where to place the particular case before them on that line.