

Dissenting Opinion of Arbitrator Orrego Vicuña

1. I very much regret not to be in full agreement with my distinguished colleagues in the Tribunal. I share many of the conclusions of the Decision, particularly the final one concerning that there has been an act of expropriation in this case in the light of the taking of possession of the Blocks by the Respondent's officials that, as the Tribunal rightly concludes, dispossessed the Claimant not only of its oil production share, and hence of its revenues, but also of the means of production that made those revenues possible, thereby being totally deprived of the effective use and control of the investment.
2. It is my respectful submission, however, that the Decision stops short of recognizing a number of other rights that the investor has in the context of the PSCs, the Hydrocarbons Legal Framework and, most significantly, the Treaty and international law. This narrower approach the Decision follows results in that a number of acts that would normally qualify as contract or Treaty breaches, and thus entail liability, are dispensed of a legal sanction and of its consequence in the light of the State's international responsibility for wrongful acts.
3. The first shortcoming with which I disagree concerns the meaning and extent of the umbrella clause as written in Article II (3) (c) of the Treaty. It is a well known fact that this matter has given place to a prolonged debate in investment arbitration and international law. The CMS Award, with which I was involved as the presiding arbitrator, took one position. The CMS Annulment Committee, for whose members I have the greatest respect, took a different approach. A number of awards have followed one or other line of thought. The essential divide between these lines of jurisprudence is that concerning privity.
4. The Decision has decided to follow to the letter the decision of the CMS Annulment Committee on this last question. While the Decision notes that it is debatable whether the *Azurix*, *Siemens* and *CMS* Annulment decisions constitute a series of consistent cases in respect of the alleged privity requirement, it nonetheless concludes that there is a majority of cases supporting such requirement and assigns particular authority to the *CMS* Annulment decision. I have supported the view that tribunals ought to take into consideration prior decisions on relevant matters in spite of not amounting to legal precedents that ought to be followed, but in this particular matter I do not believe there

is such consistency that would compel the Decision to decide as it has. No doubt the *CMS* Annulment is a very respectable opinion, but it is just one opinion among other and the fact of it being the outcome of annulment proceedings does not make it more authoritative, as *Continental Casualty* and other cases evidence. Even some cases such as *Siemens* and *Azurix* that are often invoked as supporting the requirement of privity are not quite conclusive on this issue as the Decision notes, certainly not as a matter of principle as distinguished from the circumstances of the cases respectively considered. Jurisprudence is not formed by majority counting and even then the counting on this matter does not seem to add up in support of the Decision's conclusion.

5. The main question discussed by the Decision in this context is the affirmation by the *CMS* Annulment decision that obligations are entered into with regard to particular persons, who are the obligor and the obligee of rights and obligations under a contract. In this case, it is concluded, that legal relationship exists only between the Respondent and the Claimant's subsidiaries, but not the parent company that is claiming under the Treaty, including its claim for breach of the umbrella clause. From the point of view of Civil law, including the Ecuadorean Civil Code, just as from the point of view of contract law, there can be no disagreement with this premise. The issue here, however, is different as it entails determining whose rights are protected under the Treaty and who are the obligor and obligee in the context of complex business transactions usually characterizing investments.
6. The issue is not entirely new in the light of the extensive jurisprudence of commercial arbitration tribunals, most notably those operating under the International Chamber of Commerce arbitration rules, to extend the reach of the arbitration clause to third parties when there is a link between that party and the signatory of the contract. That link relates not only to obligations of the third party that are called into account but also relates to the rights that it is entitled to enforce. This very trend is also present in important domestic legislation and jurisprudence, to wit the Contract (Rights of Third Parties) Act 1999 in England which abolished the doctrine of privity of contract and allows a benefit to be conferred upon a non-contracting party.
7. In this case Article 1 of the Treaty expressly protects both direct and indirect investments. The obligations to which the umbrella clause refers are also those relating to investments. It would not really matter whether the protected investment is a minority

one, as in *CMS*, or the ownership reaches 100%, as here. What matters is that the Treaty has intended to protect all qualifying direct or indirect investments. The latter make take many different forms.

8. I regret not to be able to agree with the Decision's conclusion that while some Treaty provisions protect both direct and indirect investments, such as expropriation, on other matters, such as the umbrella clause, the scope of the protection is different and does not apply to indirect investments lacking the privity requirement. The Treaty does not make that distinction and if this had been the intention it would have had to be spelled out. A tribunal is not empowered to write into the treaty what the parties have not agreed to. Moreover, in my submission such interpretation is at odds with the rule governing interpretation of treaties under Article 31 (1) of the Vienna Convention on the Law of Treaties, particularly in so far the role of the ordinary meaning of the terms of the treaty in their context and in the light of its object and purpose is concerned.
9. It is the submission of this arbitrator that the right conclusion should have been that the entity whose interest in the investment is protected under the treaty is also entitled to benefit from the protection of an umbrella clause devised to ensure the observance of obligations concerning that investment. This is often the case when the contract is signed by an investment vehicle or by a local company channeling the investment. When the use of such vehicles or local companies is required by the host State by means of legislation or regulation such conclusion becomes imperative.
10. An interpretation to the effect that only the corporate entity having signed the contract can rely on the protection of the umbrella clause will inevitably lead to a negation of the protection in question depriving the treaty of all meaning in this context. Such a view entails extending the treaty protection to its beneficiaries, including the umbrella clause, with the one hand, and then denying such protection with the other hand. In spite that it is sometimes thought that such an interpretation is helpful to restrict the liability of the host country, in fact it might well have the opposite effect as it will put an end to many kinds of joint-ventures and other forms of investment that are channeled through investment vehicles to the benefit of the host State. To begin with no investment would be channeled through a local company which is by definition prevented from claiming against its own State of nationality.

11. The essential test continues to be the determination of whose is the real interest in the investment, as it was well explained by the *Goetz* tribunal: “le Tribunal observe que la jurisprudence antérieure du CIRDI ne limite pas la qualité pour agir aux seules personnes morales directement visées par les mesures litigieuses mais l’étend aux actionnaires de ces personnes, qui sont les véritables investisseurs”. A number of contemporary decisions have recognized such interests, a view that I believe to be consistent with both the applicable treaty and international law. Exceptions are of course justified, as when corporate personality is abused as a mere jurisdictional device to obtain an otherwise unavailable access to international arbitration. No such abuse is present in this case nor has it been alleged to be.
12. The conclusions of the Decision concerning the unavailability of the umbrella clause as far as contract claims are concerned touches upon a number of other questions of importance. The Claimant has noted in this respect that it is paradoxical that while the application of the umbrella clause is denied as to the protection of its rights under the PSCs, its contract obligations are nevertheless relied upon for the purpose of the counterclaim made in this case. The Decision rightly concludes that such counterclaim is based on a specific agreement between the parties as to the question of jurisdiction, but such an agreement does not cover of course the questions relating to the merits that will inevitably be centered upon the provisions of the PSCs.
13. Another implication of the Decision’s conclusions on this matter devolves on the much debated subject of the relations between contract claims and treaty claims. It is today well accepted that not every breach of contract amounts to a treaty breach, just as it is also accepted that certain contract breaches can be the source of treaty claims. To the extent that no contract rights are recognized in the light of the privity question, there would be no treaty rights arising from that source at all. The issue, however, does not seem to be as simple as that and additional complexities may be noted.
14. The Decision has rightly concluded that the waiver of claims with prejudice by Claimant’s subsidiaries does not mean that they have waived the underlying rights and these may be relied upon by the Claimant to pursue its Treaty claims. Most certainly such waiver has not been made by the Claimant. It thus follows that in spite of the finding that the lack of privity impedes the Claimant to claim contract rights under the PSCs, there are still underlying rights that may be claimed for as Treaty claims.

15. This leads to yet another complexity relating to the umbrella clause that the parties have discussed and the Decision has decided upon: the link of that clause to the breach, not of contract but of legislation. It is also well known that different interpretations have been made in respect of this matter by decisions of investment tribunals, some believing that the umbrella clause can only apply to contract obligations and other affirming that, in addition, it can apply to commitments made by law or regulation. This arbitrator is of the view that while normally such legislative extent might be difficult to establish, either because of the general scope of legislation or because the obligations might not be specific enough, it can also understand that in some cases, such as this one, it is justified.
16. The Decision has concluded that under Ecuador's Hydrocarbons Legal Framework there are in fact obligations concerning the right to a share of production in the contract area, just as there is a right to tax adjustment when contracts are modified, but further concluding that since these rights assume the existence of a contract once they are included in the PSCs the purpose of the legal provisions is exhausted and they cannot any longer serve as an obligation to be protected under the umbrella clause separately from the PSCs. I regret not to share this last conclusion.
17. The obligations contained in the Hydrocarbons Legal Framework are specific enough to every investment taking advantage of its provisions to enter into a PSC. The scope of the Legal Framework is also very specific to this sector. It is thus this arbitrator's submission that if the contractual enforcement of the right fails to be kept with, the rights under the Legal Framework survive untouched and they can serve as the very basis of an umbrella clause claim under the Treaty, separately from the contract and therefore do not become necessarily exhausted. In the instant case the rights were included in the PSCs but not observed when the time came and, moreover, the PSCs were terminated by the Caducidad process by Respondent's unilateral decision. The rights will hence be available for umbrella clause protection in spite that the contract rights might not be recognized as available to the Claimant.
18. The second major question motivating this dissent concerns the manner how an increase of the State's share of production of natural resources and income can be achieved. One can fully understand and respect the State's policy objective to share the benefits resulting from windfall profits, as it is evident in all corners of the world. A 50% share

is probably the expression of the equitable participation on a fifty-fifty split basis, but the Tribunal is bound to decide the controversy submitted to it not under equity but under the governing law as written in the Hydrocarbons Legal Framework, the PSCs, the Treaty and international law. Under the rule of law, particularly in the light of specific commitments and the inclusion of tax stabilization clauses, there are only three avenues open to attend to such objectives.

19. The first avenue is by means of negotiations which in the instant case did not succeed. The second is to attempt judicial recognition of the modification of a contract in the light of the doctrine of *rebus sic stantibus*. The doctrine is also referred to in the record although the Respondent alleged not to have relied on it in justification of the measures adopted. The Decision concludes in this respect that the Respondent has not invoked such doctrine and that there is no need to examine its requirements. This arbitrator must note, however, that arguments as to the unforeseeable character of the oil price increase, which are of the essence of that doctrine, have been made. It would have been preferable for the Decision to examine this doctrine in the light of the strict requirements for its application under international law.
20. The third avenue is to alter production sharing and income distribution by means of expropriation subject to prompt, adequate and effective compensation that is not available in this case either. In this context I must respectfully disagree with the manner how the Decision has dealt with expropriation.
21. While as noted above I fully agree with the conclusion of the Decision that there has been expropriation and that the acts in question are unlawful, I submit that the Decision has narrowed these findings down to the question of taking of possession of the Blocks. The issues surrounding the effects of Law No. 42, the Coactiva process and the ultimate measure of Caducidad of the PSCs also justify in this arbitrator's views a finding of expropriation.
22. I have no disagreement with the findings of the Decision as to the fact that the record evidences that the economy of the PSCs was not linked to a certain price per barrel of oil or to an internal rate of return of 15% each. As rightly concluded it was only linked to the economic value of its oil participation share. Moreover, I concur with the Decision's findings as to the fact that the tax absorption clauses are equivalent to tax stabilization clauses.

23. While agreeing with the premise that States have an inherent authority to tax and that such power finds its limits in the requirements of customary international law as to non-discrimination and of not amounting to confiscation, I disagree with the Decision's conclusion that the effects of Law 42 at either a 50% or a 99% participation in the increase of revenues above a certain minimum threshold do not result in expropriation of the investment. In fact, after having the Decision concluded that by introducing a price factor to allocate oil revenues, Law 42 modified the parties' choice to exclude such a factor and hence resulted in oil revenues being redirected to the State in the form of taxes, with the added result that the refusal to apply a correction factor so as to absorb the effects of the taxation approved specifically breached the PSCs, the Decision goes on to conclude that neither the 50% nor the 99% increase in participation amount to substantial deprivation of the value of the investment.
24. This arbitrator shares the view that substantial deprivation is an appropriate standard to determine expropriation under international law, albeit not the only one, but even then the facts of this case prove that substantial deprivation did indeed occur. The reasoning of the Decision on this matter is that because taxes amounted beforehand to a level of 40%, including therein income tax and employment contribution, the increase to 50% would only mean, after complex calculations, that the investor's take of the total oil revenues was reduced by 29.2% for Block 7 and 32.8% reduction for Block 21. Applying the same exercise to the increase to 99% it is concluded that the reduction for Block 7 would amount to 58% and for Block 21 to 70.2%.
25. While considering that these last figures considerably diminished Burlington's profits the Decision concludes that they do not prove that the investment became unprofitable or worthless. I respectfully dissent from this finding as no reasonable businessman would be likely to conclude that after having to turn over to the State 50% or, worse, 99% of its revenue income such venture would be profitable or valuable. Indeed it would be almost impossible to find a willing buyer in such circumstances because of the adverse effects of the measures adopted on the viability of the business.
26. In this arbitrator's submission there can be many exercises at calculating how profits are affected or unaffected. In this case this arbitrator is not comfortable with the calculation exercise undertaken by the Decision, with the added difficulty that the amortization of capital investments has not been considered in spite that it has carefully complied with

the requirements of the law. The concept of substantial deprivation is not, however, a mathematical exercise but a question of reasonableness. The increases under Law 42 are, particularly at the 99% level, beyond any standard of reasonableness, as has been stated by the very Respondent government when deciding to roll back the top figure to 70% in certain circumstances.

27. What matters in the end is not to judge what taxes were before the increase, but which is the overall impact of the measures taken. It does not matter either whether the measures are called a tax, a royalty or a levy in spite of lengthy arguments of the parties in this context. The essential determination is which share of the income will be taken by the State one way or the other. A 50% tax level on income, while not unheard of, is very substantial. A 99% tax level is simply not just an expropriation but a confiscation, even if in this case the investor was allowed to keep a certain minimum income arising from the economy of the PSCs as interpreted by the Respondent. In the end it means that the individual or entity affected will work one half of its time, or close to a 100% of its time, for the State while being allowed that minimum income. I cannot consider any such effect reasonable. Moreover, I believe it raises a serious issue concerning the freedom of the individual in a democratic society. Substantial deprivation is therefore very much the effect of such measures.
28. There are in this arbitrator's view two other shortcomings affecting the finding of expropriation. One concerns the Coactiva measures directed to enforce the tax dues by means of which oil was seized and later auctioned at below market prices. The Decision concludes that since these measures only affected oil and not the entire investment there could be no direct expropriation under the Treaty. The Decision further concludes that the effects of Coactiva measures are not different from those of Law 42 at 99%, and because the latter were found not to amount to expropriation their enforcement neither could then have that effect.
29. This arbitrator respectfully disagrees with that conclusion. First direct expropriation need not affect the entirety of the investment to be in breach of Treaty rights. More importantly, however, is the fact that revenues were affected as a result of enforcement measures of Coactiva, certainly during the period of enforcement and in the end permanently as a result of related measures of taking of possession and Caducidad. The view that at the end of collection the investor would have resumed its earnings capacity

proved to be quite theoretical, among other reasons because the value of property will have been seriously affected as a consequence of the process as a whole, including in particular the possibility of disposing of the assets concerned.

30. Moreover, such measures were adopted in disregard of the provisional remedies ordered by the Tribunal, a situation that renders Coactiva quite at odds with the orderly conduct of arbitration proceedings and the authority of the Tribunal. I respectfully suggest that such an event should not pass without consequences.
31. Another shortcoming of the Decision's findings concerns Caducidad. While the Decision rightly concludes that the taking of possession of the blocks constitute an act of unlawful expropriation because of the reasons therein explained, it does not believe it necessary to discuss the termination of the PSCs by means of Caducidad in view that expropriation had already occurred with the taking of possession and hence Caducidad came only to formalize a prevailing state of affairs. This arbitrator believes that termination of contracts in the circumstances is an aggravating factor of the unlawfulness of expropriation because all rights are then dispensed with, not just the means of production. The investor ends up empty handed and the many millions that have been invested simply vanish with all accompanying rights and guarantees.
32. The process of expropriation as a whole is interlinked in its various components. Beginning with Law 42, followed by Coactiva, culminating in the taking of possession and ending up in Caducidad are all elements that cannot be disaggregated. Characterizing as expropriation only the taking of possession isolates those other elements and narrows down the effects of expropriation. While some measures in themselves might not be enough in the Decision's view to amount to direct expropriation, if one looks at the process as a whole the interlinking noted leads from one step to the other. In this arbitrator's view this is thus a case where, in spite that expropriation is not admitted in respect of the various components, a phase of creeping expropriation leads finally to a situation of direct expropriation. The two kinds of expropriation are not incompatible and it is necessary to approach the effects of expropriation from beginning to end, not just at the end. Among other consequences of one or the other choice there is the question that the date of expropriation as to establishing compensation will be earlier or later.

33. This arbitrator believes that this is where the Fair and Equitable Treatment provided for under Article II. 3 of the Treaty, specifically relied upon by the provisions on expropriation of Article III of the same Treaty, has an important role to play. Even if the measures preceding formal direct expropriation are not considered as amounting to expropriation, a conclusion that as noted this arbitrator does not share, they do not seem to be in compliance with the meaning of Fair and Equitable Treatment. Because of the link between the provisions noted expropriation cannot ignore the fact that measures that were conducive to it might be in breach on the Fair and Equitable Treatment standard, thus compounding liability.
34. It is submitted that this is not a case of a stand-alone standard that might be irreconcilable with the findings of the Decision on Jurisdiction, which is in itself open to doubt on this point, but of standards that apply consecutively so as to take into consideration the aggregate of measures intervening in this case and ultimately resulting in the expropriation noted. Not even the fact that Article X of the Treaty restricts jurisdiction in taxation matters to, among other cases, expropriation, would prevent this conclusion since that very Article remits to expropriation under Article III which in turns provides the link to Fair and Equitable Treatment. It is thus the very Treaty that has foreseen an inter-linkage of measures that might be conducive to expropriation.
35. With all due respect one is left with the impression that these shortcomings convey the wrong message beyond the case in point. It would appear that an investor, or for that matter any individual, might be squeezed by means of taxation or other measures until its income is largely or entirely diverted to the State. It would also appear that its remaining assets could be attached and auctioned so as to collect the taxes due. Finally, there would be termination of all its rights. None of such measures would entail liability. But do not send in the police or the army to take possession, this being the only measure resulting in unlawful expropriation. Because of the above reasons I respectfully believe differently.

Respectfully submitted,

[signed]

Francisco Orrego Vicuña

8th November 2012