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New Model BIT proposed by Ecuador: Is the Cure Worse than the Disease?

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Like a chronicle of a death foretold, the systematic denunciation by Ecuador of the Bilateral Investment Treaties ("BITs") signed with various states formally began in 2009. Although, the origin of the complaints goes back to 2008, when the current Constitution of the Republic of Ecuador was enacted and specifically forbid the execution of any international treaty in which the Ecuadorian State "*surrendered jurisdiction to international arbitration entities*".

In 2010, Ecuador approved the termination of treaties executed with Finland, the United Kingdom and Germany; in 2011, those signed with Sweden and France, and in 2017, the remaining 12 BITs in force with Argentina, Bolivia, Canada, Chile, China, Spain, USA, Italy, Netherlands, Peru, Switzerland and Venezuela.

On this basis, in 2013, former President Rafael Correa created the Commission for Sovereignty, Integration, International Relations and Security of the National Assembly ("CAITISA") in charge of reviewing the provisions of all the BITs executed by Ecuador, which, in its final report, deeply criticized the text of the majority of them. Many of its observations are reflected in the new Model Bilateral Investment Agreement ("BIA").

This document intends to (non-exhaustively) outline the salient characteristics of the BIA that Ecuador intends to negotiate with other States.

Definition of Investment

Regarding the definition of investment, in principle, the BIA provides for the requirements of the *Salini* test to establish the existence of an investment in article 3(2). These requirements are: (i) a contribution of money or assets; (ii) a certain duration; (iii) risk; and (iv) a contribution to the host State's economy. However, the BIA also introduces requirements that must be met in addition to the test. These additional requirements are: (i) respect for human rights obligations; (ii) respect for environmental obligations; and (iii) subjection to national legislation, which is tied to the condition that there are no acts of corruption in order for the investment to exist. Consequently, article 15(5) of the BIA includes the clean hands doctrine to prevent arbitration for investors who commit acts of corruption; something that was adopted in the iconic *World Duty Free* case.

The same article provides a list (which given its literalness seems to be specific rather than illustrative) of the types of capital deployment that constitute an investment provided they meet the requirements determining its existence. Some examples are: (i) shares and participations in companies; (ii) real property rights; (iii) contractual rights; and (iv) concessions. The same article, at the end of section 2, contains a specific list of activities that are not considered investments under the Treaty. In essence, it excludes activities such as the following: (i) portfolio investments; (ii) intellectual property rights that are not protected by the host State; (iii) commercial contracts for the sale of goods and services; (iv) bank loans; and (v) debt instruments from some contracting states. Any activities that are not considered as investments on the basis of the BIA are excluded from its protection.

Definition of Investor

Article 3 (3) of the BIT prescribes two regimes to define an investor. Firstly, for a natural person, it implements the International Law test of effective nationality; that is, the individual will be a national of the State with which he/she has the closest connection. For an investor with dual nationality, one of these nationalities cannot be of the host State. Secondly, for a legal person, the BIA provides for the theory of effective control. Therefore, only a company with an activity in the issuing State will be considered an investor, provided that it is not controlled by a national of the host State or a third party of another State. In both cases, the investor must have an investment in the host State to be considered as such.

Fair and Equitable Treatment (FET)

FET is one of the most important substantive protections for investors under International Investment Law. This standard is included in article 7 of the BIA. Its definition equates Fair and Equitable Treatment to the minimum standard of international treatment, similar to article 5 in Chapter 11 of the NAFTA. The definition is complemented by the standard of national treatment for foreign investors, stipulated in article 5 of the BIA. The exception to this is in article 6, which refers to the different types of treatment that the host State may accord investors of Small and Medium-sized Enterprises (SMEs). Lastly, article 7 states that investor treatment will be guided by Customary International Law.

Despite the above, and somewhat contradictorily, the BIA limits violations of FET to two specific situations: i) denial of justice, and, ii) discrimination.

Firstly, FET can be violated by denial of justice. The BIA provides for two situations where there is a denial of justice: (i) illegal judicial decision; and (ii) wrongful refusal by the judicial authority to hear the claim. In any case, the investor must exhaust "*all national levels of jurisdiction*", in order to be able to file a claim for breach of this standard. In principle, it would seem that this requirement is limited to the scenario where the authority fails to hear the claim; thus excluding the standard of effective means recognized in previous cases against Ecuador.

Secondly, FET is violated in the case of discrimination. The BIA defines it as "*an exceptional and singular treatment of the investor*". However, this type of treatment only breaches FET when it is based on "*reasons of nationality, sex, race or religion*". Other types of singular treatment, even if illegal, are not protected under the treaty.

Expropriation

The BIA meets the standard of the *Chorzow* case. Any legitimate expropriation must: (i) be in the public interest; (ii) observe due process; and (iii) provide a just, adequate and prompt compensation.

There are two special circumstances that are regulated by the BIT. Firstly, article 17 provides for the scenarios that must be considered in order to quantify the compensation for the investment, namely: (i) the use of the investment; (ii) pending obligations of the investor; (iii) fault of the investor in the damage caused; and (iv) any type of environmental damage. These situations are above all illustrative. The host State may analyze "*any other relevant consideration to achieve an adequate balance between the public interest and the interests of the investment or investor*".

Secondly, article 7 (9) expressly excludes claims for indirect expropriation from the treaty. This would seem to be a response to a historical reason relating to ICSID arbitrations pursued by certain oil companies against Ecuador, which had differing results. For example, in the *Burlington* case, the Tribunal ruled that there was no indirect expropriation. On the contrary, in the face of similar events, in the *Perenco* case, the Tribunal concluded that there was an indirect expropriation. In any case, there is a certain risk in the exclusion, since creeping expropriation cases would be left unprotected, something which occurred in the *Yukos* case, and there would be no way to file a claim under the BIA.

Dispute Resolution

In accordance with the BIA, arbitration for violation of the treaty is only possible if it is submitted to "*arbitration mechanisms in regional proceedings in Latin America*" or to arbitration centers of the host State, under the premise that the "*place of arbitration is a Latin American country agreed by the Contracting Parties*".

Claims for violation of the treaty seek to protect the investment. In this case, there is a multi-tiered clause that provides for direct negotiation before arbitration.

The claim only begins when the other party is notified of the dispute. The BIA establishes the extinguishment of the right to arbitration if the arbitration claim has not been filed within three years following notice of the dispute. Furthermore, if the claimant has not begun negotiations within 90 days, the claim will be understood to be abandoned and it will not be possible to re-file the claim. Another distinction of the notice of dispute is that the BIA requires the notice of dispute to have the same subjective and objective subject matter as the arbitration claim that is subsequently filed.

On the basis of the experience in the *Burlington* case, article 21 of the BIT provides standing to the host State of the investment to file counterclaims in arbitration based on violations by the investor of its obligations under the treaty (e.g. human rights, environment, corruption, etc.).

Additionally, in keeping with the inclination towards local legislation concerning public private partnerships and investment promotion, for investor-State claims, article 21 of the BIA requires local administrative proceedings to be exhausted as a prior condition for arbitration. This requirement does not apply to State-State disputes.

Tax matters are expressly excluded from the subject-matter jurisdiction of arbitral tribunals formed under the BIA.

Also, the BIA limits the sanctions that can be imposed by arbitral tribunals on the host States of the investment, stating that such sanctions may only be economic and, under no circumstances, of specific performance.

Lastly, the BIA states that the award is final for State-State disputes, but provides for the possibility of filing (i) a horizontal motion for clarification; (ii) a vertical motion of appeal (pursuant to the method in the BIA); or (iii) an action for annulment of the arbitral award in cases of investor-State disputes. The action for annulment is admissible on specific grounds that concern: (i) violation of due process; (ii) inconsistencies and (iii) lack of jurisdiction of the arbitral tribunal.

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It is clear then that the new BIA brings significant changes compared to the current BITs in force around the world. Many of the changes seem positive, but many others eliminate protections that are necessary for promoting investment, which could negatively affect its acceptance by other States.

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