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Check-Mate to ICSID Treaty-Based Arbitration in Ecuador: The Constitutional Court's Decision on the Ecuador-Costa Rica FTA's Constitutionality

David Molina Coello (MIDS – Geneva Center for International Dispute Settlement) · Wednesday, October 25th, 2023

In a new chapter of Ecuador's backlash to the Investor-State Dispute Settlement (**ISDS**) system saga, the Constitutional Court of Ecuador (**Court**) declared Art. 15.20 of the Ecuador-Costa Rica FTA (**FTA, Treaty**) unconstitutional. This provision provides for ICSID or UNCITRAL arbitration in case of violation of the substantive protections accorded to foreign investors in the Treaty (**ISDS Provision**). According to this decision, the FTA can only be ratified if the ISDS Provision is adjusted to provide for arbitration seated in the region. This blog post examines the Court's reasoning considering the concerns that the Ecuadorian arbitration community expressed to the Court and reflects on the decision's practical implications.

Background to the Constitutional Court's Decision

To recall, Ecuador enacted a new Constitution in 2008, which precluded the government from entering into "[t]reaties or international instruments where the Ecuadorian State yields its sovereign jurisdiction to instances of international arbitration in contractual or commercial disputes between the State and natural persons or legal entities" (translation) (**Art. 422**). Arbitration seated in the region is excluded from this prohibition.

Based on Art. 422, and aligned with the previous government's expressed hostility towards ISDS, the Court declared that all Ecuador's Bilateral Investment Treaties were unconstitutional. Ecuador also denounced the ICSID Convention in 2009.

Ending Ecuador's isolation from the system, a new government ratified the ICSID Convention in August 2021 with the Constitutional Court's support. However, the sitting Court's stance on ISDS provisions in treaties, given Art. 422's prohibition, remained uncertain.

After the Court declared inadmissible a first request for interpretation of Art. 422, the opportunity to analyse this matter arose with the Ecuador-Costa Rica FTA. The issue at stake was whether the ISDS Provision in the FTA falls within Art. 422's prohibition. Despite its authority to deviate from past rulings for cogent reasons, the recent decision by the sitting Court on July 31, 2023 upheld the 2008 interpretation that ISDS provisions in treaties are incompatible with the Constitution.

The Court's Interpretation of Art. 422's Prohibition and the Concerns of the Ecuadorian Arbitration Community

The main issues the Court had to address to determine whether the ISDS Provision falls within the prohibition of Art. 422 were:

1. The meaning of yielding "sovereign jurisdiction to instances of international arbitration" in a treaty; and
2. The distinction between contractual or commercial and investment disputes.

This blog-post's author submitted an *amicus curiae* on behalf of the Ecuadorian Arbitration Institute and Ecuador Very Young Arbitration Practitioners (ECUVYAP) dealing with these issues, and recalling the Court's obligation to interpret Art. 422 in light of the international practice in treaty-based investment disputes. Further, the *amicus* advocated for an interpretation in which the ISDS Provision is not affected by the prohibition of Art. 422.

The Court ultimately held that the ISDS Provision allows investors to commence arbitration against the state, thereby yielding Ecuador's sovereign jurisdiction [At 176].

The Court seems to accept the *amicus* contention that an ISDS Provision is an unilateral offer to arbitrate and that the agreement to arbitrate only comes into existence after the investor has filed its claim (as held by investment treaty tribunals like *Toto v. Lebanon*, para. 92; *Generation Ukraine v. Ukraine*, paras. 12.2-12.3; and *ADC v. Hungary*, para. 363). However, and without any further reasons, the decision states that concluding an arbitration agreement between the investor and the host state in terms of the offer to arbitrate is clear proof that the state yields its sovereign jurisdiction, if not in the treaty, in this further agreement [At 177].

This is despite the fact that interpreting ISDS provisions as offers to arbitrate implies that a treaty party is not truly "entering into" the provision, as such act requires a bilateral rather than a unilateral action. Consequently, the verb directing Art. 422's prohibition does not apply to ISDS provisions. Likewise, states do not yield "sovereign jurisdiction to instances of international arbitration" by including an ISDS provision in an international investment treaty. The basis of jurisdiction for a treaty-based tribunal is not the unilateral offer in the treaty but the agreement that comes into existence when the investor accepts the offer, generally by filing a claim (*See Ethyl v. Canada*, para. 59;*Achmea B.V. v. The Slovak Republic (I)*, para. 223; and *Fynerdale Holdings v. The Czech Republic*, para. 264.b). Therefore, and contrary to the Court's decision, the agreement between the investor and the State does not fall within Art. 422's prohibition. This provision requires that the agreement is concluded between states, not between a private party and the state. Further, although the "yielding of sovereign jurisdiction" is not a concept of international law, the prohibition refers to a scenario in which a treaty provision excludes the host state's inherent power to rule on the dispute in national courts. This is not the case for ISDS provisions in a treaty. National courts retain jurisdiction over an eventual dispute unless the investor accepts the state's offer to arbitrate.

Puzzlingly enough, and contrary to its previous paragraphs that seem to adopt the arbitration without privity theory (as explained by Paulsson), the Court also held that accepting the *amicus* would render Art. 422's prohibition moot [At. 186]. It did so without referring to the *amicus*' interpretation that the prohibition's effect utile refers to what Gary Born has defined as Bilateral

Arbitration Treaties. Under this type of treaty, the states agree to set arbitration (instead of national courts) as a mandatory mechanism to solve commercial disputes of certain nature that may arise between them and the other party's citizens, or between both parties' citizens.

Regarding the distinction between contractual or commercial and investment disputes, the Court held that the definition of investment under the FTA falls within Art. 1454 of the Ecuadorian Civil Code that defines a contract as an act by which a party agrees to transfer, do, or refrain from doing something [At 179-181]. While for most tribunals that have addressed the matter, an investment is broader than a simple contractual relationship, for the Court, an investment is a type of contractual relationship. The Court's reasoning is unclear on the logical steps it took to come to this conclusion. Generally, the understanding on this issue is that whereas a "contractual or commercial" dispute may emerge from a simple agreement, such as providing goods and services, an investment under the treaty should entail defined parameters including duration, assets, and associated risks (*See Ipek v. Turkey*, para. 292 and *Romak v. Uzbekistan*, paras. 229-230).

Finally, the Court determined that the ISDS Provision did not provide for arbitration seated in Latin America or the Caribbean (which is the exception to Art. 422's prohibition), rendering it unconstitutional [At 189].

The Implications of the Court's Decision to Render the ISDS Provision Unconstitutional

The decision has left many issues unresolved regarding the rules of Constitutional interpretation under Ecuadorian law when confronted with concepts used by international tribunals. However, the most significant concern it has generated involves the terms of renegotiation that the government should pursue to amend Article 15.20. The decision is explicit that any ISDS provision should mandate arbitration with its geographical seat in Latin America or the Caribbean. On that note, the government could propose to:

1. Determine an arbitral seat in the region for all the ad-hoc or administered options the parties may decide to include in the treaty. This alternative enhances certainty, but it also increases the renegotiation efforts and costs the states might need to incur to modify the provision.
2. Agree that the arbitral seat for any administered arbitration option will be the centre's place of constitution, whilst allowing ad-hoc tribunals to choose a seat in the region; or allow any eventual tribunal (ad-hoc or administered) to choose a seat in the region. Any of these options create a diversified pull in case of dispute and allow to customize the arbitral proceedings depending on the claimant's initiative. Nevertheless, they entail some renegotiation efforts that might require specific research and complex drafting.
3. Maintain UNCITRAL arbitration as the only option to solve ISDS disputes in the treaty, with the indication that the seat should be in the region.

Although all the options above are feasible, the latter appears to be the most efficient. It will allow to customize the arbitral proceedings to each dispute and a prompt renegotiation of the ISDS provision.

In any case, what is certain is that, despite its recent ratification of the ICSID Convention, Ecuador is prevented from concluding treaties providing for ICSID arbitration [At 189] given its lack of seat. Then, the question remains whether the day will come when Ecuador, a ratifying party to the ICSID Convention, uses ICSID in a treaty-based dispute again. As far as the Court is concerned,

the response remains: not today.

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