Kluwer Arbitration Blog

Ecuador Sends Mixed Signals: The Constitutional Court (Wrongly) Declared a Treaty Containing an ICSID Arbitration Provision Unconstitutional

David Toscano, Gabriela Ortega, Sebastian Arrieta, Valentina Paladines (Tadir Dispute Resolution) · Saturday, December 2nd, 2023

Ecuador distanced itself from the International Centre for Settlement of Investment Disputes ("ICSID") system more than a decade ago. During this period, Ecuador withdrew from all its bilateral investment treaties ("BITs") and the 1966 Convention on the Settlement of Investment Disputes between States and Nationals of Other States ("ICSID Convention" or "Convention"). In August 2021, Ecuador rejoined the ICSID Convention. This brought expectations for Ecuador to potentially enter into new BITs (or treaties incorporating investment protection provisions) providing for ICSID arbitration.

In March 2022, Ecuador signed a Trade Association Agreement with Costa Rica ("Agreement"), which required clearance from the Constitutional Court of Ecuador ("Constitutional Court") to be subsequently ratified by the President of Ecuador. On 28 July 2023, the Constitutional Court rendered judgement No. 2-23-TI/23 ("Decision"). To the surprise of many, the Decision declared the Trade Association Agreement – and thus the Agreement – unconstitutional. The reason: the Agreement incorporated ICSID arbitration.

The Decision

The Constitutional Court ruled that the Agreement is "unconstitutional" because – among other reasons – it provides for ICSID arbitration in article 15.20. According to the Court, ICSID arbitration is contrary to Article 422 of the Constitution of Ecuador ("Constitution") for the following reasons:

1. Article 422 of the Constitution prohibits Ecuador from executing international treaties that "yield sovereign jurisdiction" in "contractual or commercial" disputes between Ecuador and private parties.
2. The agreement incorporates ICSID arbitration to adjudicate disputes between investors (private parties) and the State.
3. The subject matter of a dispute under the Agreement is "commercial" or "contractual" as the obligations under the Treaty would necessarily consist of those arising from contracts as provided in article 1454 of the Ecuadorian Civil Code (*i.e.*, "to do something"; "to abstain from

doing something"; and "to transfer the property of something to a third party").

4. If Ecuador is condemned by international tribunals, it would be equivalent to yielding "sovereign jurisdiction".
5. Thus, the Agreement is unconstitutional.

The Dissenting Opinion

Four Justices of the Court rendered a dissenting opinion ("Dissenting Opinion"). The Dissenting Opinion held that the Agreement is an international treaty and, as such, its scope of application is governed by international law (as opposed to local law). Being a sovereign State, Ecuador does not yield sovereign jurisdiction by entering into an international treaty, nor does it by providing its consent to international arbitration. On the contrary, by entering into an international treaty and agreeing to arbitration, Ecuador is exercising its sovereign powers. Furthermore, the Constitution itself recognizes arbitration (which includes international arbitration) as an alternative dispute resolution method. Hence, Article 422 cannot be regarded as prohibiting international treaties containing international arbitration provisions. This is consistent with local legislation.

The Dissenting Opinion points to the fact that the Ecuadorian Code of Production and Investments ("***COPCI***") contains provisions promoting international arbitration. Indeed, the COPCI provides for mandatory arbitration in investment contracts.

The Agreement Should Not Have Been Declared Unconstitutional

I) The Agreement Does Not Yield Sovereign Jurisdiction

The Court adopted the legal definition of "jurisdiction" as the power to adjudicate and enforce judgments to define "sovereign jurisdiction". While this is correct, the prohibition under article 422 of the Constitution refers to international treaties, thus, it should be understood in the light of international law. In this context, "sovereign jurisdiction" should be understood within the concept of "sovereign immunity" on jurisdiction. This means that a state may not be subject to the jurisdiction of other states' courts. Agreeing to international arbitration does not equal to "yielding" the State's sovereign immunity on jurisdiction. On the contrary, it is consistent with the principle of "sovereign immunity" as the state would be expressly agreeing to be subject to the jurisdiction of an international tribunal – as opposed to courts of other states. As the Dissenting Opinion points out, providing consent to international arbitration through an international treaty is precisely exercising the state's sovereignty.

In addition, as held in the Dissenting Opinion, understanding the prohibition under Article 422 of the Constitution as the inability of Ecuador to enter into international treaties that provide for international arbitration would be contrary to other provisions of the Constitution. In particular, it would be contrary to article 190, which recognizes arbitration as a valid alternative dispute resolution method to the jurisdiction of local courts. Accordingly, the Court's interpretation results in article 190 of the Constitution being rendered ineffective.

A correct interpretation that gives *effet utile* to all provisions of the Constitution is not a broad one, but one that is restricted to the text of article 422. Such an interpretation would ban a very specific type of international treaty, in which: i) Ecuador agrees to international arbitration; ii) with the purpose of adjudicating "contractual or commercial" disputes; iii) between private parties and the State. This is not the case of the Agreement (or any BIT or agreement containing investment provisions) because the disputes that may arise from it – which would have been adjudicated by an ICSID tribunal – would not be "contractual" or "commercial", but rather investment disputes arising out of the violation of international law.

II) Disputes Under the Agreement Are Not "Contractual" or "Commercial"

The Court made a fallacious interpretation of Article 422 of the Constitution by finding that disputes that may arise from the Agreement would necessarily be "contractual" or "commercial".

Contractual or commercial disputes do not equate to investment disputes. A dispute arising under the Agreement is one under international law and not one under a contract. Article 15.20 of the Agreement provides for investment disputes to be resolved through ICSID arbitration. It is the breach of international law obligations that would be adjudicated under the Agreement. Unlike disputes under the Agreement (international treaty), contractual or commercial disputes are domestic in nature and are to be solved under the (domestic) applicable law.

The Court's analysis falls short as it fails to differentiate "investment" disputes from "commercial" ones, ignoring that these two concepts are mutually exclusive. At the risk of oversimplifying a rather complex discussion under investment treaty law, the "Salini test" (*Salini Costruttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco*, §§ 50-58) is illustrative. Indeed, for an "investment" to exist under the ICSID Convention the following criteria have been considered: i) contributions; ii) of a certain duration; iii) participation in the risk of the transaction; iv) contribution to the economic development of the host State. In general, these criteria have been used in ICSID arbitration precisely to differentiate a mere "commercial" transaction from an "investment". Needless to say, the Court did not engage with this discussion.

Instead, the Court resorted to local law (the Civil Code) to conclude that disputes under the Agreement would necessarily be contractual. This is fallacious. Obligations under international law may well consist of "doing something"; "abstaining from doing something"; or "transferring the property of something to a third party" (such as obligations under a contract ruled by the Civil Code). This does not mean that obligations included in the treaty are contractual. What is relevant is the source of the obligation. In this case, that source is an international treaty – not a contract between an investor and the State. Thus, any dispute arising out of the Agreement cannot be a "contractual one."

Finally, even if one were to concede that Article 422 should be construed under local law and not in light of the basic concepts of international law, the Court's analysis fails. Article 13 of the COPCI provides the elements of an investment: i) flow of resources; ii) that produce goods and services; iii) that expand production capacity; and iv) create jobs. Article 8 of the Code of Commerce contains a list of acts that are considered "acts of commerce". None of these contain the elements of an "investment" under the COPCI. Thus, the analysis of the Court is not consistent with Ecuadorian law either.

Conclusion

Article 15.20 of the Agreement is not unconstitutional: the Agreement does not fall within the prohibition of Article 422 of the Constitution; the Agreement does not yield sovereign jurisdiction. By entering into the Agreement (and BITs in general), Ecuador is exercising its sovereignty. ICSID arbitration under the Agreement does not refer to contractual or commercial disputes. With the Decision, Ecuador sends contradictory messages to the international community. It is difficult to understand that, on the one hand, Ecuador decided to rejoin the ICSID system and, on the other, its highest court on constitutional matters rules that a treaty providing for ICSID arbitration is unconstitutional.

Court, Ecuador, ICSID Arbitration, Latin America, Trade and investment agreements, Uncategorized
You can follow any responses to this entry through the Comments (RSS) feed. You can leave a response, or trackback from your own site.