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PARTIAL DISSENTING OPINION

IN THE MATTER OF AN UNCITRAL ARBITRATION

BETWEEN

ENCANA CORPORATION (CLAIMANT)

VS

REPUBLIC OF ECUADOR (RESPONDENT)

[London Court of International Arbitration Administered Case No. UN 3481]

I.

1. I find myself unable to share the reasoning set forth in paras. 184-199 of the Final Award in this case (the "Award") regarding the Claimant's direct expropriation claim, and the Award's final determination of such claim. For reasons set forth further below, I distance myself from the statement in para. 183 of the Award to the extent it limits the material benefits susceptible to expropriation under article VIII.1 of the Canada-Ecuador Agreement for the Promotion and Reciprocal Protection of Investments of 29 April 1996 (the "Treaty") to acquired rights as characterized in the said paragraph. Unlike the Award, I am of the opinion that conduct attributable to Ecuador has expropriated EnCana's returns on its investments in Ecuador in breach of article VIII.1 of the Treaty.

2. The Award states that, for an expropriation of an investment or a return to exist, it is required that the expropriated rights exist under the laws of the country creating them (Ecuador). The Award proceeds on the assumption that, for the period prior to the passing of the Interpretative Law [1]: (i) the EnCana subsidiaries did have a right to VAT refunds under Ecuadorian law accrued as a result of transactions giving rise to such refunds during such period, and that, during such period, the fact that amounts not obtained out of such refunds should be considered as amounts that should or could have been yielded by the investment, but were not, is an issue that

[1] Law No. 2004-41 of August 3, 2004, gazetted on August 11, 2004 (Ecuador's Official Gazette no.397); I Respondent's Rejoinder Exhibits, at tab 83.

may directly give rise to the application of article VIII.1 of the Treaty; and (ii) the *Servicios de Rentas Internas* of Ecuador ("SRI") took "at some point" a policy decision to do everything in its power to deny refunds to the oil companies.

3. As to the period ensuing after the enactment of the Interpretative Law, and VAT refunds that would have occurred (but did not and shall not take place because of the Interpretative Law) as a result of transactions giving rise to VAT refunds that took place during such subsequent period, the Award considers that the issue is not *per se* an issue directly subject to the Treaty provisions, since Ecuador should be considered free to determine for the future its tax regime corresponding to transactions occurred during the period elapsed after the passing of the Interpretative Law.

4. However, by relying essentially on the rationale underlying the *Waste Management* case decision[2] (albeit admitting that, unlike the present case, *Waste Management* concerned an alleged breach of a contractual obligation attributable to the host State), the Award concludes that, even for the period prior to the passing of the Interpretative Law, the value represented by a statutory right to a payment of a refund is not expropriated by a mere refusal to pay ".... provided: (a) the refusal is not merely willful; (b) the courts [of the host State] are open to the aggrieved private party; and (c) the [host State] court's decisions are not themselves overridden or repudiated by the [host] State...". On such bases, the Award decides that, since Ecuador's conduct does not meet any of those requirements, Ecuador has not infringed the Treaty's article VIII.1 on expropriation.

5. In connection with the period prior to the passing of the Interpretative Law, the Award differentiates between international claims based on the denial of legal rights under the host State law and those relating to the seizure of physical assets. The former would be only admissible on the merits if, although such rights are found to exist under the host State law (presumably as a result of a court of law decision of such State under its own law), the State refuses to recognize such rights in disregard of the decisions of its own courts, or when a denial of justice attributable to the State has been incurred.

6. According to this approach: (i) prior to the substantive admissibility of any expropriation claim on the merits under article VIII.1 of the Treaty based on a denial of EnCana's rights (as characterized in the Award) attributable to Ecuador, the redress of any grievances giving rise to such claims must be first sought before the courts of Ecuador, apparently by exhausting all the available *échelons* to such effect in the Ecuadorian court system; and

[2] Waste Management Inc. vs. United Mexican States(2004) 43 ILM 967.

(ii) even if the outcome of such process proves adverse to the legal position of Ecuador under its own laws, such expropriation claim would be only admissible if the State would fail to honor or would otherwise seek to neutralize the decisions of its own courts. According to the Award, the way for an expropriation claim under the Treaty would be also open in case of a denial of justice, although the Award seems to suggest that a denial of justice would only materialize if access to the Ecuadorian court system were denied. In essence, this approach is premised on the principle that all matters relating to EnCana's entitlement rights to its investment and returns are exclusively governed by the host State's local laws and must be settled by its own courts.

7. Also according to this approach, an international arbitral tribunal constituted under the Treaty would not be entitled to directly judge whether Ecuador's conduct that could be considered as a denial of such rights under Ecuadorian law is, *qua* Ecuadorian State conduct, an infringement of the Treaty so long as the passage through the Ecuadorian judiciary described above has not been completed. An implicit consequence is that, should the Ecuadorian courts conclude in a final way, and without a denial of justice (in the limited sense suggested by the Award) having been incurred, that Ecuador's conduct was licit conduct under its own laws, an expropriation claim under article VIII.1 of the Treaty is excluded.

II.

8. An assumption that EnCana or its subsidiaries have a legal entitlement to VAT refunds or an economic value equivalent to such refunds under Ecuadorian law seems to be of little practical significance if, despite such assumption, a prior determination of the validity of the State's objections to granting such refunds – necessarily based on a State denial of such legal entitlement - is still to be obtained from its own courts and its own laws as a sort of prior "substantive" exhaustion of local remedies constituting a precondition to accessing substantive rights under the Treaty.

9. To require such "substantive" exhaustion of local remedies, consisting of a prior and final determination by the local courts of the host State under its own national law of disputes concerning the entitlement rights (or denial of such rights) of a foreign investor covered by the Treaty, suggests the existence of a public international law hard-and-fast rule, binding on international arbitral tribunals, according to which such rights are localized in the host State, exclusively governed by its own laws and, for that reason, that disputes involving such rights must be previously adjudicated by the courts of the host State under its own laws, before

related claims under international law are ripe for decision on the merits at the international level. There would be a *renvoi* from international law to domestic law and jurisdictions in this respect, that would materialize through conflict-of-laws rules and international jurisdiction rules embedded in public international law leading to such outcome.

10. Nevertheless, such *renvoi* to the *lex rei sitae* or an equivalent localizing principle pointing to the application of the national law of the host State essentially makes sense in connection with rights *in rem* on property or regulations regarding real property rights because of the absence of public international law substantive rules dealing with the intricacies of such matters. Further, such *renvoi* to the application of a national law regarding matters that need to be preliminarily settled under such law in connection with a claim to be decided under public international law does not necessarily mean that the final *determination* of issues also falling under such law (or its interpretation) is to be also entrusted to the national courts of law of the State enacting the applicable law with binding effects on the international arbitral tribunal, so that the latter has to await such determination before adjudicating on whether State conduct governed by its laws is or is not wrongful conduct under international law.

11. An international arbitral tribunal is entitled to look at such laws and their interpretation by the local courts and authorities of the host State as they are at a specific point in time prudently determined by the arbitral tribunal, i.e., as facts considered relevant by the arbitral tribunal for reaching its own determinations: (i) on whether State conduct, irrespective of whether it is illicit conduct under such State's laws or not, then was or not, *per se*, a treaty violation; (ii) if such conduct then commenced or not to have harmful effects for the foreign investor or its investment; and (iii) such conduct's continuing harmful effects.

12. Consequently, the local laws, administrative acts and practices and other conduct attributable to the host State at the moment they had the effect of operating the deprivation of property, are *facts* to be freely evaluated by the arbitrators to determine if the foreign investor's entitlement to protection under international law has been infringed at a specific moment in time or not. An international arbitral tribunal enjoys discretion – to be reasonably exercised - to evaluate at which moment such conduct, considered as a fact or cluster of facts, has acquired sufficient level of gravity, permanence or irrevocability – as well as harmful effects - to constitute a treaty violation, and such discretion is not controlled by hard-and-fast rules, or determinations of local courts under their own laws.

13. In any case, even if such *renvoi* were admitted to exist, it cannot be automatically extended to exclude or postpone the direct application of international law and an international adjudication process under such law

when the State conduct being considered adversely and directly affects – as it will be shown later - ownership rights existing and directly protected under international law, and the issue at stake is to determine whether such rights have been infringed or not. Otherwise, international tribunals bound to apply treaty provisions creating such form of ownership would be forced to abdicate their authority and obligation to do so in favor of the national law, courts and the legislative enactments of the "delinquent" State, which would control the "law" to be taken into account or applied by international tribunals to find out if the conditions for admissibility on the merits of international claims are ripe or not. The ancient wisdom of the precept that the *juge de l'action est le juge de l'exception* would thus be defeated without any principled basis to do so.

14. Further, the Treaty and its definition of investment do not permit to distinguish between different forms of ownership depending on whether the assets at stake are tangible or intangible to determine if State conduct is expropriatory or not under its article VIII.1, nor establish different threshold requirements for the admissibility of claims under such article – such as the prior pursuit of local substantive remedies – depending on the different nature or characteristics of the assets allegedly expropriated. Under international law – and most likely under comparative constitutional law – it would seem that what defines protected ownership is not the type of asset being taken, but the fact that the asset in question is susceptible of economic value for the actual or purported holder of rights on such asset. The different nature of the owned asset should not lead to different conclusions when it comes to determining entitlement issues and the reciprocal role played by national and international law and jurisdictions in connection with such issues.

III.

15. Therefore, entitlement issues raised by the present case must, first and foremost, be considered against the backdrop of the investor's rights under the Treaty, including ownership or legal entitlement rights directly rooted in and protected by the Treaty susceptible of being expropriated through conduct attributable to Ecuador in infringement of article VIII.1 of the Treaty.

16. The form of investor's ownership, legal entitlement or "*propiedad*" directly arising under and protected by the Treaty – and through the Treaty, by public international law[3] – is the investor's investment and investment returns. As indicated before, the common denominator characterizing ownership is the economic value of what is owned. A

[3] Treaty, article XIII.7.

taking of this "property", entitlement or ownership may be covered by article VIII.1 of the Treaty.

17. The foreign investor's legitimate return expectations are inextricably linked to the foreign investor's entitlement under the Treaty to its investment and returns and are an indivisible part of such entitlement. This is particularly true in respect of the foreign investor's differentiated entitlement under the Treaty to investment returns. Under the Treaty, investment returns are specifically covered by the Treaty provisions as a distinctly protected category under such provisions, including its article VIII.1. Precisely, investment returns are premised on expectations essentially formed when the investment is made or about to be made. Legitimate expectations to a return are a part of (and almost invariably determine) the investment sale value, are taken into account in case of a sale of the investment property to a third party, and thus have economic substance and meaning of their own. Thus, the foreign investor's return entitlement protected by the Treaty is not limited to returns already accrued and extends to the legitimate investor's expectations throughout its investment's life and embodied in the very notion of returns.

18. Further, the Treaty definition of Investment clearly indicates that it refers to "...assets, tangible or intangible [....] acquired in the *expectation* or used for the purpose of economic benefit or other business purposes"[4]. Legitimate expectations inherent in the right to obtain a return on an investment necessarily depend on future return projections made by the investor on or around the point in time of making its investment premised, among other things, on foreseeable tax burdens that impact the recouping of the investment and investment returns throughout the investment life.

19. Such factors are necessarily taken into account by an investor when evaluating the risks and conditions, contractual or not, under which the investor made its decision to invest and constitute the expectation to an economic benefit to which the Treaty specifically refers. Each fiscal year in which a return covered by the Treaty is reduced or is not obtained because of economic burdens, including tax burdens, not accounted for when the investment was made, may constitute a taking of returns under article VIII.1 of the Treaty, whose negative economic impact may be projected for future years.

20. Such expectations constitute an interest that, because having an economic, and even pecuniary, value is a form of ownership (or *derecho de propiedad*) under the Treaty. Thus, the legal entitlement inherent in such legitimate expectations presents itself in the form of ownership or *"propiedad"* rights directly protected by the Treaty and is not premised on the national law of the host State once the investment, that comprises the

[4] Article I (g)(vi) of the Treaty (my italics).

right to obtain returns on the investment, has been made in accordance with the laws and regulations of the host State. As from then, not only the public international law entitlement to returns and legitimate expectations associated with them as protected by the Treaty exists, but whether such entitlement later suffers or not from conduct attributable to the host State must be judged from the public international law perspective, irrespective of the actual level of protection met by such expectations at the national plane.

21. In the context of the present case, any expropriation of returns, including the legitimate expectations inextricably associated with the notion of returns, occurs at the moment the expropriatory conduct takes place, and its effects continue for the ensuing period along which returns are expected to materialize and accrue according to such expectations. Subsequent State action, such as the enactment of legislation having as its sole purpose providing legitimacy to the State conduct whereby such expropriation took place, may succeed (if such subsequent action is valid under such State's laws) in legitimizing such conduct within the province of the local legal system of such State, but does not necessarily have a similar effect on the international plane when what is at stake is the legitimacy of such conduct from the perspective of the Treaty's provisions. This is particularly true when the subsequent legislation confirms the factual or legal situation that gave rise to Treaty breaches predating the passing of such legislation.

22. In this respect, what is at stake is not whether a State may impose or not specific obligations – including tax obligations - for the future through the enactment of new laws or the modification of the existing ones or the sovereign rights of the State to do so under its own laws or international law, but whether such legislation may have the effect of cleansing for the future wrongful State conduct according to the Treaty that has already taken place and started to have harmful consequences before the enactment of such legislation, and that remains unremedied from the international law perspective. For these reasons, I consider appropriate to look at the period after August 11 2004 (when the Interpretative Law legitimizing the Ecuadorian authorities interpretation of article 69-A of the Ecudorian Tax Code became effective) to determine the continuing harmful effects or consequences of conduct attributable to Ecuador constituting a violation of article VIII.1 of the Treaty that was consummated before the passing of the Interpretative Law.

23. Thus, EnCana's entitlement to its investment and its attached natural components without which an investment is inconceivable – the right to a return and the legitimate economic expectations embodied in such right – which are protected by international law, are not embedded in Ecuadorian law but in the Treaty itself. The entitlement to such rights and expectations

crystallizes once the investment has been accepted by Ecuador according to its laws, something that in the present case has undoubtedly happened. Although of course such entitlement is subject to commercial and a certain measure of legal risks that must be borne by the investor, the latter is not to bear risks or burdens that the Treaty itself puts on Ecuador, such as State conduct that is discriminatory or not in the public interest, if it leads to a taking of the investor's entitlement to its investment or returns consecrated by the Treaty without compensation. Such entitlement is thus acquired or vests on the day the investment materializes and projects itself throughout the life of the investment, which in this case is not limited to the date of enactment of the Interpretative Law, since the entitlement, with all its future projections, recognizes a valid legal source under the Treaty that predates the Interpretative Law. Such entitlement and associated projections cannot be neutralized for the future through State conduct without incurring a breach of the Treaty under which such entitlement came to life.

24. Determinations of these matters fall within the realm of the exclusive jurisdiction vested in arbitral tribunals set up in accordance to the Treaty requirements once the investor has chosen to take its claims to such tribunals in compliance with the relevant Treaty provisions, must be exclusively judged according to the latter, and are not determined by Ecuadorian courts or the laws of Ecuador. State conduct is merely considered as a fact to determine if it constitutes or not a Treaty violation irrespective of determinations at the national plane of its licit or illicit nature. A different approach would void article VIII.1 of the Treaty of any meaningful content at least in connection with tax measures – essentially coming into life through national law enactments - something that its member countries could not have had in mind when both adopting such article and excepting expropriatory tax measures from the general exclusion – provided for in article XII.1 of the Treaty - of tax measures from the Treaty's scope of application.

25. An interference in legitimate expectations of the foreign investor protected by the Treaty as a foreign investor's proprietary interest includes State incoherent conduct obscuring the national legal treatment of matters directly determining the foreign investor's entitlement to returns covered by the Treaty. Indeed, also under Ecuadorian law, expectations based on legal provisions are valid expectations protected by the law[5], so that the frustration of such expectations through State conduct may constitute a legal infringement under the laws of Ecuador. Incoherent, unprincipled or contradictory host State conduct regarding the existence of tax burdens or the absence of tax benefits may negatively affect the income yield of the investment in ways that could not have been accounted for when making the investment, have a negative impact on the investment returns protected

[5] Paredes cross-examination, transcript Day 1, at 117.

by the Treaty, and thus directly give rise to an expropriation claim under article VIII.1 of the Treaty without the need of seeking first any form of relief to the grievances on which the foreign investor bases its Treaty expropriation claim before the courts of the host State unless so expressly required, or going beyond what is expressly required, by the Treaty itself in this respect.

26. The fact that entitlement to such legitimate expectations is protected by public international law in the form of an international treaty requires from an international tribunal bound to apply its provisions to directly judge if State conduct has objectively blurred such entitlement rights or left them in an undefined limbo in a way defeating their materialization or effectiveness without the need of reaching or awaiting conclusions on the licit or illicit nature of such conduct under such State's laws, subordinating its determinations on whether such conduct infringes treaty provisions to national court determinations of the incumbent State on the licit or illicit nature of such conduct, or awaiting the incurrence by such State of further illicit conduct under its own laws by disregarding the adverse determinations of its own courts.

27. Since in such context there is no need to go through an exhaustion of local remedies stage as a threshold requirement – procedural or substantive – to be satisfied prior to the materialization of an international treaty claim, the notion of denial of justice is not called to play any role. The mere fact that State conduct at stake has been subject to evaluation or determination by local courts does not prevent an international tribunal from looking into the same conduct and such determinations as facts relevant for establishing the meaning and effects of such conduct in its task of determining if it infringes international law (in this case, conduct in violation of article VIII.1 of the Treaty), without such exercise implying a review of such determinations or being subordinated to the prior existence of a denial of justice at the local judiciary level of the host State that reviewed or was called to review such conduct.

IV.

28. In any case, the Treaty does not require going through the laws and exhausting the local jurisdictions of Ecuador or judging the level of respect paid by Ecuador to its own courts to determine if a claim on the merits from a covered investor is admissible under article VIII.1 of Treaty.

29. In fact, the Treaty expressly precludes the possibility for the foreign investor to pursue or continue claims regarding measures challenged under

the Treaty before the national courts or authorities of the host state (article XIII(3)(b)). The plain reading of this provision does not permit to assign to it just procedural consequence. By pursuing any such claims, the foreign investor would both lose its procedural right to access an international tribunal and jeopardize its chances to prevail on the merits in its international law claims.

30. The Treaty cannot offer the possibility of obtaining substantive relief under international law in case of expropriation, require a waiver of legal actions before national courts of the respondent State as a condition for seeking and obtaining such substantive relief, and in the same breath deny such relief because the investor would have failed to obtain first a final determination from the courts of such State on whether there is merit or not for the interpretation of the local law on which the State relies upon to deny the existence of the grievances on which the investor bases its expropriation Treaty claim. Otherwise, if the national courts would reach the conclusion that the conduct of the State is in keeping with the national legal system, and have done so without incurring a denial of justice, there would be no room left for an international expropriation claim under the Treaty.

31. The only limited opportunity granted by the Treaty (granted as a right, but not imposed as an obligation) for the investor to access the local courts without jeopardizing its international claims is afforded by article VIII.2 of the Treaty[6]. Such provision permits the investor to have recourse to the local courts "or other independent authority" of the expropriating State just for a "prompt review" of its case "under the law of the Contracting Party making the expropriation", and does not require or suggest the need to go through an entire appeals process to the effect of carrying out and completing such review.

32. However, this provision does not refer to, nor imply, the existence of any "finality rule" requiring to attain certain thresholds of review on the merits under national law to permit to access substantive legal protection under the Treaty or international law, nor subordinate substantive access to remedies under the Treaty to compliance or not by the Ecuadorian Government with the determinations of its own courts, although such non-compliance may be relevant for establishing the existence of State conduct in violation of the Treaty. Finally, this provision does not indicate or suggest that an unfavorable determination by the Ecuadorian courts or authorities of the foreign investor's case presented in the course of this review process would preclude a further claim under article VIII.1 of the Treaty.

[6] Article VIII.2: "The investor affected shall have a right, under the law of the Contracting Party making the expropriation, to prompt review, by a judicial or other independent authority of that Party, of its case and of the valuation of its investment or returns in accordance with the principles set out in this Article".

33. Be it as it may, even if the Treaty required going through the procedure envisaged by article VIII.2 of the Treaty – which it does not - such procedure was for all practical purposes satisfactorily exhausted through the applications made by the EnCana's subsidiaries first to the Ecuadorian Tax Authorities and secondly the Ecuadorian Tax Court and the administrative and judicial determinations successively obtained from them.Any threshold requirements to advance Treaty substantive expropriation claims on the merits consisting of granting the local authorities and courts the prior opportunity of redressing under their own laws grievances of the foreign investor likely to give rise to Treaty claims have then been met should it be considered that such requirements need be satisfied as a pre-condition to a claim for expropriation under the Treaty .

34. I do not share the view that the *Waste Management* case, relating to contractual disputes centered in an essential part around the Acaverde Concession Agreement, that contained a specific arbitration mechanism venued in Mexico to deal with such disputes, is relevant for or governs the present case, where such circumstances are not present

35. *Waste Management* concerned a claim in contract (a concession) and the need to exhaust local remedies before an agreed upon local arbitral tribunal regarding an alleged contractual violation prior to determining if a breach amounting to a treaty violation had been committed. The previous exhaustion of the local remedy agreed by the parties was necessary (absent a treaty (NAFTA) provision directly providing for treaty remedies in case of contractual breaches) in order to determine, in compliance with the arbitral clause freely consented to by the private investor, first, if there was a breach of the contract, and second, in case of an affirmative response, the remedy to be granted by the arbitrators to compensate for such breach.

36. Unlike *Waste Management,* the present case does not concern a contractual breach, in its turn contractually requiring a determination by a local jurisdiction prior to considering if there is a breach attributable to the State as a Treaty violation – i.e., that can be elevated to the international plane – but conduct attributable to the State directly placed at the international law plane by virtue of the Treaty provisions and susceptible to being considered as a direct Treaty infringement, including article VIII.1 protecting against expropriation. There is no provision in the Treaty referring investor-State disputes to any specific venue, forum or court of the host State or its judiciary.

V.

37. It is in order to examine now if conduct attributable to Ecuador has operated an expropriation of EnCana's returns in breach of article VIII.1 of the Treaty. This requires an analysis of determinations of the Ecuadorian Tax Courts, the SRI conduct and the conduct of the Ecuadorian governmental authorities.

38. If the State expropriates a covered investment or return, the expropriating measure may not be "discriminatory" or not for a "public purpose". If any of such circumstances is present, and the State fails to pay compensation as provided for in the Treaty, such measure will infringe its article VIII.1.

39. The measures or conduct at stake attributable to Ecuador that may be labeled as expropriatory are essentially – but not only - different resolutions from the SRI either denying VAT tax refunds or revoking previous measures granting VAT tax refunds. It will now be considered if the measures at stake are discriminatory, have been adopted for a public purpose, and whether the measures have caused an expropriation of rights (returns) covered by the Treaty.

A. Are the Measures Discriminatory?

40. There is satisfactory evidence in the present case that the interpretation by the SRI of article 69-A of the Tax Code, supported thereafter by the Ecuadorian Congress through the Interpretative Law, is discriminatory, and that, should such interpretation lead to a deprivation of property qualifying as an expropriation under the Treaty, it would constitute a discriminatory measure in violation of article VIII.1 of the Treaty. Flowers, broccoli, tea, timber, bananas, shrimp, fresh fish sectors exporters – all producers of non-manufactured goods - are entitled to VAT refunds in Ecuador. The oil and gas sector adversely affected by such interpretation is exclusively and entirely composed of foreign companies, a situation that is not shared by the other non-manufacturing export sectors in Ecuador just mentioned. There is no convincing uncontested evidence proving that Petroecuador is subject to VAT. There is uncontested evidence that any shortfall caused by an eventual absence of VAT refunds to Petroecuador is covered through infusion of funds from the Ecuadorian State, a windfall benefit which, certainly, does not extend to the foreign oil companies[7]. I share the view held in the *Occidental* case that not only unequal tax treatment inflicted to operators in the oil and gas sector of Ecuador should be considered to determine the existence of discriminatory

[7] Paredes, Transcript Day 1, at 104, 125, 128-129;140-141.

or unequal treatment conduct under the Treaty within such sector[8]. Tax treatment generally granted to exporters of non-manufactured products corresponding to different sectors of the Ecuadorian economy not entirely controlled by foreign interests other than the oil an gas sector is relevant for establishing if tax treatment of exporters in this latter sector is discriminatory or not under article VIII.1 of the Treaty.

41. The admission by Ms. Mena in the Hearing that the policy of denial of VAT refunds to the oil and gas sector, that according to her had been always implemented by Ecuador, should have been defined through the enactment of laws clearly establishing that only exports of non-manufactured products characterized as "non-traditional", particularly agricultural products, are exempted from VAT refunds, rather than through the administrative determinations of the Ecuadorian Tax Authority[9], confirms that EnCana and its subsidiaries were justified in legitimately expecting that under Ecuadorian law the latter's activities and revenue and the former's investment returns were not to be burdened by VAT, as it was the case in respect of other non-manufacturing export sectors of the Ecuadorian economy. Further, EnCana and its subsidiaries were not and could not be privy to the internal exchanges, changes in position and possible misunderstandings between Petroecuador's President Mr. Barniol and Ms. Mena - SRI's then Director - on whether the economic impact of the VAT was absorbed or not by the production sharing agreements between Petroecuador or Petroproducción with the foreign oil companies[10], and any confusion derived from such misunderstanding for the SRI, translating itself into significant fluctuations in the SRI's legal position in respect of VAT refunds and EnCana's or its subsidiaries interest in such refunds, may not be validly opposed to EnCana to excuse the discriminatory frustration of its legitimate return expectations originated in substantial part in SRI conduct attributable to Ecuador finally denying VAT refunds to EnCana's subsidiaries.

42. The legitimate expectations of EnCana regarding VAT refunds affecting its investor's rights received confirmation through the very actions and conduct of the SRI in compliance with what the SRI then understood as its obligations under Ecuadorian law, when the SRI authorized the payment of VAT refunds to EnCana's subsidiaries through 9 Resolutions spanning between March 8 2000 and March 16 2001.The justification given by Ms. Mena for these payments – errors committed by the SRI when processing the flood of VAT refund applications ensuing the enactment of article 69A

[8] Occidental Exploration and Petroleum Company and the Republic of Ecuador, Award of July 1, 2004, at nos. 173-177; EnCana's Vol. I Exhibits to its Response to the Respondent's Counter-Memorial on the Merits, Tab 5.
[9] Mena, transcript Day 4, at 75-76.
[10] Mena, transcript Day 4, at 89-92.

of the Tax Code – is hardly credible if one is to believe Ms. Mena's assertion that the invariable policy of Ecuador – even before the enactment of article 69-A - had always been not to grant VAT refunds to oil companies[11]. In face of such supposedly settled and steadfast tax policy concerning an export sector that is probably the main source of foreign currency of Ecuador, it is difficult to accept that those refund payments were the consequence of a processing mistake incurred by the SRI rather than of a reasoned and reasonable interpretation of the tax laws – shared by EnCana and its subsidiaries – according to which the rights to VAT refunds extended to foreign oil and gas exporters, like other exporters of non-manufactured products.

43. In tune with such precedents, the Interpretative Law targets a specific category of investors and exporters, the oil companies, and particularly the multinational ones. It was prompted by international arbitration VAT refund claims introduced by such companies against Ecuador and the adverse outcome for Ecuador in one of such arbitrations, as well as the uncertainties at the level of the Ecuadorian judiciary as to the interpretation of Ecuadorian legislation regarding VAT refunds to exporters. Beyond such circumstances, that are directly expressed in the Interpretative Law, it does not provide for principled public policy or public interest reasons for discriminating between exporters of oil and exporters of other non-manufactured "products" based on an analysis of the tax legal situation existing when EnCana invested in Ecuador, except for asserting that article 69-A of the Tax Code does not permit VAT refunds to oil exporters.

44. Unlike the Award, I am of the opinion that the Interpretative Law by itself, or in conjunction with other measures attributable to the Ecuadorian Government, is relevant for evaluating whether conduct of Ecuador prior to its enactment violates article VIII.1 of the Treaty in connection with EnCana's investment or investment returns. Irrespective of whether the Interpretative Law is retrospective or retroactive or not, it serves the purpose of throwing light on the aims and intended effects of the conduct of Ecuador alleged to infringe article VIII. 1 of the Treaty prior to the Interpretative Law, in the same way the subsequent or *ex post* conduct of a party to a juristic act serves the purpose of understanding the meaning and purposes of such juristic act when it came into being.

45. The discriminatory nature of the SRI's resolutions as a component of expropriatory conduct under the Treaty was raised in the pleadings before the Tax Court in the City Oriente Limited ("COL") Case and the AEC Ecuador Ltd.[previously named City Investment Co.Ltd.] ("AEC") Case pre-dating the Interpretative Law. Since the Treaty – like other treaties

[11] Mena, transcript Day 4, at 65-66, 83.

ratified by Ecuador - unquestionably is a part of Ecuadorian law[12], it is also part and parcel of the legal framework subject to the consideration of the Ecuadorian Tax Courts when deciding on the issues raised during such proceedings.

46. For example, in the AEC Case, the claimant unequivocally raised under the following terms (to the extent reflected through the recitals of the Tax Court decision) the expropriation issue under the Treaty:

"Por otra parte, desconocer a su representada el derecho a la restitución del IVA pagado implica una violación del principio de la generalidad de la ley tributaria en su aplicación subjetiva, también garantizado por la Constitución de la República (Art.256) y ratificado por el Código Tributario, constituyendo un acto de franca discriminación frente a la compañía que representa al impedírsele ejercitar un derecho que la ley reconoce a todos los contribuyentes que pagan IVA para la producción de bienes exportados, en franca violación de los derechos grantizados por la Constitución de la República en sus artículos 12, 23 (numeral 3) y 256. Además, esta medida tributaria expedida por el SRI es equivalente a una expropiación, pues la priva a su representada la facultad de ejercer un derecho considerado al celebrarse el Contrato con el Estado, todo ello en el marco del Convenio para el Fomento y Protección Recíproca de las Inversiones sucrito entre Ecuador y Canadá...."[13].

47. The SRI's only argument to reject that its resolutions are discriminatory was not to deny that they advance a discriminatory application of article 69-A of the Tax Code, but that such resolutions permit to avoid double dipping by the oil company:

"Dice que ante la alegación de la actora en el sentido de que la resolución hoy impugnada ha violado el artículo 256 de la Contitución el cual consagra los principios de igualdad y de generalidad que rigen al sistema tributario ecuatoriano, por el contrario, a pesar que las empresas contratistas no han cumplido con los presupuestos de hecho y derecho para tener un derecho a la devolución del IVA, el Estado ha reconocido a través del porcentaje de participación, los tributos satisfechos por éstas en la ejecución del contrato, respetando la esencia de las inversiones en materia hidrocarburífera. Lo que el Servicio de Rentas Internas ha evitado es que el Estado ecuatoriano en desmedro de sus escasos recursos destinados a la consecución del bienestar de sus ciudadanos, beneficie doblemente por un mismo concepto a las empresas contratistas, por lo que tampoco se ha afectado el Convenio para el Fomento y Protección Recíproca de las Inversiones sucrito entre Canadá y Ecuador."[14]

48. The Tax Court chose not to address that the interpretation and application of article 69-A by the SRI was discriminatory under the Treaty or in violation of the Treaty provisions on expropriation. The Tax Court did not pass either any judgment on the oil company's right to obtain a VAT refund for VAT applied on the basis of the 10% tax rate:

"...por lo tanto, la Sala llega a las siguientes conclusiones: 5.1.- Solo se discute el incremento del IVA del 10 al 12 %; y, 5.2.- No es aplicable la cláusula 8.6 porque se supone que ese incremento del 2% del IVA será reembolsado vía crédito tributario. Por los motivos expuestos, la Sala estima

[12] Paredes, transcript Day 1, at 109.
[13] AEC Case in: Ecuador Jurisdictional Objections, Exhibits Vo.II, tab 19, pág.11. The underlining is mine. Idem COL Case, Tab 20 of Vol. II Ecuador's Jurisdictional Objections, at 10-11.
[14] *Ibidem*, AEC Case at 25; COL Case at 23-24..

pertinente analizar los fundamentos legales para el reconocimiento del crédito tributario alegado conforme al inciso tercero del artículo 65 y el artículo 69-A expresamente invocados por la parte actora en su libelo de demanda"[15].

49. Clearly, the Tax Court did not pronounce itself on the refund of VAT at the 10% Tax Rate because it chose to conclude, on the basis of the communications from the President of Petroecuador referred to by the Tax Court in its decision, that since the VAT refund was not covered by the X factors in the Production Sharing Agreements, the negative economic consequences for the oil operator derived from such circumstance was to be resolved within the context of the relevant Production Sharing Agreement economic stabilization provisions[16]; namely article 8.6 or article 11.09 thereof on economic readjustment for change of circumstances (i.e., through negotiations with Petroecuador), and not through the tax system, to which, however, the President of Petroecuador referred the Tax Court for deciding on the 2% percent increase of the VAT rate from 10 % to 12%[17]. The Tax Court accepted his views without challenge. For this reason, the Tax Court concluded that only a decision on the 2 % differential remained without the boundaries of the Production Sharing Agreements and fell within the purview of the Ecuadorian tax legislation. However, as far as the 10% VAT refund is concerned, and for all practical purposes, the Tax Court decisions really were *non liquet*, because, if on one hand the Tax Court did not pronounce itself on the existence of an obligation of the State to grant the VAT refunds under the tax laws, it did not deny, on the other, that the EnCana's subsidiaries were entitled to an economic value representing the VAT refunds at the 10% VAT rate, to be accounted for within the context of renegotiations of the X factor under, as the case may be, article 8.6 or article 11.9 of the Production Sharing Agreements[18].

50. Further, as it will be shown below, the Tax Court's considerations on the application of article 69-A in connection with the refund of the 2% VAT differential were *obiter dictum* and did not require examining whether its application would be in infringement of article VIII.1 of the Treaty, since the Tax Court decided not to apply article 69-A and, instead, granted the 2% VAT differential refund on the basis of another Tax Code provision. Since the refund was granted, the consideration of discriminatory

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[15] *Ibidem*, AEC case at 34; COL Case at 32.

[16] The EnCana subsidiaries in Ecuador, City Oriente Ltd. ("COL") and AEC Ecuador Ltd.("AEC") are parties to production sharing agreements with the Ecuadorian State Companies Petroecuador and Petroproducción (the "Production Sharing Agreements").

[17] *Ibidem*, AEC Case at 32-34; COL Case at 30-32.

[18] In fact, in the AEC Case the correct reference is to article 8.6 of the AEC Production Sharing Agreement as modified by Amendatory Contract of May 21, 1999 (AEC Case at 31); whereas in the COL Case (where such modification apparently did not take place), the correct reference is to article 11.9 of the COL Production Sharing Agreement (COL Case at 31).

treatment of the foreign investor or its investment under the Treaty would have been moot.

51. Therefore, the Tax Court did not consider the existence of possible discriminatory treatment under the Treaty or any possible infringement of its article VIII.1 caused by the SRI's interpretation of article 69-A of the Tax Code, although it was invited, and had the opportunity, to do so in the course of proceedings meeting the requirements of article VIII.2 of the Treaty making possible, for example, a determination of whether local legislation (or its interpretation by local authorities) should be overruled on the ground that it is incompatible with international law as incorporated into Ecuadorian law.

B. Were the Measures Taken or not Taken for a Public Purpose?

52. The discriminatory nature of the measures taken and not taken by Ecuador in connection with EnCana's investments and returns under the Treaty renders more difficult to identify a clear and principled public purpose underlying such measures in compliance with article VIII.1 of the Treaty. A measure responding to the classic definition of taxation; i.e., a measure merely imposing an obligation to pay money for public purposes, such purpose being "raising public monies"[19], cannot automatically satisfy the public purpose requirement under article VIII.1 of the Treaty for a tax measure not to be expropriatory, because if such were the case, all taxation measures would always satisfy such requirement, thus depriving it of any significant meaning within the context of such provision. The public purpose to be satisfied by a tax measure in compliance with article VIII.1 is not met just because its immediate or ultimate objectives or effects consist of increasing or improving the tax revenues of Ecuador.

53. The initial measures (and the SRI's pleadings before the Ecuadorian Tax Courts in the COL Case and the AEC Case) relied on the fact that, since the VAT refunds had operated through the X factor in the Production Sharing Agreements between COL and AEC with Petroecuador or Petroproducción, granting a VAT refund through the VAT tax reimbursement mechanism would lead to double dipping and unjust enrichment. This is the public purpose underlying such measures. Since both Petroecuador and the Ecuadorian courts (COL and AEC Cases Tax Court Decisions) and the Interpretative law have made crystal clear that the X factor does not permit a VAT tax refund unless the X factor is renegotiated (and so that no double dip is possible), this public purpose justification has proven inexistent.

54. Another public purpose justification would be the interest of the Ecuadorian state in advancing the application of a particular interpretation

[19] Cowper, Day 3 transcript, at 88.

of its its own law, namely, article 69-A of the Tax Code, in order to avoid what would be considered an economic damage to the Ecuadorian economic interests should such provision not be interpreted in a certain way . Such public purpose may be also considered as embodied in the Interpretative Law.

55. As indicated before, the Tax Courts deciding the COL and AEC Cases did not consider the application of article 69-A of the Tax Code to VAT refunds at the 10% rate sought by the claimants in such cases. However, since such decisions referred them to a renegotiation process within the context of the Product Sharing Agreements, that necessarily presupposes assigning economic value to such tax refund and recognizing a right to such value – a tax right – of the private investor in such process, it is hard to conclude that a possible economic detriment for Ecuador derived from the recognition of such tax rights to the private investor is a matter of vital public or national interest, because if such were the case such recognition should have been excluded and article 69-A of the Tax Code should have been applied instead. The same analysis is pertinent in connection with the Interpretative Law, that also refers private foreign investors in the oil sector of Ecuador to a renegotiation of their product sharing agreements to seek compensation for VAT refunds not granted to them.

56. A similar conclusion is reached when considering the tax treatment of the VAT refund to oil exporting companies resulting from the 2% differential originated in the increase of the VAT tax rate from 10 % to 12%. Although in connection with such differential the Tax Court (in accordance with the position expressed by the President of Petroecuador) interprets that article 69-A of the Tax Code precludes VAT refunds to oil companies, it does not address the argument that its application would be discriminatory or expropriatory either. In fact, considering such argument was not relevant since the Tax Court ended up by not applying article 69-A of the Tax Law and granting the refund of the 2% VAT rate increase on the basis of article 16 second paragraph of the Tax Code because of a "modification of the economic relationship between the parties"[20].Thus, the considerations of the Tax Court regarding the non-application of article 69-A of the Tax Law – proffered exclusively when considering the 2% VAT refund - are *obiter dicta* since they do not constitute the legal basis on which the Tax Court finally determined the rights of the applicant to obtain an economic value equivalent to a VAT refund.

57. In fact, the decision of the Tax Court in this latter respect undermines the mandatory nature attributed by Ecuador to its interpretation of article 69-A premised on the protection of public interests, which would require its

[20] *Ibidem,* AEC Case at 43: "*....realizándose el presupuesto previsto en el inciso segundo del artículo 16 del Código Tributario, por haberse modificado las relaciones económicas establecidas entre los interesados*". Identically, COL Case at 42.

immediate application to existing contractual relationships, since at the end of the day, the Tax Court authorized the payment of a sum of money equal to the 2 % VAT Refund, an impoverishment of the State to the benefit of the foreign investor that should not have been allowed if article 69-A of the Tax Code, a mandatory public law rule, really means what Ecuador says it means.

58. Article 12 second paragraph of the Tax Code[21] does not impose an absolute and mandatory obligation on the Tax Court to approve the return of tax moneys or allow to restrain or limit the immediate application of a mandatory rule of law to existing relationships that would exclude such return, but just limits itself to vesting a court of law with largely discretionary, equitable powers to interpret provisions of the Tax Code on the basis of the principle of economic realism. The fact that the Tax Court decided in its discretion to use such equitable authority in connection with a situation that according to the SRI's position is covered by article 69-A of the Tax Code undermines the mandatory effects and public interest role attributed by the SRI to article 69-A of the Tax Code through such interpretation. In fact, the economic reality rationale given by the Tax Court to rely on article 12 second paragraph of the Tax Code is in exact – and indeed blatant - opposition to the rationale on which the SRI bases its interpretation of article 69-A of the Tax Code. By referring to article 12, second paragraph of the Tax Code, the Tax Court relies on the destination principle and the adverse consequences to the economy of Ecuador if Ecuador would export its taxes and thus adversely affect its oil exports to foreign markets[22] should the 2% VAT refund not be granted. Indeed, at the end of the day the Tax Court relies on the same legal principles advanced by EnCana and its subsidiaries to reject the SRI's interpretation of article 69-A of the Tax Code.

59. Such circumstance also decisively weakens the argument – hinted in the opinions of Ecuador's experts – that since oil in the ground is a non-renewable natural resource belonging to the Ecuadorian State subject to depletion, oil producers and exporters are not entitled to the same VAT refund treatment afforded to the producers and exporters of renewable natural resources. If such were indeed the case, there should not be any room left for VAT refunds under the shadow of article 12 second paragraph of the Tax Code, the Regulations of the Hydrocarbons Law, or

[21] Article 12 of the Tax Code (I Exhibits to EnCana's Counter-Memorial on the Merits, Tab 32): "Calificación del Hecho Generador: Cuando el hecho generador consista en un acto jurídico, se calificará conforme a su verdadera esencia y naturaleza jurídical, cualquiera que sea la forma elegida por los interesados.
Cuando el hecho generador se delimita atendiendo a conceptos económicos, el criterio para calificarlos tendrá en cuenta las situaciones o relaciones económicas que efectivamente existan o se establezcan por los interesados conforme a su verdadera esencia, con independencia de las formas jurídicas que se utilicen."
[22] AEC Tax Court Case cited supra, at 42: "No conviene a la economía de los países exportar tributos, puesto que ello perjudicaría al comercio exterior". Also, COL Case at 40.

– as the case may be - article 8.6 or article 11.9 of the relevant Production Sharing Agreement, as decided or mandated by the Tax Courts and the Ecuadorian authorities, at both the Executive and Legislative Branch levels.

60. The Supreme Court decisions for the COL Case of January 14, 2004, and for the AEC Case of February 12, 2004[23], affirming the decisions of the Tax Court heretofore referred to, had the ultimate effect of condoning the application by the Tax Court of article 12 second paragraph of the Tax Code neutralizing the immediate application of its article 69- A according to the SRI's interpretation of this provision. The above considerations seriously compromise the existence of a principled public interest or "public purpose" behind the SRI's resolutions denying VAT refunds based on such interpretation.

C. Did the Measures Operate an Expropriation of Treaty Covered Rights

61. The Tax Court decisions and other conduct attributable to Ecuador have the practical effect of referring EnCana's subsidiaries and their one and only shareholder to a renegotiation of the Product Sharing Agreements in order to seek satisfaction for the negative economic impact caused by the denial of VAT refunds by the SRI. However, by referring them to such renegotiation process with the aim of obtaining, within its context, an economic adjustment that would take care of or at least consider the economic value represented by the 10 % VAT refund, the Tax Court necessarily recognized such subsidiaries' entitlement to an economic value under Ecuadorian law representative of the VAT refund. It would be inconceivable to refer a company to a negotiation process to adjust an existing contractual relationship to which such company is a party, in the course of which certain rights having an economic value of such company are to be compromised or traded, without recognizing such company's legal entitlement to such rights (whatever such value might be or end up being) that are central to the negotiation process and without which such process would not have any reason to exist: in this case, the entitlement to a VAT refund value. Such recognition is a further confirmation that EnCana was justified in its legitimate expectations, embodied in its right to a return protected under the Treaty, to exclude the economic burden corresponding to such value when estimating its returns and pace for recouping its investment at the moment of deciding to invest in Ecuador through its subsidiaries.

62. That going through such process is, however, the only remedy made available to EnCana's subsidiaries under the Ecuadorian legal system was confirmed by the manifestations of the Ecuadorian President, SRI's then

[23] I Ecuador's Counter-Memorial on the Merits – Exhibit 27 (COL Case decision); Exhibit 28 (AEC Case decision).

Director Ms. Mena, and by the Interpretative Law. Evidence heard during the Hearing from a SRI lawyer[24] indicated that the Ecuadorian courts would consider themselves bound to apply the Interpretative Law in connection with pending cases or cases being re-heard. In fact, Exhibit A to Ecuador's post-hearing letter of May 16, 2005 contains a decision of the District Tax Court No.1 of Quito denying VAT refunds to Petróleos Colombianos Limited based on the retroactive application of the Interpretative Law. Such decision confirms the binding nature of the Interpretative Law for all Ecuadorian courts and its so far unchallenged retrospective or retroactive effects. A legal expert from Ecuador also admitted during the Hearing the possible retroactive application of the Interpretative law[25]. Thus, not only the only possibility contemplated in the Treaty under its article VIII.2 to go through the local courts and authorities was exhausted, but the decisions obtained reasonably reflect the final position of the Ecuadorian Government regarding VAT refunds in respect of EnCana's tax claims before and after the enactment of the Interpretative Law.

63. The mere existence and purpose of the Interpretative Law (to clarify the meaning of article 69-A of the Tax Code) confirms EnCana's legitimate expectations, based on a reasonable interpretation of the Ecuadorian tax legislation and practices so far of the SRI, that it was entitled to VAT tax refunds when making its return projections at the moment of investing. The passing of the Interpretative Law only makes sense because the then existing legislation supported such reasonable interpretation on which EnCana legitimately relied upon to invest in Ecuador or at least to expect a certain level of tax burdens affecting its investment returns, and because Ecuador, at some point in time, chose to disagree with such interpretation.

64. The Interpretative Law also confirms that such legitimate expectations had and have an economic value: thus, that the non-fulfillment of such expectations would trigger adverse consequences for the investor's returns. If such were not the case, the Interpretative Law would not open the door for the possibility of providing economic relief to the foreign investor for the VAT burden imposed on it because of the SRI's intrerpretation of article 69-A of the Tax Code through the renegotiation of the Product Sharing Agreements. In that respect, the Interpretative Law is fully consistent with the practical outcome of the Tax Court First Instance AEC Case and COL Case decisions and the letters of the President of Ecuador and the SRI's then Director, Ms. Mena, also referring the foreign investor to such renegotiation process. In a letter dated October 27 2003 to Ms. Mena, the Ecuadorian President instructed

[24] Venegas, transcript Day 3, at 182-183.

[25] Expert evidence during the Hearing indicated that the Ecuadorian courts would consider themselves bound to apply the Interpretative Law in connection with pending cases or cases being re-heard, transcript Day 4, at 29 (Salgado).

her to resolve the VAT refund issues with the oil companies through the economic stability provisions set forth in article 16 of the Regulations of the Ecuadorian Hydrocarbon Law. In such letter, the Ecuadorian President made clear that it was setting out the Ecuadorian Government's position in respect of the VAT refunds requested by the oil companies[26]. On the basis of such letter, Ms. Mena wrote to the President of Petroecuador transmitting the Ecuadorian President's instructions to resolve such issues both through renegotiation of the Production Sharing Agreements terms and conditions under such article and the economic stabilization clauses found in the Production Sharing Agreements[27].

65. However, the legal entitlement under the Treaty to EnCana's return expectations has not been accompanied by a proper or even clearly existing remedy under Ecuadorian law, since it depends, according to the Interpretative Law and its precedents referred to above, on a renegotiation of economic terms of the Production Sharing Agreements, i.e, on a hypothetically consensual process aimed at changing or likely to change the fundamental bases on which, not only the investor's returns were projected but, more than that, that informed the investor's very decision to invest. Thus, the "remedy" puts at risk legitimate expectations and contractual and legal rights and obligations on the basis of which the investor invested in the Ecuadorian oil sector, and goes beyond the issue of the VAT refunds and legitimate expectations concerning such refunds. Because of such circumstances, such pretended remedy is in fact a covert way of refusing any meaningful remedy at all.

66. Further, the general referral in the Interpretative Law to the renegotiation of the Product Sharing Agreements for restoring such economic value to the investor is not accompanied by principles and bases that will govern the renegotiation process in any predictable way or that permit to foresee its outcome, or how it will be implemented. Indeed, as undisputed evidence shows, the VAT tax burden "is a very tricky item to capture in the participation factors"[28]. It is not even clear if such renegotiation process will be governed by the economic adjustment, hardship or renegotiation clauses found in such Agreements, or will take place outside the scope of such clauses, since the letters of the President of Ecuador and Ms. Mena also refer to a renegotiation process under provisions found in the Regulations to the Ecuadorian Hydrocarbon law. There is no evidence of the existence of specific norms or rules permitting to understand how such renegotiation is to materialize or how the provisions in such

[26] "Art. 16. Estabilidad Económica. Los porcentajes de las partes en la producción del área del contrato serán ajustados cuando el sistema tributario aplicable al contrato haya sido modificado para restablecer la economía del contrato vigente hasta antes de la modificación tributaria".Letter produced by Ecuador at the request of the Arbitral Tribunal, transcript Day 4, at 101.
[27] I Compendium of EnCana's Materials (submitted at the Hearing), tab 9.
[28] Keplinger cross-examination, transcript Day 1, at 47.

Regulations and the economic adjustment clauses in the Production Sharing Agreements are to interact. Finally, the Production Sharing Agreements do not impose such a renegotiation as an obligation on the parties thereto in case of an economic change of circumstances affecting the tax situation in Ecuador; i.e., resorting to such negotiation is not a contractual obligation imposed on, but a right vested in, the private contracting party. Ecuadorian governmental conduct prior to the Interpretative Law and the Interpretative Law itself, however, unilaterally impose such negotiation process on the private contractor as a necessary step for seeing its VAT refund rights materialize.

67. Through such general referral to the renegotiation process under or in respect of the Production Sharing Agreements, the situation of confusion to the detriment of the foreign investor is both perpetuated and aggravated, since the full recognition of EnCana's subsidaries rights to the VAT refunds is subject to a renegotiation permitting to question and erode such rights without excluding from the picture non-tax elements or circumstances likely to be factored in the negotiation process. To add further confusion to the picture, the Interpretative Law clearly collides with the Ecuadorian Supreme Court decisions in the AEC and COL Cases, where the Supreme Court decided that it was improper for the SRI (and for the Tax Courts) to seek to entrust or to entrust the determination of tax public law issues involving tax monies or tax revenues (and thus the public interest of the Ecuadorian State) such as the refund of tax amounts, to private law channels (such as the renegotiation of the Production Sharing Agreements or the application of their hardship or stabilization clauses) that remain outside the realm of the tax laws and, presumably, also of the control and powers of the Ecuadorian tax authorities.

68. By virtue of article XIII.1 of the Treaty, expropriatory conduct under its article VIII.1 may also consist of measures taken and not taken.The right of the foreign investor, acknowledged through conduct of the Government of Ecuador, to receive some economic value in the course of a renegotiation process for failure to receive a tax refund, is a tax right, since it implies assigning some (although unspecified) value to the foreign investor's failure to obtain a tax refund and confirms EnCana's return expectations, free of the VAT burden, protected under the Treaty. Unquestionably, the only articulate basis for assigning an economic value to such right is that it constitutes some form of economic entitlement to a VAT tax refund, or that such value is determined by the absence of such refund.

69. Nevertheless, such recognition of the existence of a tax right is unaccompanied by any remedy within the Ecuadorian tax system except for conduct attributable to the Ecuadorian State referring EnCana's subsidiaries to a renegotiation process of uncertain outcome (which

constitutes a measure not taken under the Treaty, because it does not provide a clear and proper or clean remedy to satisfy the legal entitlement recognized to such subsidiaries). By recognizing an entitlement to an economic value attributable to a tax refund that was refused and did not take place (such recognition being a tax measure), but denying a clear and unconditional remedy providing such legal entitlement with any real or apparent teeth, since there is no guarantee that the negotiation process will or may succeed, or that the economic value of such entitlement will not end up by being diluted in the negotiation process (failure to provide a remedy of any meaningful substance being a measure not taken), Ecuador has deprived EnCana's subsidiaries of rights to the payment of money amounts that negatively affect and substantially erode EnCana's rights to investment returns, including legitimate expectations embodied in such rights regarding the non-existence of VAT burdens affecting its returns, that are covered by the Treaty and protected under its article VIII.1 in case of expropriation.

70. In such context, there is no reason to believe that EnCana's subsidiaries shall receive through the Production Sharing Agreements' renegotiation process an economic value equal or equivalent to the asset they have been deprived of: VAT refunds at the 10% rate. Tax refunds are assets in the sense of "any kind of asset", "claims to money having a financial value" listed under the definition of investment in article I (g) of the Treaty and have been properly recorded as receivables in the books of EnCana's subsidiaries.

71. The evidence has also proved that such receivables have a market value, i.e., are quoted in the market and may be traded at a small discount[29]. Such asset may be used "...for the purpose of economic benefit..." (article I(g), penultimate paragraph of the Treaty), since by improving the cash flow situation of the subsidiary, it enhances its economic health and the returns of the sole shareholder (EnCana) by reducing the need to resort, first, to the retained earnings account (or reserve), out of which returns are payable to the shareholders, or, second, to cash infusions (loans or equity) from the shareholder, in order to fund the subsidiaries' business. Returns, as defined in the Treaty, include profits and dividends (article I(j) of the Treaty) and are expressly subject to its expropriation provision (article VIII.1). Although the fact that EnCana's subsidiaries have been deprived of this asset through conduct attributable to Ecuador may not give rise, under the circumstances of the present case, to an indirect expropriation of EnCana's investment, it may still constitute conduct expropriatory of EnCana's returns corresponding to such investment to the extent such returns have been negatively affected as a consequence of the denial of VAT refunds.

[29] Transcript Day 1, Keplinger at 41; Paredes at 90-91.

72. The position stated above does not imply advocating any review by an international arbitral tribunal constituted under the Treaty of local court determinations as to the meaning or "right" interpretation of article 69-A of the Tax Code or the exercise by such tribunal of functions inherent in an appeals court in respect of local court findings or conclusions as to how such provision is or should be interpreted or applied locally. What is being examined at such international arbitral tribunal level is whether measures based on such interpretation – considered as a fact - constitute an expropriatory taking under the Treaty. What may not be wrongful under local Ecuadorian law or an interpretation thereof may be wrongful under the Treaty or international law no matter what the Ecuadorian courts say or fail to say. State conduct found to be licit under national law – for example, because the State in breach complies with the decisions of its own courts - may however constitute a public international law infringement, particularly when the State's international obligations at stake are set out in a treaty (to which such State is a party) vesting an international arbitral tribunal with the power to adjudicate on such infringement. Finally, since article VIII.1 of the Treaty provides for an objective test for evaluating if State conduct is expropriatory conduct in violation of the Treaty, whether such conduct was or not in bad faith or intentional or not is not decisive to conclude whether such violation has been incurred or not.

VI.

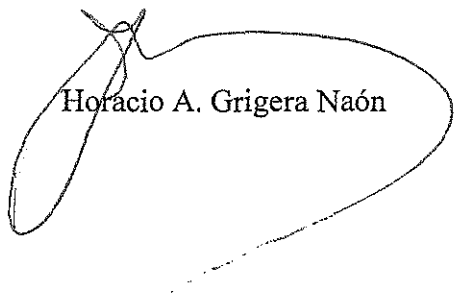
73. A return is expropriated when adversely affected in a substantial way by a measure or string of measures. A measure or series of measures do not need to totally eliminate returns to be expropriatory. A substantial or significant deprivation of returns suffices. On the contrary, the expropriation of returns as an independent category separately contemplated in the Treaty and distinguished from an expropriation of the underlying investment would become meaningless, because requiring the total or quasi-total suppression of returns for an expropriation of returns to exist would be tantamount to requiring the existence of a *de facto* expropriation of the underlying investment, enjoying independent protection under the Treaty.

74. Revenue reductions already amounting, as of June 2004, to US$ 72,354,141.00 in the case of AEC and, as of November 30, 2003, already amounting to US$ 5,993,182.00 in the case of COL, undoubtedly deprives EnCana's subsidiaries of substantial assets with necessarily adverse substantial effects on EnCana's return on its investment in Ecuador through such subsidiaries and the recouping of its invested funds[30]. These

[30] Keplinger, transcript Day 1, at 45-46.

figures are equal to the VAT refund receivables showing on the books of the EnCana's subsidiaries as of such dates[31]. No persuasive evidence has been brought forward to question EnCana's evidence supporting these figures. By substantially or significantly depriving EnCana of returns on its investment through its subsidiaries in Ecuador caused by the denial of VAT refunds to the latter necessarily adversely impacting in a considerable manner the existence or size of such returns and legitimate expectations related thereto covered by the Treaty, through discriminatory measures not supported in a principled way by a public purpose or public interest, I conclude that Ecuador expropriated EnCana's returns on such investment in violation of article VIII.1 of the Treaty and is entitled to compensation for the ensuing damages.

December 30 2005.



Horacio A. Grigera Naón

cc. Professor James Crawford
Christopher Thomas, QC
Adrian Wistanley, Registrar, LCIA

[31] EnCana's Post-Hearing submissions, no.546, at 127.