

## Investment Treaty News (ITN), March 2, 2006

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**Arbitration Watch:**  
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1. Canadian firm Encana loses BIT arbitration with Ecuador over tax refunds,  
By Luke Eric Peterson

Canada's largest energy firm, the Encana Corporation, has lost an arbitration with the Republic of Ecuador arising out of a dispute over some 80 Million Dollars (US) in Value-added taxes (VAT).

Encana was the second multinational energy firm to mount a claim under a bilateral investment treaty against Ecuador in relation to disputes over VAT. In 2004, US-based Occidental Petroleum and Exploration Company prevailed in a similar arbitration against Ecuador under the US-Ecuador BIT.\*

However, in a ruling released in February of this year, a majority of a 3 member arbitral tribunal held that Ecuador was not liable for breaches of the Canada-Ecuador BIT in relation to its treatment of Encana and its subsidiaries.

Encana initiated its arbitration in March of 2003, with little fanfare, under the UNCITRAL rules of arbitration (which impose no duty to disclose the existence of an arbitration claim).

The Canadian firm alleged that Ecuador's denial of VAT refunds to two of Encana's Barbados-based subsidiaries was in violation of guarantees contained in the Canada-Ecuador BIT.

Encana, through its subsidiaries, held 4 contracts for the exploration and exploitation of oil and gas within Ecuadorian territory. These contracts, which had been concluded with the state oil agency, Petroecuador, were ambiguous as to whether or not VAT expenditures by Encana's subsidiaries (for example in relation to local purchases and imported goods or supplies) were to be reimbursed by the state tax authorities.

Encana's subsidiaries had been granted VAT rebates for a brief window of time – from March 2000 to March 2001 - however these refunds were ultimately halted by Ecuador's tax agency. Moreover, those refunds which had been disbursed were deemed to have been mistakenly paid out by the tax agency.

In turning to arbitration under the Canada-Ecuador BIT, Encana contended that its treatment at the hands of the tax authorities was contrary to several provisions of the BIT, including guarantees of national treatment, fair and equitable treatment, as well as the stricture against expropriation without compensation.

Of particular relevance to the tribunal's examination of Encana's claim was Article XII of the BIT which expressly limited the application of that treaty in cases where taxation measures were at the centre of the dispute. Indeed, in disputes where taxation measures were at issue, Article XII permitted claims based on only two grounds.

First, an investor could claim that a tax measure breached the terms of an investment agreement (for e.g. a contract) between the central government authorities of the host state and the investor. In such circumstances, the investor could claim that such a breach amounted to a further breach of the investment treaty, provided that the tax authorities of Ecuador and Canada had been given 6 months to review such a claim, and had not determined that the measure failed to breach the relevant agreement (e.g. the contract).

Ultimately, Encana was unable to bring a claim on this basis, because the participation contracts in question had not been concluded by Encana itself, but rather by the company's Barbados-based subsidiaries. Accordingly, the tribunal would rule that there was no Canadian "investor" – as defined under the Canada-Ecuador treaty – who had entered into an investment agreement with the Ecuadorian authorities.

There was, however, a second avenue open to Encana; it could argue that it had borne the brunt of taxation measures which amounted to an expropriation under the terms of the Canada-Ecuador treaty.

(In examining this claim, the tribunal would affirm that the BIT barred Encana from pleading that taxation measures violated other provisions of the treaty, for example fair and equitable treatment or national treatment.)

Encana's expropriation claim was divided into two parts. First, there was a claim of "direct" expropriation, which held that Encana had been deprived of refunds owed to it under Ecuadorian law. Second, there was a claim of "indirect" expropriation which held that – irrespective of whether or not Encana was entitled to refunds as a matter of Ecuadorian law – the actions of the tax agency had such a significant impact on Encana's operations that they were equivalent to expropriation.

As to the second of these claims, the tribunal was particularly skeptical. The tribunal held that foreign investors - unless they have obtained a specific promise of tax stability - will need to assume the risk of changes to the tax regime over the life of the investments. Thus, it would take an "extraordinary" tax measure, or one that was "punitive in amount or arbitrary in incidence", before it could be held that such a measure violated the investment treaty rules against "indirect" (or creeping) forms of expropriation.

As for the claim of "direct" expropriation, the 3 tribunal members diverged on this point. A majority held that Ecuador had not breached this treaty obligation, while the third arbitrator held that Ecuador had committed a "direct" expropriation.

In their majority opinion, Prof. James Crawford and J. Christopher Thomas, had no difficulty determining that legal rights - such as a right to a tax refund under Ecuadorian law - could, in theory, be subjected to a direct expropriation, contrary to the investment treaty obligations of the host state. However, in order for such a claim to be made out, the majority held that it would need to be shown by Encana that Ecuador's tax agency had made a "definitive determination contrary to law", such that there had been an "actual and effective repudiation of legal rights".

The majority noted that this had not occurred – and that, to the contrary, the oil companies were able to challenge their treatment in the local courts and that Ecuadorian officials were showing good faith whilst the issues were thrashed out in the courts.

In his dissent, arbitrator Dr. Horacio Grigera Naon criticized the majority view for seeming to impose a "substantive" requirement upon Encana to exhaust its domestic legal remedies, before it could make out a claim under the Canada-Ecuador treaty. Grigera argued forcefully for the jurisdiction of international arbitration tribunals to review the actions of local officials and courts at a fixed moment in time – and in light of international law - without needing to wait for local officials or local courts to resolve all disputes under local law.

Further, he disagreed with what he characterized as the majority's improper distinction between tangible and intangible types of assets, and its subsequent elaboration of different admissibility thresholds for claims depending upon whether they involved tangible (e.g. real property) or intangible (e.g. legal rights) assets.

Copies of the majority and dissenting opinion are available on-line at the address below.

Following its setback before the tribunal, it remains unclear what further steps may be taken by Encana. The firm could seek to challenge the arbitral award in the courts of the country where the arbitration was legally sited - in this case, the United Kingdom.

Indeed, the UK courts are already reviewing the arbitral award rendered in a companion arbitration between Occidental and Ecuador. Following a determination by a separate tribunal in that case which held Ecuador liable for breaches of the US-Ecuador BIT, Ecuador turned to the UK courts in an effort to overturn the arbitral award. That matter is still proceeding.

A source familiar with Encana's case, told ITN that a decision had yet to be taken as to whether to challenge the award in the UK courts.

\* For earlier reporting on the Occidental v. Ecuador case see:  
[http://www.iisd.org/pdf/2004/investment\\_investsd\\_july16\\_2004.pdf](http://www.iisd.org/pdf/2004/investment_investsd_july16_2004.pdf)

Copies of the February 2006 Encana v. Ecuador award and the separate opinion of Arbitrator Horacio Grigera Naon are available on-line at  
<http://www.investmentclaims.com>

## 2. One of two arbitrators disqualified in Pinochet-era expropriation case at ICSID, By Luke Eric Peterson

Following a request by Chile to disqualify the three-member arbitral tribunal presiding over a high-profile expropriation claim, a final decision has been reached. Minister Mohammed Bedjaoui, an Algerian national, has been disqualified from further service on the tribunal, while Professor Pierre Lalive will continue in his capacity.

As earlier reported in this newsletter, Chile's extraordinary request was lodged in August of 2005, in the country's long-running arbitration with Mr. Victor Pey Casado and the Salvador Allende Foundation.

Chile's own nominee to the tribunal, Mr. Galo Leoro Franco, an Ecuadorian national, resigned his seat on the tribunal immediately after Chile launched its challenge. The remaining two arbitrators declined to resign, voicing their opposition Chile's disqualification request.

After hearing extensive arguments and pleadings on the disqualification bid, the International Centre for Settlement of Investment Disputes (ICSID) elected to pass Chile's request on to the Secretariat of the Permanent Court of Arbitration for a decision.

On February 14th, the Acting Secretary General of ICSID wrote to PCA Secretary-General, Tjaco T. van den Hout, requesting a recommendation to the Chairman of ICSID's Administrative Council "as to what his decision should be on the proposal for the disqualification of the two remaining members of the arbitral tribunal ...."

ICSID also forwarded the voluminous correspondence in the case, comprising almost 40 letters and submissions related to the disqualification request.

On February 17th, Mr. van den Hout wrote to ICSID to give his recommendation: "i. That the proposal to disqualify Professor Pierre Lalive be rejected; and ii. That the proposal to disqualify Minister Mohammed Bedjaoui be accepted."

No reasons were given for the decisions.

As such, the grounds for Mr. Bedjaoui's disqualification remain unknown. Chile had argued for the removal of the entire tribunal on account of the unusual length of the arbitral proceedings. In addition, the Chilean government also advanced further individual grounds for the removal of Messers Bedjaoui and Lalive.

In the case of Mr. Bedjaoui, Chile contended that his recent appointment as Foreign Minister of Algeria offered an additional ground for his disqualification.

As was earlier reported by this news service, Chile had alleged that Mr. Bedjaoui's continuing service as an arbitrator could conflict with Algerian law – a claim apparently denied by Mr. Bedjaoui – as well as pose diplomatic complications for Chile's foreign relations with Algeria.

Further to those arguments, Chile would later tender additional grounds for Mr. Bedjaoui's disqualification: alleging bias and lack of impartiality, arising out of Mr. Bedjaoui's reaction to the initial request for disqualification.

For his part, Mr. Bedjaoui rejected all of Chile's arguments for his disqualification, including allegations of bias and impartiality. He will not, however, learn the reasons underlying the recent decision to disqualify him from further service in the arbitration.

Already, the arbitration pitting Mr. Pey and the Salvador Allende Foundation against the Republic of Chile has earned a place in the ICSID record books – having been registered by the Centre back in 1998, the tribunal had yet to issue a ruling on jurisdiction at the time when Chile filed its disqualification bid in August 2005.

The dispute at the heart of the case arises out of the 1973 overthrow of the government of

socialist President Salvador Allende by General Augusto Pinochet. Mr. Pey claims ownership of a Chilean newspaper, El Clarin, which was seized and later formally expropriated by the Pinochet regime.

For a fuller account of the Pey v. Chile case, see an earlier ITN report: “World Bank President will rule on Chile’s effort to disqualify tribunal in ICSID case”, Investment Treaty News, December 14, 2005, available on-line by clicking [here](#).

### 3. Vivendi-Argentina water dispute resumes after unsuccessful jurisdictional challenge, By Luke Eric Peterson

The longest-running arbitration dispute on the ICSID docket resumed in November of last year, after an unsuccessful bid by the Government of Argentina to challenge the jurisdiction of a new tribunal hearing the case.

The French investors, Compañía de Aguas del Aconquija S.A. and Compagnie General des Eaux first brought their claim against Argentina under the France-Argentina bilateral investment treaty in the closing days of 1996.

The claimants had entered into a long-term water and sewage concession with the Tucuman province of Argentina in 1994-1995. However, the investors allege that they promptly encountered hostility from the Tucuman authorities and local politicians, which served to exacerbate consumer hostility to the investment, and ultimately served to destroy the economic prospects of the concession.

In particular, the claimants have criticized the Tucuman authorities for inciting customers not to pay their utility bills, and for forcing a renegotiation – and eventually – a termination of the project.

A tribunal empanelled in 1997 had found jurisdiction to hear the dispute, but went on to reject the claims on their merits. The tribunal held that questions of alleged treaty breach were so intertwined with alleged contractual breaches, that the two could not be satisfactorily disentangled. Accordingly, the tribunal ruled that the appropriate forum to rule on alleged contractual breaches was the body specified in the concession contract, the Tucuman courts.

However, this ruling did not stand. The award was partially annulled in July of 2002, when a so-called ad-hoc annulment committee consisting of 3 members ruled that the original tribunal had neglected to exercise its powers, specifically by finding jurisdiction to hear the claim, but then failing to examine the alleged treaty breaches on their merits.

Thus, in August of 2003, the claim was re-submitted to ICSID, and a tribunal was established, consisting of Swiss Professor Gabrielle Kaufmann-Kohler; Mexican lawyer Carlos Bernal Vereza; and J. William Rowley, Chairman of the Canadian law firm McMillan Binch Mendelsohn.

This tribunal had begun to hear the Vivendi case on its merits, however in March of 2005, Argentina filed an exceptional series of objections to the tribunal's competence and jurisdiction, bringing the merits phase to a halt.

Lawyers for Argentina raised several objections. Argentina alleged that there had been a change in corporate ownership of Compañía de Aguas del Aconquija S.A (CAA) and that Vivendi Universal had failed to show that it had succeeded Compagnie General des Eaux as the rightful owner of CAA.

Further, Argentina objected that Vivendi's claim was a derivative claim (i.e. a claim made by a minority shareholder) which should be forbidden by Argentina and International Law.

Also, Argentina offered a reading of the 2002 annulment decision which would bar the claimants from bringing claims which alleged that breaches of the water concession contract rose to the level of a breach of the France-Argentina bilateral investment treaty.

Prior to examining these objections, the tribunal observed that it was, in general, bound to follow the first tribunal's jurisdictional conclusions – as these had not been annulled as part of the aforementioned proceeding.

Although Argentina plead that “new facts” could permit a subsequent tribunal to reconsider an earlier tribunal's jurisdictional conclusions, there would be no need to clarify this point, as the present tribunal held that there were no “new facts” to be examined. With respect to the questions raised about a change in CAA's corporate ownership, the tribunal found that Vivendi continued to hold the majority stake in CAA, notwithstanding the fact that other of Vivendi's water assets were spun off to a new entity, Veolia.

Turning to examine other of Argentina's jurisdictional objections, the tribunal observed that derivative claims (i.e. by a minority shareholder) were permitted, as had been established by the earlier tribunal's jurisdictional ruling in the Vivendi case. What's more, the tribunal noted that they have been permitted as a matter of course in numerous other ICSID proceedings in which Argentina has been involved.

As for Argentina's argument that the earlier annulment ruling had the effect of limiting the ability of the claimants to bring treaty claims arising out of alleged breach of the concession contract, the tribunal also rejected this argument. The tribunal observed that the 2002 annulment ruling had, in fact, not annulled the earlier holding by the first tribunal that it had jurisdiction over all claims arising under the France-Argentina investment treaty. (Rather, the annulment committee had faulted the first tribunal for its failure to exercise this jurisdiction in a meaningful way).

Accordingly, the present tribunal concluded:

“Because the ad-hoc committee affirmed the jurisdiction of the First Tribunal and annulled the portion of the First Tribunal’s award where it declined to deal with those claims on the merits, this Tribunal is now charged with resolving all claims for Treaty breach, including contract-related Treaty claims.”

After reviewing – and dispensing with – all of Argentina’s jurisdictional objections, the tribunal went on to observe that the objections were not only “unfounded”, but deemed to have “been raised inappropriately at this stage of the proceedings, in an attempt, for the most part, to reargue elements of the First Tribunal’s jurisdictional decision, as endorsed by the ad hoc committee.”

Although the tribunal elected to reserve its ruling on costs of these proceedings, it added that it “takes note” of a request by the Claimants that Argentina should bear “all of the costs of the jurisdictional phase, including legal fees.”

The proceeding has now resumed and the parties are exchanging arguments on the merits. A hearing is slated to be held this summer.

A copy of the November 14, 2005 jurisdictional ruling in the case has been obtained by ITN and made available on-line by clicking [here](#).

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**Negotiation Watch:**  
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4. Advisory committee offers environmental report card on US-Peru FTA,  
By Damon Vis-Dunbar

More than two dozen external advisory committees have presented the US Congress with feedback on the US-Peru free trade agreement, offering a mixture of praise and criticism for the treaty’s investment chapter.

In general, the investment chapter of the US-Peru FTA mirrors other US investment agreements of recent vintage, which members of the Trade and Environment Advisory Committee (TEAC) view as a marked improvement over the investment chapter of the North American Free Trade Agreement (NAFTA). However, the Trade and Environment Advisory Committee does not point to any further improvements which have been made since the conclusion of a new US investment treaty negotiating template in 2004.

Among the provisions welcomed by TEAC members is a more precise definition given to the term “indirect expropriation.” A side-letter to the US-Peru FTA, considered to be an integral part of the agreement, offers an elaboration of how tribunals should define “indirect expropriation”. This side-letter is designed to reduce the likelihood that legitimate public welfare measures - for example, health or environmental regulations - would be construed as “indirect expropriations” of a foreign investor’s property.

TEAC members were less enthused by the broad definition given to “investment” in the US-Peru FTA, in particular the inclusion of “tangible or intangible, movable or immovable property, and related property rights,” which has become a staple in US and other investment agreements.

“There is a lack of clarity regarding the definition of this term and there is no comparable US jurisdictional concept,” cautions the TEAC report.

By contrast, a number of industry advisory committees have praised the investment chapter’s comprehensive definition of investment. Indeed, industry committees have offered largely positive reviews of the treaty’s investment chapter, particularly its coverage of both new and existing investments. A number of recent US agreements, including the Morocco FTA and the Central America Free Trade Agreement (CAFTA), had applied only to new investments – a feature which drew criticism from industry groups, who raised fears that this signaled a shift towards reduced investor protections.

The Advisory Committee for Trade Policy Negotiations (ACTPN) hailed the reversion to earlier practice in this area: “The committee stresses the importance of covering both existing and prospective investments, and has urged consistently that such investment provisions be part of all future agreements. The ACTPN is very pleased that the Peru agreement goes beyond earlier agreements in this regard and sets a higher standard than in the past.”

However, members of committees representing services and financial industries did express concern over the so-called fork-in-the-road provision contained in the new US-Peru agreement. This provision, which has been absent from a number of recent US bilateral investment treaties, precludes investors from using investor-state arbitration if the same claim has already been brought to a local administrative or court tribunal.

“While the Committee does not object to this provision in particular, it is concerned that the differing standards in recent Free Trade Agreements (FTAs) and Bilateral Investment Treaties (BITs) could too easily cause confusion for investors overseas who may inadvertently bring a domestic challenge, only to find that they have unwittingly lost access to the investor-to-state dispute settlement system.”

The Peru-US agreement draws explicit attention to existing US investments in the natural resources sectors which are governed by so-called stability agreements. These contracts entered into between the Government of Peru and foreign investors, guarantee stable tax and regulatory regimes, but have occasioned a number of protracted disputes.

“Ironically, it is from these very preferential arrangements that many of the most significant problems for US and other foreign investors emerge,” said Earl Anthony Wayne, Assistant Secretary, Bureau of Economic and Business Affairs, before a US congressional committee in 2004.

Incorporating these contracts into its remit, the new US-Peru agreement states that “a breach of a stability agreement by the Government of Peru may constitute a breach of an investment agreement (i.e. the US-Peru trade agreement) of which it is a part.”

This step was taken to “reassure” investors who have signed stability agreements that they would have access to protections provided by the investment treaty, says Fernando Cantuarias Salaverry, Dean of the School of Law, Universidad Peruana de Ciencias Aplicadas, in an interview with ITN.

However, these new treaty protections do not apply in all circumstances. In particular, the new US-Peru agreement does not extend its protective cover to certain stability agreements; an “illustration” of one type of stability agreement is provided in an annex to the new FTA’s investment chapter. The FTA makes clear that if a stability agreement signed between Peru and the foreign investor is identical to this model, then “a breach of such a stability agreement by the Government of Peru shall not constitute a breach of the investment agreement (i.e. the FTA).”

Rather, disputes under such investor-state agreements would be carried out in Lima under the provisions of Peru’s General Law on Arbitration, subject to the supervisory jurisdiction of the Peruvian courts.

The US-Peru trade agreement was concluded in early December, 2005, and has yet to be ratified by either Peru or the US. Rob Portman, US Trade Representative, said during a recent press conference that he hoped to see the agreement move through the US Congress by the summer. The US is also eager to see Peru ratify the agreement before that country’s election later this year.

The US goal had been to negotiate a single Andean-US FTA, until negotiations with Ecuador and Colombia faltered late last year. It was at that point, that talks with Peru continued to proceed on their own. In a new development this week, however, the US announced that it had concluded an FTA with Colombia. Text of that agreement had not been released at press time. While negotiations with Ecuador have faltered, the US signed a bilateral investment treaty with that country more than a decade ago.

Elsewhere, Peru is still working on a bilateral investment treaty with Canada. Negotiators had been optimistic that an agreement could be reached by the end of last year. But that deadline has been pushed back several times, and a spokesperson for International Trade Canada now says that the two sides are aiming to conclude talks by March.

Sources:

ITN interviews

The Advisory Group Reports on the U.S.-Peru TPA are now available on-line by clicking [here](#).

The text of the US-Peru FTA is available on-line by clicking [here](#).

United States Trade Disputes in Peru, Hearing Before the Subcommittee on the Western Hemisphere of the Committee on International Relations of the House of Representatives, October 6, 2004. Available on line by clicking [here](#).

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**Briefly noted:**  
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5. US dairy company sues Canada under NAFTA's Chapter 11,  
By Damon Vis-Dunbar

A US exporter of dairy products this week filed a request for arbitration under the North American Free Trade Agreement's investment chapter, alleging that Canada's restrictions on exports of milk are tantamount to expropriation.

Delaware-based Great Lakes Farms (GLF) exports dairy products from the Province of Ontario to the US. In its statement of claim, the company alleges that restrictions on its ability to export milk and cheese to the US, which were put in place after the World Trade Organisation ruled in 1999 that Canada was illegally subsidizing domestic milk producers, threaten its investment in Canada.

GLF had been operating outside the Province of Ontario's monopoly supply management system, by purchasing milk from producers who do not have production quotas. It says that over the last few years the province has placed undue restrictions on its ability to purchase milk from these farmers, thus limiting its ability to export.

The company seeks some \$78 Million CAD in compensation for breach of four provisions in the NAFTA agreement: National Treatment; Treatment in Accordance with International Law; Conduct of Monopolies and State Enterprises; and Full, Fair and Effective Compensation for Expropriation.

A copy of GLF's notice of intent is available on-line by clicking [here](#).

6. Investment Treaty News seeks intern to work as reporter-researcher in Geneva office

The International Institute for Sustainable Development (IISD) is seeking an intern to work out of IISD's Geneva, Switzerland office for a 6 month period commencing August 2006. The successful candidate will serve as a reporter-researcher for Investment Treaty News (ITN). ITN tracks the negotiation of international treaties governing foreign direct investment, as well as lawsuits between businesses and governments arising under such treaties. The position is a paid internship, and the prospects for post-internship work and

consulting opportunities are significant. Applicants must be Canadian citizens or permanent residents and under 30 years of age at the time of taking up the internship. Candidates should have strong language skills, encompassing not only English, but additional languages as well. A background in journalism, law, or international affairs, while not essential, is strongly desired. Further information about the internship, along with application information, will be posted on-line shortly at: [http://www.iisd.org/interns/apply\\_positions.asp](http://www.iisd.org/interns/apply_positions.asp) . Specific queries about the position can also be directed to Luke Eric Peterson at [lpeterson@iisd.ca](mailto:lpeterson@iisd.ca)

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