

**INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES**

WASHINGTON, D.C.

In the arbitration proceeding between

**PERENCO ECUADOR LIMITED**

Claimant

and

**THE REPUBLIC OF ECUADOR**

Respondent

**ICSID Case No. ARB/08/6**

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**DECISION ON REMAINING ISSUES OF  
JURISDICTION AND ON LIABILITY**

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*Members of the Tribunal*

Judge Peter Tomka, President  
Mr. Neil Kaplan, C.B.E., Q.C., S.B.S.  
Mr. J. Christopher Thomas, Q.C.

*Secretary of the Tribunal*

Mr. Marco Tulio Montañés-Rumayor

Date: 12 September 2014

## REPRESENTATION OF THE PARTIES

Representing **Perenco Ecuador Limited:**      Representing the **Republic of Ecuador:**

Mr. Mark W. Friedman  
Ms. Ina Popova  
Mr. Thomas Norgaard  
Ms. Sonia Farber  
Ms. Terra Gearhart-Serna  
Debevoise & Plimpton LLP

Dr. Diego García Carrión  
Procurador General del Estado  
and  
Dra. Blanca Gómez de la Torre  
Directora Nacional de Asuntos  
Internacionales y Arbitraje

and

Mr. Gaëtan Verhoosel  
Three Crowns LLP  
and  
Ms. Carmen Martínez López  
Covington & Burling LLP

and

Mr. Eduardo Silva Romero  
Mr. Pierre Mayer  
Mr. Daniel Gal  
Mr. José Manuel García Represa  
Ms. Maria Claudia Procopiak  
Ms. Audrey Caminades  
Dechert LLP

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## FREQUENTLY USED ABBREVIATIONS AND ACRONYMS

Amended Request	Amended Request for Arbitration dated 30 April 2008, submitted on 18 July 2008
Arbitration Rules	ICSID Rules of Procedure for Arbitration Proceedings
Bill for the Law Reforming the Hydrocarbons Law or Bill	Bill of the Law Amending the Hydrocarbons Law presented by the President of the Republic of Ecuador to the President of Congress, 1 March 2006
BIT or the Treaty	Agreement between the Government of the French Republic and the Government of the Republic of Ecuador on the Reciprocal Promotion and Protection of Investments
Block 7 Participation Contract or Block 7 Contract	Contract Modifying the Service Contract to a Participation for the Exploration and Exploitation of Hydrocarbons in Block 7 of the Amazon Region, including the Contract for the Coca-Payamino Unified Field
Block 21 Participation Contract or Block 21 Contract	Participation Contract for the Exploration and Exploitation of Hydrocarbons in Block 21 of the Amazon Region
Burlington	Burlington Resources Inc.
CEL	<i>Comité Especial de Licitaciones</i> or Petroecuador's Special Bidding Commission
CEPE	<i>Corporación Estatal Petrolera Ecuatoriana</i>
CLAPSA	Compañía Latinoamericana Petrolera Sociedad Anónima
Counter-Memorial	Ecuador's Counter-Memorial on Liability and Counterclaims dated 5 December 2011
Decision on Jurisdiction	Decision on Jurisdiction dated 30 June 2011

Decision on Provisional Measures	Decision on Provisional Measures dated 8 May 2009
Ecuador	Republic of Ecuador
First Implementing Regulation	Decree No. 1672 Implementing Law 42-2006 of 13 July 2006
ICSID Convention	Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, dated 18 March 1965
ICSID or the Centre	International Centre for the Settlement of Investment Disputes
Law 42 or the HCL Amendment	Law No. 2006-42 Amending the Hydrocarbons Law
Law 44	Law 44 Amending the Hydrocarbons Law, Official Registry No. 326 of 29 November 1993
LET	<i>Ley de Equidad Tributaria</i> of 29 December 2007
Memorial on the Merits	Claimant's Memorial dated 10 April 2009
OCP	<i>Oleoducto de Crudos Pesados</i>
Oryx	Oryx Ecuador Energy Company
Perenco or PEL	Perenco Ecuador Limited
Petroecuador	<i>Empresa Estatal Petróleos del Ecuador</i>
PIL	Perenco International Limited
Preussag	Preussag Energie GMBH PBP
Rejoinder	Ecuador's Rejoinder on Liability dated 27 July 2012

Request	Request for Arbitration dated 30 April 2008
Reply	Claimant's Reply to Respondent's Counter-Memorial dated 12 April 2012
Revised Memorial	Claimant's Revised Memorial dated 5 August 2011
Santa Fe	Santa Fe Minerales del Ecuador Sociedad Anónima
Second Implementing Regulation	Decree No. 662 Implementing Law 42-2006 of 4 October 2007
SIPETROL	Sociedad Internacional Petrolera Sociedad Anónima
The Parties	Collectively the Claimant and Respondent

## **I. INTRODUCTION**

### **A. The Parties**

1. The Claimant, Perenco Ecuador Limited, is a company incorporated under the laws of the Commonwealth of the Bahamas. The Claimant avers that at the material time, namely on 17 October 2007, when consent to the arbitration of this dispute was given, it was controlled by French nationals and hence the Tribunal has jurisdiction over the Treaty claim brought by Perenco.<sup>1</sup> The Claimant has also advanced claims of breach of the Participation Contracts relating to Blocks 7 and 21. The Claimant is hereinafter referred to as **“Perenco”** or **“the Claimant.”**
2. The Respondent is the Republic of Ecuador and is hereinafter referred to as **“Ecuador”** or **“the Respondent.”**
3. The Claimant and the Respondent are hereinafter collectively referred to as **“the Parties.”** The Parties’ respective representatives and their addresses are listed above on page (i).

### **B. The Dispute**

4. This proceeding concerns alleged breaches by Ecuador of the obligations under the Agreement between the Government of the French Republic and the Government of the Republic of Ecuador on the Reciprocal Promotion and Protection of Investments (**“the Treaty”** or the **“BIT”**) and two **“Participation Contracts”** (also known as **“production sharing contracts”**) concluded by the Claimant and Petroecuador, the latter acting on the State’s behalf, relating to the exploration and exploitation of Blocks 7 and 21 situated in the Ecuadorian Amazon region.
5. The Participation Contracts are, first, the Contract Modifying the Service Contract to a Participation for the Exploration and Exploitation of Hydrocarbons in Block 7 of the Amazon Region, including the Contract for the Coca-Payamino Unified Field (**“the Block 7**

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<sup>1</sup> Amended Request for Arbitration dated 30 April 2008, paragraph 14 (**“Amended Request”**). For a further description of the facts relating to this aspect of the Claimant’s claim, see below at section III.A.

**Participation Contract**” or **“the Block 7 Contract”**),<sup>2</sup> and second, the Participation Contract for the Exploration and Exploitation of Hydrocarbons in Block 21 of the Amazon Region (**“the Block 21 Participation Contract”** or **“the Block 21 Contract”**),<sup>3</sup> (together, the two contracts will be referred as **“the Participation Contracts”** or **“the Contracts”**). Perenco also entered into Joint Operating Agreements with other entities holding interests in Blocks 7 and 21.<sup>4</sup> These agreements, and the Parties’ respective rights and obligations under the Contracts will be described in further detail below.

## II. PROCEDURAL HISTORY

6. On 30 April 2008, the International Centre for Settlement of Investment Disputes (**“ICSID”** or **“Centre”**) received a request for arbitration (**“the Request”**) from Perenco against the Republic of Ecuador and *Empresa Estatal Petróleos del Ecuador* (**“Petroecuador”**). Perenco’s Request was brought to ICSID on the basis of Article 9 of the Treaty and the arbitration clauses contained in the Participation Contracts.
7. On 4 June 2008, the Secretary-General of ICSID registered the Request in accordance with Article 36(3) of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (**“ICSID Convention”**).
8. On 28 July 2008, the Claimant filed an amended request for arbitration (**“the Amended Request”**).
9. The Tribunal was initially constituted on 21 November 2008 as follows: Thomas Bingham, a national of the United Kingdom, appointed as President by the party-appointed arbitrators, after consultation with the parties; Charles N. Brower, a national of the United States, appointed by the Claimant; and J. Christopher Thomas QC, a national of Canada, appointed by the Respondent.

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<sup>2</sup> Exhibit CE-17, Participation Contract for the Exploration and Exploitation of Hydrocarbons for Block 7 of the Amazon Region, 23 March 2000 (translation resubmitted on 04-12-12) (**“Block 7 Participation Contract”**).

<sup>3</sup> Exhibit CE-10, Participation Contract for the Exploration and Exploitation of Hydrocarbons (Crude Oil) in Block 21 of the Ecuadorian Amazon Region, 20 March 1995 (translation resubmitted on 04-12-12) (**“Block 21 Participation Contract”**).

<sup>4</sup> Exhibits CE-31, Novation of Joint Operating Agreement in respect of Block 7, Oriente Basin, Ecuador, 12 December 2002, and CE-32, Novation of Joint Operating Agreement in respect of Block 21, Oriente Basin, Ecuador, 12 December 2002.

10. On 7 February 2009, the Tribunal held a First Session with the Parties in Washington, DC. The agreements of the Parties were embodied in Minutes signed by the President and the Secretary of the Tribunal and circulated to the Parties.
11. On 9 February 2009, the Tribunal fixed the procedural calendar.
12. On 19 February 2009, Perenco filed a request for provisional measures.
13. On 20 February 2009, the Respondent filed observations on the Claimant's request for provisional measures.
14. On 21 February 2009, the Claimant filed a response to the Respondent's observations on the request for provisional measures.
15. On 26 February 2009, the Respondent filed further observations on the request for provisional measures.
16. On 27 February 2009, the Claimant filed a reply on provisional measures.
17. On 6 March 2009, the Respondent filed a rejoinder on provisional measures.
18. On 9 March 2009, the Claimant filed further observations on provisional measures.
19. A hearing on provisional measures was held in Paris, France, on 19 March 2009.
20. On 10 April 2009, Perenco filed its Memorial on the Merits ("**the Memorial**"). It was accompanied by the witness statements of Mr. Eric D'Argentré, Mr. Laurent Combe, and Mr. Patrick Spink, as well as by the first expert report of Dr. Hernán Pérez Loose.
21. On 8 May 2009, the Tribunal issued its Decision on Provisional Measures ("**the Decision on Provisional Measures**") holding that:

79. ... circumstances require it to recommend, and it does recommend, provisional measures restraining the Respondents from:

- (1) demanding that Perenco pay any amounts allegedly due pursuant to Law 42;
- (2) instituting or further pursuing any action, judicial or otherwise, including the actions described in the notices dated 19 February and 3 March 2009, to

collect from Perenco any payments Respondents claim are owed by Perenco or the Consortium pursuant to Law 42;

(3) instituting or pursuing any action, judicial or otherwise, against Perenco or any of its officers or employees, arising from or in connection with the Participation Contracts; and

(4) unilaterally amending, rescinding, terminating, or repudiating the Participation Contracts or engaging in any other conduct which may directly or indirectly affect or alter the legal situation under the Participation Contracts, as agreed upon by the parties.<sup>5</sup>

22. On 17 July 2009, Ecuador and Petroecuador filed, in separate submissions, Objections to Jurisdiction. Ecuador's Objections were accompanied by the witness statement of Dr. Christian Dávalos and the first expert reports of Professors Juan Pablo Aguilar Andrade, Luis Parraguez Ruiz and Hernán Salgado Pesantes. The Respondent made a formal application under Article 41(2) of the Convention that its jurisdictional objections be dealt with as a preliminary question.
23. On 17 September 2009, Perenco filed its Counter-Memorial on Jurisdiction. It was accompanied by the witness statement of Mr. Andrew Derman and the second expert report of Dr. Hernán Pérez Loose.
24. Ecuador and Petroecuador jointly filed a Reply on Jurisdiction on 17 November 2009, to which they attached the second expert reports of Professors Aguilar and Parraguez.
25. On 16 December 2009, following the resignation of Judge Brower, the Secretary-General notified the Parties of the vacancy on the Tribunal and suspended the proceedings pursuant to Rule 10(2) of the ICSID Rules of Procedure for Arbitration Proceedings ("**the Arbitration Rules**").
26. On 13 January 2010, the Claimant appointed Mr. Neil Kaplan CBE, QC, SBS, a national of the United Kingdom, and the Tribunal was reconstituted.
27. On 15 January 2010, Perenco filed its Rejoinder on Jurisdiction, to which it attached the third expert report of Dr. Pérez Loose.

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<sup>5</sup> Decision on Provisional Measures, paragraph 79.

28. On 17 February 2010, following the resignation of Lord Bingham, the proceedings were suspended again.
29. The Parties were unable to agree on a third arbitrator to serve as the President of the Tribunal and consequently invoked Article 38 of the ICSID Convention to request that the Chairman of the Administrative Council designate the President of the Tribunal. The Chairman designated Judge Peter Tomka, a national of Slovakia, to sit as President, and the Tribunal was reconstituted on 6 May 2010.
30. A hearing on jurisdiction was held in The Hague, Netherlands, from 2 to 4 November 2010. Present at the hearing were:

For the Claimant:

Mr. Roland Fox	Perenco
Mr. Rodrigo Márquez	Perenco
Mr. Mark W. Friedman	Debevoise & Plimpton LLP
Mr. Gaëtan Verhoosel	Covington & Burling LLP
Ms. Carmen Martínez López	Covington & Burling LLP
Ms. Ina C. Popova	Debevoise & Plimpton LLP
Mr. Thomas H. Norgaard	Debevoise & Plimpton LLP
Ms. Sonia Farber	Debevoise & Plimpton LLP
Ms. Terra Gearhart-Serna	Debevoise & Plimpton LLP
Ms. Suzanne Siu	Covington & Burling LLP
Ms. Mary Grace McEvoy	Debevoise & Plimpton LLP
Mr. Richard Brea	Debevoise & Plimpton LLP

For the Respondent:

Dr. Diego García Carrión	The Republic of Ecuador
Dr. Francisco Larrea	The Republic of Ecuador
Mr. Francisco Mendoza	EP Petroamazonas
Mr. Andrés Donoso	Secretario Nacional de Hidrocarburos
Mr. Pierre Mayer	Dechert (Paris) LLP
Mr. Eduardo Silva Romero	Dechert (Paris) LLP
Mr. Daniel Gal	Dechert (Paris) LLP
Mr. Philip Dunham	Dechert (Paris) LLP
Mr. Álvaro Galindo	Dechert (Paris) LLP
Mr. José Manuel García Represa	Dechert (Paris) LLP
Mr. Timothy Lindsay	Dechert (Paris) LLP
Ms. Maria Claudia Procopiak	Dechert (Paris) LLP
Ms. Ana Carolina Simões e Silva	Dechert (Paris) LLP

Ms. Audrey Caminades  
Mr. José Caicedo Demoulin  
Ms. Celia Campbell  
Ms. Antonia Pascali

Dechert (Paris) LLP  
Dechert (Paris) LLP  
Dechert (Paris) LLP  
Dechert (Paris) LLP

31. On 30 June 2011, the Tribunal issued a Decision on Jurisdiction (“**the Decision on Jurisdiction**”). The Decision, in its operative clause, states that the Tribunal decided:

1. to defer its decision on its competence over Claimant’s Treaty claims to the merits phase of the proceeding;
2. that it has competence *ratione materiae* over the Claimant’s contract claims under the Block 7 and Block 21 Participation Contracts;
3. that it has no competence over Petroecuador;
4. that in view of the Tribunal’s request for the submission of any relevant *travaux préparatoires* of the Treaty in the possession of the other Contracting Party, as well as for further evidence on the issue of the Perrodo heirs’ relationship to the Claimant, such material must be submitted prior to the filing of the Respondent’s Counter-Memorial so as to allow the Respondent sufficient time to address such material in its pleading. The Parties are directed to jointly approach the responsible French authorities and request the disclosure of any relevant *travaux préparatoires* of the Treaty should they exist;
5. that any such *travaux préparatoires* shall be filed no later than 1 August 2011;
6. that the Claimant shall file any additional evidence pertaining to the Perrodo heirs’ relationship to the Claimant no later than 1 August 2011;
7. that to enable the Tribunal to be in a position to decide all claims should it resolve the remaining objection in the Claimant’s favour, the Parties shall address both the merits of the Claimant’s contract claims and its Treaty claims in their pleadings.<sup>6</sup>

32. On 5 August 2011, the Claimant filed a revised Memorial on the Merits (“**the Revised Memorial**”). It was accompanied by the witness statements of Mr. François Hubert Marie Perrodo and Mr. Roland Fox, the second witness statements of Mr. Eric D’Argentré and Mr. Patrick Spink, the expert report of Mr. Bernard Reynis, and the fourth expert report of Dr. Hernán Pérez Loose.

33. On 5 December 2011, Ecuador filed a Counter-Memorial on Liability and Counterclaims (“**the Counter-Memorial**”). It was accompanied by the witness statements of Dr. Galo Chiriboga

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<sup>6</sup> Decision on Jurisdiction, paragraph 242.

Zambrano, Mr. Pablo Luna, Mr. Diego Montenegro, Mr. Derlis Palacios, Mr. Wilson Pastor Morris, Mr. Germánico Pinto, Mr. Marco Puente, Mr. Manuel Solís, the third witness statement of Dr. Christian Dávalos, and the expert reports of Integrated Environmental Management Services S.A. de C.V. (IEMS), Mr. Brian Moree QC, RPS Energy, Fair Links, Mr. Ricardo Crespo Plaza and the third expert report of Professor Aguilar.

34. On 12 April 2012, the Claimant filed a Reply to the Respondent’s Counter-Memorial on Liability (“**the Reply**”). It was accompanied by the witness statements of Mr John Crick, Mr Rodrigo Márquez Pacanins, the second witness statement of Mr. Roland Fox, the expert reports of Professor Joseph P. Kalt and Mr Brian C. Simms QC, and the fifth expert report of Dr. Hernán Pérez Loose.
35. On 27 April 2012, the Respondent filed a Supplemental Memorial on Counterclaims. It was accompanied by the second witness statements of Mr. Pablo Luna and Mr. Diego Montenegro, and the second expert report of IEMS.
36. On 9 July 2012, the Tribunal issued Procedural Order No. 2 regarding the Claimant’s request for production of documents.
37. On 20 July 2012, the Tribunal issued Procedural Order No. 3 regarding the Respondent’s request for production of documents.
38. On 27 July 2012, the Respondent filed a Rejoinder on Liability (“**the Rejoinder**”). It was accompanied by the second witness statements of Dr. Galo Chiriboga, Mr. Derlis Palacios, Mr. Wilson Pastor Morris, Mr. Germánico Pinto, the fourth witness statement of Dr. Christian Dávalos, and the expert report of the Brattle Group, the second expert reports of Mr. Brian Moree QC, RPS, Fair Links, and the fourth expert report of Professor Aguilar.
39. A hearing on the merits and on the pending jurisdictional issue took place in The Hague, Netherlands from 8 to 16 November 2012. In addition to the Members of the Tribunal, their assistants (Mr. Daniel Purisch, Dr. Romesh Weeramantry and Ms. Tara Davenport), and the Secretary of the Tribunal, present at the hearing were:

For the Claimant:

Mr. Roland Fox	Perenco
Mr. Rodrigo Márquez	Perenco
Mr. Mark Friedman	Debevoise & Plimpton LLP
Mr. Gaëtan Verhoosel	Covington & Burling LLP
Ms. Carmen Martínez López	Covington & Burling LLP
Ms. Ina Popova	Debevoise & Plimpton LLP
Mr. Thomas Norgaard	Debevoise & Plimpton LLP
Ms. Sonia Farber	Debevoise & Plimpton LLP
Ms. Terra Gearhart-Serna	Debevoise & Plimpton LLP
Ms. Suzanne Siu	Covington & Burling LLP
Ms. Mary Grace McEvoy	Debevoise & Plimpton LLP
Mr. Richard Brea	Debevoise & Plimpton LLP

For the Respondent:

Dr. Diego García Carrión	The Republic of Ecuador
Dra. Christel Gaibor	The Republic of Ecuador
Dr. Francisco Larrea	The Republic of Ecuador
Mr. Francisco Mendoza	EP Petroamazonas
Mr. Andrés Donoso	Secretario Nacional de Hidrocarburos
Mr. Pierre Mayer	Dechert (Paris) LLP
Mr. Eduardo Silva Romero	Dechert (Paris) LLP
Mr. Daniel Gal	Dechert (Paris) LLP
Mr. Philip Dunham	Dechert (Paris) LLP
Mr. Álvaro Galindo	Dechert (Paris) LLP
Mr. José Manuel García Represa	Dechert (Paris) LLP
Mr. Timothy Lindsay	Dechert (Paris) LLP
Ms. Maria Claudia Procopiak	Dechert (Paris) LLP
Ms. Ana Carolina Simões e Silva	Dechert (Paris) LLP
Ms. Audrey Caminades	Dechert (Paris) LLP
Ms. Celia Campbell	Dechert (Paris) LLP
Ms. Antonia Pascali	Dechert (Paris) LLP

40. The following persons were examined:

On behalf of the Claimant:

Mr. François Perrodo	Perenco
Mr. Roland Fox	Perenco
Mr. Rodrigo Márquez Pacanins	Perenco
Mr. Eric d'Argentré	Perenco

Mr. Patrick Spink	Rushden Energy Advisers Ltd.
Mr. Laurent Combe	Perenco
Mr. John Crick	Perenco
Prof. Joseph P. Kalt	Harvard University / Compass
	Lexecon
Dr. Hernán Pérez Loose	Coronel & Pérez
Mr. Brian Simms QC	Lennox Paton
Mr. Bernard Reynis	Retired

On behalf of the Respondent:

Dr. Christian Dávalos	Private consultant
Dr. Galo Chiriboga Zambrano	General Prosecutor of the Republic of Ecuador
Mr. Wilson Pastor Morris	Minister of Non-Renewable Natural Resources of the Republic of Ecuador
Prof. Juan Pablo Aguilar	Pontificia Universidad Católica del Ecuador
Mr. James Dow	The Brattle Group
Mr. Anton Mélard de Feuarent	Fair Links
Mr. Brian Moree QC	McKinney, Bancroft & Hughes
Mr. Gene B. Wiggins III	RPS

41. The hearing was recorded and transcribed verbatim, and copies of the recordings and the transcripts were subsequently delivered to the Parties.
42. The Tribunal deliberated by various means of communication, including meetings in The Hague on 16 March 2013, 17 September 2013 and 27-28 May 2014. The Tribunal has taken into account all of the pleadings, documents and testimony submitted in this case.

### III. THE FACTS

43. As noted above, the dispute between the Parties concerns the Block 7 and Block 21 Participation Contracts. Perenco was the sole operator and majority holder of Participation Contract rights in both Blocks, holding a 53.75% interest in Block 21 and a 57.5% interest in Block 7. The remaining interest in both Blocks was held by Burlington Resources Oriente Limited (“**Burlington Oriente**”), with which Perenco has formed a Consortium.
44. The following sections present a summary of facts of this dispute relevant to the Tribunal’s findings.

## **A. Ownership and Control of the Claimant**

45. Before turning to address the chain of events that led to the initiation of this arbitration, it is necessary to summarise the facts insofar as they relate to the Respondent's objection to the Tribunal's jurisdiction over Perenco's Treaty claim. Submissions on the objection, and the evidence of witnesses tendered by the Parties in relation thereto, are addressed further below at sections IV.A.(1), and VII.
46. Perenco is part of the Perenco Group of Companies founded by a French national, the late Mr. Hubert Perrodo, in 1975. Among other things, it is engaged in the exploration and exploitation of hydrocarbon resources.
47. Perenco was incorporated in the Bahamas in November 2001 to hold the Perenco Group's investments in Ecuador.
48. From the time that Mr. Hubert Perrodo took Perenco private in 1995<sup>7</sup> until his demise on 29 December 2006 as a result of a climbing accident in France, he controlled the Perenco Group of Companies.<sup>8</sup>
49. At the time of Mr. Perrodo's death, on 29 December 2006, Perenco was part of the following corporate structure:<sup>9</sup>
- a) Its sole shareholder was Perenco Gabon S.A (formerly Perenco S.A), also incorporated in the Commonwealth of the Bahamas.
  - b) Perenco Gabon S.A, in turn, was wholly owned by Perenco S.A. (formerly Perenco Oil and Gas), also incorporated in the Commonwealth of the Bahamas.
  - c) Perenco S.A was wholly owned by Perenco International Limited ("PIL"), also incorporated in the Commonwealth of the Bahamas.
  - d) 92.9% of the registered shares of PIL were owned by Mr. Hubert Perrodo and the remaining 7.1% of the shares were owned by another Bahamian company, Glenmor Energy Limited, whose sole shareholder was Mr. François Perrodo, Mr.

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<sup>7</sup> Reply, paragraph 12.

<sup>8</sup> 2<sup>nd</sup> Witness Statement of Patrick Spink, paragraphs 3-7.

<sup>9</sup> Exhibit E-1, Letter from Debevoise & Plimpton to Dechert dated 8 July 2009 enclosing letter from Debevoise & Plimpton to ICSID dated 28 May 2008, with attached Organizational Chart.

Hubert Perrodo's eldest son. Mr. Hubert Perrodo gifted 7.1% of the shares in PIL to his son in 2004.<sup>10</sup>

50. Mr. Hubert Perrodo died intestate. Under French law, upon the death of an intestate, the entirety of his estate vests automatically in his heirs.<sup>11</sup> The evidence is that Mr. Perrodo's 92.9% shareholding in PIL formed part of his estate and thus ownership of that shareholding also vested automatically in his heirs, namely, his widow, Ka Yee Perrodo, and his three children, François, Nathalie and Bertrand (subject to a further issue of determining the heirs' respective entitlements, a matter discussed further below).<sup>12</sup>
51. Under Bahamian law, where an intestate had property sited in the Commonwealth of the Bahamas, it is necessary for there to be a grant of the estate to an administrator pursuant to Letters of Administration. The heirs instructed Bahamian counsel, Ms. Heather Thompson, to make an application for Letters of Administration on 16 April 2009 in respect of the estate.<sup>13</sup> Letters were duly granted on 19 August 2009.<sup>14</sup>
52. The delay between the time of Mr. Hubert Perrodo's death and the application and grant for Letters of Administration appears to be due to a dispute between Ka Yee Perrodo and her children, as evidenced by the fact that on 15 February 2008, Mrs. Perrodo lodged a caveat in the Supreme Court of the Bahamas preventing any grant of Letters of Administration from being made in respect of the estate of Hubert Perrodo.<sup>15</sup> Mrs. Perrodo later withdrew the Caveat on 30 March 2009 and the application for Letters of Administration was made shortly

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<sup>10</sup> 1<sup>st</sup> Witness Statement of Roland Fox, paragraph 11; 2<sup>nd</sup> Witness Statement of Roland Fox, paragraph 2.

<sup>11</sup> 2<sup>nd</sup> Witness Statement of Roland Fox, paragraph 3.

<sup>12</sup> *Ibid.*; Exhibit CE-220, Material subject to the Confidentiality Order issued by the Tribunal, paragraphs 2-5; see also, 1<sup>st</sup> Witness Statement of Roland Fox, paragraph 12.

<sup>13</sup> Counter-Memorial, paragraph 38.

<sup>14</sup> *Ibid.*; Exhibit CE-240, Letters of Administration in the Estate of Hubert Firmin François Perrodo, in the Supreme Court of the Bahamas Probate Side, 19 August 2009 (also attached to the Expert Report of Bernard Reynis as Exhibit 2).

<sup>15</sup> Exhibit E-72, Caveat filed in the Supreme Court of the Bahamas by Carrie Perrodo in the Estate of Hubert Perrodo, dated 15 February 2008; see also, Transcript, Hearing on the Merits, Day 2, pp 420-422 (Testimony of François Perrodo).

thereafter.<sup>16</sup> It was only on 22 December 2011 that the heirs of Hubert Perrodo were registered as shareholders of PIL (the ultimate parent company of Perenco).<sup>17</sup>

53. Quite apart from the handling of the estate and the ultimate distribution of the PIL shares to the heirs, steps were also taken by PIL's Board of Directors shortly after Mr. Perrodo's death, first to elect his eldest son François Perrodo as a member and Chairman of the Board of Directors of PIL and Perenco S.A. on 12 January 2007<sup>18</sup> and then, on 24 September 2007, to elect Ka Yee Perrodo and Nathalie Perrodo to PIL's Board of Directors.<sup>19</sup>

## **B. Ecuador's Hydrocarbons Industry**

54. This Section summarises the facts of this dispute relating to the development of Ecuador's hydrocarbons industry insofar as they are relevant to the Tribunal's findings.
55. Prior to 1993, like many other countries, Ecuador had adopted the 'service contract' modality for oil and gas explorations.<sup>20</sup> Under a service contract, the contractor, usually an international oil company, provides all the services necessary to explore and develop the State's oil deposits in return for payment of a fee which is supposed to cover the costs of production incurred as well as a margin of profit.<sup>21</sup> The contractor acts solely as a service provider under this model and it is not entitled to any share in any oil that may be produced. In such an arrangement, there may be little commercial incentive for the contractor to seek to exploit an oilfield to its maximum potential, consistent with proper drilling practices.
56. This arrangement thus had its disadvantages, both for Ecuador and for the oil companies operating in the country. When oil prices were low, as was the case during the 1980s and 90s,

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<sup>16</sup> Exhibit E-73, Notice of Withdrawal filed in the Supreme Court of The Bahamas by Carrie Perrodo in the Estate of Hubert Perrodo dated 30 March 2009.

<sup>17</sup> Exhibit CE-294, Email correspondence between Roland Fox and Heather Thompson, enclosing instructions from Perrodo heirs, 22 December 2011.

<sup>18</sup> Exhibit CE-198, Board of Directors Meeting Minutes of Perenco International Limited, 12 January 2007, PER 03639; see also, 2<sup>nd</sup> Witness Statement of Roland Fox, paragraph 6; Transcript, Hearing on the Merits, Day 2, p 371 (Testimony of Roland Fox).

<sup>19</sup> Exhibit CE-199, Board of Directors Meeting Minutes of Perenco International Limited, 24 September 2007.

<sup>20</sup> See Exhibits CE-1, Service Contract for the Exploration and Exploitation of Hydrocarbons Block 7, Amazon Region, Ecuador, 18 December 1985 (in Spanish with English translation of excerpts); CE-5, Law 44 Amending the Hydrocarbons Law, Official Registry No. 326 of 29 November 1993 (in Spanish with English translation of excerpts as revised on 11-01-12) ("Law 44").

<sup>21</sup> Transcript, Hearing on the Merits, Day 1, pp 37-38 (Opening Statement of Mr Mark Friedman).

Ecuador ran the risk that the service fees generated by the contractor would exceed the revenue it received from oil sales and consequently, it would incur losses, especially when it had little control over the costs incurred by the contractor and the contractor had little incentive to keep such costs down.<sup>22</sup> Further, due to the fee structure of the service contracts, the oil companies had little incentive to enter into such contracts because of the absence of any “upside” potential.<sup>23</sup> They therefore lacked any commercial motivation to fully exploit the oil and gas resources of Ecuador in accordance with the State’s overall development goals. This is evidenced by the fact that from 1988 to 1993, no service contracts were signed in Ecuador.<sup>24</sup>

57. Ecuador thus resolved to revamp its existing hydrocarbons law to make investment in its hydrocarbons industry more attractive.<sup>25</sup> On 29 November 1993, Ecuador passed Law 44 to amend its existing Hydrocarbons Law to recognise “participation contracts” as the preferred contractual model for the exploration and exploitation of its hydrocarbon resources.<sup>26</sup> The explanatory memoranda accompanying Law 44 reasoned that the risks involved in exploration and exploitation of its hydrocarbon resources needed to be shared with international oil companies due to the scarce resources that Ecuador could commit to such ventures, and that “the Services Contract does not allow the contracting company to own a production flow”, “[t]his characteristic denatur[ing] the interest and purpose of international oil companies, for the majority of which the availability of production for selling oil in international markets is an essential item.”<sup>27</sup>

58. As was the case for service contracts under the law of Ecuador, under production sharing contracts the ownership of the hydrocarbon resources remained with the State. However, the form of remuneration to the contractor is based upon a production-sharing modality, requiring the contractor to fund all costs of exploration and exploitation of the hydrocarbons in exchange for a share of the oil produced, the proportion of which would depend on allocation formulas

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<sup>22</sup> Revised Memorial, paragraphs 13-15.

<sup>23</sup> *Ibid.*

<sup>24</sup> Exhibit CE-4, Law 44 Legislative Debates of 17-18 November 1993 (in Spanish with English translation of excerpts), PER 00481 (“Law 44 Legislative Debates”).

<sup>25</sup> *Ibid.*

<sup>26</sup> Exhibit CE-5, Law 44.

<sup>27</sup> Exhibit CE-303, Official Communication No. 93-225, Quito, 29 October 1993, p 4.

set out in each contract.<sup>28</sup> The evidence is that most oil companies, including Perenco, prefer participation contracts even though there is no guarantee that their costs will be covered, because there is a greater potential reward, particularly when oil prices rise.<sup>29</sup>

59. Law 44 defined participation contracts as follows:

[C]ontracts executed by the State, by means of Petroecuador, whereby the contractor is delegated with...the right to explore and exploit hydrocarbons in the contract's area, making at its own account and risk all investments, cost and expenses necessary for the exploration, development and exploitation.

The contractor...will have the right to a participation in the production from the contract's area, which will be calculated on the basis of the percentages offered and agreed therein, in relation with the volume of hydrocarbons produced. This participation, valued at the sales price of hydrocarbons from the contract area, which in no case shall be less than the reference price, will be the contractor's gross income, from which the contractor will make deductions and pay income tax, in accordance with the rules set in the Internal Tax Regime Law.<sup>30</sup>

60. Apart from amending the Hydrocarbons Law, Ecuador also took other steps to create a legal and regulatory environment conducive to attracting further foreign investment in the hydrocarbons and other sectors. For example, in 1997, Ecuador enacted Law 46 on “the Law on Promotion and Guarantee of Investments”, the stated objective of which was to “promote national and foreign investment and regulate the rights and obligations of the investors so that they may effectively contribute to the economic and social development of the country.”<sup>31</sup> Other measures included amendments to its Constitution which guaranteed that foreign investment should be afforded the same rights and treatment as national investment,<sup>32</sup> the enactment of privatisation laws in 2000 which allowed investors to acquire up to 51% of the

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<sup>28</sup> 1<sup>st</sup> Witness Statement of Patrick Spink, paragraph 10.

<sup>29</sup> 1<sup>st</sup> Witness Statement of Patrick Spink, paragraph 11.

<sup>30</sup> Exhibit CE-5, Law 44, Article 4.

<sup>31</sup> Exhibit CE-13, Law 46 on Promotion and Guarantee of Investments, Official Registry 219 of 19 December 1997 (in Spanish with English translation of excerpts as revised on 11-01-12), PER 00741.

<sup>32</sup> Exhibit CE-22, Country Commerce: Ecuador, The Economist Intelligence Unit, December 2001, PER 01358.

shares in electric and telecommunications businesses,<sup>33</sup> as well as measures to replace the then-Ecuadorian currency, the *sucre*, with the US dollar.<sup>34</sup>

61. The Government also sought to facilitate the financing and construction of a new pipeline, the *Oleoducto de Crudos Pesados* or “**OCP**”.<sup>35</sup> In February 2001, the Government and a seven-company consortium concluded a US\$ 1.1 billion agreement to construct the OCP.<sup>36</sup> The OCP made it possible for significant quantities of Ecuador’s oil reserves hitherto located in remote areas of the Amazon to be produced and shipped in a commercially viable manner.<sup>37</sup>

### C. Perenco’s interests in the Participation Contracts for Blocks 7 and 21

62. Blocks 7 and 21 are located in the Ecuadorian Amazonian Region and each covers an area of approximately 200,000 hectares.

63. In January 1994, shortly after the enactment of Law 44, Petroecuador’s Special Bidding Commission (known in Spanish as the *Comité Especial de Licitaciones* (“**CEL**”)) announced the 7<sup>th</sup> International Bidding Round for the Exploration and Exploitation of Hydrocarbons for Block 21, a block that had not been previously exploited.<sup>38</sup>

64. On 15 March 1995, the CEL awarded the Exploration and Exploitation of Block 21 to a group of companies, namely, Oryx Ecuador Energy Company (“**Oryx**”), Santa Fe Minerales del Ecuador Sociedad Anónima (“**Santa Fe**”), Sociedad Internacional Petrolera Sociedad Anónima (“**SIPETROL**”) and Compañía Latinoamericana Petrolera Sociedad Anónima (“**CLAPSA**”).<sup>39</sup> The Participation Contract between Petroecuador and these companies was signed on 20 March 1995.<sup>40</sup> Shortly after, in June 1995, Santa Fe transferred its rights and obligations in the Block 21 Participation Contract to Preussag Energie GMBH PBP

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<sup>33</sup> *Ibid.*

<sup>34</sup> *Ibid.*

<sup>35</sup> Revised Memorial, paragraph 22.

<sup>36</sup> 1<sup>st</sup> Witness Statement of Patrick Spink, paragraphs 14 - 15

<sup>37</sup> *Ibid.*

<sup>38</sup> Witness Statement of Andrew B. Derman, paragraph 5.

<sup>39</sup> *Ibid.*

<sup>40</sup> Exhibit CE-10, Block 21 Participation Contract.

(“**Preussag**”).<sup>41</sup> In June 1999, Kerr McGee Ecuador Energy Corporation acquired Oryx, including its interest in Block 21.<sup>42</sup>

65. Unlike Block 21, Block 7 was originally operated pursuant to a Service Contract concluded in 1985 between British Petroleum (“**BP**”) and the state-owned enterprise *Corporación Estatal Petrolera Ecuatoriana* (“**CEPE**”) (Petroecuador’s predecessor).<sup>43</sup>
66. In 1990, BP assigned the Block 7 Service Contract to Oryx.<sup>44</sup> It was only in 1999 (some six years after Law 44 contemplated the transformation of Service Contracts into Participation Contracts) that Petroecuador began discussions on the transition of the Block 7 Services Contract to a Participation Contract.<sup>45</sup> On 10 March 2000, shortly after Kerr McGee acquired Oryx, the CEL approved the Block 7 Services Contract’s migration to a Participation Contract between Petroecuador and the same consortium that by that time held interests in Block 21, namely, Kerr McGee, Preussag, SIPETROL and CLAPSA II.<sup>46</sup> On 23 March 2000, the Participation Contract for Block 7 was signed between Petroecuador and Kerr McGee, Preussag and SIPETROL and CLAPSA II.<sup>47</sup>
67. In August 2001, Perenco’s Vice President of Business Development, Mr. Patrick Spink, was contacted by the Business Development Manager of Burlington Resources Inc. (“**Burlington**”). Burlington’s subsidiary, Burlington Oriente, was in discussions to acquire Kerr McGee’s interests in Blocks 7 and 21. According to Mr. Spink, Burlington originally intended to purchase all of Kerr McGee’s interests in Blocks 7 and 21 but had decided not to

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<sup>41</sup> Exhibit CE-23, Decree 343 from the Ministry of Energy and Mines approving the transfer of Kerr-McGee’s interest in the Participation Contract for Block 21 to Perenco and Burlington, 9 May 2002 (in Spanish with English translation of excerpts).

<sup>42</sup> Exhibit CE-23, Decree 323 from the Ministry of Energy and Mines approving the transfer of Kerr-McGee’s interest in the Participation Contract for Block 21 to Perenco and Burlington, 9 May 2002 (in Spanish with English translation of excerpts).

<sup>43</sup> Exhibit CE-1, Service Contract for the Exploration and Exploitation of Hydrocarbons Block 7, Amazon Region, Ecuador, 18 December 1985 (in Spanish with English translation of excerpts).

<sup>44</sup> Rejoinder, paragraph 709.

<sup>45</sup> Exhibit CE-257, Negotiation Commission to Change the Block 7 Contract, Report on Negotiation Results, 3 November 1999 (in Spanish with English translation).

<sup>46</sup> Exhibit CE-16, Resolution No. 620-CEL-2000 of the Special Bidding Commission of Petroecuador approving the execution of the Participation Contract for the Exploration and Exploitation of Hydrocarbons for Block 7 of the Amazon Region, 10 March 2000 (in Spanish with English translation of excerpts), PER 00791.

<sup>47</sup> Exhibit CE-17, Block 7 Participation Contract.

proceed with the full purchase due to a major acquisition it had made in Canada.<sup>48</sup> Burlington still wished to proceed with the purchase of 5% of Kerr McGee's interest and suggested that Perenco purchase the remaining interest.<sup>49</sup>

68. According to Mr. Spink, from Perenco's perspective, this opportunity was potentially lucrative because it provided the Perenco Group with the possibility of acquiring a combination of a mature asset (Block 7), that is, an asset which already had infrastructure and which was already producing oil, as well as a greenfield development project (Block 21), which had not been developed at all. While the Perenco Group had operated only mature fields, and had minimal experience with greenfield developments in Colombia and West Africa, it was looking for other suitable development opportunities. Purchasing Kerr McGee's interests in Blocks 7 and 21 would allow Perenco to generate income from Block 7 while it incurred costs in developing a greenfield block in a remote area where the oil was believed to be of poorer quality.<sup>50</sup>
69. According to the evidence of the Claimant, having regard to these factors, along with Perenco's perception of the favourable investment environment in Ecuador at the time, Perenco purchased 45% of Kerr McGee's interest in Blocks 7 and 21 for a purchase price of US \$79 million in or around December 2001.<sup>51</sup>
70. On 2 September 2002, after the requisite government approval had been obtained,<sup>52</sup> Kerr McGee assigned its interests in the Participation Contracts for Blocks 7 and 21 to Perenco.<sup>53</sup> The ownership interests in the Blocks at this time were as follows:

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<sup>48</sup> 1<sup>st</sup> Witness Statement of Patrick Spink, paragraph 4.

<sup>49</sup> *Ibid.*

<sup>50</sup> *Ibid.*, paragraph 5; see also, Transcript, Hearing on the Merits, Day 2, p 441 (Testimony of Patrick Spink).

<sup>51</sup> 1<sup>st</sup> Witness Statement of Patrick Spink, paragraph 6.

<sup>52</sup> Exhibits CE-24, Decree 342 from the Ministry of Energy and Mines approving the transfer of Kerr-McGee's interest in the Participation Contract for Block 7 to Perenco and Burlington, 9 May 2002 (in Spanish with English translation of excerpts), PER 01413 and CE-25, Performance Guarantee for the Participation Contract for Block 21, issued by Perenco, S.A, 16 May 2002.

<sup>53</sup> Exhibits CE-27, Assignment Contract of Kerr-McGee's interest in the Participation Contract for Block 21 to Perenco and Burlington, 4 September 2002 (in Spanish), and CE-28, Assignment Contract of Kerr-McGee's interest in the Participation Contract for Block 7 to Perenco and Burlington, 4 September 2002 (in Spanish).

	<b><u>Block 7</u></b>	<b><u>Block 21</u></b>
Perenco	45 %	45 %
Burlington	30 %	37.5 %
Preussag	25 %	17.5 %

71. Perenco's purchase of Kerr McGee's interests in Blocks 7 and 21 was also accompanied by its purchase of Kerr McGee's 1.809% equity stake in the Consortium operating the OCP. This included an undertaking of ship-or-pay commitments for Block 21 of 20,000 barrels per day until 2018. If Perenco did not ship these 20,000 barrels a day, it would incur payment obligations for the unused capacity.<sup>54</sup>
72. Shortly after acquiring its interests in the Blocks, Perenco entered into two Joint Operating Agreements with Burlington and Preussag whereby Perenco became the Operator of the Joint Operations.<sup>55</sup> Perenco's responsibilities as Operator included the management of joint operations as well as the distribution of profits and administration of joint debts and expenses. In late 2005, to comply with Ecuadorian tax requirements intended to simplify income tax auditing and collection, the three companies entered into a Consortium Agreement, which became effective on 1 January 2006.<sup>56</sup>
73. Three years after acquiring the interests in Blocks 7 and 21 from Kerr McGee, Perenco and Burlington decided to acquire Preussag's interests in Block 7 and Block 21. On 7 September 2005, the agreement for the purchase was signed and the requisite government approvals were also given.<sup>57</sup> Perenco agreed to pay US \$23.5 million for interests acquired by it.<sup>58</sup> The allocation of interests between Perenco and Burlington were then as follows:

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<sup>54</sup> 1<sup>st</sup> Witness Statement of Patrick Spink, paragraph 16.

<sup>55</sup> Exhibits CE-31, Novation of Joint Operating Agreement in respect of Block 7, Oriente Basin, Ecuador, 12 December 2002, and CE-32, Novation of Joint Operating Agreement in respect of Block 21, Oriente Basin, Ecuador, 12 December 2002.

<sup>56</sup> Exhibits CE-47, Consortium Agreement between Preussag International Energie GMBH, Burlington and Perenco, 30 December 2005 (in Spanish with English translation), and CE-44, Addendum to Joint Operation Agreements between Preussag International Energie GMBH, Burlington and Perenco, 6 December 2005.

<sup>57</sup> Exhibit CE-38, Sale and Purchase Agreement between Preussag International Energie GMBH, Burlington and Perenco, for Blocks 21 and 7, 7 September 2005; 1<sup>st</sup> Witness Statement of Patrick Spink, paragraphs 21-22.

	<b><u>Block 7</u></b>	<b><u>Block 21</u></b>
Perenco	57.5 %	53.75 %
Burlington	42.5 %	46.25 %

74. As part of the agreement, Perenco agreed to purchase a small additional equity interest in the OCP, which thereafter stood at 2.1608%.<sup>59</sup>
75. The Participation Contracts for Blocks 7 and 21 were set to expire in 2010 and 2021, respectively. The two Contracts differ in certain terms, but they generally follow the same scheme. In essence, they granted Perenco the right to, “carry out, on its own account and risk, the activities for Crude Oil exploitation and additional exploration in the Contract Area, investing the capital and using the necessary personnel, equipment, machinery and technology for full performance, in exchange for which the Contractor shall receive, as a participation, a percentage of the Measured Production.”<sup>60</sup>
76. Clause 8.1 of each of the Participation Contracts set forth the formula for calculating participation percentages. The Contracts allocated oil production on the basis of two variables, namely, the volume of oil produced (the X factor) and the quality of crude oil produced (the Y factor).<sup>61</sup> According to the formula, as production increases in volume, or quality, the contractor’s participation percentage decreases.<sup>62</sup>
77. The Participation Contract for Block 7 sets out the following participation formula:<sup>63</sup>

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<sup>58</sup> *Ibid.*

<sup>59</sup> *Ibid.*

<sup>60</sup> Exhibit CE-17, Block 7 Participation Contract, clause 4.2 (PER 04758).

<sup>61</sup> Clause 8.1 of the Block 7 and 21 participation contracts: Exhibits CE-17, Block 7 Participation Contract, PER 04803 and CE-10, Block 21 Participation Contract, PER 04687.

<sup>62</sup> *Ibid.*

<sup>63</sup> Exhibit CE-17, Block 7 Participation Contract, PER 04804.

Block 7		
Daily Average Production Per Year (Barrels)	Contractor's Participation	Ecuador's Participation
< 5000	76.2 %	23.8 %
5000 – 10,000	74.2 %	25.8 %
> 10,000	65 %	35 %

78. The Participation Contract for Block 21 sets out the following participation formula:<sup>64</sup>

Block 21		
Daily Average Production Per Year (Barrels)	Contractor's Participation	Ecuador's Participation
< 30,000	67.5 %	32.5 %
30,000 – 60,000	60 %	40 %
> 60,000	60 %	40 %

79. The Participation Contracts also contained a tax modification clause, which required the application of a “correction factor” when changes to the tax regime had an impact on the “economy” of the contract. In this regard, the Block 7 Participation Contract stated:

**Modification to the tax regime:** In the event of a modification to the tax regime or the creation or elimination of new taxes not foreseen in this Contract, or a change in the employee profit-sharing regulations in effect on the signature date of this Contract and as described in this Clause, or their interpretation, which have consequences for the economy of this Contract, a correction factor shall be included in the participation percentages, which absorbs the increase or decrease in the tax burden or the employee profit-sharing. This correction factor shall be calculated between the Parties and following the procedure set forth in Article thirty-one (31) of the Regulations for Application of the Law Amending the Hydrocarbons Law.<sup>65</sup>

<sup>64</sup> Exhibit CE-10, Block 21 Participation Contract, PER 04687.

<sup>65</sup> Exhibit CE-17, Block 7 Participation Contract, Clause 11.12 (PER 04823-04824).

80. The Block 21 Participation Contract stated in similar terms:

**Modification to the tax regime and employee profit sharing:** In the event of a modification to the tax regime, the employee profit-sharing, or their interpretation, which has consequences for the economy of this Contract, a correction factor shall be included in the participation percentages to absorb the increase or decrease in the tax burden. These adjustments shall be approved by the Administrative Council based upon a study that the Contractor will present for this purpose.<sup>66</sup>

#### **D. Oil price increases and Ecuador's response**

81. Shortly after Perenco purchased its interests in Blocks 7 and 21, international oil prices began to rise dramatically. Block 7 produced a crude oil known in the market as "Oriente Crude" and Block 21 produced a crude oil known as "Napo Crude", the latter considered to be of lower quality than Oriente Crude. During the 1980s and 90s, a period of relative stability in oil prices, the price for Napo and Oriente Crude was around US \$15/bbl.<sup>67</sup> The WTI benchmark for crude oil at the time was about US \$20/bbl.<sup>68</sup> These prices remained more or less at the same level until the 2000s.<sup>69</sup>
82. In early 2002, the price of Ecuadorian crude was still fluctuating around US \$15/bbl. By 2005, however, prices had more than tripled, reaching US \$50/bbl.<sup>70</sup>
83. By 2006, the Ecuadorian crude price had risen to US \$60/bbl (US \$70/bbl WTI), and by March 2008, it rose further to almost US \$90/bbl (US \$100/bbl WTI), reaching nearly US \$120/bbl (USD \$130/bbl WTI) in June 2008.<sup>71</sup> The global financial crisis caused oil prices to fall sharply to below US \$30/bbl through 2008 and the beginning of 2009, but prices then began to recover, stabilising in the range of US \$60-70/bbl for most of 2009 and 2010.

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<sup>66</sup> Exhibit CE-10, Block 21 Participation Contract, Clause 11.7 (PER 04699).

<sup>67</sup> Counter-Memorial, paragraph 144.

<sup>68</sup> "WTI" is the acronym of an industry benchmark known as "West Texas Intermediate."

<sup>69</sup> Counter-Memorial, paragraphs 144 and 145; Exhibit E-75, Precios de los Crudos Ecuatorianos y Diferencias con Respecto al WTI, Nro. 12; Ene. 2006 a Dic. 2009, and Ene. 1991 a Dic. 2006, published by the Banco Central del Ecuador.

<sup>70</sup> *Ibid.*

<sup>71</sup> *Ibid.*

84. In August 2005, the *Contraloría General del Estado* became concerned about the impact of rising oil prices on the Ecuadorian petroleum sector and undertook an audit of participation contracts and service contracts for the period 1 March 2000 to 30 October 2004.<sup>72</sup> The *Contraloría General del Estado* acts as an “external auditor” of State agencies in Ecuador, and its directions to agencies regarding their use of public monies are, according to the Respondent, enforceable by way of administrative sanctions.<sup>73</sup> It concluded that the increase in oil prices was generating extraordinary profits for oil companies and that the participation contracts should be renegotiated.<sup>74</sup> Shortly thereafter, in September 2005, the Board of Directors of Petroecuador recommended that the Special Bidding Committee of Petroecuador initiate renegotiations of all of the participation and service contracts then in force.<sup>75</sup>

**E. Origins of the dispute: Events relating to Law 42-2006 Amending the Hydrocarbons Law**

85. In November 2005, the then-President of the Republic of Ecuador, Mr. Luis Alfredo Palacio González, announced the goal of renegotiating the participation contracts in order to provide the State with a greater share of revenue from crude oil sales.<sup>76</sup> Petroecuador then informed oil companies operating in Ecuador of its intention to renegotiate its participation contracts with them.<sup>77</sup> The Claimant alleges that while the Ecuadorian government initiated discussions with some oil companies, there were no serious attempts to negotiate with it.<sup>78</sup>

86. The Respondent, on the other hand, alleges that all the oil companies in Ecuador, including Perenco, refused to renegotiate their contracts.<sup>79</sup>

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<sup>72</sup> Exhibit E-80, *Oficio* No. 039073 from the *Contraloría General del Estado* to Petroecuador dated 22 August 2005.

<sup>73</sup> Transcript, Hearing on the Merits, Day 1, p 272 (Opening Statement of Eduardo Silva Romero).

<sup>74</sup> Exhibit E-80, *Oficio* No. 039073 from the *Contraloría General del Estado* to Petroecuador dated 22 August 2005.

<sup>75</sup> Exhibit E-81, *Resolución* No. 016-DIR-2005-09-13 of Petroecuador’s Board of Directors dated 13 September 2005 and CE-39, *Oil contracts to be reviewed*, *El Comercio*, 11 September 2005 (in Spanish with English translation).

<sup>76</sup> Revised Memorial, paragraph 59: on 9 November 2005, according to a news article published by *El Comercio* in Ecuador, it was reported that the “government will shortly review the contracts with foreign oil companies, with a view to having them leave the State ‘at least half (50 per cent) of their profits’” (see Exhibit CE-39, *Oil contracts to be reviewed*, *El Comercio*, 11 September 2005 (in Spanish with English translation), PER 01547).

<sup>77</sup> Exhibit CE-43, *The first phase of the oil renegotiation kicked off with meetings*, *El Comercio*, 22 November 2005 (in Spanish with English translation).

<sup>78</sup> Revised Memorial, paragraph 59.

<sup>79</sup> Counter-Memorial, paragraph 17; Rejoinder, paragraphs 320-328; see also, Transcript, Hearing on the Merits, Day 1, pp 273-274 (Opening Statement of Eduardo Silva Romero).

87. Before announcing its intention, in November 2005 Petroecuador wrote to the Chairman of the Permanent Specialized Commission on Civil and Criminal Matters in Ecuador regarding the proposal to renegotiate oil and gas contracts.<sup>80</sup> Referring to the Regulations for Application for the Law Reforming Law 44, Petroecuador stated:

Article 32 of the mentioned Regulations establishes the procedure to be followed for the contractual modification submitted for approval to the CEL. In summary, this procedure indicates that the contractual modifications may be proposed by either of the parties, and it corresponds to PETROECUADOR to negotiate them with the contractor, requiring always the prior consent of the other party. In the event that a mutual agreement is reached based on the respective specifications, the CEO shall submit the modifications agreed upon with the contractor to the Board of Directors for its information and for a report.<sup>81</sup>

**(1) The enactment of Law 42**

88. On 1 March 2006, President Palacio submitted a bill to Congress proposing to amend the Hydrocarbons Law (a **“Bill for the Law Reforming the Hydrocarbons Law”** or the **“Bill”**), stating in the accompanying explanatory memorandum that he “ha[d] invited the oil companies that have contracts with the Ecuadorian State to begin processes of reaching an understanding for the equitable distribution of the extraordinary earnings.”<sup>82</sup>
89. The cover letter of the Bill stated that it “should be processed as economically urgent” and that its rationale may be summed up “as the recovery of economic equity to the benefit of the State in hydrocarbons exploration and exploitation contracts entered into by the Republic of Ecuador.”<sup>83</sup> The significant increase in prices, the explanatory memorandum stated further, “obligates the National Government to submit reforms to the Hydrocarbons Law to the National Congress.”<sup>84</sup>

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<sup>80</sup> Exhibit CE-40, Letter from Petroecuador to Congressman Luis Fernando Torres regarding the renegotiation of oil contracts, 11 October 2005 (in Spanish with English translation).

<sup>81</sup> *Ibid.*, PER 01557.

<sup>82</sup> Amended Request, paragraph 25; Exhibits CE-50, Bill of the Law amending Hydrocarbons Law, presented by President Palacio to the President of Congress, 1 March 2006 (in Spanish and English), PER 01722 and CE-51, Legislative Debates on Draft Legislation, 9 March 2006, 29 March 2006, 19 April 2006 (in Spanish with English excerpts); see also, Counter-Memorial, paragraph 178.

<sup>83</sup> Exhibit CE-50, Bill of the Law amending Hydrocarbons Law, presented by President Palacio to the President of Congress, 1 March 2006 (in Spanish and English), PER 01718.

<sup>84</sup> *Ibid.*, PER 01719.

90. The memorandum stated further that “[t]he contracts for oil and gas exploration and exploitation in Ecuador were entered into considering the *rebus sic stantibus* [‘things standing thus’] clause, which means that the contracts are understood to have been reached under the tacit condition that the original conditions contracted will subsist, and that when this is not so and a change in those circumstances occurs, equilibrium in the contractual obligations needs to be reestablished to the extent that something extraordinary and unforeseeable has an impact on what the parties had foreseen, on which economic basis they assumed their obligations.”<sup>85</sup> It concluded that “[a]t all times, the equilibrium of the contracts is being maintained, since all the technical, economic and legal parameters considered by the companies in their analysis are being respected, and what is being legislated upon are those events that never formed a part of the will of the parties, such as the extraordinary increase in crude oil prices at the international level.”<sup>86</sup>
91. The National Congress of Ecuador convened an extraordinary meeting on 29 March 2006 to debate the Bill. The Claimant directed the Tribunal to statements made by various members of Congress which displayed a range of opinion. One representative asserted “here we are going to know who is who; either we vote for the motherland, for the people, for the poor, for the humble, or we vote for the transnational companies that have stolen our blood, our life, our hope.”<sup>87</sup> Another representative focused on the nature of the contractual relations Petroecuador had entered into with the oil companies, noting that: “...faced with the bill sent by the President of the Republic, we have discussed if under the law whether or not we can by law unilaterally amend oil contracts with retroactive effect. That and nothing else is the legal discussion.”<sup>88</sup>
92. The Tribunal notes that ascertaining the intent of the legislative body by means of reference to the statements of individual legislators is notoriously difficult and apt to lead to a misapprehension of the intent of the legislature as a whole which is reflected in its acts. It has

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<sup>85</sup> Exhibit CE-50, Bill of the Law amending Hydrocarbons Law, presented by President Palacio to the President of Congress, 1 March 2006 (in Spanish and English), PER 01719; see also, Revised Memorial, paragraph 63.

<sup>86</sup> Exhibit CE-50, Bill of the Law amending Hydrocarbons Law, presented by President Palacio to the President of Congress, 1 March 2006 (in Spanish and English), PER 01721.

<sup>87</sup> Revised Memorial, paragraph 65; citing Exhibit CE-51, Bill of the Law amending Hydrocarbons Law, presented by President Palacio to the President of Congress, 1 March 2006 (in Spanish and English), PER 01980.

<sup>88</sup> *Ibid.*, PER 01990.

taken note of these and other statements, but it has not attempted to use them as a means of attaching legal significance to the acts of the legislature.

93. The Ecuadorian Congress passed the Law No. 2006-42 Amending the Hydrocarbons Law (the “**HCL Amendment**”) on 19 April 2006.<sup>89</sup> The Law's preamble referred to the Ecuadorian State's duty to “defend the natural heritage of the country and preserve the sustainable growth of the economy, as well as balanced, equitable development for the collective good.”<sup>90</sup> It referred to Article 247 of the Constitution, stating that “subsoil resources are the inalienable and imprescriptible property of the Ecuadorian government and, therefore, its exploitation must take place on the basis of national interests and in accordance with the principle of reasonability.”<sup>91</sup>

94. Article 2 of the HCL Amendment stated as follows:

“Article...Participation of the State in surplus prices from the sale of oil and gas not agreed upon or not foreseen. Contractor companies that maintain participation contracts for the exploration and exploitation of hydrocarbons in effect with the Ecuadorian state under this Law, without prejudice to the volume of crude oil subject to participation that corresponds to them, when the effective monthly medium price of FOB sale of Ecuadorian oil petroleum goes above the monthly average prices in effect at the time of the execution of the contract, expressed in constant prices for the month of liquidation, will recognize in favor of the Ecuadorian state a participation of at least 50% of the extraordinary income generated by the difference in price. For purposes of this Article, extraordinary revenues shall be understood to mean the difference in the above-described price, multiplied by the number of barrels produced.”<sup>92</sup>

95. Following this, Decree No. 1583 Implementing Law 42-2006 was formally issued on 23 June 2006.<sup>93</sup>

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<sup>89</sup> Amended Request, paragraph 26; Exhibit CE-53, HCL Amendment.

<sup>90</sup> Exhibit CE-53, HCL Amendment, PER 02030.

<sup>91</sup> *Ibid.*

<sup>92</sup> Exhibit CE-53, HCL Amendment, PER 02030.

<sup>93</sup> Revised Memorial, paragraph 67.

## (2) Implementation of Law 42

96. On 6 July 2006, the Ministry of Energy and Mines notified Perenco by letter that the prices in effect at the time of execution of the Block 7 and 21 Participation Contracts were US \$25.111383 and US \$15.358274.<sup>94</sup> These became the relevant “reference” prices for the purpose of Article 2 of the HCL Amendment.
97. In July 2006, for instance, the market price for Oriente Crude from Block 7 was US \$65.66/bbl and the adjusted reference price was US \$30.01/bbl. Thus, the Law 42 “levy” (to use the Respondent’s term in this arbitration<sup>95</sup>) was US \$17.825 per barrel of oil produced in Block 7 (50% of the difference between US \$65.66/bbl and US \$30.01/bbl). Law 42 would give the Government of Ecuador an increased participation in the revenues generated from all sales above such reference prices. On the foregoing example, the Contractor would realise US \$47.835 on the sale of a barrel of oil, rather than the market price of US \$65.66/bbl.
98. On 13 July 2006, the Government issued Executive Decree No. 1672 Implementing Law 42-2006, which replaced Decree No. 1583 Implementing Law 42-2006 of 23 June 2006 (the “**First Implementing Regulation**”).<sup>96</sup>
99. It, amongst other things, identified the kind of agreements covered by the HCL Amendment, set the exact percentage of “extraordinary income” payable to the State (50%), provided the formula to assist in determining the corresponding quantum, and stipulated that payments pursuant to Law 42 were to be made on a monthly basis.<sup>97</sup>
100. After the law was enacted, by letter dated 26 July 2006 Perenco wrote to the Central Bank of Ecuador, copied to Petroleum Contracts Administrative Unit of Petroecuador, referring to the letter it received from the latter notifying it of its Law 42 dues for Block 21, and enclosing a cheque for US \$14,525,361.00. Perenco “state[d] for the record” that it considered Law 42 to

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<sup>94</sup> Amended Request, paragraph 29 and as evidenced in Exhibit CE-13 to Amended Request, English translation of the Letter from the DNH to Perenco notifying the reference prices in effect at the time of execution of the contracts, 6 July 2006 and English translation of the Letter from the DNH to Perenco notifying the applicable inflation rate to the reference prices for Blocks 7 and 21, 25 March 2008.

<sup>95</sup> See, for example, Counter-Memorial, paragraphs 185, 422, 460, 482, 527 *et seq.*

<sup>96</sup> Exhibit CE-58, Decree No. 1672, Implementing Law 42-2006 Amending the Hydrocarbons Law, Official Registry No. 312, 13 July 2006 (in Spanish with English translation) (“**Decree No. 1672**”).

<sup>97</sup> Exhibit CE-58, Decree No. 1672.

be “unconstitutional along with other legal entities that have filed their respective actions with the Constitutional Court” and that it “violates certain rights of Consortium members explicitly contained in the Participation Contracts for Blocks 7 and 21, and in certain International Treaties”, but that until the law was declared as such, it would make the payment under protest and with its rights reserved.<sup>98</sup>

101. As Perenco’s letter noted, around this time a Constitutional Court challenge was launched by Mr. Mauricio Pinto Mancheno in his own interests and in the interests that he represented as the Chairman of the Chamber of Manufacturers of Pinchincha, as well as the legal representative of one thousand citizens (based on Article 276(1) of the Constitution of Ecuador).<sup>99</sup> There is no record evidence as to the membership of the Chamber of Manufacturers. It was contended by the Respondent that it was obvious that the oil companies were behind the claim, but there is not sufficient evidence of this to make any kind of finding of fact, although the judgment did record the contention of the Head of the Congress in answer to the petition that Mr. Pinto was the “official defender of multinational oil companies that allegedly, in the plaintiff’s view, are harmed or injured by the challenged law”.<sup>100</sup>
102. On 6 September 2006, the Constitutional Tribunal ruled that Law 42 was constitutional and further that it did not violate the principles of Ecuadorian civil law concerning the performance of the contracts.<sup>101</sup> The petitioners had challenged the form and substantive constitutionality of Law 42, submitting that it amounted to a modification of the legal system to which oil contracts with the State were subject, violating fundamental rights to certainty, non-retroactivity, property, and the modification of administrative contracts by agreement only.<sup>102</sup> The Constitutional Tribunal examined the distinction between administrative and civil law contracts under Ecuadorian law, and then between administrative contracts for the provision of

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<sup>98</sup> Exhibit CE-263, Letter from the Consortium to Banco Central del Ecuador, 26 July 2006 (in Spanish with English translation), PER 04279.

<sup>99</sup> Exhibit CA-313, Constitutional Tribunal decision of 31 August 2006 regarding the Constitutionality of Law 42, Official Registry (Supplement) 350, 6 September 2006 (in Spanish with English translation) (Revised translation as agreed by parties submitted 2013-12-04) (“**Constitutional Tribunal’s Decision on Law 42**”).

<sup>100</sup> Exhibit CA-313, Constitutional Tribunal’s Decision on Law 42, p 19. At the hearing, Mr. Eduardo Silva Romero contended that the “constitutional challenge was sponsored by oil companies, obviously.” Transcript, Hearing on the Merits, Day 1, p 277.

<sup>101</sup> Exhibit CA-313, Constitutional Tribunal’s Decision on Law 42, p 27.

<sup>102</sup> *Ibid.*, pp 18-19.

public services and otherwise. It concluded that unlike contracts between private parties, the Administration in an administrative contract “is placed in a privileged position with respect to what is being administered...[a]nd it is precisely this position of privilege that allows the government...to exercise the power to modify or revise the agreement”.<sup>103</sup>

103. A relevant illustration of this was that the *pacta sunt servanda* principle applicable to the contract had the potential to “fall apart when causes emerge that substantially alter[ed] those that formed the reality or the state of things upon which the contract was executed.”<sup>104</sup> The Court held that Law 42 fell within the ambit of this principle, creating “obligations on subjects that ha[d] not been the subject of contractual stipulation, which ha[d] not been negotiated or anticipated” by the parties to the contracts.<sup>105</sup> It buttressed this further by concluding that Article 249 of the Constitution, which prohibited unilateral modifications of contracts by legislation, did not apply to oil contracts with the State because Article 249 referred exclusively to administrative contracts for the provision of public services (which differed from contracts for hydrocarbon exploration and exploitation), and the State would waive expressly its power to modify in the contract, as recognized in Article 271 of the Constitution.<sup>106</sup> Finally, the Court held that Law 42 did not violate the constitutional guarantee against retroactivity, or the right to property since hydrocarbons are a non-renewable natural resource subject to public dominion.<sup>107</sup>

104. During this time, Perenco continued to invest in Blocks 7 and 21. According to the Claimant, as 2006 drew to a close, it had invested some US \$55,004,000 and US \$46,938,000 in Blocks 21 and 7, respectively, for the year.<sup>108</sup> From April 2006 to October 2007, the Consortium invested an additional US \$61 million and drilled an additional 15 wells in Blocks 7 and 21 compared to the previous year.<sup>109</sup> The Consortium also submitted to Ecuador on 6 November

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<sup>103</sup> *Ibid.*, p 24.

<sup>104</sup> *Ibid.*

<sup>105</sup> Exhibit CA-313, Constitutional Tribunal’s Decision on Law 42, p 25.

<sup>106</sup> *Ibid.*

<sup>107</sup> Exhibit CA-313, Constitutional Tribunal’s Decision on Law 42, pp 25-27.

<sup>108</sup> Revised Memorial, paragraphs 48 and 52.

<sup>109</sup> Witness Statement of Laurent Combe, paragraph 20.

2006 an amendment to its development plan for Block 7 in relation to the Oso field.<sup>110</sup> Its development plan indicated that it anticipated continued positive cash flows in the midst of the initial application of Law 42 at a rate of 50%.<sup>111</sup> The 2006 Oso Development Plan was approved by the Ministry of Energy and Mines in Ecuador in March 2007.<sup>112</sup>

105. This did not, however, detract from the concerns expressed by Perenco with regard to Law 42's economic impact on its Ecuadorian operations. On 18 December 2006, Perenco wrote to Petroecuador, requesting that the latter initiate the administrative process whereby the parties would analyse the economic impact of Law 42 on Blocks 7 and 21 pursuant to clause 11 of both Contracts, and stated its intention to file the necessary economic data in support of its request to adjust the percentage of participation in its favour.<sup>113</sup> Petroecuador did not respond officially to this request.
106. During the hearing, there was a substantial exchange between the parties as to the timing of this request and specifically whose responsibility it was to deal with the adjustment of the participation in the circumstances.
107. In the Respondent's view, on a proper construction of the Participation Contracts, the onus was on the contractor to substantiate its claim that a new or increased tax affected the economy of the Contracts.<sup>114</sup> Notably, Dr. Chiriboga, who was at the time the President of Petroecuador, testified that the burden was on Perenco to prove to the State that, contrary to its evaluation of the impact of Law 42, the equilibrium of the Contracts had been modified to such an extent that it triggered the administrative process provided for therein.<sup>115</sup>

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<sup>110</sup> Exhibit E-77, Amendment to the Additional Development Plan for Block 7 – Oso Field dated October 2006 (in Spanish with English translation).

<sup>111</sup> *Ibid.*, p 7.; Witness Statement of Laurent Combe, paragraphs 11 and 20, as clarified in his testimony, Transcript, Hearing on the Merits, Day 2, p 508 (Testimony of Laurent Combe).

<sup>112</sup> Exhibit E-128, Ministry of Energy and Mines Decree No. 40 approving the 2006 Oso Development Plan dated 9 March 2007 (in Spanish with English translation), p 4; Witness Statement of Laurent Combe, paragraph 20.

<sup>113</sup> Exhibits E-129, Letter from the Consortium to Petroecuador dated 18 December 2006 (Block 21) (in Spanish with English translation) and E-130, Letter from the Consortium to Petroecuador dated 18 December 2006 (Block 7) (in Spanish with English translation).

<sup>114</sup> Transcript, Hearing on the Merits, Day 1, pp 279-280 (Opening Statement of Eduardo Silva Romero) where the Respondent submits that Perenco failed to provide Petroecuador with the evidence illustrating the impact of Law 42 on the economy of the Participation Contracts, which in its submission was necessary.

<sup>115</sup> Transcript, Hearing on the Merits, Day 4, p 1016 (Testimony of Galo Chiriboga Zambrano).

108. For its part, the Claimant asserted first, that it had taken sufficient steps to initiate the process and second, that it received informal signs of a negative reaction from the Ecuadorian authorities then in office (in mid-December 2006, the Palacios administration was about to leave office). One of the Claimant's witnesses, Mr. Laurent Combe, testified that although Perenco calculated Law 42's impact on the economy of the Contracts, it did not send the data because it would be too confrontational. Mr. Combe testified that no further action was taken in support of the application because the company did not wish to exacerbate relations with the Government.<sup>116</sup> It is common ground that the taxation modification negotiations contemplated in clause 11 of both Contracts did not take place.
109. On 4 October 2007, the administration of President Rafael Correa Delgado issued a further decree, Decree No. 662 (the "**Second Implementing Regulation**"), which increased the State's share of revenue from sales above the reference price from 50% to 99%.<sup>117</sup> Dr. Chiriboga, then the Minister of Mines and Petroleum in Ecuador, testified that this percentage was chosen based on financial analysis undertaken within or on behalf of Ecuadorian state agencies and discussed in meetings with the President.<sup>118</sup>
110. Thus, from October 2007, as a matter of Ecuadorian law, Perenco was obliged to deliver to Ecuador, in addition to its contractually agreed participation in volume, an additional participation in revenue of at least 99% of its income from all sales of oil above the applicable reference price (which, as noted above in paragraph 96, varied as between Block 7 and Block 21 oil).<sup>119</sup>

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<sup>116</sup> Transcript, Hearing on the Merits, Day 2, pp 521-524 (Testimony of Laurent Combe). Mr. Combe's evidence was that while Perenco had the numbers available, its request of 18 December 2006 was to prompt the initiation of the process during which the information would be formally presented. This was reiterated by the witness in his re-examination when asked what he expected would follow the letter of 18 December 2006 to Petroecuador: Transcript, Hearing on the Merits, Day 2, pp 530-531.

<sup>117</sup> Exhibit CE-64, Decree No. 662, Implementing Law 42-2006 Amending the Hydrocarbons Law, 4 October 2007 (in Spanish with English translation).

<sup>118</sup> Transcript, Hearing on the Merits, Day 4, pp 947-948 (Testimony of Galo Chiriboga Zambrano).

<sup>119</sup> Revised Memorial, paragraph 69.

**(3) Payments under Law 42, the initiation of ICSID arbitration, negotiations and *Ley de Equidad Tributaria***

111. Perenco (and its fellow member of the consortium, Burlington) made payments pursuant to the HCL Amendment from July 2006 through to April 2008.<sup>120</sup>
112. Shortly after the Second Implementing Regulation adjusted the percentage of “extraordinary revenue” to 99% in favour of the State, on 17 October 2007, Perenco wrote to the Ministry of Foreign Affairs and the Ministry of Mines and Petroleum notifying Ecuador that it “accept[ed] and [gave] its consent to the offer of Ecuador to submit any dispute related to the [HCL Amendment], or with any other measure that impacts Perenco’s investments in Ecuador, to the International Centre Center for the Settlement of Investment Disputes (“CIADI”) for their resolution through arbitration according to Article 25 of the [Convention] and Article 9 of the Treaty.”<sup>121</sup>
113. The Tribunal notes parenthetically that on this date, the late Hubert Perrodo’s estate in the Bahamas was un-administered and un-distributed.<sup>122</sup> It will revert to this state of affairs below.
114. Throughout the period in which Perenco paid the Law 42 duties, it did so on a “without prejudice” or “*bajo protesta*” basis.<sup>123</sup>
115. At the same time, it is common ground that Perenco was willing to consider working with the Government of Ecuador in arriving at a compromise. It wrote to the Ministry of Mines and Petroleum on 24 October 2007 requesting information regarding the model of the service agreement the Government was proposing to use as the basis for negotiations moving

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<sup>120</sup> Amended Request, paragraph 30; Revised Memorial, paragraph 126. The Consortium began to make such payments pursuant to Law 42, under protest, on 26 July 2006: Exhibit CE-263, Letter from the Consortium to Banco Central del Ecuador, 26 July 2006 (in Spanish with English translation).

<sup>121</sup> Exhibit CE-264, Letter from Perenco to Ministry of Foreign Affairs and Ministry of Mines and Petroleum, October 17, 2007 (in Spanish with English translation), PER 04284; Amended Request, paragraph 15.

<sup>122</sup> Counter-Memorial, paragraph 38.

<sup>123</sup> Revised Memorial, paragraph 76; see Exhibits CE-66, Letter from Perenco to Petroecuador regarding payment under protest of Law 42 assessments and negotiation of contracts, 14 December 2007, (in Spanish with English translation), CE-68, Letter from the Consortium to Petroecuador regarding payment under protest of Law 42 assessment and negotiations of contracts, 18 February 2008 (in Spanish with English translation) (18 February 2008 letter from Perenco in response to 15 January 2008 notification from Ecuador), and CE-70, Letter from the Consortium to Petroecuador regarding payment under protest of Law 42 assessment and negotiations of contracts, 15 April 2008 (in Spanish with English translation) (15 April 2008 letter from Perenco in response to 13 March 2008 notification from Ecuador).

forward.<sup>124</sup> During the hearing, Dr. Chiriboga testified that while Ecuador had by this time contracted the services of the Mexico office of Curtis, Mallet-Prevost, Colt & Mosle LLP to produce a model of the proposed service contract and some drafts were available, they had not been discussed internally.<sup>125</sup> Consequently, Ecuador determined it was not in a position to accede to Perenco's request and did not respond to it.<sup>126</sup>

116. On 29 December 2007, Ecuador passed a further law, the *Ley de Equidad Tributaria* (the "LET"), an initiative to facilitate new negotiations between the government and oil companies.<sup>127</sup> This law contemplated an alternative to the strict application of Law 42 at 99% by providing for: a tax rate at 70%, a statutory reference price not fixed by Ecuador but subject to negotiation on a case-by-case basis, and applicable only to oil companies that also agreed to enter into "transitory agreements" to transform their existing Participation Contracts into an agreement more akin to a service contract model, to come into effect from January 2008.<sup>128</sup>
117. In a national address delivered on 23 January 2008, President Correa set out his view as to the options available to oil companies operating in Ecuador under a Participation Contract, stating that a company could either pay the State its share of the extraordinary revenue under Law 42, renegotiate its contract into a service agreement or terminate the contract, with the State compensating the company for the monetary expense it had incurred thus far pursuant to its participation contract.<sup>129</sup> In connection with the option to renegotiate, the President stated that a service agreement model "always should have been the preponderant figure in the oil industry" and that companies had 45 days to come to a renegotiated agreement with the State or continue paying their dues under Law 42.<sup>130</sup>

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<sup>124</sup> Exhibit CE-265, Letter from the Consortium to Ministry of Mines and Petroleum, 24 October 2007 (in Spanish with English translation).

<sup>125</sup> Transcript, Day 4, Hearing on the Merits, p 933 (Testimony of Galo Chiriboga Zambrano).

<sup>126</sup> Transcript, Day 4, Hearing on the Merits, pp 933-935 (Testimony of Galo Chiriboga Zambrano).

<sup>127</sup> Exhibit EL-86, *Ley de Equidad Tributaria*, Articles 164 to 172, 29 December 2007 (in Spanish with English translation); Counter-Memorial, paragraphs 190-191,

<sup>128</sup> *Ibid.*

<sup>129</sup> Exhibit CE-67, Excerpt from the 53rd National Address of President Rafael Correa, San Miguel de Salcedo, 26 January 2008 (in Spanish with English translation, re-submitted on 04-12-12).

<sup>130</sup> *Ibid.*

118. During the course of 2008 the Parties sought to negotiate an alternative model to the existing Participation Contracts for Blocks 7 and 21.<sup>131</sup>
119. Negotiations between Petroecuador and Perenco (in its capacity as the operator of the Consortium) began on 21 January 2008 and carried on, albeit fitfully at times, throughout the balance of the year.<sup>132</sup> According to Mr. Eric d'Argentré, Perenco's Country Manager in Ecuador, "[t]hroughout 2008 [Perenco] made repeated attempts to seek compromises that would be acceptable to all parties", and he "personally attended many meetings, had phone conversations, exchanged written correspondence, analyzed various proposals and took other steps to try to find a deal."<sup>133</sup> Minister Chiriboga agreed that in 2008 "[i]n general, there was a good cooperation between the State and Perenco in order to reach an agreement that would benefit [both]" and stated "[he] met Perenco's representatives, either individually or jointly with other companies, to discuss the progress of the negotiations, as often as requested."<sup>134</sup>
120. While events unfolded in Ecuador, the heirs to Hubert Perrodo were disputing their respective entitlements to the estate. On 15 February 2008, Madame Perrodo filed a caveat in the Supreme Court of the Bahamas to preclude any grant of Letters of Administration being made in respect of the estate.<sup>135</sup> (This caveat was later withdrawn by Madame Perrodo on 30 March 2009).<sup>136</sup>

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<sup>131</sup> Revised Memorial, paragraph 78; see also, Transcript, Hearing on the Merits, Day 3, p 560 (Testimony of Eric d'Argentré) where Mr. d'Argentré confirms that Perenco was aware that it was Ecuador's intention that the negotiations should result in converting participation contracts to service contracts.

<sup>132</sup> Exhibits CE-266, Record of initiation of negotiations of the Participation Contracts between Perenco and Petroecuador, 20 January 2008, and Attendance Lists, 21-28 January 2008 (in Spanish with English translation), and CE-268, Letter from the Consortium to Petroecuador, 1 February 2008 (in Spanish with English translation); see also, Transcript, Hearing on the Merits, Day 3, pp 558-560 (Testimony of Eric d'Argentré). For example, Perenco on behalf of the consortium wrote to the coordinator of Petroecuador's negotiation team with a "financial proposal" for the renegotiation of the Block 7 and 21 Contracts (see Exhibit CE-268, Letter from the Consortium to Petroecuador, 1 February 2008 (in Spanish with English translation)). Mr. Rodrigo Márquez Pacanins, Group Assistant General Counsel of Perenco Group from 2001 to 2008, testified that Perenco granted a request by Burlington to be present at the negotiations up till April 2008 because it would "facilitate the negotiation process", even though it was understood that it was Perenco which had acted on behalf of the Consortium in the negotiations: see Transcript, Hearing on the Merits, Day 3, p 717 (Testimony of Rodrigo Márquez).

<sup>133</sup> 1<sup>st</sup> Witness Statement of Eric d'Argentré, paragraph 14; Revised Memorial, paragraph 83.

<sup>134</sup> 1<sup>st</sup> Witness Statement of Galo Chiriboga Zambrano, paragraphs 12-25.

<sup>135</sup> Counter-Memorial, paragraph 28, caveat found at Exhibit E-72, Caveat filed in the Supreme Court of The Bahamas by Carrie Perrodo in the Estate of Hubert Perrodo dated 15 February 2008.

<sup>136</sup> Counter-Memorial, paragraph 28, withdrawal of caveat found at Exhibit E-73, Notice of Withdrawal filed in the Supreme Court of The Bahamas by Carrie Perrodo in the Estate of Hubert Perrodo dated 30 March 2009.

121. In March 2008, Petroecuador and Perenco reached a preliminary agreement (the “*Acta de Acuerdo Parcial*”) regarding Block 7.<sup>137</sup> This “transitory agreement” provided that: (i) Block 7 would continue to be operated under the participation sharing model for five years before being migrated to another contract model (more akin to service contract model); (ii) the term of the Block 7 contract, which was set to expire in 2010, would be extended until 2018; (iii) Ecuador’s share would be increased for the period 2008 to 2010, and thereafter linked to oil prices for the period 2010 to 2018; and (iv) the statutory reference price would be increased to US \$42.5/bbl (from US \$ 25.111383 as of 6 July 2006).<sup>138</sup>
122. Thereafter, the Consortium wrote to Petroecuador setting out its proposals for Blocks 7 and 21 on 11 March 2008 and 25 March 2008, respectively, and it appears that the parties were relatively close to reaching a mutually acceptable agreement on making a transition to a new contractual model.<sup>139</sup> The benefit to Perenco (when compared to the status quo) was clear in that it would have another eight years to exploit Block 7 and the revenue sharing obligation would be triggered at a higher reference price.<sup>140</sup>
123. However, on 12 April 2008, President Correa announced that all existing production-sharing agreements were to be terminated within the year and new contracts would be employed, the form and particulars of which were unspecified.<sup>141</sup> Contractors were informed that it would be a common service contract model.<sup>142</sup>

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<sup>137</sup> Exhibits E-84, *Acta de Acuerdo Parcial* signed by Perenco and Petroecuador dated 11 March 2008, and CE-269, Letter from the Consortium to Petroecuador, 11 March 2008 (in Spanish with English translation).

<sup>138</sup> *Ibid.*

<sup>139</sup> Exhibits CE-269, Letter from the Consortium to Petroecuador, 11 March 2008 (in Spanish with English translation), and CE-270, Letter from the Consortium to Petroecuador, 25 March 2008 (in Spanish with English translation); see also, E-84, *Acta de Acuerdo Parcial* signed by Perenco and Petroecuador dated 11 March 2008.

<sup>140</sup> *Ibid.*

<sup>141</sup> Amended Request, paragraph 31; Revised Memorial, paragraph 78; CE-69, *Negotiations with oil companies come to a halt*, El Comercio (online edition), 13 April 2008 (in Spanish with English translation), available at [http://www2.elcomercio.com/noticiaEC.asp?id\\_noticia=184277&id\\_seccion=3](http://www2.elcomercio.com/noticiaEC.asp?id_noticia=184277&id_seccion=3), *Correa proposes “single model” for contracts with foreign oil companies*, El Diario (online edition), 14 April 2008 (in Spanish with English translation), available at <http://www.eldiario.com.ec/noticias-manabi-ecuador/75940>, *Government to propose six month agreement with oil companies*, El Comercio (online edition), 15 April, 2008 (in Spanish with English translation), available at [http://www2.elcomercio.com/noticiaEC.asp?id\\_noticia=184439&id\\_seccion=6](http://www2.elcomercio.com/noticiaEC.asp?id_noticia=184439&id_seccion=6).

<sup>142</sup> 1<sup>st</sup> Witness Statement of Galo Chiriboga Zambrano, paragraphs 15-17. In his cross-examination, Mr. Chiriboga stated that while the draft Transitory Agreement was not available for the contractors to review at the time of his press conference on 14 April 2008, one was prepared and “immediately after” made available to the contractors for their review: Transcript, Hearing on the Merits, Day 4, pp 977-978 (Testimony of Galo Chiriboga Zambrano).

124. This was an abrupt and unexpected change in the negotiating circumstances. Mr. d'Argentré testified that that "after months of what [was] thought were productive negotiations, this announcement was very surprising."<sup>143</sup> An article in the Ecuadorian newspaper *El Comercio*, dated 13 April 2008, entitled, "Negotiations with oil companies come to a halt", reported that "[n]egotiations with oil companies were suspended by a decision from the President" and "[e]ven though the Head of State had given a term of 45 days for negotiations to conclude" "[a]t the last minute, he decided that new contracts would not be signed."<sup>144</sup> A quote from a radio address by President Correa in an article in the online edition of Ecuador's *El Diario*, dated 14 April 2008, entitled "Correa proposes 'single model' for contracts with foreign oil companies" quoted the President as to the reasoning behind his decision to suspend negotiations:

"I said 45 days, I think in January, for renegotiation of contracts... We were close to a deal, but I stopped it, because, even though we've secured major benefits, I think that we can do better."<sup>145</sup>

125. By letter dated 15 April 2008, Perenco notified Ecuador that it would continue to make payments under protest in compliance with Law 42 for March 2008, and expressed its "deep concern derived from the Ecuadorian Government's announcement to put an end to the current negotiations."<sup>146</sup> In another letter of the same date, Perenco wrote to the Minister of Mines and Petroleum expressing surprise at the President's announcement that Ecuador had decided to

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The Transitory Agreement was allegedly provided to Perenco in May 2008: Transcript, Hearing on the Merits, Day 4, p 980 (Testimony of Galo Chiriboga Zambrano).

<sup>143</sup> 1<sup>st</sup> Witness Statement of Eric d'Argentré, paragraph 9.

<sup>144</sup> Exhibit CE-69, *Negotiations with oil companies come to a halt*, *El Comercio* (online edition), 13 April 2008 (in Spanish with English translation), available at [http://www2.elcomercio.com/noticiaEC.asp?id\\_noticia=184277&id\\_seccion=3](http://www2.elcomercio.com/noticiaEC.asp?id_noticia=184277&id_seccion=3), *Correa proposes "single model" for contracts with foreign oil companies*, *El Diario* (online edition), 14 April 2008 (in Spanish with English translation), available at <http://www.eldiario.com.ec/noticias-manabi-ecuador/75940>, *Government to propose six month agreement with oil companies*, *El Comercio* (online edition), 15 April 2008 (in Spanish with English translation), available at [http://www2.elcomercio.com/noticiaEC.asp?id\\_noticia=184439&id\\_seccion=6](http://www2.elcomercio.com/noticiaEC.asp?id_noticia=184439&id_seccion=6), PER 02183 and 02188.

<sup>145</sup> *Ibid.*

<sup>146</sup> Exhibit CE-70, Letter from the Consortium to Petroecuador regarding payment under protest of Law 42 assessment and negotiations of contracts, 15 April 2008 (in Spanish with English translation).

discontinue all renegotiations of Participation Contracts.<sup>147</sup> The Minister of Mines and Petroleum did not respond to this letter.<sup>148</sup>

126. Two weeks later, on 30 April 2008, the Board of Directors of Perenco S.A. authorised the filing of a Request for Arbitration with ICSID against Ecuador and Petroecuador.<sup>149</sup> The request was filed on that same day with the ICSID Secretary-General.
127. In the face of this, Ecuador proposed a ‘transitional agreement’ on 16 May 2008, which it requested Perenco sign as a pre-condition to further negotiations. The agreement included a term obliging Petroecuador and its counterparty to “take best efforts so that, within a period of 120 days, they can sign the new Service Agreement for Exploration and Exploitation of Hydrocarbons, and as a show of good faith, the Contractor will suspend its proceedings before ICSID.”<sup>150</sup> This was followed by a letter from the Ministry of Mines and Petroleum, dated 13 June 2008, in which it stated that all oil companies were to sign amended agreements with the State which would include a commitment to migrate to a service provision agreement within one year.<sup>151</sup> Perenco refused to do so.<sup>152</sup> Dr. Chiriboga testified that, at this time, the draft proposed “service contract” had not as yet been provided to contractors.<sup>153</sup>
128. Perenco replied to the Minister of Mines and Petroleum and the Executive President of Petroecuador on 19 June 2008, referring to the ICSID arbitration it had initiated and continued calls for payments under Law 42 from the State, and proposing a discussion between parties on the “possibility of a mutually agreeable solution regarding disputed Law 42 payments that

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<sup>147</sup> Exhibit CE-271, Letter from Perenco to the Ministry of Mines and Petroleum and Petroecuador, 15 April 2008 (in Spanish with English translation).

<sup>148</sup> Transcript, Hearing on the Merits, Day 4, p 978 (Testimony of Galo Chiriboga Zambrano): Dr. Chiriboga explained that he did not respond because this action by Ecuador should not have come as a surprise to Perenco after months of negotiations, and this was in keeping with the goal of the negotiations.

<sup>149</sup> Exhibit CE-202, Extract of Board of Directors Meeting Minutes of Perenco S.A., 30 April 2008.

<sup>150</sup> Exhibit CE-273, Ecuador draft “transitional negotiation agreement,” 16 May 2008 (in Spanish with English translation), PER 04502.

<sup>151</sup> Exhibit CE-71, Letter from the Ministry of Mines and Petroleum to Perenco and other oil companies regarding the migration to service provision agreements, 13 June 2008 (in Spanish with English translation). This was in response to opposition from most contractors to the 120 days time limit given to conclude a services contract. Contractors were resistant because Ecuador had not at this time provided it with a draft of the proposed services contract: see Transcript, Hearing on the Merits, Day 4, pp 981-983 (Testimony of Galo Chiriboga Zambrano).

<sup>152</sup> Exhibit CE-274, Letter from the Consortium to the Ministry of Mines and Petroleum and Petroecuador, 13 June 2008 (in Spanish with English translation).

<sup>153</sup> Transcript, Hearing on the Merits, Day 4, p 992 (Testimony of Galo Chiriboga Zambrano).

become due pending the arbitrations.”<sup>154</sup> It referred to the 13 May 2008 decision of an ICSID tribunal (the Decision on Revocation of Provisional Measures and other Procedural Matters in *City Oriente Ltd v. Republic of Ecuador and Empresa Estatal Petroleos del Ecuador (Petroecuador)*),<sup>155</sup> in which that tribunal had ordered Ecuador to refrain from asserting Law 42 payment demands during the pendency of the arbitration. Perenco proposed the option of transferring the disputed Law 42 payments into an escrow account, maintained by an independent escrow agent in a neutral location, pending the resolution of its dispute with Ecuador.<sup>156</sup> This proposal was not accepted by Ecuador and for the balance of 2008 (and into 2009) the Consortium deposited the disputed Law 42 amounts into a segregated account located outside of Ecuador.<sup>157</sup>

129. The question of disputed Law 42 payments aside, Perenco continued to request negotiations with Ecuador. On 26 June 2008, Perenco wrote to the Minister of Mines and Petroleum requesting the timetable for new negotiations as well as information pertaining to the terms of the new service contracts proposed by Ecuador.<sup>158</sup> On 16 July 2008, Mr. d’Argentré, writing on behalf of Perenco, and Mr. Alex Martinez, vice-president of Burlington, informed the Ministry of Mines and Petroleum and Petroecuador that Perenco and Burlington considered they had no choice but to reject the proposal to enter into the proposed “transitory agreement”.<sup>159</sup> They continued to request that Ecuador engage in a negotiation towards a compromise acceptable to both Ecuador and the Consortium.<sup>160</sup>

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<sup>154</sup> Exhibit CE-72, Letter from Perenco and Burlington to the Ministry of Mines and Petroleum and Petroecuador proposing an escrow account for transfer of disputed Law 42 payments, 19 June 2008 (in Spanish with English translation), PER 02204.

<sup>155</sup> *City Oriente Ltd v. Republic of Ecuador and Empresa Estatal Petroleos del Ecuador (Petroecuador)*, ICSID Case No. ARB/06/21, Decision on Revocation of Provisional Measures and other Procedural Matters (13 May 2008).

<sup>156</sup> Exhibit CE-72, Letter from Perenco and Burlington to the Ministry of Mines and Petroleum and Petroecuador proposing an escrow account for transfer of disputed Law 42 payments, 19 June 2008 (in Spanish with English translation), PER 02204.

<sup>157</sup> As noted by the Tribunal at paragraphs 11 and 30 of its Decision on Provisional Measures; and see Exhibit CE-208, Letter from Perenco to the Ministry of Mines and Petroleum and Petroecuador, regarding the Provisional Measures decision, 11 May 2009 (in Spanish with English translation), PER T-03683.

<sup>158</sup> Exhibit CE-276, Letter from Perenco to the Ministry of Mines and Petroleum and Petroecuador, 26 June 2008 (in Spanish with English translation).

<sup>159</sup> Exhibit CE-74, Letter from Perenco and Burlington to Ecuador showing disagreement with draft agreement proposed by Ecuador, 16 July 2008 (in Spanish with English translation).

<sup>160</sup> *Ibid.*

130. Twelve days later, on 28 July 2008, the Ministry of Mines and Petroleum informed Perenco that negotiations had and would remain terminated.<sup>161</sup>
131. On 4 August 2008, Perenco wrote to the Minister of Mines and Petroleum requesting a meeting to clarify the situation and urging the resumption of negotiations.<sup>162</sup> A meeting was subsequently held between Mr. d'Argentré and Minister Chiriboga and both agreed that negotiations could resume, though they disagreed as to the pre-conditions for that to occur.<sup>163</sup> Mr. d'Argentré testified that after President Correa's speech in April 2008, the negotiations urged by Perenco were in its own name and not on behalf of the Consortium.<sup>164</sup> Burlington did not take part in subsequent negotiations, and Mr. d'Argentré testified that he did not communicate with Burlington about Perenco's negotiations with Ecuador.<sup>165</sup>
132. On 14 August 2008, Perenco wrote to Minister Chiriboga, confirming the decision to recommence negotiations, and again requesting a draft of the new contracts that were being prepared by Ecuador.<sup>166</sup>
133. In its reply of 18 August 2008, the Ministry informed the Consortium that it would not recommence negotiations unless the Consortium agreed to convert its Participation Contracts to service contracts and withdrew its claims in this arbitration.<sup>167</sup>
134. Around this time, Burlington expressed its desire to divest itself of its assets in Ecuador to Perenco, stating that it had no intention of signing another contract with the State.<sup>168</sup> This

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<sup>161</sup> Exhibits CE-76, Letter from the Ministry of Mines and Petroleum to Perenco terminating negotiations regarding the amendment of the Participation Contract for Block 7, 28 July 2008 (in Spanish with English translation) and CE-277, Constitutional Tribunal, File No. 039-2002, Official Registry No. 130 of 22 July 2003 (in Spanish with English translation).

<sup>162</sup> Exhibit CE-78, Letter from Perenco to the Ministry of Mines and Petroleum regarding termination of negotiations announced by Ecuador, 4 August 2008 (in Spanish with English translation).

<sup>163</sup> Transcript, Hearing on the Merits, Day 3 (Testimony of Eric d'Argentré), p 581, and in Exhibit CE-278, Letter from Perenco to the Ministry of Mines and Petroleum, 14 August 2008 (in Spanish with English translation), PER 04519.

<sup>164</sup> Transcript, Hearing on the Merits, Day 3, pp 662-663 (Testimony of Eric d'Argentré).

<sup>165</sup> *Ibid.*

<sup>166</sup> Exhibit CE-278, Letter from Perenco to the Ministry of Mines and Petroleum, 14 August 2008 (in Spanish with English translation).

<sup>167</sup> Exhibit CE-279, Letter from the Ministry of Mines and Petroleum to Perenco and Burlington, 18 August 2008 (in Spanish with English translation).

<sup>168</sup> Exhibit E-86, Letter from Burlington to the Minister of Mines and Petroleum dated 10 September 2008.

position was conveyed to representatives of the Ministry of Mines and Petroleum on 10 September 2008, and reiterated in a letter from Burlington to Petroecuador's Executive President on 7 October 2008.<sup>169</sup> Perenco however responded to Ecuador's terms of negotiation in its own letter of 27 August 2008, stating that it was prepared to begin negotiations on 1 September 2008 with a view to replacing the Participation Contracts with service contracts and with the issue of the pendency of the ICSID arbitration on the agenda for discussion.<sup>170</sup>

135. In September 2008, Petroecuador informed Perenco that a resolution had been adopted by the Special Committee for Bidding to form a negotiating team to renegotiate the Participation Contracts for Blocks 7 and 21.<sup>171</sup>
136. Negotiations between Perenco and Ecuador resumed in October 2008, with Perenco stating that it was prepared to agree in principle to migrate to a service contract, the application of the *Ley de Equidad Tributaria* tax at 70% and a higher statutory reference price in relation to Blocks 7 and 21 (US \$42.5/bbl for Block 7 and US \$48/bbl for Block 21).<sup>172</sup>
137. This led to the Parties agreeing on a draft transitory agreement for Block 7 in the form of a Minutes of Partial Agreement signed by representatives of Petroecuador and Perenco on 3 October 2008.<sup>173</sup> It recorded the parties' agreement to migrate from a participation contract to a service contract in a period of 180 days, and that *Ley de Equidad Tributaria*, or 70% tax rate,

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<sup>169</sup> *Ibid.*; E-88, Letter from Burlington to Petroecuador dated 7 October 2008 at paragraph 1 (“[W]e do not accept the terms and conditions expressed in the above referenced Record of Partial Agreement and will not be signing Modification Agreements that the Government of Ecuador, Petroecuador and Perenco Ecuador Limited may agree upon as a result of such renegotiation process”). In its letter to the Ministry of Mines and Petroleum dated 10 September 2008 Burlington informed the Ministry that it would prefer to proceed with the divestment of its assets and for that purpose was interested into entering negotiations to reach a mutually satisfactory agreement for the sale of its interest.

<sup>170</sup> Exhibit CE-280, Letter from Perenco to the Ministry of Mines and Petroleum, 27 August 2008 (in Spanish with English translation). In the first paragraph, Perenco states it was “acting exclusively in its own name”; see also, Transcript, Hearing on the Merits, Day 3, pp 592-593 (Testimony of Mr. d’Argentré).

<sup>171</sup> Exhibit CE-281, Letter from Petroecuador to Perenco, 11 September 2008 (in Spanish with English translation).

<sup>172</sup> Exhibits E-87, *Acta de Acuerdo Parcial* signed by Perenco and Petroecuador dated 3 October 2008; E-89, *Acta de Acuerdo Parcial* signed by Perenco and Petroecuador dated 17 October 2008 and CE-149, Partial Agreement Act between Perenco and Petroecuador, 17 October 2008 (Redacted); Counter-Memorial, paragraph 215.

<sup>173</sup> *Ibid.*

would apply over a base rate of US \$42.50 per barrel of oil.<sup>174</sup> The Parties entered into a similar transitory agreement with respect to Block 21 on 17 October 2008.<sup>175</sup>

138. Perenco forwarded comments on the draft to Petroecuador's Negotiation Team on 31 October 2008 and 7 November 2008.<sup>176</sup> Perenco considered that the draft was subject to further discussion and until it was formally concluded, not binding on the Parties.<sup>177</sup>
139. On 14 November 2008, Petroecuador wrote to inform Perenco that the draft model service contract had been drawn up under which 100% of the production would belong to Ecuador and a fee per barrel will be paid to the Consortium.<sup>178</sup>
140. Perenco wrote to the Petroecuador Negotiation Team on 19 November 2008, enclosing copies of drafts of the amended Participation Contracts based on the amendments agreed to in the negotiations.<sup>179</sup>
141. Perenco received a reply on 20 November 2008 in which Petroecuador stated that Perenco's comments were untimely as they should have been provided prior to the signing of Minutes of the Partial Agreement on 3 October 2008 and 17 October 2008 (for Blocks 7 and 21, respectively).<sup>180</sup>

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<sup>174</sup> *Ibid.*; Burlington rejected the terms and conditions of the Minutes of Partial Agreement in a letter to Petroecuador dated 7 October 2008 (found at Exhibit E-88, Letter from Burlington to Petroecuador dated 7 October 2008).

<sup>175</sup> *Ibid.* The transitory agreement stipulated a base price of US \$48.00 per barrel and that till the transition to service contracts the State participation percentage applicable to Block 21's Participation Contract would increase by 8 percentage points (E-89, *Acta de Acuerdo Parcial* signed by Perenco and Petroecuador dated 17 October 2008).

<sup>176</sup> Exhibit CE-282, Letter from Perenco to Petroecuador, 12 November 2008 (in Spanish with English translation).

<sup>177</sup> Transcript, Hearing on the Merits, Day 3, p 664 (Testimony of Eric d'Argentré); see also, Transcript, Hearing on the Merits, Day 3, pp 761-764 (Testimony of Rodrigo Marquez) where Mr. Marquez was cross-examined by counsel for Ecuador whether there was an understanding that the Minutes were not meant to be binding on the parties until formally finalised, to which he responded that such an understanding was "[i]ncorporated by reference" (p 763) because it followed from other minutes during the negotiation, which were not intended to be binding but only served to encourage further negotiation.

<sup>178</sup> Exhibit CE-283, Letter from the Ministry of Mines and Petroleum to Perenco, 14 November 2008 (in Spanish with English translation).

<sup>179</sup> Exhibit CE-284, Letter from Perenco to Petroecuador, 19 November 2008 (in Spanish with English translation).

<sup>180</sup> Exhibit CE-80, Letter from Petroproducción to Perenco rejecting comments on draft transitory agreements and informing that the transitory agreements had been approved by the Ecuadorian government, 20 November 2008 (in Spanish with English translation).

142. The discussions between Burlington and Ecuador had failed to lead to an agreement over the divestiture of the former's interest in Blocks 7 and 21 and the breakdown in that relationship affected the relationship between Ecuador and Perenco.<sup>181</sup>
143. In a letter dated 16 December 2008, Burlington referred to a conference call with Perenco on 10 December 2008 where Perenco "describe[d] the benefits of signing the draft agreement."<sup>182</sup> Burlington informed Perenco that it "weigh[ed] the risks of signing the transitory agreement quite differently from Perenco" and it refused to sign the proposed draft transitory agreements.<sup>183</sup> In addition, Burlington stated that it was "not under any legal obligation of any kind to sign the draft agreements" and "if, nevertheless, Perenco decide[d] to pursue the execution of transitory agreements, Burlington hereby reserves all rights and remedies under applicable law, without prejudice, to protect its interests in the PSCs."<sup>184</sup> Mr. d'Argentré testified that, to his knowledge, Burlington had by this time made this position clear to the Government of Ecuador as well.<sup>185</sup>
144. On 24 December 2008, Perenco received a letter from the Ministry of Mines and Petroleum stating that:

After the negotiation process carried out with the PETROECUADOR team, the conversations held in this Office with your Principal and, as a result of the impossibility of arriving at a final agreement between the parties, due to the intransigent position of your partner Burlington Resources, I would be very grateful if you would immediately instruct your work team to initiate the process of reversion of Block 7, the contract for which ends in the year 2010.

Moreover, PERENCO, in its capacity as Operator, must also immediately assign its negotiating team to early termination of the Block 21 contract, by mutual agreement.<sup>186</sup>

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<sup>181</sup> Exhibits E-90, Letter from Perenco to Burlington dated 27 November 2008; E-91, Letter from Burlington to Perenco dated 16 December 2008; CE-81, Letter from the Ministry of Mines and Petroleum to Perenco regarding the process of reverting of Block 7 and early termination of the Participation Contract for Block 21, 23 December 2008 (in Spanish with English translation).

<sup>182</sup> Exhibit E-91, Letter from Burlington to Perenco dated 16 December 2008; see also, Transcript, Hearing on the Merits, Day 3, pp 599-601 (Testimony of Eric d'Argentré).

<sup>183</sup> *Ibid.*

<sup>184</sup> *Ibid.*

<sup>185</sup> Transcript, Hearing on the Merits, Day 3, p 666, lines 16-19 (Testimony of Eric d'Argentré).

<sup>186</sup> Exhibit CE-81, Letter from the Ministry of Mines and Petroleum to Perenco regarding the process of reverting of Block 7 and early termination of the Participation Contract for Block 21, 23 December 2008 (in Spanish with English translation).

145. This led Perenco to write to the Minister of Mines and Petroleum to request him to reconsider the position expressed in the letter of 24 December 2008.<sup>187</sup> However, on 21 January 2009, the Minister of Mines and Petroleum announced that the negotiations to have Perenco continue operating in Ecuador had become “practically impossible”.<sup>188</sup>
146. The present arbitration, which had been initiated on 30 April 2008, thereafter proceeded in earnest. The First Session of the Tribunal was held on 7 February 2009 at the seat of the Centre in Washington D.C. At this session, the Claimant did not pursue its application for provisional measures which it had included with its Amended Request for Arbitration dated 30 April 2008.<sup>189</sup>
147. One week after the First Session of the Tribunal, in a radio address on 14 February 2009, President Correa declared that he had ordered enforcement actions against two companies, Repsol and Perenco, because they failed to pay their dues pursuant to Law 42. He challenged what he described as their “defiance”, and commented on the impact that the State’s actions might have on Ecuador’s relationship with the governments of France and Spain:

But two companies, Perenco and Repsol, with which Burlington is also allied, have wasted our time. Agreements were reached, and then backed out of. I believe, I fear, that they thought they were still dealing with previous administrations. Gentlemen, we will not permit that. This is going to create friction with the governments of France and Spain, which are very protective of their transnational corporations, and for this we are sorry. We like these governments and hold them in high esteem, but on this subject we must observe our national sovereignty and our national interests.<sup>190</sup>

148. During this proceeding, the Claimant has adverted to statements by senior Ecuadorian officials, including President Correa’s description of the Claimant as a French transnational corporation just quoted.

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<sup>187</sup> Exhibit CE-289, Letter from Perenco to the Ministry of Mines and Petroleum, 8 January 2009 (in Spanish with English translation).

<sup>188</sup> Statement of Ecuador’s Minister of Mines and Petroleum Derlis Palacios as quoted by Ecuador’s *El Comercio* in 21 January 2009 article entitled “Government will seek to terminate contract with Perenco after negotiations fail”: Exhibit CE-84, PER 02336. See also, Exhibit CE-87, Excerpt from the informal transcript of the statements made by President Rafael Correa, Quito, 14 February 2009 (in Spanish with English translation).

<sup>189</sup> Amended Request, paragraph 43.

<sup>190</sup> Exhibit CE-87, Excerpt from the informal transcript of the statements made by President Rafael Correa, Quito, 14 February 2009 (in Spanish with English translation); Revised Memorial, paragraph 91; Transcript, Hearing on the Merits, Day 1, p 152 (Opening Statement of Mark Friedman).

149. A Reuters article of the same date quoted Minister Derlis Palacios as having stated that both companies “will ‘either pay the debt or their stuff will be seized’.”<sup>191</sup> This was a reference to the *coactiva* proceedings that were then initiated against both members of the Consortium.

**F. *Coactiva* proceedings, the Tribunal’s Decision on Provisional Measures, intervention in the Blocks and declaration of *Caducidad***

**(1) *Coactiva* proceedings**

150. Article 21 of the Special Law of the *Empresa Estatal Petróleos del Ecuador (Petroecuador and its Subsidiaries)* empowers Petroecuador to exercise a “*coactiva* jurisdiction.”<sup>192</sup> Petroecuador, acting as a “Court of Enforcement”, is empowered to employ a wide range of enforcement measures, including seizures, attachments, liens, and prohibitions against transfer or assignment of property, in order to collect on a debt owing in accordance with the forcible enforcement provisions contained in the Code of Civil Procedure of Ecuador.<sup>193</sup>

151. By letter of 18 February 2009, the Respondent informed the Tribunal that the President and the Minister of Mines and Petroleum “have had no other alternative but to announce – in strict compliance with International Law, the Constitution, the laws and decrees of Ecuador – that a ‘coercive procedure’ will be promptly initiated – the result of which can be challenged before the Ecuadorian civil courts – against Perenco to demand that it pay the amounts it still owes pursuant to the obligations arising out of the application of Law 2006-42 and its regulatory decrees.”<sup>194</sup>

152. Perenco by letter of 19 February 2009 requested the Minister of Mines and Petroleum to refrain from taking such coercive collective measures, known in Ecuador as “*coactivas*”.<sup>195</sup>

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<sup>191</sup> Exhibit CE-86, *Ecuador to freeze Repsol, Perenco assets over tax*, Reuters News, 14 February 2009, available at <http://www.reuters.com/article/marketsNews/idUSN142548752009021>; Revised Memorial, paragraph 91.

<sup>192</sup> Exhibit CE-20, Petroecuador’s Special Law, 18 September 1989, available at <http://www.petroecuador.com.ec> (in Spanish with English translation of excerpts), PER 01211; Revised Memorial, paragraph 93.

<sup>193</sup> *Ibid.*

<sup>194</sup> Exhibit CE-88, Letter from Ecuador to the Tribunal informing it about a “coercive procedure” to be initiated by Ecuador against Perenco, 18 February 2009 (in Spanish with English translation), PER 02350.

<sup>195</sup> Exhibit CE-89, Letter from Ecuador to the Ministry of Mines and Petroleum asking it to refrain from taking coercive measures to enforce Law 42 payments, 19 February 2009 (in Spanish with English translation).

153. However, on that same day, Ecuador commenced the *coactivas* against Perenco (and Burlington) for the sums claimed to be owed pursuant to Law 42 in relation to the Blocks' 2008 production.<sup>196</sup> This prompted the submission of the Claimant's Application for Provisional Measures that same day.<sup>197</sup> Perenco was ordered by the Court of Enforcement of Petroecuador to pay the sums of US \$171,782,211.00 and US \$155,685,236.00 within 3 days of the date of the order or to "supply within the same amount of time equivalent goods for attachment."<sup>198</sup>
154. This was followed by a second and third issuance of enforcement notices against Perenco on 20 and 25 February 2009.<sup>199</sup>
155. Meanwhile, on 24 February 2009, the Tribunal wrote to the Parties regarding Ecuador's enforcement actions, requesting the Parties to "refrain from initiating or continuing any action or adopting any measure which may, directly or indirectly, modify the *status quo* between the parties *vis-à-vis* the participation contracts, including any attempt to seize any assets of the

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<sup>196</sup> Exhibits CE-90, Forcible collection notice from the Court of Enforcement of Petroecuador demanding payment of Law 42 assessments for Block 7 and the Coca-Payamino Unified Field, 19 February 2009 (in Spanish with English translation) and CE-91, Forcible collection notice from the Court of Enforcement of Petroecuador demanding payment of Law 42 assessments for Block 21, 19 February 2009 (in Spanish with English translation); Revised Memorial, paragraph 92.

<sup>197</sup> Claimant's Application for Provisional Measures dated 19 February 2009.

<sup>198</sup> Exhibits CE-90, Forcible collection notice from the Court of Enforcement of Petroecuador demanding payment of Law 42 assessments for Block 7 and the Coca-Payamino Unified Field, 19 February 2009 (in Spanish with English translation), PER 02360 and CE-91, Forcible collection notice from the Court of Enforcement of Petroecuador demanding payment of Law 42 assessments for Block 21, 19 February 2009 (in Spanish with English translation), PER 02369; Revised Memorial, paragraph 92. During the hearing, Mr. d'Argentré confirmed that the Consortium had as a whole withheld US \$332 million as of February 2009: Transcript, Hearing on the Merits, Day 3, p 612 (Testimony of Eric d'Argentré).

<sup>199</sup> Exhibits CE-92, Second forcible collection notice from the Court of Enforcement of Petroecuador demanding payment of Law 42 assessments for Block 7 and the Coca-Payamino Unified Field, 20 February 2009 (in Spanish with English translation), CE-93, Second forcible collection notice from the Court of Enforcement of Petroecuador demanding payment of Law 42 assessments for Block 21, 20 February 2009 (in Spanish with English translation); CE-94, Third forcible collection notice from the Court of Enforcement of Petroecuador demanding payment of Law 42 assessments for Block 7 and the Coca-Payamino Unified Field, 25 February 2009 (in Spanish with English translation) and CE-95, Third forcible collection notice from the Court of Enforcement of Petroecuador demanding payment of Law 42 assessments for Block 21, 25 February 25, 2009 (in Spanish with English translation).

Claimant, until it has had an opportunity to further hear from the parties on the question of provisional measures.”<sup>200</sup> The Tribunal proposed a possible hearing date of 19 March 2009.<sup>201</sup>

156. Ecuador responded to the Tribunal on 26 February 2009, stating it could not comply with the Tribunal’s request.<sup>202</sup> Throughout this proceeding Ecuador characterised the Tribunal's letter as recommending a course of action, and not imposing upon it an obligation to comply.<sup>203</sup>
157. Meanwhile, on that same day, the Minister of Mines and Petroleum set a deadline for Perenco to pay the claimed US \$327 million debt by 2 March 2009.<sup>204</sup>
158. The Tribunal responded to the Respondent’s statement of its position on 27 February 2009, stating it “regrets the stance adopted by the Respondent Republic of Ecuador and must necessarily take a serious view of any failure to comply with its request.”<sup>205</sup> Meanwhile, Perenco moved to apply to the 2<sup>nd</sup> First Instance Civil Court of Pichincha in Ecuador for nullification of the forcible collection notices on the ground that the Tribunal had exclusive jurisdiction over the dispute surrounding the application of Law 42 to the Participation Contracts for Blocks 7 and 21.<sup>206</sup>
159. Ecuador proceeded with the enforcement measures. On 3 March 2009, Perenco’s personnel at its facilities in Quito received two notices from the Court of Enforcement of Petroecuador. The Court ordered the immediate seizure of all of Blocks 7 and 21’s crude production and cargoes.<sup>207</sup> The Court notified OCP on 4 March 2009 of the seizure of all of Block 21’s crude

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<sup>200</sup> Exhibit CE-203, Letter from the Tribunal requesting that the parties refrain from initiating or continuing any action, or adopting any measure which may modify the status quo between the parties vis-à-vis the Participation Contracts, 24 February 2009; Revised Memorial, paragraph 94.

<sup>201</sup> *Ibid.*

<sup>202</sup> Exhibit CE-204, Letter from the Tribunal communicating its regret concerning the stance adopted by Ecuador with regard to Provisional Measures, 27 February 2009; Revised Memorial, paragraph 95.

<sup>203</sup> For example, see Transcript, Hearing on the Merits, Day 1, p 206 (Opening Statement of Pierre Mayer).

<sup>204</sup> Decision on Provisional Measures, paragraph 15.

<sup>205</sup> Exhibit CE-204, Letter from the Tribunal communicating its regret concerning the stance adopted by Ecuador with regard to Provisional Measures, 27 February 2009; Revised Memorial, paragraph 95.

<sup>206</sup> Exhibit CE-96, Perenco’s objection to the forcible collection process filed with the 2<sup>nd</sup> First Instance Civil Court of Pichincha, Ecuador, 28 February 2009 (in Spanish with English translation), PER 02405-02406.

<sup>207</sup> Exhibits CE-97, Notice from the Court of Enforcement of Petroecuador regarding seizure of Block 7’s oil production, 3 March 2009 (in Spanish with English translation) and CE-98, Notice from the Court of Enforcement of Petroecuador regarding seizure of Block 21’s oil production, 3 March 2009 (in Spanish with English translation); Revised Memorial, paragraph 96.

oil and provided instructions for the retention of the crude until the Law 42 debt was collected.<sup>208</sup>

160. Also on 3 March 2009, the Minister of Mines and Petroleum, Mr. Derlis Palacios, was interviewed on Ecuadorian television. In response to questions regarding the proposed actions that the State could take against Perenco and the reasons why Perenco had failed to pay its Law 42 debt thus far, the Minister stated that the deadline to pay was 2 March 2009, and the State was “completing all necessary steps to adopt that measure (i.e. *coactiva*) as soon as possible.”<sup>209</sup> He stated further that he had met with Perenco’s country manager in order to try to find a solution and he had concluded that the main resistance faced by Perenco was as a result of its American partner, Burlington. In the course of this interview, as in the case of the President of Ecuador’s earlier description of the Claimant as a “French” company, Minister Palacios described Perenco in like terms. He went on to emphasise that “we are neither confiscating nor terminating the contract.”<sup>210</sup>

161. Around this time, the 2<sup>nd</sup> First Instance Civil Court in Ecuador dismissed Perenco’s application to nullify the *coactivas*.<sup>211</sup>

162. On 4 March 2009, Perenco informed its buyers, Shell West and ConocoPhillips, of an event of *force majeure* under their contracts.<sup>212</sup>

163. The Tribunal responded to the actions taken by the Court of Enforcement of Petroecuador by way of letter to the Parties on 5 March 2009. Referring to its 24 February 2009 letter, the Tribunal stated it “wished to make clear, in view of the parties’ most recent exchange of correspondence, that its 24 February 2009 *request* had and continues to have the same authority as a *recommendation*, as envisaged in Article 47 of the ICSID Convention and ICSID

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<sup>208</sup> Exhibit CE-100, Petroecuador’s notice to OCP containing instructions for the seizure of Perenco’s oil production, 3 March 2009 (in Spanish with English translation); Revised Memorial, paragraph 96.

<sup>209</sup> Exhibit CE-206, Excerpt from an interview with Derlis Palacios, former Minister of Mines and Petroleum, conducted by Rodolfo Baquerizo of GAMA TV, 3 March 2009 (in Spanish with English subtitles).

<sup>210</sup> *Ibid.*

<sup>211</sup> Exhibit CE-99, Decision of the 2<sup>nd</sup> First Instance Civil Court of Pichincha dismissing Perenco’s objection to the forcible collection process commenced by the Court of Enforcement of Petroecuador, 3 March 2009 (in Spanish with English translation).

<sup>212</sup> Exhibits CE-101, Letter from Perenco to Shell West regarding an event of *force majeure*, 4 March 2009 and CE-102, Letter from Perenco to ConocoPhillips regarding an event of *force majeure*, 4 March 2009.

Arbitration Rule 39.”<sup>213</sup> It additionally confirmed the date for a hearing on the application for provisional measures, namely, 19 March 2009, at the World Bank’s offices in Paris.<sup>214</sup>

164. On 6 March 2009, Perenco applied to the 2<sup>nd</sup> First Instance Civil Court of Pichincha in Ecuador to reconsider the dismissal of its application regarding the collection notices.<sup>215</sup> Its application was dismissed on 9 March 2009.<sup>216</sup> Appeals against this decision were later dismissed, with the 2<sup>nd</sup> First Instance Civil Court stating that Perenco could appeal no further due to the failure to comply with the 3 March 2009 collection notices.<sup>217</sup>
165. On 11 March 2009, counsel for the Respondent wrote to the Tribunal, explaining that it did so “not to cavil with the Tribunal’s decision, but to formally record the Republic of Ecuador’s reservation of rights in relation to it.”<sup>218</sup> It set out a number of reasons why it considered the Tribunal’s decision to “retrospectively change the form of [Tribunal’s] request” of 24 February 2009 was prejudicial to Ecuador’s rights in the arbitration, which were reserved.<sup>219</sup>
166. While in the midst of the hearing on provisional measures, the Claimant received from the Ministry of Mines and Petroleum a notice stating that the State had recalculated the amounts due from the Consortium under Law 42 for the period 25 April 2006 to 31 December 2008 (including interest), and it now was said to owe US \$719,087,992 (of which, in the Claimant’s submission, Perenco was said to allegedly owe US \$359,000,000).<sup>220</sup> This included interest of US \$17,773,608 from 24 August 2006 to 19 March 2009.<sup>221</sup>

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<sup>213</sup> Exhibit CE-205, Letter from the Tribunal informing the parties that the 24 February 2009 request by the Tribunal has the same authority as envisaged in Article 47 of the ICSID Convention and ICSID Arbitration Rule 39, 5 March 2009 [Italics in original.]; Revised Memorial, paragraph 97.

<sup>214</sup> *Ibid.*

<sup>215</sup> Exhibit CE-103, Perenco’s request for reconsideration filed with the 2nd First Instance Civil Court of Pichincha, 6 March 2009 (in Spanish with English translation).

<sup>216</sup> Exhibit CE-104, Decision of the 2nd First Instance Civil Court of Pichincha dismissing Perenco’s request for reconsideration, 9 March 2009 (in Spanish with English translation).

<sup>217</sup> Exhibit CE-107, Decision of the 2nd First Instance Civil Court of Pichincha dismissing Perenco’s appeal, 16 March 2009 (in Spanish with English translation).

<sup>218</sup> Exhibit CE-207, Letter from Respondent regarding Tribunal’s request to make a formal recommendation under Article 47 of the ICSID Convention, 11 March 2009, PER 03679; Revised Memorial, paragraph 98.

<sup>219</sup> *Ibid.*

<sup>220</sup> Exhibit CE-110, Letter from the Ministry of Energy and Petroleum reassessing Law 42 amounts allegedly due by Perenco, 19 March 2009 (in Spanish with English translation), PER 02528; Revised Memorial, paragraph 99.

<sup>221</sup> *Ibid.*

## (2) Auction of Consortium crude and the Tribunal's Decision on Provisional Measures

167. On 6 April 2009, the Court of Enforcement in Ecuador issued an order stating that Petroecuador would begin selling the Consortium's crude at an auction to be held on 15 May 2009.<sup>222</sup> The winning bidder was to pay Petroecuador by means of a direct deposit in an account it held in the Central Bank of Ecuador.<sup>223</sup> A public announcement advertising the auction was published in *El Comercio*.<sup>224</sup>
168. While events unfolded in Ecuador, on 16 April 2009, Bahamian legal counsel Ms. Heather Thomson was instructed, pursuant to powers of attorney granted to her by the Perrodo heirs, to apply to the Supreme Court of the Commonwealth of the Bahamas for Letters of Administration in respect of the Perrodo estate in the Bahamas. (The Letters of Administration were later issued on 19 August 2009.<sup>225</sup>)
169. On 8 May 2009, the Tribunal issued its Decision on Provisional Measures recommending that Ecuador refrain from demanding that Perenco pay amounts allegedly due pursuant to Law 42, instituting or further pursuing any action, judicial or otherwise, to collect from Perenco any payments owed by Perenco or the Consortium pursuant to Law 42, instituting or further pursuing any action, judicial or otherwise, against Perenco or any of its offices or employees arising from or in connection with the Participation Contracts and unilaterally amending, rescinding, terminating or repudiating the Participation Contracts.<sup>226</sup>
170. The Tribunal also found in its Decision that the Respondents should enjoy a measure of security in relation to sums accruing to them from Perenco (not the Consortium) under Law 42 from the date of the Decision until any later decision that might find that the Tribunal had no jurisdiction to entertain the dispute, or that the Respondents were entitled to claim and enforce the payments required by the Law. It considered that such security was best provided by

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<sup>222</sup> Exhibit CE-112, Petroecuador's notice to Perenco regarding the public auction of Perenco's oil production seized by Petroecuador (Napo Crude), 6 April 2009 (in Spanish with English translation); Revised Memorial, paragraph 99.

<sup>223</sup> *Ibid.*

<sup>224</sup> Exhibit CE-114, Press announcement regarding the public auction of Perenco's oil production seized by Petroecuador (Oriente Crude), to take place on 15 May 2009 (in Spanish with English translation).

<sup>225</sup> See above at paragraph 51.

<sup>226</sup> Decision on Provisional Measures, paragraph 62.

payment of the sums so accruing into an escrow account, from which sums would be disbursed on the direction of the Tribunal or by agreement of the Parties and it invited the parties to agree the terms and conditions on which such account may be established, and to establish it within 120 days from the issuance of the Decision. If, at the end of that period, the Parties failed to agree or act, either party was at liberty to revert to the Tribunal.<sup>227</sup>

171. On 11 May 2009, Mr. d'Argentré wrote to the Minister of Mines and Petroleum in Ecuador, Mr. Derlis Palacios, and the President of Petroecuador, Rear-Admiral Luis Jaramillo, noting that the Tribunal had invited the Parties to “work jointly to coordinate the creation of an escrow account to deposit the disputed sums generated” from the date of the Decision, and in relation to the proposed auction of the oil that had been seized pursuant to the *coactivas*, that Perenco was open to starting “discussions immediately as to what would be the most efficient way to restore Perenco’s title to the crude oil now under attachment.”<sup>228</sup> He concluded by stating that while Perenco “will continue defending [its] rights in the arbitration, [it] remain[s] willing to talk in order to reach an amicable solution to our dispute on terms that will find acceptance with all parties.”<sup>229</sup>
172. According to Mr. d'Argentré, shortly after the letter of 11 May 2009 was sent, representatives of Perenco met with Minister Palacios. Mr. d'Argentré testified that the “meeting was not productive” because it “quickly became clear to [him] that the Tribunal’s Decision did not have much of an impact on Minister Palacios or his colleagues” who informed Mr. d'Argentré and his colleagues that “the seizure of [the Consortium’s] crude was non-negotiable and ... the auction would have to go forward.”<sup>230</sup> Minister Palacios is alleged to have advised Mr. d'Argentré and his colleagues at this meeting that if he or “any other Perenco personnel tried to interfere with the auction, [they] would face criminal charges.”<sup>231</sup>

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<sup>227</sup> *Ibid.*, paragraphs 62-63.

<sup>228</sup> Exhibit CE-208, Letter from Perenco to the Ministry of Mines and Petroleum and Petroecuador, regarding the Provisional Measures decision, 11 May 2009 (in Spanish with English translation).

<sup>229</sup> *Ibid.*

<sup>230</sup> 2<sup>nd</sup> Witness Statement of Eric d' Argentré, paragraph 9.

<sup>231</sup> *Ibid.* Mr. d' Argentré claims that Perenco’s representatives received similar caution from Mr. Mera, Legal Counsel to President Correa, in a meeting on 14 May 2009: paragraph 13.

173. Perenco then sought a meeting with the Attorney-General of Ecuador, Mr. Diego García Carrión. The Attorney-General, according to Mr. d'Argentré, maintained in this meeting that he was not in a position to intercede in the dispute, suggesting that Perenco focus its efforts on communicating with Minister Palacios and Rear-Admiral Jaramillo.<sup>232</sup>
174. Perenco's representatives (Mr. d'Argentré and Ms. Gabriela Rumazo, Perenco's then-legal counsel in Ecuador) then met with Mr. Alexis Mera, Legal Counsel to President Correa, on 14 May 2009 at the Presidential Palace. Mr. d'Argentré testified that they related to Mr. Mera the chronology of events and the detrimental impact of the HCL Amendment and the events following it on Perenco's operations in Ecuador.<sup>233</sup> Mr. Mera, according to Mr. d'Argentré, is said to have responded to the suggestion that Ecuador "consider cancelling the auctions as a good faith gesture" so that negotiations could proceed as follows: "Ecuador did not intend to comply with the Tribunal's provisional measures orders and that the auction would go forward regardless."<sup>234</sup>
175. Perenco then wrote to Mr. Patricio Uteras Hidalgo, the Judge who ordered the seizure of Perenco's crude on 14 May 2009, and to Mr. Wong Loon, President of OCP Ecuador S.A., on 15 May 2009. Perenco referred to the Tribunal's order of 8 May 2009, describing it as having resulted in an international obligation upon Ecuador and its state agencies to refrain from "further seizing and auctioning Block 7 and Block 21 crude oil, and entitles Perenco to full, effective and immediate control of such crude oil."<sup>235</sup>
176. On 15 May 2009, Ecuador proceeded as scheduled with its auction of the seized crude oil. Approximately 720,000 barrels of Napo crude and 720,000 barrels of Oriente crude seized from the Blocks were to be sold.<sup>236</sup> No buyers attended the auction.<sup>237</sup>

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<sup>232</sup> 2<sup>nd</sup> Witness Statement of Eric d' Argentré, paragraph 10; Revised Memorial, paragraph 105.

<sup>233</sup> 2<sup>nd</sup> Witness Statement of Eric d' Argentré, paragraph 13.

<sup>234</sup> *Ibid.*

<sup>235</sup> Exhibits CE-211, Letter from Perenco to Wong Loon, President of Oleoducto De Crudos Pesados Ecuador, S.A., (OCP) regarding redelivery of crude oil, 15 May 2009 and CE-210, Letter from Perenco to Patricio Uteras Hidalgo regarding redelivery of crude oil, 14 May 2009 (in Spanish with English translation); Revised Memorial, paragraph 105.

<sup>236</sup> Exhibit CE-114, Press announcement regarding the public auction of Perenco's oil production seized by Petroecuador (Oriente Crude), to take place on 15 May 2009 (in Spanish with English translation), PER 02543 and 02544; Revised Memorial, paragraph 107.

177. On that same day, counsel for the Respondent wrote to the Tribunal, addressing the relationship between the Tribunal’s Decision on Provisional Measures and the auction:

Ecuador has the highest respect for this learned Tribunal, and has carefully considered the recommendations set forth in the Decision. Ecuador wishes to inform the Tribunal, however, that it is not in a position to implement certain of the recommendations at this time, in so far as they would restrain Ecuador from enforcing Law 42 against Perenco or the Consortium of which it is a member.

Law 42 and its implementing Decrees (referred to herein collectively as ‘Law 42’) were enacted at the highest levels of government, and have been upheld by the Ecuadorian Constitutional Court. Under the circumstances, Law 42 must be applied and enforced, lest the integrity of the legal order be undermined. Were any public officials to refuse to do so in relation to Perenco or the Consortium, they would face serious sanctions for failing to carry out their duties, notwithstanding the Decision.

...

Nevertheless, Ecuador is committed to furthering the central goal of the Decision, namely to avoid any actions that would undermine the effectiveness of any potential award that might be issued (should the Tribunal ultimately affirm its jurisdiction and proceed to the merits). To that end, Ecuador intends to carry out the enforcement of Law 42 in such a way as to avoid any disruption of Perenco’s business. In particular, Ecuador does not intend to seize any assets of the Consortium beyond oil equivalent in value to the outstanding debt. Nor does Ecuador intend to terminate the relevant Participation Contracts, or take legal action against Perenco representatives.<sup>238</sup>

178. Counsel for the Claimant responded to Ecuador’s letter on 19 May 2009.<sup>239</sup> Referring to what it described as Ecuador’s “disrespect” and “disregard” of the Decision on Provisional Measures, it stated this reflected “in words a policy Respondents have in recent days also communicated through deeds, including service of additional Law 42 assessment notices, convening an auction to sell seized crude oil (which failed when no buyers bid) and failing to respond to Perenco’s overture to discuss the Tribunal directed escrow arrangement.”<sup>240</sup>
179. Perenco referred to Ecuador’s statement that it intended to carry out the enforcement of Law 42 in such a way as to avoid disruption of Perenco’s business by stating “Perenco simply

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<sup>237</sup> Revised Memorial, paragraph 109; Counter-Memorial, paragraph 231.

<sup>238</sup> Exhibit CE-212, Letter from Respondents regarding the Tribunal’s Decision on Provisional Measures and Law 42, 15 May 2009.

<sup>239</sup> Exhibit CE-213, Letter from Perenco regarding Respondent’s non-compliance with provisional measures, 19 May 2009.

<sup>240</sup> *Ibid.*

cannot operate indefinitely without revenues and funding losses. Nor should it be coerced into doing so.”<sup>241</sup>

### **(3) Efforts to compromise and proposed settlement offer**

180. On 21 May 2009, Perenco submitted to Ecuador a proposed settlement offer that, according to Mr. d'Argentré, “include[d] terms which had seemed amenable to Ecuador during past negotiations.”<sup>242</sup> The terms of this proposal was that Ecuador would receive 70% above the applicable reference price (US \$42.50 per barrel for Block 7 and US \$48.00 for Block 21), would retain all the payments made till May 2009 in respect of Law 42, in addition receiving a fixed amount of US \$2,725,000 monthly for a period of 6 months and a variable amount equal to the total barrels of crude produced each month by both blocks (not counting the State's participation in barrels) multiplied by US \$5.00, and in exchange the term of the participation contract for Block 7 would be extended to June 2021 and the contracts' terms to otherwise remain the same in all other respects.<sup>243</sup>
181. It appears that representatives of the Government of Ecuador considered this offer provocative.<sup>244</sup> A week after submitting its proposal, Mr. d'Argentré and Ms. Rumazo were summoned to Minister Palacios' office, who, according to Mr. d'Argentré, stated that President Correa was offended by the settlement offer, that Ecuador refused to comply with the Tribunal's decision and Perenco had one week to submit a revised proposal or be expelled from the country.<sup>245</sup>
182. In his second witness statement, Mr. Derlis Palacios refers to this meeting with Perenco in late May 2009.<sup>246</sup> He testified that during the meeting he discussed the proposal Ecuador had

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<sup>241</sup> *Ibid.*, PER 03699.

<sup>242</sup> 2<sup>nd</sup> Witness Statement of Eric d' Argentré, paragraph 15.

<sup>243</sup> Exhibit E-94, Letter from Perenco to the Minister of Mines and Petroleum and Petroecuador dated 21 May 2009, p 4. In exchange, the State would agree not to “present any demand related to Law 42 or any similar demand during the duration of the Participation Contracts for Block 7 and 21”, and would refund to Perenco the 1.44 million barrels which were the subject of the first auction for the Consortium “to sell and distribute the income from the sale “according to the terms of the Participation Contracts.” If the terms were met, the Claimant undertook to “stipulate that the arbitration proceedings before the ICSID [would be] suspended.”

<sup>244</sup> Transcript, Hearing on the Merits, Day 2, p 315 (Opening Statement of Eduardo Silva Romero).

<sup>245</sup> 2<sup>nd</sup> Witness Statement of Eric d' Argentré, paragraph 16; Revised Memorial, paragraph 112.

<sup>246</sup> 2<sup>nd</sup> Witness Statement of Derlis Palacios, paragraph 35.

received and which he considered “was not serious.”<sup>247</sup> Mr. Palacios characterised the proposed offer as “a clear provocation.”<sup>248</sup> He added that, in his opinion, the proposal was an attempt by Perenco to seek “confrontation in order to make use of any reaction by the State in this arbitration.”<sup>249</sup>

183. Following this meeting, the Claimant wrote to Minister Palacios, stressing that it did not intend to offend him or the Government of Ecuador, and explaining that it had presented the proposal only with the intention of putting a “quick end to the controversy that has divided us.”<sup>250</sup>

184. Perenco stated that if the offer was not to the satisfaction of Ecuador, the Parties should alternatively proceed with the option of depositing disputed sums of Law 42 debts into an escrow account and “return to normal operations” while the arbitration continued.<sup>251</sup>

Addressing the threat of expulsion, Mr. d’Argentré stated:

If, as you indicated to me on Monday at our meeting, Ecuador decides in any event to expel Perenco and Burlington from the country, we realize that there is nothing that we can do to stop you. If that is the road that Ecuador chooses then we suggest a meeting at least to discuss the technical means for us to hand over operations in a safe, orderly way over a reasonable period of time.<sup>252</sup>

185. Mr. Wong Loon, President of OCP Ecuador S.A., responded to Perenco’s letter on 26 May 2009. Mr. Wong Loon stated that upon Perenco’s request it had sought to clarify with the Enforcement Court of Petroecuador “if the *Orden de Embargo* was valid and outstanding” in light of the Tribunal’s decision. He stated further that “[t]he Enforcement Court of Petroecuador through notice dated 21 May 2009 and served to OCP Ecuador S.A. on 25 May 2009 ... has responded to OCP Ecuador S.A. that the *Orden de Embargo* issued on 3 March 2009 affecting Perenco Ecuador Limited’s production and shipments has not been

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<sup>247</sup> *Ibid.*

<sup>248</sup> *Ibid.*

<sup>249</sup> *Ibid.*

<sup>250</sup> Exhibit CE-215, Letter from Perenco to the Ministry of Mines and Petroleum, regarding proposed settlement agreement, 27 May 27 2009 (in Spanish with English translation), T-PER 03705; Revised Memorial, paragraph 105.

<sup>251</sup> *Ibid.*

<sup>252</sup> *Ibid.*, T-PER 03706.

modified.”<sup>253</sup> He further notified Perenco that the Transportation Agreement between OCP Ecuador S.A. and Perenco Ecuador Limited, dated 30 January 2011, had been affected by a continuing “*Force Majeure Event* caused by a Political Event [which] occurred on March 3, 2009.”<sup>254</sup>

186. On 26 May 2009, Ecuador’s Minister of Foreign Relations, Trade and Integration, Mr. Fander Falconi, spoke to the French Ambassador to Ecuador, Mr. Didier Lopinot, regarding the “differences that exist between [Perenco] and the Ecuadorian State.”<sup>255</sup>

187. The following day, Ambassador Lopinot wrote to Minister Falconi (copying Minister Palacios), informing him that the French authorities intended to “organize a meeting in the next few days with the President” of Perenco, and requesting Ecuador to “postpone all measures that have been planned regarding [Perenco].”<sup>256</sup>

188. Minister Palacios then responded to Perenco’s letters of 21 May 2009 and 26 May 2009 on 1 June 2009, rejecting its proposed offer for a number of reasons, primarily that it would seem to detract from the binding and non-negotiable nature of the terms of Law 42, and that Perenco could not guarantee the agreement of its fellow consortium member, Burlington.<sup>257</sup> He did however state that the “Ecuadorean State is open to discussing...an agreement.”<sup>258</sup>

189. On 2 June 2009, Petroecuador issued a notice regarding the planned auction of Perenco’s crude on 3 and 8 July 2009.<sup>259</sup>

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<sup>253</sup> Exhibit CE-214, Letter with attachments from OCP Ecuador to Perenco regarding redelivery of crude oil, 26 May 2009 (attachments in Spanish with English translation), PER 03701; Revised Memorial, paragraph 105.

<sup>254</sup> *Ibid.*

<sup>255</sup> Exhibit CE-153, Letter from the Ambassador of France to the Republic of Ecuador, addressed to the Minister of Foreign Affairs regarding a forthcoming meeting to discuss Perenco’s dispute with Ecuador, 27 May 2009 (in Spanish with English translation); 2<sup>nd</sup> Witness Statement of Eric d’ Argentré, paragraph 17; Revised Memorial, paragraph 114.

<sup>256</sup> Exhibit CE-153, Letter from the Ambassador of France to the Republic of Ecuador, addressed to the Minister of Foreign Affairs regarding a forthcoming meeting to discuss Perenco’s dispute with Ecuador, 27 May 2009 (in Spanish with English translation).

<sup>257</sup> Exhibit CE-216, Letter from the Ministry of Mines and Petroleum to Perenco regarding Law 42, 1 June 2009 (in Spanish with English translation), T-PER 03707; Revised Memorial, paragraph 118.

<sup>258</sup> *Ibid.*

<sup>259</sup> Exhibits CE-154, Notice issued by Petroecuador regarding 3 July 2009 auction of Perenco’s crude, 2 June 2009 and CE-155, Notice issued by Petroecuador regarding 8 July 2009 auction of Perenco’s crude, 2 June 2009.

190. On 5 June 2009, the French Secretary of State in Charge of Foreign Trade, Mme Anne-Marie Idrac, wrote to Minister Palacios to express her “concern in relation to the recent developments surrounding the dispute between your government and French company Perenco[.]”<sup>260</sup> Minister Idrac stated that “it [stood] to the mutual best interest of both our countries that a French company like Perenco, which invests considerable sums every year in this industry and hires several hundred employees in your country, should enjoy operational conditions that are economically viable.”<sup>261</sup>

#### **(4) Second attempt at an auction and the declaration of *Caducidad***

191. On 8 June 2009, Mr. Germánico Pinto replaced Minister Derlis Palacios as Minister of Mines and Petroleum.<sup>262</sup> Thereafter, in a 14 June 2009 article in a local news service in Quito, the new minister was quoted in an interview with state-run channel *Ecuadortv* as stating that: “Perenco is challenging an Ecuadorean law and is taking this challenge to an arbitrator, a third party, and that is unacceptable.”<sup>263</sup>

192. On 25 June 2009, Mr. d’Argentré and Perenco’s Regional Manager for Latin America, Mr. Rodrigo Márquez, met with Minister Pinto to discuss settlement terms. According to Mr. d’Argentré, Minister Pinto maintained Ecuador’s position that in order to cease the *coactivas*, the Consortium would have to agree to pay all outstanding Law 42 amounts under a payment plan (amongst other conditions).<sup>264</sup> Perenco did not agree to this.<sup>265</sup>

193. Mr. Márquez then wrote to Minister Pinto on 2 July 2009, referring to the 25 June 2009 meeting and the terms communicated to Perenco. Mr. Márquez stated that Perenco was not in a

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<sup>260</sup> Exhibit CE-156, Letter from the Secretary of State in charge of Foreign Trade of the French Republic to the Minister of Mines and Petroleum regarding Perenco’s dispute with Ecuador, 5 June 2009 (in French with English translation), T-PER 02918.

<sup>261</sup> *Ibid.*

<sup>262</sup> Exhibit CE-217, Two issues take down Derlis Palacios, [www.elcomercio.com](http://www.elcomercio.com), 9 June 2009 (in Spanish with English translation), T-PER 03710; Revised Memorial, paragraph 119.

<sup>263</sup> Exhibit CE-218, Minister of Mines and Petroleum considers Perenco's claim unacceptable, [eluniverso.com](http://eluniverso.com), 14 June 2009 (in Spanish with English translation), T-PER 03712; Revised Memorial, paragraph 119.

<sup>264</sup> Revised Memorial, paragraph 121.

<sup>265</sup> Revised Memorial, paragraph 122.

position to offer to “pay off the amounts in dispute as a condition for lifting the enforcement measure and suspending the auction”<sup>266</sup>, adding that:

“... the most prudent thing would be to suspend the auction of crude oil from Blocks 7 and 21, scheduled for July 3<sup>rd</sup>, and to lift the enforcement measures, in compliance with stipulations of the decisions regarding the injunctions. That way, we would be able to return to relative operational normality at Blocks 7 and 21, and minimal conditions would be created to facilitate a dialogue and the possibility of a negotiated resolution to this conflict.”<sup>267</sup>

194. Mr. Márquez reaffirmed that Perenco was desirous to continue “pursuing and making room for dialogue.”<sup>268</sup>

195. Petroecuador proceeded with the auction of the Consortium’s crude on 3 July 2009. The Respondent maintains that Perenco threatened legal action against any company who stepped forward to submit a bid in the auction of its oil.<sup>269</sup> A press release by Perenco on 3 July 2009 quotes a statement by Mr. Márquez, the Latin American Regional Manager of the Perenco Group, that “[a]nyone who purchases the seized crude oil under the circumstances is buying property that Ecuador and Petroecuador are not entitled to sell...[c]onsequently, anyone who buys at the Government auction may be liable for conversion or other misdeeds” and “Perenco is prepared to enforce its rights wherever it becomes necessary to do so.”<sup>270</sup> Mr. d’Argentré testified that this was not intended as a threat, and attributed the subsequent lack of external bidders at the auction to the fact that “buyers were aware of the situation and that the crude belonging to Perenco seized was under [sic] Provisional Measures from the Tribunal.”<sup>271</sup> Under cross-examination, however, Mr. d’Argentré acknowledged that the press release may have been treated as a threat by potential buyers, or at the least “inform[ing] all buyers that [it] would – [it] could take legal action against them.”<sup>272</sup> Since there were no bidders, Petroecuador purchased the full volume of oil offered at a 50% discount to the market price, thereafter

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<sup>266</sup> Exhibit CE-222, Letter from Perenco to the Ministry of Mines and Petroleum regarding lifting the enforcement measures, 2 July 2009 (in Spanish with English translation), T-PER 03747.

<sup>267</sup> *Ibid.*

<sup>268</sup> *Ibid.*, T-PER 03748.

<sup>269</sup> Transcript, Hearing on the Merits, Day 2, pp 315-316 (Opening Statement of Eduardo Silva Romero).

<sup>270</sup> Exhibit E-57, “Perenco Will Protect Its Rights in Ecuadorian Oil Seized in Defiance of International Arbitration Tribunal Orders,” PR Newswire, London, 3 July 2009.

<sup>271</sup> Transcript, Hearing on the Merits, Day 3, pp 616- 619 (Testimony of Eric d’Argentré).

<sup>272</sup> Transcript, Hearing on the Merits, Day 3, pp 620-621 (Testimony of Eric d’Argentré).

crediting these sales against Perenco's alleged Law 42 'debt' at the measured-at-the auction price.<sup>273</sup>

196. The Consortium responded to the auction by beginning to plan to suspend operations in the Blocks.<sup>274</sup>
197. On 30 June 2009, the Consortium prepared a suspension plan for Blocks 7 and 21.<sup>275</sup> The suspension plan, in the words of Mr. d'Argentré, would take two to three weeks to be completely executed.<sup>276</sup>
198. The Claimant wrote to Minister Pinto on 2 July 2009, stating it was not in a position to pay its Law 42 assessments and requested that the auction be suspended and *coactiva* measures be lifted.<sup>277</sup> As noted above, on 3 July 2009, Petroecuador proceeded with the auction of the Consortium's crude as scheduled.<sup>278</sup>
199. On 13 July 2009, Perenco and Burlington jointly wrote to Minister Pinto to inform Ecuador of the Consortium's intention to commence the suspension of its operations on 16 July 2009.<sup>279</sup> During the hearing, Mr. John Crick, a Perenco employee and advisor to Perenco's chief executive officer, was asked by counsel for Ecuador whether he was aware if Perenco had commissioned or undertaken a specific analysis of the effects of the proposed suspension

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<sup>273</sup> Revised Memorial, paragraph 124; Counter-Memorial, paragraphs 240 and 244; see Exhibits E-92, Table – Auctions Block 7, p 2 (see Auction No. 1, dated 3 July 2009) and E-93, Table – Auctions Block 21, p 3 (see Auction No. 1, dated 3 July 2009); cf. Exhibits CE-290, Excerpts from DNH, Special Purpose Audit Report on the Production Investments, Income, Costs and Expenses of Production, Commercialization, Transport and Storage, and Other Costs of Perenco Ecuador Limited, Block 7 and Coca-Payamino Unified Field, Period of 1 January 2009 to 31 December 2009, issued 7 April 2011 (in Spanish with English translation), PER 04597 and CE-291, Excerpts from DNH, Special Purpose Audit Report on the Production Investments, Income, Costs and Expenses of Production, Commercialization, Transport and Storage, and Other Costs of Perenco Ecuador Limited, Block 21, Period of 1 January 2009 to 31 December 2009, issued 7 April 2011 (in Spanish with English translation), PER 04606.

<sup>274</sup> Revised Memorial, paragraphs 127-128.

<sup>275</sup> Exhibit E-99, The Consortium's Ecuador Suspension Plan dated 30 June 2009.

<sup>276</sup> 2<sup>nd</sup> Witness Statement of Eric d' Argentré, paragraph 27.

<sup>277</sup> Exhibit CE-222, Letter from Perenco to the Ministry of Mines and Petroleum regarding lifting the enforcement measures, 2 July 2009 (in Spanish with English translation).

<sup>278</sup> See above at paragraph 195.

<sup>279</sup> Exhibit CE-224, Letter from Consortium to the Ministry of Mines and Petroleum regarding suspension of operations in Blocks 7 and 21, 13 July 2009 (in Spanish and English); Exhibit CE-225, Letter from Perenco to the Ministry of Mines and Petroleum regarding suspension of operations in Blocks 7 and 21, 15 July 2009 (in Spanish with English translation).

before this letter.<sup>280</sup> Mr. Crick testified that he was “not aware of [such a] study” but did not feel that this was unexpected because of Perenco’s familiarity with the conditions of each well and reservoir in Blocks 7 and 21.<sup>281</sup>

200. Minister Pinto responded by letter of 15 July 2009, stating that “in response to [Perenco’s] astounding threat to suspend [its] oil operations in Ecuador, we must warn you that an illegal and unilateral decision of this nature would cause serious technical and monetary damage to the Republic of Ecuador” and “the public authorities of the Ecuadorian Government reserve all their rights, which may include bringing action before the competent forum to seek payment of damages.”<sup>282</sup> He stated that Ecuador remained open to receiving a *bona fide* proposal on the payment of the Consortium’s Law 42 debt.<sup>283</sup>

201. In addition, by letter of the same date, the Hydrocarbons Directorate in Ecuador wrote to the Consortium, informing it that it had not received any notice for suspension of its operations, as required by Ecuadorian law.<sup>284</sup> Such notice was supplied to the Directorate the following day.<sup>285</sup>

202. The Claimant responded to Minister Pinto’s letter of 15 July 2009 on 16 July 2009 stating, amongst other things, that since Ecuador has “consistently defied the Tribunal’s orders and continues to take coercive measures that indefinitely deprive Perenco and Burlington of all income, Perenco and Burlington have no other choice but to minimize expense by suspending operations.”<sup>286</sup>

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<sup>280</sup> Transcript, Hearing on the Merits, Day 5, p 1107 (Testimony of John Crick).

<sup>281</sup> Transcript, Hearing on the Merits, Day 5, pp 1107-1109 (Testimony of John Crick).

<sup>282</sup> Exhibit CE-226 Letter from the Ministry of Mines and Petroleum to Perenco regarding payment of debt, 15 July 2009 (in Spanish with English translation), T-PER 03772-03773; Revised Memorial, paragraph 132.

<sup>283</sup> *Ibid.*

<sup>284</sup> Exhibit E-102, Letter from the DNH to the Consortium dated 15 July 2009.

<sup>285</sup> Exhibit CE-227, Letter from Perenco advising the National Hydrocarbons Directorate of suspension of operations, 16 July 2009 (in Spanish with English translation).

<sup>286</sup> Exhibit CE-228, Letter from Perenco to the Ministry of Mines and Petroleum regarding payment of disputed Law 42 amounts, 16 July 2009, p 2 (in Spanish and English) (Revised on 11-01-12).

203. On 16 July 2009, Mr. d'Argentré initiated procedures for the suspension of operations in the respective blocks.<sup>287</sup> This was done pursuant to a Technical Action Plan produced by Perenco and Burlington.<sup>288</sup>
204. Ecuador took control of the Blocks on that same day.<sup>289</sup> Ecuador maintains the position that its intervention in the Blocks, including its subsequent declaration of *caducidad*, was necessary in order to avoid “irreparable damage to hydrocarbons because these are strategic resources.”<sup>290</sup> Moreover, Ecuador alleges that Perenco abandoned the Blocks having performed the “necessary calculations” leading it to conclude it “was best...to adopt a strategy of self-expropriation.”<sup>291</sup>
205. Agence France Presse reported on 20 July 2009 that “France warn[s] Ecuador on Monday that its decision to take control of two oil concessions operated by French oil group Perenco could jeopardise foreign investment in the country.”<sup>292</sup>
206. Petroecuador, in a statement from its Executive President Rear-Admiral Luis Jaramillo, informed Perenco’s employees that the government intended to continue with normal operations in Blocks 7 and 21.<sup>293</sup> For this purpose, Petroecuador passed a resolution on 16 July 2009, authorised by Rear-Admiral Jaramillo, characterising the suspension as an “emergency situation” and accordingly granting to itself the authority to, through Petroamazonas, “take all action of an administrative, technical, operational, economic and legal nature as is necessary, up to and including the direct engagement of goods and services to overcome this emergency so as to allow the normal performance of production activities in Blocks 7 and 21.”<sup>294</sup>

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<sup>287</sup> Revised Memorial, paragraph 134.

<sup>288</sup> Exhibit E-242, Technical Action Plan to Suspend Operations at Blocks 7 and 21.

<sup>289</sup> Exhibits CE-230, Ecuador Takes Perenco Fields on Threat to Halt Output (Update 2), Bloomberg.com, 16 July 2009 and CE-233, Paris Warns Quito over Perenco Oil Field Takeover, Agence France Presse, 20 July 2009.

<sup>290</sup> Transcript, Hearing on the Merits, Day 1, p 192 (Testimony of Attorney-General García Carrión).

<sup>291</sup> Transcript, Hearing on the Merits, Day 1, p 193 (Testimony of Attorney-General García Carrión).

<sup>292</sup> Exhibit CE-233, *Paris Warns Quito over Perenco Oil Field Takeover*, Agence France Presse, 20 July 2009.

<sup>293</sup> Exhibit CE-234, *Ecuador to Run Perenco Fields*, Oil Daily, 20 July 2009.

<sup>294</sup> Exhibit CE-229, Petroecuador Resolution 356.09, 16 July 2009 (in Spanish with English translation), T-PER 03778-03779.

207. Perenco and Burlington jointly protested the takeover by letter dated 17 July 2009 to Minister Pinto and Rear-Admiral Jaramillo, asserting that the actions of the Government of Ecuador and Petroecuador constituted “an unlawful confiscation of the Consortium’s property and violation of the Consortium’s fundamental rights of ownership of this property.”<sup>295</sup> Perenco and Burlington demanded the “immediate payment by Ecuador of fair and adequate compensation.”<sup>296</sup>
208. According to Mr. d’Argentré, once it “became clear that Perenco would not be resuming control of the Consortium’s operations in the near future, [he] began to notify [Perenco’s] services providers, vendors, employees and local community leaders that Perenco would be terminating its contractual obligations on grounds of *force majeure* arising from the Government’s takeover of the Blocks.”<sup>297</sup>
209. On 20 July 2009, Petroecuador issued a notice of the planned auction of Perenco’s crude oil on 26 August 2009.<sup>298</sup>
210. On the following day, Ecuador wrote to Perenco stating that it had abandoned the blocks and had thus left the State with no option but to assume operational responsibilities.<sup>299</sup> Perenco denied that this was the case in a letter dated 23 July 2009.<sup>300</sup>
211. Also on 23 July 2009, Minister Pinto stated that the production of oil fields in Blocks 7 and 21 were in “perfect condition” after the Ecuadorian State had assumed control over its operations.<sup>301</sup>

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<sup>295</sup> Exhibit CE-231, Letter from Perenco to the Ministry of Mines and Petroleum regarding takeover of facilities, 17 July 2009 (in Spanish and English), PER 03783.

<sup>296</sup> *Ibid.*

<sup>297</sup> 2<sup>nd</sup> Witness Statement of Eric d’ Argentré, paragraph 38; Revised Memorial, paragraph 100.

<sup>298</sup> Exhibit CE-157, Notice issued by Petroecuador regarding 26 August 2009 auction of Perenco’s crude, 20 July 2009.

<sup>299</sup> Exhibit CE-236, Letter from Petroecuador to Perenco regarding suspension of operations, 21 July 2009 (in Spanish with English translation).

<sup>300</sup> Exhibit CE-238, Letter from Perenco to the Ministry of Mines and Petroleum and Petroecuador regarding takeover of Blocks 7 and 21, 23 July 2009 (in Spanish and English).

<sup>301</sup> Exhibit E-106, *Producción de campos 7 y 21 está en perfectas condiciones, según Ministro Germánico Pinto, in Ecuador Inmediato*, 23 July 2009.

212. On 24 July 2009, in a letter to Perenco and Burlington, Petroecuador reiterated that they had abandoned the blocks without justification and that they were obliged to resume operations immediately.<sup>302</sup> Thereafter, on 14 August 2009, the National Directorate of Hydrocarbons passed a resolution ratifying retrospectively the actions of Petroecuador in relation to Blocks 7 and 21 as of 17 July 2009.<sup>303</sup>
213. On 18 August 2009, Petroecuador sent a notice to Perenco giving it 10 days to resume operations.<sup>304</sup> Perenco and Burlington replied jointly on 28 August 2009, stating that Ecuador's acts constituted an expropriation of their investments in Ecuador, and that the suspension of operations was intended to mitigate their losses in accordance with law.<sup>305</sup>
214. On 12 November 2009, the Ministry of Non-Renewable Natural Resources (the successor to the Ministry of Mines and Petroleum) initiated proceedings to declare *caducidad* of the contracts.<sup>306</sup>
215. *Caducidad* was formally declared by Ecuador on 20 July 2010.<sup>307</sup>

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<sup>302</sup> Exhibits E-107, Letter from Petroecuador to Perenco and Burlington dated 24 July 2009 and E-114, Letter from Petroecuador to Burlington and Perenco dated 24 July 2009.

<sup>303</sup> Exhibit E-109, DNH Resolution No. 617 dated 14 August 2009.

<sup>304</sup> Exhibit CE-239, Letter from Petroecuador to Perenco requesting Perenco to resume operations, 18 August 2009 (in Spanish with English translation); Revised Memorial, paragraph 143.

<sup>305</sup> Exhibit CE-243, Letter from Perenco Ecuador to the Ministry of Mines and Petroleum and Petroecuador regarding suspended operations in Blocks 7 and 21, 28 August 2009 (in Spanish and English); Revised Memorial, paragraph 143.

<sup>306</sup> Exhibit CE-244, Notice from the Ministry of Non-Renewable Natural Resources to Perenco regarding commencement of *caducidad* proceedings for the Block 7 Participation Contract, 12 November 2009 (in Spanish with English translation).

<sup>307</sup> Exhibits CE-246, *Caducidad* decision by the Ministry of Non-Renewable Natural Resources, Block 7, 20 July 2010 (in Spanish with English translation) and CE-247, *Caducidad* decision by the Ministry of Non-Renewable Natural Resources to Perenco, Block 21, 20 July 2010 (in Spanish with English translation).

#### IV. SUMMARY OF THE PARTIES' CLAIMS AND RELIEFS

##### A. Jurisdiction

###### (1) Whether Perenco is a company 'controlled by' French nationals within the meaning of Article 1(3)(ii) of the Treaty

216. Article 1(3) of the Treaty defines "companies" which have standing to claim under the Treaty as:

- (i) Any body corporate constituted in the territory of either Contracting Party in accordance with its legislation and having its registered office there,
- (ii) *Any body corporate controlled by nationals of one Contracting Party* or by bodies corporate having their registered office in the territory of one of the Contracting Parties and constituted in accordance with that Party's legislation.<sup>308</sup>

217. Perenco submitted that it was at all relevant times controlled by French nationals. Thus, it is a French company for the purposes of the Treaty and consequently has the requisite standing to bring a claim regarding alleged breaches of the Treaty by the Respondent.<sup>309</sup>

218. Ecuador submitted that Perenco bears the burden of establishing this Tribunal's jurisdiction *ratione personae* pursuant to the ICSID Convention and the Treaty, and has failed to do so.<sup>310</sup> It stressed that, to succeed, Perenco had to prove that it was directly controlled by Mr. Hubert Perrodo's heirs on both the date on which consent to arbitration is purported to be effected (17 October 2007) as well as on the date on which the Request for Arbitration was registered by the Centre (4 June 2008).<sup>311</sup> It contended that on each of those dates Perenco was not controlled by the heirs of the late Mr. Perrodo within the meaning of Article 1(3)(ii).<sup>312</sup>

219. Ecuador's argument in this regard was two-fold.

220. First, Ecuador asserted that the Treaty required legal control and that at the relevant dates, no Perrodo heir had the legal capacity to control the ultimate parent company of Perenco Ecuador

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<sup>308</sup> Exhibit CE-7, Treaty, PER 00520 [Emphasis added.].

<sup>309</sup> Amended Request, paragraph 14. Exhibit CE-6 to the Amended Request identifies Hubert Perrodo on the register of members of Perenco Gabon S.A. (formerly, Perenco S.A. and the sole shareholder in Perenco), holding 90,498 shares.

<sup>310</sup> Counter-Memorial, paragraphs 27-32.

<sup>311</sup> Rejoinder, paragraph 24.

<sup>312</sup> *Ibid.*

Limited, namely, PIL.<sup>313</sup> This was because the shares in that company were not transferred to Mr. Perrodo's heirs in accordance with Bahamian law until 22 December 2011, well after the two dates previously noted.<sup>314</sup>

221. Ecuador asserted further that the relevant test was whether the heirs individually or collectively had the legal capacity to control Perenco on the relevant dates, particularly the critical date of 17 October 2007 (the date on which consent to ICSID arbitration was purported to be given).<sup>315</sup> Ecuador argued that they did not and that Mr. Perrodo died intestate, and consequently, after his death on 29 December 2006, his estate, consisting of his shares in PIL, was left un-administered until 19 August 2009 when letters of administration were formally granted by the Bahamian courts.<sup>316</sup> On the basis that Bahamian law, not French law, governs the transmission of shares, the Perrodo heirs had, at best, an equitable interest in the shares in PIL until such time as they were legally registered as owners of the shares. This could only be achieved after the letters of administration had been granted.<sup>317</sup>

222. Pending such registration and transfer of shares, the Articles of Association of Perenco did not permit the heirs of the late Mr. Perrodo to exercise any rights in relation to the corporate governance of PIL, including voting. Accordingly, on 17 October 2007, no Perrodo, let alone François Perrodo, was vested with the legal capacity to control PIL (and, through that parent company, Perenco Ecuador Limited).<sup>318</sup>

223. Perenco challenged this position as legally and factually incorrect. It cited several cases which in its submission demonstrate the flexible approach taken by tribunals and which emphasise that different criterion may be employed to find control, this not necessarily limited to legal capacity to control.<sup>319</sup> It argued that the undisputed facts establish that the Perrodo family

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<sup>313</sup> Rejoinder, paragraphs 26-33.

<sup>314</sup> Rejoinder, paragraphs 26-31.

<sup>315</sup> Rejoinder, paragraphs 34-43.

<sup>316</sup> Counter-Memorial, paragraphs 38-39, 59-61, 85.

<sup>317</sup> Counter-Memorial, paragraphs 69-71.

<sup>318</sup> Counter-Memorial, paragraph 40. The Respondent also referred to Article 27 of the Articles of Association of PIL which provides that “the *executor or administrator of a deceased member*, the guardian of an incompetent member or the trustee of a bankrupt member shall be the only person recognised by the Company as having any title to its share” [Emphasis added.]. See also, Counter-Memorial, paragraphs 42-98.

<sup>319</sup> Reply, paragraphs 66-79.

controlled Perenco in every way significant for the purposes of the term “controlled” under Article 1(3)(ii) of the Treaty.<sup>320</sup> It argued that this control was manifested in formal and informal means.<sup>321</sup> The Perrodo family was in fact in control of the Perenco Group both when Hubert Perrodo was alive and after his death.<sup>322</sup> Moreover, at the date of consent to arbitration, the Perrodo heirs collectively owned 100% of the shares in PIL under French law and this was sufficient to establish “control” over the company (and through that, its wholly-owned subsidiary).<sup>323</sup>

224. Perenco asserted that even if the Tribunal were to proceed on the narrow approach to control advocated by Ecuador, Perenco was nevertheless legally controlled by French nationals as of 17 October 2007 because approximately 7.1 % of the shares in PIL were owned by Glenmor Energy, which in turn, was wholly owned by François Perrodo.<sup>324</sup>
225. Perenco emphasised that Ecuador has repeatedly and consistently referred to and treated it as a French company.<sup>325</sup> It argued that under ICSID jurisprudence on Article 25(2)(b), the host State’s awareness of the objective fact of control is one of the factors taken into consideration when determining “foreign control”.<sup>326</sup>
226. Ecuador’s second point was that Article 1(3)(ii) of the Treaty required “direct” control.<sup>327</sup> It asserted that according to Bahamian law, the Perrodo heirs were not capable of exercising direct control over PIL (and through that, Perenco) at the critical date because they were not shareholders of that company. The Contracting Parties intended that the term “control” refer only to “direct control” because in negotiating the Treaty they chose to remove the phrase “directly or indirectly” contained in prior drafts of the Treaty, while simultaneously

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<sup>320</sup> Reply, paragraph 73.

<sup>321</sup> *Ibid.*

<sup>322</sup> Reply, paragraphs 73-79.

<sup>323</sup> Reply, paragraphs 80-89.

<sup>324</sup> Reply, paragraphs 90-98.

<sup>325</sup> Reply, paragraphs 99-104.

<sup>326</sup> Reply, paragraphs 102-103.

<sup>327</sup> Rejoinder, paragraphs 91-129.

incorporating it elsewhere in order to expand the scope of the definition of "investment" under the Treaty.<sup>328</sup>

227. Ecuador contended that “it [was] entirely reasonable to suppose that having taken steps to protect the indirect investments of nationals of a State party, the Contracting Parties did not believe that they then needed to provide additional protection to those same investments by expanding the scope of the persons who have standing to bring treaty claims.”<sup>329</sup> It submitted that regardless of what the Tribunal interprets to be the plain and ordinary meaning of the term “control” in Article 1(3)(ii) of the Treaty, it should have regard to the *travaux préparatoires* of the Treaty which, in its view, clearly indicate that the parties’ intention was not to extend the scope of the term to indirect control, but rather to restrict it to direct control.<sup>330</sup>
228. Perenco submitted in turn that Ecuador’s argument that the use of the word “controlled” in Article 1(3)(ii) of the Treaty must be read to mean “controlled directly” should be rejected because it was refuted by the plain language of the Treaty, by pertinent components of its *travaux préparatoires*, and by prior investment treaty jurisprudence.<sup>331</sup> In Perenco’s view, the term “controlled” encompassed both direct and indirect forms of control.<sup>332</sup> It asserted that Ecuador has not offered the Tribunal one citation of a dictionary definition of the term which defined it as limited to “direct control”.<sup>333</sup> Indeed, the definitions proffered confirm that the ordinary meaning of control encompassed both direct and indirect forms of control.<sup>334</sup>
229. Moreover, Perenco averred that recourse to the *travaux* was inappropriate when the text of the Treaty was unambiguous (which it submitted was the case here).<sup>335</sup> In the event that the Tribunal determined it was necessary to consult the *travaux*, Perenco maintained that the drafting history of the Treaty confirmed the broad meaning of the word “controlled”.<sup>336</sup> The

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<sup>328</sup> Counter-Memorial, paragraphs 33, 99-137.

<sup>329</sup> Counter-Memorial, paragraphs 111 and 125.

<sup>330</sup> Counter-Memorial, paragraph 129.

<sup>331</sup> Reply, paragraph 9.

<sup>332</sup> Reply, paragraphs 18-20.

<sup>333</sup> Reply, paragraphs 21-26.

<sup>334</sup> Reply, paragraphs 21 and 23.

<sup>335</sup> Reply, paragraph 28.

<sup>336</sup> Reply, paragraphs 27-51.

*travaux* demonstrated that a proposal to limit the definition of a company “to all juridical persons *controlled directly* by nationals of one of the Contracting Parties” was notably rejected by the Contracting Parties.<sup>337</sup>

## (2) Whether claims relating to *Caducidad* are arbitrable

230. Ecuador objected to the Tribunal’s jurisdiction to consider the claims relating to *caducidad* and, alternatively, the admissibility of such claims.<sup>338</sup>
231. First, Ecuador submitted that disputes relating to *caducidad* are not arbitrable under Ecuadorian Law. Ecuador relied on the evidence of its expert, Professor Juan Pablo Aguilar Andrade, to submit that under Ecuadorian law a dispute may be submitted to arbitration only if it is of a contractual nature.<sup>339</sup> The declaration of *caducidad* was an administrative act, carrying a presumption of legality under Ecuadorian law and challengeable only before Ecuadorian courts (as per Article 173 of Ecuador’s Constitution).<sup>340</sup>
232. Perenco rejected this argument, submitting that if it were accepted Ecuador would effectively have used its domestic law to evade its Treaty obligation to submit all legal disputes regarding investments to ICSID arbitration.<sup>341</sup> In any event, supported by the evidence of its expert Dr. Héran Pérez Loose, it submitted that Ecuadorian law does not preclude arbitration of *caducidad*-related disputes because Article 173 of Ecuador’s Constitution provides only that administrative acts *may* be challenged before the Ecuadorian acts, and not that this is the exclusive forum.<sup>342</sup>

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<sup>337</sup> Reply, paragraphs 31-40 [Italics in original].

<sup>338</sup> Counter-Memorial, paragraphs 340-367.

<sup>339</sup> 3<sup>rd</sup> Expert Report of Juan Pablo Aguilar Andrade, paragraphs 181-183; Rejoinder, paragraphs 154-155.

<sup>340</sup> Counter-Memorial, paragraph 346; Rejoinder, paragraphs 157-158.

<sup>341</sup> Reply, paragraphs 108-113, reference to *Occidental Petroleum Corporation and Occidental Exploration and Production Company v. Republic of Ecuador*, ICSID Case No. ARB/06/11, Decision on Jurisdiction (9 September 2008) (“*Occidental II (Jurisdiction)*”).

<sup>342</sup> Transcript, Hearing on the Merits, Day 6, p 1533 (Testimony of Héran Pérez Loose). Ecuador’s rebuttal is found at paragraph 160 of its Rejoinder. It states that the terms of Article 173 of the Constitution indicate it does not intend a choice of forum because it allegedly uses the term “can” rather than “may”.

233. Second, Ecuador asserted that the parties to the Participation Contracts expressly carved *caducidad* out of the subject-matter jurisdiction of the Tribunal.<sup>343</sup> It referred to clauses 21.3 and 21.4 of the Block 7 Contract and clause 20.2 and Annex XVI of the Block 21 Contract,<sup>344</sup> and submitted that since “the motive for declaration of *caducidad* ... was legal and did not arise out of a disagreement of a technical or economic character” it fell strictly outside these provisions.<sup>345</sup>
234. Perenco responded that these provisions set out the procedure that should be followed by a party in terminating the contract based on different grounds. They did not exclude the submission of *caducidad*-related claims to arbitration, nor did they require the submission of *caducidad*-related claims exclusively to Ecuadorian courts.<sup>346</sup>
235. Perenco also argued that the issue was not whether a *caducidad*-related claim was “legal” but whether it was “related to technical or economic aspects.”<sup>347</sup> It characterised the declaration of *caducidad* as an “inseparable element of Ecuador’s coercive conduct against Perenco” which gave rise to a dispute concerning key provisions relating to the sharing of economic benefits under the Contracts.<sup>348</sup>
236. Perenco submitted that only an explicit and unambiguous waiver of its right to submit to ICSID arbitration could bar such claims and that none of the provisions in the Participation Contracts qualified.<sup>349</sup>

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<sup>343</sup> Counter-Memorial, paragraph 360.

<sup>344</sup> Exhibit E-58, Annex XVI (Resubmitted on 11-17-09). Annex XVI provides that “the Parties agree that any technical and/or economic dispute arising out of the application of the Participation Contract for the Exploration and Exploitation of Hydrocarbons in Block 21 of the Amazon Region, which is the object of the present Contract, shall be resolved according to the provisions of the aforementioned Convention.” (Unofficial translation of Spanish original: “[L]as Partes acuerdan que toda disputa técnico y/o económica derivada de la aplicación del Contrato de Participación para la Exploración y Explotación de Hidrocarburos en el Bloque 21 de la Amazonía, que es materia del presente Contrato, se resolverá de acuerdo con las estipulaciones establecidas en el antedicho Convenido.”).

<sup>345</sup> Counter-Memorial, paragraphs 345-355, 360; Rejoinder, paragraphs 167-190.

<sup>346</sup> Reply, paragraphs 127-136.

<sup>347</sup> Reply, paragraph 147.

<sup>348</sup> Reply, paragraphs 148-149.

<sup>349</sup> Revised Memorial, paragraphs 153-154; Reply, paragraphs 128-143.

237. Lastly, Ecuador submitted that the claims relating to *caducidad* were premature because Perenco did not seek redress from administrative courts in Ecuador in respect of the same.<sup>350</sup> Perenco responded it could not proceed before administrative courts in Ecuador because of the Tribunal’s direction in its Decision on Provisional Measures that the Parties refrain from resorting to “domestic courts of Ecuador to enforce or resist any claim...”<sup>351</sup>

## B. Merits

### (1) Introduction to the claims under the Treaty and the Participation Contracts

238. Perenco submitted that Ecuador through Law 42, the Implementing Regulations, the *coactivas* and seizure of its crude, intervention in the Blocks and declaration of *caducidad* breached its obligations under Articles 4, 5 and 6 of the Treaty, and the Participation Contracts.<sup>352</sup>

239. At paragraph 2 of its Revised Memorial, Perenco explained that:

Wielding Law 42, Ecuador not only eviscerated fundamental terms of the Participation Contracts, but in doing so turned what in all other respects was a highly profitable business into one that, in 2008 – despite record oil prices – generated a loss of nearly \$63 million, and at the same time took for itself hundreds of millions of dollars that it was not entitled to under the Contracts. Respondent’s actions also cost Perenco millions of dollars in foregone profits that Perenco would have earned if not for the enactment and enforcement of Law 42.<sup>353</sup>

240. For its part, Ecuador framed the enactment and application of Law 42 in very different terms:

Law 42 – together with the *Ley de Equidad Tributaria* – represented a legitimate means for Ecuador to achieve a major public policy goal of both re-establishing the economic equilibrium of its participation contracts (including the Participation Contracts) which had been disrupted by massive and unforeseen oil price increases, and opening discussions with the oil companies operating in Ecuador with a view to agreeing upon more adapted economic models in light of the new oil-market price order prevailing since the mid-2000s. These measures were accordingly taken by Ecuador in accordance with its duty to seek a fair

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<sup>350</sup> Counter-Memorial, paragraphs 362-367; Reply, paragraphs 163-173.

<sup>351</sup> Reply, paragraph 164.

<sup>352</sup> Amended Request, paragraph 33.

<sup>353</sup> Revised Memorial, paragraph 2.

allocation of the petroleum rent between the oil companies operating in Ecuador and the public.<sup>354</sup>

241. Ecuador asserted that in response to escalating oil prices and the prospect of windfall profits, “most, if not all major producing oil countries in a comparable position to Ecuador [had] taken measures similar to Law 42 to maintain the economic stability of their concession contracts since 2002.”<sup>355</sup> An international tribunal could not hold a State liable for economic injury which was the consequence of *bona fide* regulation within its police powers.<sup>356</sup> The power to tax was a sovereign power within the category of a State’s police powers, and neither customary international law nor the Treaty recognized any limitations on this power.<sup>357</sup>
242. Lastly, Ecuador maintained that the events following the enactment of Law 42 and complained of by Perenco (i.e., *coactivas*, intervention in the Blocks and *caducidad*) were triggered by Perenco’s own illegal conduct.<sup>358</sup> For example, the *coactiva* process was initiated in response to Perenco’s failure to pay its Law 42 dues.<sup>359</sup> Thus, Perenco should be barred from claiming compensation in relation to these claims.<sup>360</sup>

**(2) Whether Ecuador breached Article 4 of the Treaty by failing to accord fair and equitable treatment to Perenco’s investment in Blocks 7 and 21**

243. Perenco submitted that Ecuador breached Article 4 of the Treaty obliging it to accord Perenco’s investment in Blocks 7 and 21 fair and equitable treatment and to refrain from interfering with the use and enjoyment of Perenco’s investments.<sup>361</sup> It asserted that its basic expectations as largely set forth in the Participation Contracts were that its participation was tied exclusively to the volume of production it generated, thereby isolating it from oil price

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<sup>354</sup> Counter-Memorial, paragraph 14.

<sup>355</sup> Counter-Memorial, paragraphs 15-16.

<sup>356</sup> Counter-Memorial, paragraphs 545-547.

<sup>357</sup> Counter-Memorial, paragraphs 546-548.

<sup>358</sup> Counter-Memorial, paragraphs 559, 563-567.

<sup>359</sup> Counter-Memorial, paragraph 559.

<sup>360</sup> *Ibid.*

<sup>361</sup> Amended Request, paragraph 34.

fluctuations, and Ecuador agreed not to upset this commercial bargain by making drastic changes to participation percentages in response to price fluctuations in the global market.<sup>362</sup>

244. Perenco submitted that Ecuador undermined this expectation by enacting and enforcing Law 42.<sup>363</sup> This was compounded by the raising of the percentage of revenues demanded by Law 42 to 99% on 4 October 2007.<sup>364</sup>
245. Perenco argued that it had a reasonable expectation that the Participation Contracts would not be amended given their clause 15.2 which required the prior agreement of the parties for any amendments.<sup>365</sup> It relied on this understanding when it chose to put enormous capital at risk in Ecuador.<sup>366</sup> In this connection, Perenco asserted that when it sought in good faith to negotiate with Ecuador, Ecuador responded inflexibly and unpredictably, ignoring its obligation to negotiate a correction factor and to abide by the Decision on Provisional Measures and further threatening to take legal action against its employees or expel them.<sup>367</sup>
246. Perenco further contended that it had a legitimate expectation that disputes regarding the investment would be “resolved peaceably through an international arbitration process at ICSID.”<sup>368</sup> Ecuador’s defiance of the Tribunal’s Decision on Provisional Measures was unfair and inequitable.<sup>369</sup>

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<sup>362</sup> *Ibid.*; Revised Memorial, paragraphs 156-159, 169; Reply, paragraph 282 (“Ecuador thus deliberately created an environment in which a contractor could expect that it would operate under a production sharing model where the economic benefit was allocated between the contractor and the State based on an agreed percentage of production, that the contractor would not be unilaterally and coercively forced to abandon this model for a less profitable services contract, and that any disputes over such economic matters would be peaceably resolved through binding international arbitration.”)

<sup>363</sup> Revised Memorial, paragraph 167; Reply, paragraphs 287-290.

<sup>364</sup> Revised Memorial, paragraph 167; Reply, paragraph 290.

<sup>365</sup> Revised Memorial, paragraphs 160-161; Exhibits CE-17, Block 7 Participation Contract, PER 04829 and CE-10, Block 21 Participation Contract, PER 04703.

<sup>366</sup> Revised Memorial, paragraph 159.

<sup>367</sup> Revised Memorial, paragraphs 164 and 169; Reply, paragraphs 297-300, 309.

<sup>368</sup> Revised Memorial, paragraph 163.

<sup>369</sup> Reply, paragraphs 297-300.

247. Perenco maintained that Ecuador’s actions in direct contravention of its legitimate expectations effectively removed a substantial portion of revenue to which it was entitled and rendered its investment in Blocks 7 and 21 commercially unviable.<sup>370</sup>
248. Ecuador for its part challenged whether the “legitimate expectation” as articulated by Perenco was consistent with the terms of the Participation Contracts.<sup>371</sup> It submitted that Law 42 could not modify the Participation Contracts because on a strict reading of its terms it did not affect the participation in volume of oil that Perenco was entitled to receive.<sup>372</sup> The Participation Contracts did not guarantee Perenco a right to a given revenue stream, let alone substantial profits.<sup>373</sup> Thus, Perenco had failed to prove that Law 42 affected the economy of the Contracts and that a correction factor to the Consortium’s participation should have been negotiated.<sup>374</sup>

**(3) Whether Ecuador breached Article 4 of the Treaty by interfering with Perenco’s use and enjoyment of its investment in Blocks 7 and 21**

249. In addition, Perenco submitted that Ecuador breached Article 4 of the Treaty by interfering with the management, use, enjoyment and transfer of its investment in Blocks 7 and 21.
250. Perenco’s submission was that as a result of Law 42, the Implementing Regulations and Ecuador’s actions in relation thereto, it was progressively denied the various attributes of management, use and enjoyment of its investment, namely, its exploitation of the Blocks, production and sale of crude, further investment in additional wells and infrastructure, and profits thereof.<sup>375</sup>
251. Ecuador rejected this claim. It submitted that the Participation Contracts did not preclude the State from enacting and enforcing Law 42 and Perenco could not claim that the events subsequent to the enactment of Law 42 and the termination of the Participation Contracts

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<sup>370</sup> Amended Request, paragraph 34.

<sup>371</sup> Counter-Memorial, paragraph 465. At paragraphs 272–276 of its Reply, Perenco argued in turn that Ecuador improperly contends that its Treaty obligation of fair and equitable treatment is bounded by the terms of the Participation Contracts.

<sup>372</sup> Counter-Memorial, paragraphs 24 and 469.

<sup>373</sup> Counter-Memorial, paragraphs 469-470.

<sup>374</sup> Counter-Memorial, paragraphs 464-484.

<sup>375</sup> Revised Memorial, paragraph 176; Reply, paragraphs 328-337.

interfered with the use and enjoyment of its investments as Ecuador was acting to enforce its domestic law, and was responding to Perenco's own illegal action.<sup>376</sup>

**(4) Whether Ecuador breached Article 5 of the Treaty by acting discriminatorily with regard to Perenco and its investment in Blocks 7 and 21**

252. Article 5 of the Treaty requires Ecuador to accord to nationals or companies of the other Contracting Party in respect of their investments and activities in connection with such investments, the same treatment as is accorded to its own nationals or companies, or the treatment accorded to nationals or companies of the most-favoured nation.<sup>377</sup>
253. Perenco initially submitted that Law 42 was "openly designed" to target the contracts of foreign companies and that was descriptive of both its intent and effect.<sup>378</sup> Ecuador in its Counter-Memorial argued that the Tribunal lacks jurisdiction to determine this claim because Article 5 of the Treaty excludes its application to matters of taxation, such as Law 42 and the actions taken by Ecuador to enforce it.<sup>379</sup>
254. Perenco subsequently abandoned this claim, stating in its Reply at paragraph 5 that:

In the interests of efficiency, Perenco will not advance further its claim that Ecuador also violated the most favored nation and national treatment provisions of Article 5 of the Treaty on the basis that Law 42 and its enforcement discriminated against Perenco. Perenco takes this position in light of the fact that Article 5 says that '[t]he provisions of this article shall not apply to taxation matters,' and the decision on jurisdiction issued by the tribunal in *Burlington v. Ecuador* to the effect that Law 42 should fall within the carve-out in the U.S.-Ecuador Treaty for matters of taxation. See *Burlington* (Jurisdiction), EL-109, ¶¶ 164-167. Perenco does not accept that the *Burlington* tribunal's analysis is necessarily correct or binding on this Tribunal, but, to simplify this proceeding, *it is prepared not to pursue its distinct claim for violation of Article 5 of the Treaty. The discriminatory intent and effect of Ecuador's conduct nevertheless remains*

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<sup>376</sup> Counter-Memorial, paragraphs 495-502. The Claimant at paragraphs 329-336 of its Reply submitted in turn that Ecuador had conflated its rebuttal to the claim for breach of fair and equitable treatment with that of breach of the obligation not to impede or impair the investor's right to manage, use and enjoy with respect to its investment; that there was in its view no breach of the terms of the Participation Contracts. Perenco submitted that the latter obligation is distinct from the obligation to afford fair and equitable treatment, and that the observance of contractual obligations (which Perenco disputed occurred in its case) was not a sufficient answer.

<sup>377</sup> Exhibit CE-7, Treaty, PER 00520.

<sup>378</sup> Revised Memorial, paragraph 181.

<sup>379</sup> Counter-Memorial, paragraphs 11, 505, 507-512.

*relevant to Ecuador's obligations under other Treaty provisions, including Article 4, as well as to Ecuador's contractual obligations, as discussed below.*<sup>380</sup>

255. In its Reply, the Claimant raised an alternative submission in the context of a contractual undertaking under clause 5.1.28 of the Block 7 Participation Contract not to discriminate between Contractors operating in Ecuador on participation contracts for the exploration and exploitation of hydrocarbons.<sup>381</sup> Due to the contractual nature of this claim, it is described below at paragraphs 272 and 276.

**(5) Whether Ecuador breached Article 6 of the Treaty by expropriating Perenco's investment in Blocks 7 and 21**

256. Perenco submitted that the cumulative effect of Ecuador's measures, beginning with its enactment of Law 42 (which essentially deprived Perenco of the key terms of Perenco's investment, namely the opportunity to earn profits),<sup>382</sup> the enforcement of Law 42 through its seizure and sale of Perenco's crude, its physical take-over of the Blocks and unilaterally declaring *caducidad*, resulted in a "complete taking of Perenco's assets" in breach of Article 6 of the Treaty.<sup>383</sup> Ecuador has also failed to comply with the requirements of Article 6 in that it has not put forward any public necessity justification for its actions and has not paid nor offered to pay any compensation.<sup>384</sup>

257. Perenco submitted that a measure is expropriatory "when it leads to a substantial deprivation or effectively renders useless an investor's property rights."<sup>385</sup> Relying on *Alpha Projectholding v. Ukraine*, Perenco asserted that a "government action need not amount to an outright seizure or transfer of title in order to amount to an expropriation under international law", in this way laying foundation for its submission that the actions of a State which deprive an investor of acquired contractual rights can be expropriatory.<sup>386</sup> In this light, Perenco maintained that "when a State exercise[d] its public authority unilaterally to amend the key terms of a contract

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<sup>380</sup> Reply, paragraph 5 [Emphasis added.].

<sup>381</sup> Reply, paragraphs 496-501; cf. Rejoinder, paragraphs 426-428.

<sup>382</sup> Revised Memorial, paragraph 192.

<sup>383</sup> Revised Memorial, paragraph 194; Reply, paragraphs 354-374.

<sup>384</sup> Revised Memorial, paragraph 195; Reply, paragraphs 390-396, 406-411.

<sup>385</sup> Revised Memorial, paragraph 189.

<sup>386</sup> *Ibid.*; citing paragraph 408 of CA-281, *Alpha Projectholding GMBH v. Ukraine*, ICSID Case No. ARB/07/16, Award (8 November 2010).

with an investor, with the effect of essentially depriving the investor of the contractor's benefits, such a repudiation of acquired contract rights constitute[d] a measure tantamount to expropriation."<sup>387</sup>

258. Perenco submitted that Ecuador could not excuse its conduct by arguing that Law 42 was a legitimate exercise of its sovereign rights to regulate the use of its natural resources or that its actions were permitted under Ecuadorian law.<sup>388</sup> Moreover, the fact that Perenco was prepared to make disputed payments into an escrow account, and that it moved to suspend operations in the Blocks, was immaterial to the analysis of its claim as these were "justifiable and proportionate responses to Ecuador's prior expropriatory acts."<sup>389</sup>
259. Ecuador responded by first stressing that Perenco has failed to discharge its burden of proving how the enforcement by the State of a law legitimately enacted and declared constitutional by its highest court was expropriatory.<sup>390</sup>
260. Its argument in support was two-fold.
261. First, Ecuador submitted that Law 42, the *coactiva* process, Ecuador's temporary take-over of the Blocks and *caducidad* were all *bona fide* and legitimate exercises of Ecuador's police powers and did not constitute an expropriation under international law.<sup>391</sup> Ecuador contended that, in this regard, international tribunals have consistently held that taxation measures, being one of the most important attributes of sovereignty, are permitted under international law without creating a duty to compensate.<sup>392</sup> The presumption of validity or legitimacy of a State's regulatory interference was not easy to overturn and States had a wide discretion in the exercise of their regulatory functions under domestic law.<sup>393</sup> Citing *Paushok v. Mongolia*, Ecuador submitted that Perenco could only succeed if it proved that "Law 42 was

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<sup>387</sup> Revised Memorial, paragraph 191.

<sup>388</sup> Revised Memorial, paragraphs 196-197.

<sup>389</sup> Revised Memorial, paragraph 198.

<sup>390</sup> Counter-Memorial, paragraphs 20, 569-649.

<sup>391</sup> Counter-Memorial, paragraph 544.

<sup>392</sup> Counter-Memorial, paragraphs 546-550.

<sup>393</sup> Counter-Memorial, paragraph 550.

discriminatory, arbitrary in its incidence, abusive in its purpose or involved denial of due process.”<sup>394</sup>

262. Ecuador described Law 42 as a *bona fide* exercise of police powers pursuant to its “[c]onstitutional mandate to seek a fair allocation of the revenues derived from its hydrocarbons” and, in this way, intended “to remedy a disequilibrium caused by a massive and unforeseen increase in oil prices” which resulted in oil companies making windfall profits.<sup>395</sup> In this connection, Ecuador submitted that Law 42 was duly enacted in accordance with the requisite procedure under Ecuadorian law and its constitutionality was upheld by the Ecuadorian Constitutional Court.<sup>396</sup>
263. Similarly, the events following the enactment of Law 42 were legitimate responses to Perenco’s own illegal conduct. The *coactiva* process was a normal exercise of Ecuador’s public powers to collect unpaid taxes and levies when Perenco unilaterally stopped paying its dues.<sup>397</sup> It temporarily intervened in Blocks 7 and 21 because Perenco unilaterally suspended operations in these Blocks, an action which in Ecuador’s view, was the product of what it termed a “self-expropriation” strategy.<sup>398</sup> In the face of Perenco’s intransigence in refusing to resume operations of the Blocks and the risk of damage in the Blocks, Ecuador had to continue to operate the Blocks and undertake proceedings to declare *caducidad* of the Participation Contracts.<sup>399</sup>
264. Ecuador further averred in this regard that Perenco had a duty to engage in contractual renegotiations in order to restore the economic equilibrium of the Participation Contracts, but failed to do so when it was unable to secure the agreement of its consortium partner, Burlington.<sup>400</sup>

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<sup>394</sup> Counter-Memorial, paragraphs 550-551; *Sergei Paushok, CSJC Golden East Company, CJSC Vostokneftegaz, Company v. The Government of Mongolia*, UNCITRAL, Award on Jurisdiction and Liability (28 April 2011), paragraph 321 (EL-103).

<sup>395</sup> Counter-Memorial, paragraph 557; cf. Reply, paragraphs 378-388.

<sup>396</sup> *Ibid.*

<sup>397</sup> Counter-Memorial, paragraph 559.

<sup>398</sup> *Ibid.*

<sup>399</sup> Counter-Memorial, paragraph 22, 559, 563-568.

<sup>400</sup> Counter-Memorial, paragraph 558.

265. Second, Ecuador submitted that Law 42 and the actions of the State to enforce it did not permanently deprive Perenco of its investment. It argued that the burden of proof is on Perenco and the fact that Law 42 did not amend key terms of the Participation Contracts and a stabilisation clause was not provided for means there can be no breach of contract and consequently, no repudiation of Perenco’s contractual rights.<sup>401</sup> Perenco has failed to show that Law 42 deprived it of any of its contractual rights.<sup>402</sup>
266. Ecuador submitted in the alternative that if the Tribunal were to find that Law 42 was in breach of the Participation Contracts, it was not a breach that amounted to an expropriation within Article 6.<sup>403</sup> A breach (or breaches) of a contract can only amount to an expropriation if the investor is thereby deprived of the contract’s benefits.<sup>404</sup> Ecuador argued that, in contrast, Perenco’s submission was the mere allegation, “without any true economic analysis”, that Law 42 deprived it of a key term of the Participation Contracts and consequently the benefit of its investment.<sup>405</sup>
267. Finally, Ecuador maintained that, in any event, Law 42, whether at 50% or 99%, did not amount to an expropriation.<sup>406</sup>
268. At 50%, Law 42 did not render the investment worthless, and this was supported by the fact that tax returns for Blocks 7 and 21 for the fiscal years of 2006 and 2007 indicate Perenco continued to derive significant profits from its investments in Ecuador.<sup>407</sup> Ecuador further pointed to the 1<sup>st</sup> Fair Links report to support its contention that Law 42 at 50% in April 2006 preserved Perenco’s initial expectations of return on its investment.<sup>408</sup> As for Law 42 at 99%, Ecuador submitted that this too was not expropriatory because it did not adversely affect the “reasonable profit” that Perenco could have expected to receive, using the reference price on

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<sup>401</sup> Counter-Memorial, paragraphs 570-576.

<sup>402</sup> *Ibid.*

<sup>403</sup> Counter-Memorial, paragraph 579.

<sup>404</sup> *Ibid.*

<sup>405</sup> Counter-Memorial, paragraph 580.

<sup>406</sup> Counter-Memorial, paragraphs 591-652.

<sup>407</sup> Counter-Memorial, paragraphs 594-597.

<sup>408</sup> Counter-Memorial, paragraph 598; 1<sup>st</sup> Expert Report of Fair Links, paragraphs 97-104.

which the negotiation of the Participation Contracts was based (US \$15/bbl).<sup>409</sup> Law 42 at 99% continued to apply only to the share of extraordinary revenue that Perenco was receiving.<sup>410</sup>

**(6) Whether Ecuador breached contractual undertakings not to unilaterally amend key terms of the Participation Contracts, not to discriminate and to negotiate**

269. Perenco submitted that Law 42 and its enforcement had the effect of unilaterally amending key terms of the Contracts (including but not limited to clause 8.1) in breach of the Contracts' provisions on modification.<sup>411</sup>
270. Perenco argued that by applying Law 42 Ecuador breached the *pacta sunt servanda* principle governing the Contracts pursuant to Article 1561 of the Ecuadorian Civil Code and/or a specific provision in the Contracts regarding requirements for its amendment.<sup>412</sup> This was because Law 42 had the effect of unilaterally amending key terms of the Contracts.<sup>413</sup> Moreover, the Contracts required Perenco and Ecuador to negotiate a correction factor in the event measures taken by the State upset the economy of the Contracts.<sup>414</sup> This was not done.
271. Perenco contended further that the Contracts required the parties to negotiate if the law applicable to the contract was amended.<sup>415</sup> Perenco relied on clause 22.1 of the Participation Contracts, the governing law clause, which stated that "laws in force at the time of its execution are understood to be incorporated in it."<sup>416</sup>
272. Finally, Perenco averred that by exempting the application of Law 42 to another contractor operating in Ecuador, Andes Petroleum, Ecuador breached its contractual undertaking in clause

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<sup>409</sup> Counter-Memorial, paragraphs 629-637.

<sup>410</sup> *Ibid.*

<sup>411</sup> Amended Request, paragraph 37; Revised Memorial, paragraphs 201-211.

<sup>412</sup> Revised Memorial, paragraphs 201, 208 and 211.

<sup>413</sup> Revised Memorial, paragraphs 201-211.

<sup>414</sup> Revised Memorial, paragraph 220; Reply, paragraphs 461-495.

<sup>415</sup> Revised Memorial, paragraphs 217-219.

<sup>416</sup> *Ibid.*; Exhibits CE-17, Block 7 Participation Contract, Clause 22.1 (PER 04858), and CE-10, Block 21 Participation Contract, Clause 22.1 (PER 04722)

5.1.28 not to discriminate between “Participation Contractors for the Exploration and Exploitation of Hydrocarbons”.<sup>417</sup>

273. Ecuador responded that the only guarantee that the Contracts offered to Perenco was “participation” in the form of an entitlement to a physical share in the oil produced.<sup>418</sup> Perenco could not reasonably claim a guarantee of gross income under the terms of the Contracts.<sup>419</sup>

274. Ecuador similarly rejected Perenco’s claim in relation to the triggering of the renegotiation clause in the Contracts. It submitted that it was not triggered because Law 42 did not upset the economy of the Contracts.<sup>420</sup> Ecuador submitted that Perenco has failed to discharge its burden of demonstrating that Law 42 had an impact on the economy of the Participation Contracts, and what the appropriate adjustment would have been.<sup>421</sup>

275. Ecuador denied any suggestion by Perenco that clause 22.1 operates as a stabilisation clause.<sup>422</sup> Rather, clause 22.1 must be read as providing that that the Contracts are governed by Ecuadorian legislation in force at the relevant time, in addition to laws which were in force at the time the Participation Contracts were concluded.<sup>423</sup>

276. Finally, Ecuador challenged the claim regarding the alleged breach of clause 5.1.28 of the Block 7 Contract as raised “far too late”, requesting that it be dismissed.<sup>424</sup> It was raised for the first time by the Claimant in its Reply; it was not canvassed in its Request, Memorial or Revised Memorial. Ecuador argued that, in any event, Perenco has failed to discharge its burden of proving that Perenco and Andes Petroleum were in “similar conditions” (the term in

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<sup>417</sup> Reply, paragraphs 496-501. Clause 5.1.28 of the Block 7 Participation Contract provided “The Parties understand that the treatment received by the Contractor both by the Government of Ecuador as well as by PETROECUADOR shall not be less favorable than that in similar conditions by other Participation Contractors for the Exploration and Exploitation of Hydrocarbons.” (See Exhibit CE-17, PER 04772)

<sup>418</sup> Counter-Memorial, paragraphs 394-395.

<sup>419</sup> *Ibid.*

<sup>420</sup> Counter-Memorial, paragraphs 409, 412-421.

<sup>421</sup> Counter-Memorial, paragraphs 409, 412, 422-424.

<sup>422</sup> Counter-Memorial, paragraph 397.

<sup>423</sup> Counter-Memorial, paragraphs 397-398.

<sup>424</sup> Rejoinder, paragraphs 426-427.

clause 5.1.28), that there was no justification for differing treatment, and that there was an intention to favour Andes Petroleum.<sup>425</sup>

### **(7) Whether Ecuador was contractually bound to comply with the Tribunal's Decision on Provisional Measures**

277. In its Amended Request for Arbitration dated 30 April 2008, Perenco sought provisional measures requesting the Tribunal to enjoin Ecuador from pursuing any action to collect any payments that Ecuador claimed Perenco owed as a result of Law 42 and its Implementing Regulations, and from unilaterally amending, rescinding, terminating or repudiating the Participation Contracts or any of its terms.<sup>426</sup> The chain of events that followed, leading up to and including the Tribunal's Decision on Provisional Measures of 8 May 2009, are set out in detail in the Statement of Facts at Section III. F.

278. Perenco submitted that Ecuador's "actions in defiance of the Tribunal's Provisional Measures order" formed an independent breach of the Participation Contracts' terms with respect to the agreement to arbitrate and the parties' submission to the decisions of the Tribunal.<sup>427</sup>

279. Ecuador, in response, submitted that any such failure to abide by the Tribunal's recommendation of provisional measures did not as a matter of Ecuadorian law violate the contractual obligations invoked by Perenco.<sup>428</sup> In the alternative, Ecuador argued that its actions were not causative of any loss suffered by Perenco.<sup>429</sup>

### **C. Ecuador's Counterclaims**

280. The Tribunal notes that Ecuador has filed a counterclaim in which it claims that the effect of Perenco's actions, in alleged breach of its obligations under Ecuadorian environmental law,

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<sup>425</sup> Counter-Memorial, paragraphs 529-533; Rejoinder, paragraphs 426-428.

<sup>426</sup> Amended Request, paragraph 43.

<sup>427</sup> Revised Memorial, paragraphs 222-226; Reply, paragraphs 246-253.

<sup>428</sup> Counter-Memorial, paragraphs 426-451.

<sup>429</sup> *Ibid.*

resulted in significant environmental damage to Blocks 7 and 21, and amounted to a failure to properly maintain the Blocks' infrastructure in good working condition.<sup>430</sup>

281. For the purposes of this Decision, it is unnecessary to recount the substance of Ecuador's counterclaims and Perenco's responses thereto as the Parties agreed to a separate briefing schedule and hearing. Accordingly, the Tribunal will not record the parties' submissions as they stand any further in this Decision. The counterclaims will be addressed by the Tribunal in a separate decision to be issued in due course.

#### **D. Remedies**

282. Perenco claimed full reparation in respect of its claims and to monetary damages in lieu of restitution in kind.<sup>431</sup> The award of monetary damages should include Law 42 amounts that Perenco paid under protest, revenues from oil seized by Ecuador by means of the *coactivas*, profit from foregone investments that Perenco would have made but for the implementation of Law 42, the present value of future profits from the Participation Contracts and any extensions thereof, the costs and expenses that arose from the expropriation of Perenco's property, the costs of this arbitration and compound interest at commercial rates on all amounts.<sup>432</sup>

283. Ecuador submitted that the Tribunal should find that it lacks jurisdiction over the claims in their entirety or over particular claims. In the alternative, Ecuador argued that Perenco has failed to discharge its burden of proof in respect of its claims under the Contracts and the Treaty, and that in any event the claims fail on their merits.<sup>433</sup>

284. As noted, Ecuador forwarded two counterclaims, and sought an order from the Tribunal directing Perenco to remedy any and all environmental damage in Blocks 7 and 21, and compensate for its failure to revert the Blocks to Ecuador in good working condition by paying damages to be determined in the quantum phase of this arbitration, inclusive of compound interest, and all costs and expenses of the arbitration.<sup>434</sup>

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<sup>430</sup> Counter-Memorial, paragraphs 26, 653-962.

<sup>431</sup> Revised Memorial, paragraphs 249-256.

<sup>432</sup> Revised Memorial, paragraph 256; Reply, paragraph 511.

<sup>433</sup> Counter-Memorial, paragraphs 964-979, 982.

<sup>434</sup> Counter-Memorial, paragraphs 980-983.

285. Since briefing of the quantum of both the alleged treaty and contract claims has not begun, the Tribunal will not address either of the quantum issues in this Decision.

#### **E. Prayers for Relief**

286. Perenco requested that the Tribunal issue an award in the following terms:

- a. Declaring that it has jurisdiction over Perenco's claims;
- b. Declaring that Respondent:
  - (i) failed to accord fair and equitable treatment to Perenco's investments in breach of its obligations under Article 4 of the Treaty;
  - (ii) impeded Perenco's use and enjoyment of its investments in breach of its obligations under Article 4 of the Treaty;
  - (iii) unlawfully expropriated Perenco's assets in breach of its obligations under Article 6 of the Treaty, as well as under Ecuadorian Law;
- c. Declaring that Respondent breached the Participation Contracts;
- d. Ordering Respondent fully to reimburse the amounts of Law 42 assessments already paid by Perenco under protest, which are US\$220,402,943.74;
- e. Ordering Respondent to pay monetary damages in an amount that would wipe out all the consequences of Respondent's illegal acts and re-establish the situation which would have existed if those acts had not been committed, including but not limited to:
  - (i) Ordering Respondent to pay the full and fair market value of the volumes of crude oil that were seized from Perenco from 3 March 2009 until 16 July 2009;
  - (ii) Ordering Respondent to pay the forgone profits from 16 July 2009 until the expiration date of both Participation Contracts; as well as those that would have been derived from an extension of the Block 7 Contract;
  - (iii) Ordering Respondent to pay the profit from forgone investments that Perenco would have made but for the implementation of Law 42;
  - (iv) Ordering Respondent to pay all costs and expenses that arose from the expropriation of Perenco's property, including the fair market value of Perenco's assets in Ecuador that would not have been turned over to Ecuador at the end of the Contract's life;

- f. Ordering Respondent to pay all the costs of the arbitration, as well as Perenco's professional fees and expenses;
- g. Ordering Respondent to pay interest at commercial, annually compounding rates on the above amounts until full payment is received;
- h. Declaring that Perenco has no further obligation of any kind, to Ecuador, Petroecuador or any other Ecuadorian department or instrumentality, whether under the Participation Contracts or otherwise, with respect to Blocks 7 and 21; and
- i. Ordering any such other relief as the Tribunal may deem appropriate.<sup>435</sup>

287. Ecuador requested that the Tribunal render an award in the following terms:

- a. Declaring on jurisdiction
  - (i) that Claimant is not controlled by French nationals and the Arbitral Tribunal therefore lacks *ratione personae* jurisdiction over the Claimant;
  - (ii) that the Arbitral Tribunal lacks jurisdiction over Perenco's claims regarding the *caducidad* decrees and all matters related thereto.
- b. Declaring on admissibility regarding Perenco's claims regarding the *caducidad* decrees and all matters related thereto
  - (i) in the alternative to the finding of lack of jurisdiction over Perenco's claims regarding the *caducidad* decrees and all matters related thereto, that Perenco's claims regarding the *caducidad* decrees and all matters related thereto are inadmissible.
- c. Declaring on admissibility regarding Perenco's new contractual claim for alleged breach of clause 5.1.28 of the Block 7 Participation Contract
  - (i) having abandoned its Article 5 Treaty claim, that Perenco's attempt to bring its discrimination claim as a new contractual claim (for alleged breach of clause 5.1.28 of the Block 7 Participation Contract) submitted for the first time with its Reply is inadmissible.

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<sup>435</sup> Reply, paragraph 511.

- d. Declaring on liability
- (i) that Ecuador's enactment of Law 42 and implementing decrees did not breach the Participation Contracts and that all of Perenco's claims related thereto are therefore dismissed;
  - (ii) that the Renegotiation Clauses were not triggered nor breached by Ecuador's enactment of Law 42 and implementing decrees and that all of Perenco's claims related thereto are therefore dismissed;
  - (iii) that the Participation Contracts do not contain any "*stabilization clause*";
  - (iv) that, given that the Participation Contracts have not been breached, the Treaty has not been breached either and that all of Perenco's Treaty claims related thereto are therefore dismissed;
  - (v) that Law 42 was a legitimate and *bona fide* exercise by Ecuador of its sovereign taxation powers;
  - (vi) that Ecuador's enactment of Law 42 and implementing decrees does not amount to a breach of the Treaty and that all of Perenco's claims related thereto are therefore dismissed;
  - (vii) that Ecuador's institution of the *coactiva* procedures does not amount to a breach of the Treaty and that all of Perenco's claims related thereto are therefore dismissed; and
  - (viii) that Ecuador's assumption of operations in Blocks 7 and 21 does not amount to a breach of the Treaty and that all of Perenco's claims related thereto are therefore dismissed.
- e. Ordering Perenco to pay all the costs and expenses incurred by Ecuador to defend the Article 5 (of the Treaty) claim, recently withdrawn by Perenco;
- f. Ordering Perenco to pay all the costs and expenses of this arbitration, including Ecuador's legal and experts fees and ICSID's other costs; and
- g. Ordering Perenco to pay compound interest at an adequate commercial interest rate on the amounts stated in the preceding paragraph from the date of disbursement thereof until the date of full payment.

h. Awarding such other relief as the Arbitral Tribunal considers appropriate.<sup>436</sup>

## V. JURISDICTION OVER CLAIMANT'S CONTRACT CLAIMS

288. The Tribunal recalls its finding in its Decision on Jurisdiction that in general the claims for breach of the Block 7 and Block 21 Contracts by reason of the application of Law 42 fall within its jurisdiction.<sup>437</sup>

289. Ecuador, however, objected to the Tribunal's jurisdiction under the Contracts to consider any claims relating to *caducidad* and, alternatively, to the admissibility of such claims.<sup>438</sup> Perenco argued, both as part of its argument regarding a chain of events set into motion by Ecuador's refusal to comply with the Decision on Provisional Measures as well as a separate argument, that the declaration of *caducidad* constituted a breach of contract.<sup>439</sup>

### A. The remaining objection of the Respondent

290. Ecuador submitted that disputes relating to *caducidad* were not arbitrable under Ecuadorian Law.<sup>440</sup> The Contracts provided, in clauses 20.2.12 and 20.2.1.3 of the Block 21 and Block 7 Contracts respectively, that the arbitration is "governed by the provisions of this Contract...and the laws of Ecuador".<sup>441</sup> Ecuador contended that Ecuadorian law permits only contractual disputes to be submitted to arbitration.<sup>442</sup> The declaration of *caducidad*, however, was an

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<sup>436</sup> Rejoinder, paragraphs 624-640.

<sup>437</sup> Decision on Jurisdiction, paragraphs 147, 161 and 242.

<sup>438</sup> Counter-Memorial, paragraphs 340, 343-367; see above at paragraphs 230,231, 233, and 237.

<sup>439</sup> Revised Memorial, paragraphs 212, 222-226; Reply, paragraphs 246-253.

<sup>440</sup> Counter-Memorial, section 5.1.1; Rejoinder, paragraphs 144-166; see above at paragraphs 230-232.

<sup>441</sup> [Emphasis added.]. Taken from clause 20.2.12 of the Block 21 Contract (see Exhibit CE-10, PER 04717). Clause 20.2.1.3 of the Block 7 Contract similarly provided "the arbitration in law shall be guided by the provisions of this Participation Contract...and the laws of Ecuador."

<sup>442</sup> Counter-Memorial, paragraphs 346-348 [Emphasis added.]; Rejoinder, paragraphs 154-155; 3<sup>rd</sup> Expert Report of Juan Pablo Aguilar Andrade, paragraphs 182-183. Professor Aguilar referred to Article 4 of the Arbitration and Mediation Law in Ecuador, of which an English translation was provided at paragraph 11 of his 4<sup>th</sup> expert report: "The persons or companies that are capable of settling *may submit to arbitration* governed by this Law, provided they fulfill the requirements established herein. For the different entities in the public sector to submit to arbitration, in addition to complying with the requirements of this Law, they shall fulfill the following additional requirements: a) Enter into an agreement to arbitrate, before the emergence of the dispute; in the event the agreement is sought to be signed after the dispute has arisen, the Attorney General of the State must be consulted, whose opinion will be binding; b) *The legal relationship to which the agreement relates shall be contractual in nature*; c) The arbitration agreement must include the manner in which the arbitrators will be selected; and, d) The

“expression of the State’s power (*pouvoir public*) exercised through an administrative act that falls outside of the scope of issues that parties can dispose of (*materias transigibles*).”<sup>443</sup> Administrative acts carry a presumption of legality under Ecuadorian law and may only be challenged before Ecuadorian courts (as per Article 173 of Ecuador’s Constitution).<sup>444</sup>

291. In this connection, Ecuador relied on the decision of an ICSID tribunal in *Repsol YPF Ecuador S.A. v. Empresa Estatal Petróleos del Ecuador (Petroecuador)*,<sup>445</sup> which in its view found that issues relating to the validity of administrative acts, such as *caducidad*, were not arbitrable under Ecuadorian law.<sup>446</sup>

292. Ecuador’s legal expert, Professor Aguilar, began his evidence in this regard with the premise that *caducidad* was “an administrative sanction imposed through an administrative act.”<sup>447</sup> He referred to Article 65 of the Executive Branch’s Legal and Administrative Regime Act in Ecuador<sup>448</sup> and decisions of the Constitutional Tribunal<sup>449</sup> and the Supreme Court of Justice<sup>450</sup> to support the proposition that an administrative act may take the form of a unilateral declaration in the exercise of administrative function that produces direct and individual legal effects.<sup>451</sup> He asserted that under Ecuadorian law such administrative acts enjoyed a “presumption of legitimacy”, the burden falling on the party challenging the act to demonstrate that it was carried out in a manner that did not comply with applicable law or regulation.<sup>452</sup>

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arbitration agreement, through which the public sector institution waives ordinary jurisdiction, must be signed by the person authorized to contract on behalf of said institution. Failure to fulfill the above requirements implies the nullity of the arbitration agreement.” [Emphasis added.]

<sup>443</sup> Counter-Memorial, paragraph 346 [Italics in original.]; Rejoinder, paragraphs 157-158.

<sup>444</sup> *Ibid.*

<sup>445</sup> Exhibit CE-170, *Repsol YPF Ecuador S.A. v. Empresa Estatal Petróleos del Ecuador (Petroecuador)*, ICSID Case No. ARB/01/10, Award (20 February 2004), paragraph 151 (Unofficial translation from Spanish original).

<sup>446</sup> *Ibid.*; Counter-Memorial, paragraphs 350-351.

<sup>447</sup> 3<sup>rd</sup> Expert Report of Juan Pablo Aguilar Andrade, paragraph 160.

<sup>448</sup> Professor Aguilar asserted that it provided that an administrative act could be “a unilateral declaration made in the exercise of the administrative functions [sic] which produce[d] individual legal effects directly.” 3<sup>rd</sup> Expert Report of Juan Pablo Aguilar Andrade, paragraph 161.

<sup>449</sup> Case File 013-AA-99-IS, supplement to Official Gazette 122, 4 February 1999 (3<sup>rd</sup> Expert Report of Juan Pablo Aguilar Andrade, Annex No. 104).

<sup>450</sup> Judicial Gazette, Series XVII, No. 15, p 5212 (3<sup>rd</sup> Expert Report of Juan Pablo Aguilar Andrade, Annex No. 103).

<sup>451</sup> 3<sup>rd</sup> Expert Report of Juan Pablo Aguilar Andrade, paragraphs 161-163.

<sup>452</sup> 3<sup>rd</sup> Expert Report of Juan Pablo Aguilar Andrade, paragraphs 166-167, 171. Professor Aguilar at paragraph 171 suggested that the administrative act must be complied with “unless its illegitimacy is proven *judicially*.” [Emphasis added.]

Professor Aguilar stated that under Ecuadorian law such a challenge could only be brought before its administrative courts.<sup>453</sup> In his view the declaration of *caducidad* in this arbitration fit perfectly into this notion of an administrative act in Ecuador, and could not be challenged otherwise than in Ecuadorian administrative courts.<sup>454</sup>

293. Professor Aguilar interpreted Article 74(4) of the Hydrocarbons Law, which identifies the legal and contractual breaches of sufficient gravity to justify the imposition of the sanction of *caducidad*, as providing a prerogative administrative power (as opposed to a contractual power) to sanction.<sup>455</sup> This further supported his position that *caducidad* could not be the subject of arbitral review since it was not a dispute which was contractual in nature, as required by Article 4 of the Arbitration and Mediation Law (where a party to the dispute is a public sector entity).<sup>456</sup>
294. Second, and in the alternative, Ecuador submitted that the parties to the Contracts expressly and contractually carved *caducidad* out of the subject-matter jurisdiction of the Tribunal.<sup>457</sup> Ecuador relied on clauses 21.3 and 21.4<sup>458</sup> of the Block 7 Contract and clause 20.2 and Annex XVI of the Block 21 Contract.<sup>459</sup> The former provided that if the Contract was terminated by reasons *other than caducidad*, the procedure to which the parties have agreed for disputes to be

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<sup>453</sup> 3<sup>rd</sup> Expert Report of Juan Pablo Aguilar Andrade, paragraph 172. Professor Aguilar cited Article 217(1) of the Organic Code of Judicial Function in Ecuador which provides that “[t]he judges of the Contentious Administrative chambers are charged with: 1. Hearing and resolving disputes that arise between the public administration and individuals for violation of legal norms or individual rights, whether in normative acts of lower in rank than the law, or in administrative acts or facts.” (Organic Code of Judicial Function, 9 March 2009, Annex No. 101 to Aguilar, 3<sup>rd</sup>).

<sup>454</sup> 3<sup>rd</sup> Expert Report of Juan Pablo Aguilar Andrade, paragraphs 171-172, 179-181; 4<sup>th</sup> Expert Report of Juan Pablo Aguilar Andrade, paragraphs 15-18.

<sup>455</sup> 3<sup>rd</sup> Expert Report of Juan Pablo Aguilar Andrade, paragraphs 179-181; 4<sup>th</sup> Expert Report of Juan Pablo Aguilar Andrade, paragraphs 20-51.

<sup>456</sup> 3<sup>rd</sup> Expert Report of Juan Pablo Aguilar Andrade, paragraphs 182-183; 4<sup>th</sup> Expert Report of Juan Pablo Aguilar Andrade, paragraphs 11-14. In the English translation provided in the translated reports of both legal experts, the pertinent sentence in Article 4(b) reads: “The *legal relationship* to which the agreement [Aguilar: “relates shall”] [Pérez Loose: “refers must”] be contractual in nature.” [Emphasis added.] See 5<sup>th</sup> Expert Report of Hernan Pérez Loose, paragraph 17; 4<sup>th</sup> Expert Report of Juan Pablo Aguilar Andrade, paragraph 11.

<sup>457</sup> Counter-Memorial, section 5.1.2; cf. Reply, paragraphs 125-150.

<sup>458</sup> Ecuador in its Counter-Memorial at paragraph 354 refers to clauses 21.2.3 and 21.2.4 of the Block 7 Participation Contract, but this seems to be in error as these do not exist. The provisions excerpted are found instead at clauses 21.3 and 21.4 of the Contract, at Exhibit CE-17, PER 04858. This is confirmed by Ecuador in its Rejoinder, paragraph 169.

<sup>459</sup> Counter-Memorial, paragraphs 354-355; Rejoinder, paragraphs 167-190.

submitted to arbitration should be followed.<sup>460</sup> Clause 20.2 of the Block 21 Contract in turn provided that “if a caducity proceeding is initiated, in the event that the cause for caducity is related to technical or economic aspects” the matter may be submitted to arbitration by either party.<sup>461</sup> This had to be read together with Annex XVI which provides that once the ICSID Convention had been approved by the “National Congress of the Republic of Ecuador and, therefore, [was] fully in force, the Parties agree[d] that any technical and/or economic dispute arising out of the application of the Participation Contract ... shall be resolved according to the provisions of the aforementioned Convention, leaving, accordingly, without effect the Arbitration procedure provided in Clause twenty of the Contract.”<sup>462</sup>

295. In this regard, in characterising the nature of claims in this arbitration that relate to *caducidad*, Ecuador submitted that because “the motive for the declaration of *caducidad* ... was legal and did not arise out of a disagreement of a technical or economic nature” it fell strictly outside the subject-matter jurisdiction of the Tribunal as contractually delineated.<sup>463</sup>
296. Lastly, Ecuador submitted that the claims relating to *caducidad* were premature because Perenco had not sought redress from the Ecuadorian administrative courts.<sup>464</sup> It contended that treaty claims are “defective” unless there has been a “reasonable attempt by the investor” to pursue available judicial redress within the State, a ground distinct, in Ecuador’s submission from the requirement to exhaust local remedies.<sup>465</sup> Ecuador submitted that this claim was not

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<sup>460</sup> Clauses 21.3 and 21.4 of the Block 7 Contract provides “21.3 In cases of termination for reasons other than caducity, the procedures agreed to by the Parties in Clause Twenty shall be followed. 21.4 *For the effects of caducity and sanctions, the provisions of Chapter IX of the Hydrocarbons Law shall apply.*” [Italics in original, emphasis added.] (Exhibit CE-17, PER 04858)

<sup>461</sup> Clause 20.2 of the Block 21 Participation Contract provides that “**Technical and/or Economic Arbitration:** In the event that the disputes are related to any matter not included within the scope of the previous clause or if, for any reason, submitting the matter to a consultant does not produce a final and binding resolution, the technical matters involving economic aspects, and vice-versa, shall be subject to a consulting and arbitration procedure accepted by Ecuadorian Law. Legal matters may not be submitted to arbitration and shall be submitted to the jurisdiction and competence set forth in the relevant legal provisions.

Additionally, if a caducity proceeding is initiated, in the event that the cause for caducity is related to technical or economic aspects, and the Parties have differing views, either of the Parties may submit the matter to arbitration. For as long as this process lasts, any caducity proceeding that might have been initiated shall be suspended.” (Exhibit CE-10, PER 04713-04714).

<sup>462</sup> Exhibit E-58, Annex XVI (Resubmitted on 11-17-09), p 4.

<sup>463</sup> Counter-Memorial, paragraphs 358-360.

<sup>464</sup> Counter-Memorial, section 5.1.3.

<sup>465</sup> Counter-Memorial, paragraphs 362-363, 366.

viable until and unless Perenco challenged the lawfulness of the action in Ecuador's administrative courts.<sup>466</sup>

## **B. The Claimant's submission**

297. Perenco submitted that if the Tribunal were to uphold the Respondent's objection it would be permitting Ecuador to employ its domestic laws to evade its Treaty obligation to submit all legal disputes with regard to investments to ICSID arbitration.<sup>467</sup> Perenco relied on the Decision on Jurisdiction in *Occidental II*, where the tribunal considered a similar argument and held that Ecuador could not invoke its domestic law to avoid ICSID jurisdiction under the applicable treaty.<sup>468</sup>
298. Perenco submitted that in any event Ecuadorian law did not preclude arbitration of *caducidad*-related disputes. It referred to Dr. Pérez Loose's evidence that Article 4(b) of the Arbitration and Mediation Law required only that the underlying legal relationship of the dispute be contractual and not that the dispute and the impugned conduct both had to be contractual in nature.<sup>469</sup> Perenco argued that it "cannot be disputed that the legal relationship arising out of the Participation Contracts is 'contractual in nature'."<sup>470</sup> Dr. Pérez Loose also took the view that Article 173 of Ecuador's Constitution provides only that administrative acts *may* be challenged before the Ecuadorian courts, and not that they *must* be challenged before the courts.<sup>471</sup>
299. Perenco submitted that Ecuador had misconstrued *Repsol*, asserting that it stands only for the proposition that an ICSID tribunal could have jurisdiction over an administrative act with possibly *res judicata* effect as long as the conditions of Article 25 of the ICSID Convention

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<sup>466</sup> Counter-Memorial, paragraph 364.

<sup>467</sup> Reply, paragraphs 108-113, referring to *Occidental II (Jurisdiction)*.

<sup>468</sup> Reply, paragraphs 110-112; *Occidental II (Jurisdiction)*, paragraphs 38 and 82.

<sup>469</sup> Reply, paragraphs 114-115.

<sup>470</sup> Reply, paragraph 115; 5<sup>th</sup> Expert Report of Hernan Pérez Loose, paragraph 17.

<sup>471</sup> Transcript, Hearing on the Merits, Day 6, p 1533. Ecuador at paragraph 160 of its Rejoinder argued in turn that the terms of Article 173 of the Constitution indicated it did not intend a choice of forum because it allegedly uses the term "can" rather than "may".

have been satisfied; the administrative nature of the State's conduct did not in and of itself preclude the tribunal from claiming jurisdiction.<sup>472</sup>

300. Perenco's expert also addressed the alternative scenario, namely, that if Article 4(b) of the Arbitration and Mediation Law required the disputed action to be of a contractual nature (and not just that the legal relationship from which the dispute arises is contractual), then the declaration of *caducidad* remained arbitrable because it was a "contractual administrative act".<sup>473</sup> Dr. Pérez Loose defined such acts as "administrative acts [that] presuppose the existence of a contractual relationship" and marked by the characteristics that "they are unilateral decisions through which the public entit[y] create[s], terminate[s] or modif[ies] private individual legal situations" and "whose *raison d'être* is an underlying contract or bilateral relationship established with a private citizen."<sup>474</sup>
301. Examples given of "contractual administrative acts" were the imposition of a fine on a contractor for delay or breach of contract and orders to enforce guarantees and collect on insurance policies.<sup>475</sup> Dr. Pérez Loose relied on the writings of civil legal theorists such as Juan Carlos Cassagne,<sup>476</sup> Rodolfo Barra,<sup>477</sup> Diana Ximena Correa<sup>478</sup> and Luis Berrocal,<sup>479</sup> who accepted the existence of a contractual administrative act and in one instance, referred to it as "acts through which the contracting entity imposes a fine upon the contractor or unilaterally

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<sup>472</sup> Reply, paragraphs 117-119.

<sup>473</sup> 5<sup>th</sup> Expert Report of Hernan Pérez Loose, paragraph 19.

<sup>474</sup> *Ibid.*, paragraphs 20-22.

<sup>475</sup> *Ibid.*, paragraph 21.

<sup>476</sup> CA-404, CASSAGNE, Juan Carlos: *El Contrato Administrativo* [The Administrative Contract], Second edition, Editorial Lexis Nexis Abeledo-Perrot, Buenos Aires, 2005, p 303.

<sup>477</sup> CA-400, BARRA, Rodolfo: *Los actos administrativos contractuales* [Contractual administrative acts], Editorial Ábaco de Rodolfo Palma, 1989, p 97.

<sup>478</sup> CA-407, CORREA, Diana Ximena: *El arbitraje en el Derecho Administrativo: una forma alternativa para el nuevo modelo de Estado* [Arbitration in Administrative Law: an alternative way for the new State model], Universidad de Externado de Colombia, Bogotá, 2002, p 169.

<sup>479</sup> The Colombian legal scholar Luis Berrocal defines contractual administrative acts similarly as "those that are carried out within the term of force of the contract and for the purpose of the performance thereof. These occur within the so-called contractual stage. Therefore, their existence is determined by the existence of the contract, they depend directly on it. This is the case for acts through which the contracting entity imposes a fine upon the contractor or unilaterally interprets the contract, declares its caducity, etc." CA-402, BERROCAL, Luis; *Manual del Acto Administrativo* [Administrative Acts Manual], *Tercera Edición, Ediciones Profesionales C. Ltda.*, Bogotá 2004, p 109.

interprets the contract, *declares its caducity* etc.”<sup>480</sup> He submitted that the practice of arbitral tribunals in Ecuador confirmed that caducity was arbitrable; the examples cited included in one instance *Petroproducción* as a disputing party, although the cases that considered actions terminating the contract referred to actions for ‘unilateral termination’, rather than a declaration of *caducidad*.<sup>481</sup>

302. This qualification was noted by Professor Aguilar in his fourth expert report, where he stressed that Dr. Pérez Loose’s admission as to the administrative nature of the sanction was sufficient for Ecuador to succeed on its objection.<sup>482</sup> Moreover, when pressed in cross-examination, Dr. Pérez Loose admitted that several of the decisions he cited did not deal with *caducidad*, but with fines.<sup>483</sup> He argued that they remained relevant as they demonstrated that “in Ecuador, administrative action, administrative decisions are arbitrable. Some can be infractions or fines, others can be unilateral termination of contracts, yet again *caducidad*.”<sup>484</sup>

303. When pressed further about the cases that he cited which dealt with unilateral termination, Dr. Pérez Loose stated that *caducidad* and unilateral termination are one and the same thing.<sup>485</sup> When asked whether he accepted that “there can be a termination of a contract in the exercise as a Contracting Party and there can be the termination of a contract by resort to what [could be called] ‘extra-contractual means’ in the sense of initiating a process, an administrative process, such as *caducidad*”, Dr. Pérez Loose responded that he agreed these were “two avenues”, the latter of which was “based in the law...but materialize[d] in the Contract” and it was for this

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<sup>480</sup> 5th Expert Report of Hernan Pérez Loose, footnote 25 [Emphasis in original].

<sup>481</sup> 5th Expert Report of Hernan Pérez Loose, paragraph 32.

<sup>482</sup> 4th Expert Report of Juan Pablo Aguilar Aguilar, paragraphs 41 and 46. At paragraph 46, Professor Aguilar asserted that “[s]ince there is no case law in Ecuador on the issue of the arbitrability of *caducidad*, Mr. Pérez Loose cannot affirm that the fact that *caducidad* is arbitrable is ‘undisputedly’ accepted.” During cross-examination, Professor Aguilar admitted that “[i]n Ecuador, there [was] a debate currently in connection with contractual administrative acts”, but clarified that “there is no doubt that a non-contractual administrative act, the only way it can be challenged is...the Administrative Courts[.]” (Transcript, Hearing the Merits, Day 6, p 1563).

<sup>483</sup> Transcript, Hearing on the Merits, Day 6, p 1536.

<sup>484</sup> *Ibid.*

<sup>485</sup> Transcript, Hearing on the Merits, Day 6, p 1537. See also, Dr. Pérez Loose’s response to a question from the Tribunal at p 1544.

reason that “in administrative law, this type of acts [sic]... are known as administrative contractual acts.”<sup>486</sup>

304. Addressing the further issue of a contractual carve-out of caducity from arbitration, Perenco submitted that clauses 21.3 and 21.4 of the Block 7 Contract and clause 20.2 and Annex XVI of the Block 21 Contract did not exclude *caducidad*-related claims from the Tribunal’s jurisdiction.<sup>487</sup> Instead, it argued that the clauses were purely procedural, setting out the procedure that should be followed by a party in terminating the contract based on different grounds, and not necessarily excluding the submission of *caducidad*-related claims to arbitration, nor requiring the submission of such claims exclusively to Ecuadorian courts.<sup>488</sup> In this regard, it submitted that it is significant that the clauses appear in section 21 of the Block 7 Contract, which addressed “Termination and Caducity of this Contract”, rather than the relevant sections on arbitration and applicable law (Sections 20 and 22, particularly clauses 20.3 and 20.4 which dealt with the submission to ICSID arbitration).<sup>489</sup>
305. Perenco relied on the *Occidental II* Decision on Jurisdiction where Ecuador advanced a similar argument with regard to similar provisions, and the tribunal held that the clauses did not consist of a carve-out of *caducidad* disputes from ICSID jurisdiction because there was no evidence of a “common intention” to do so.<sup>490</sup> Perenco contended that if parties intended a carve-out it would have been included in the arbitration provision of the contracts.<sup>491</sup>
306. Responding to Ecuador’s insistence on a distinction between legal and technical/economic issues, Perenco submitted that the question was not whether a *caducidad*-related claim was “legal” but whether it was “related to technical or economic aspects.”<sup>492</sup> It characterised the declaration of *caducidad* in this regard as an inseparable element of Ecuador’s coercive conduct against Perenco, which in the “words of this Tribunal [gave] rise to a ‘dispute concerning the participation percentages in the share of the produced crude oil [which]

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<sup>486</sup> Transcript, Hearing on the Merits, Day 6, p 1544.

<sup>487</sup> Reply, paragraphs 127-150.

<sup>488</sup> Reply, paragraphs 129-136.

<sup>489</sup> Reply, paragraph 130.

<sup>490</sup> Reply, paragraphs 138-139; see *Occidental II (Jurisdiction)*, paragraphs 77 to 79.

<sup>491</sup> Reply, paragraphs 141-142; cf. Rejoinder, paragraph 174.

<sup>492</sup> Reply, paragraph 147.

qualifies as an economic dispute relating to the Participation Contract”<sup>493</sup> and was part of a series of events which had an impact on key provisions relating to the sharing of economic benefits under the Contracts.<sup>494</sup>

307. Perenco submitted that “only an explicit, clear and unambiguous waiver by the investor of its right to submit treaty claims to an ICSID Tribunal [could] bar such claims in ICSID arbitration”<sup>495</sup>, and that none of the provisions in the Contracts could be said to constitute a clear and unambiguous waiver of ICSID jurisdiction over *caducidad*-related Treaty claims.<sup>496</sup>
308. Lastly, Perenco submitted that it could not proceed before administrative courts in Ecuador because of the Tribunal’s direction in its Decision on Provisional Measures that the parties should refrain from resorting to “domestic courts of Ecuador to enforce or resist any claim...”.<sup>497</sup> In any event, referring to the Decision on Jurisdiction in *Occidental II*, and the *Helnan International Hotels v. Arab Republic of Egypt* Annulment Decision, Perenco submitted that an argument to the effect that there can be no international wrong in an ICSID arbitration without a prior attempt to seek redress under municipal law is without merit.<sup>498</sup>

### C. The Tribunal’s Decision

309. The caducity issue arises in connection with both the contract claims and Treaty claims. The latter are addressed below at paragraphs 628 to 630. Insofar as the contract claims are concerned, the Tribunal’s jurisdiction hinges on the construction of the relevant provisions of the two contracts.
310. Turning to the Block 7 Contract, the Tribunal notes firstly that the power to declare *caducidad* is an administrative power residing in the Ministry of Energy and Mines, not in Perenco’s counterparty, Petroecuador.

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<sup>493</sup> Reply, paragraphs 148-149, quoting from the Decision on Jurisdiction, paragraph 146.

<sup>494</sup> *Ibid.*

<sup>495</sup> Reply, paragraphs 151-162.

<sup>496</sup> *Ibid.*

<sup>497</sup> Reply, paragraph 164, quoting from paragraph 61 of the Decision on Provisional Measures.

<sup>498</sup> Reply, paragraphs 165-168; Exhibits CA-351, *Occidental II (Jurisdiction)*, paragraph 59, and CA-345, *Helnan International Hotels v. Arab Republic of Egypt*, ICSID Case No. ARB/05/19, Decision of the *ad hoc* Annulment Committee (14 June 2010), paragraphs 47-49.

311. Second, *caducidad* is one of nine specified ways in which the Contract can terminate. Termination and *caducidad* are plainly not coterminous concepts.
312. Third, the sub-clauses dealing with *caducidad* (clause 21.2 and 21.3) specify the procedure which the Ministry must follow, provide for cure periods for the contractor, and expressly distinguish between other forms of termination and termination by *caducidad*: “In cases of termination *for reasons other than* caducity, the procedures agreed to by the Parties in Clause Twenty [“Consulting and Arbitration”] shall be followed.”<sup>499</sup> That is, by the Contract’s express terms, all other forms of termination can be arbitrated and *caducidad* cannot.
313. The Tribunal considers that the Block 7 Contract is thus clear that *caducidad* is subject to a separate regime. Declarations of caducity were excluded from the Contract’s arbitration provisions, and the Tribunal thus lacks jurisdiction to review the declaration of *caducidad* for the Block 7 Contract.
314. The situation is different under the terms of the Block 21 Contract, which does not provide that “[i]n cases of termination for reasons other than caducity, the procedures agreed to by the Parties in [the Arbitration section]” shall apply. Instead, it states that if a *caducity* proceeding has been initiated, and the cause is related to technical or economic aspects, and the parties “have differing views”, either party may submit the matter to arbitration.<sup>500</sup> In such event, the process of caducity should be suspended for the duration of the arbitration.<sup>501</sup> As the Tribunal discussed in its Decision on Jurisdiction, the parties also added provisions regarding the procedure of the arbitration through Annex XVI to the Block 21 Contract.<sup>502</sup> Annex XVI provides that:

Once the Convention on the Settlement of Investment Disputes, ICSID, has been approved by the National Congress of the Republic of Ecuador and, therefore, is fully in force, *the Parties agree that any technical and/or economic dispute arising out of the application of the Participation Contract for the Exploration*

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<sup>499</sup> Clause 21.3 of the Block 7 Participation Contract: Exhibit CE-17, Block 7 Participation Contract, PER 04858 [Emphasis added.].

<sup>500</sup> See Clause 20.2 of the Block 21 Participation Contract: Exhibit CE-10, Block 21 Participation Contract, PER 04713-04714.

<sup>501</sup> See Clause 20.2 (last sentence of first paragraph) of the Block 21 Participation Contract: Exhibit CE-10, Block 21 Participation Contract, PER 04714.

<sup>502</sup> Decision on Jurisdiction, paragraphs 125-147.

and Exploitation of Hydrocarbons in Block 21 of the Amazon Region, which is the object of the present Contract, shall be resolved according to the provisions of the aforementioned Convention, *leaving, accordingly, without effect the Arbitration procedure provided in clause twenty of the Contract.*

For the application of the Convention on the Settlement of Investment Disputes, ICSID, the following procedural rules shall also apply:

1. The Parties agree to submit to the INTERNATIONAL CENTRE FOR THE SETTLEMENT OF INVESTMENT DISPUTES *any technical and/or economic dispute relating to this Participation Contract* for the Exploration and Exploitation of Hydrocarbons for resolution through the Arbitration mechanism, which for all effects is hereafter referred to as “THE CENTRE”...<sup>503</sup>

315. The Tribunal found that Annex XVI had to be considered when determining the scope of its *ratione materiae* competence over contractual claims.<sup>504</sup> It found that the contractual claims advanced by Perenco that concerned a “technical” or “economic” dispute relating to the Block 21 Participation Contract fell within the Tribunal’s jurisdiction, and that this was not a cumulative test (i.e. the dispute need not be of a technical *and* an economic nature).<sup>505</sup> Clause 20.2 of the Block 21 Contract contemplates that a dispute regarding a declaration of caducity which is related to technical or economic aspects may be submitted to arbitration. Annex XVI does not single out caducity, placing upon the subject-matter jurisdiction of the Tribunal the sole limitation that the claim should concern a “technical” or “economic” dispute.

316. Having regard to the Tribunal’s findings in its Decision on Jurisdiction, the Tribunal considers that the declaration of *caducidad* has economic consequences and therefore falls within its subject-matter jurisdiction. The Tribunal accordingly finds that it has jurisdiction to entertain Perenco’s claim that Ecuador breached the Block 21 Contract when it declared *caducidad*.

## **VI. CLAIMS FOR BREACH OF CONTRACT**

317. The Tribunal begins by identifying the law applicable to the claims of breach of contract, before turning to consider the Parties’ submissions and its findings on liability.

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<sup>503</sup> Exhibit E-58, Annex XVI (Resubmitted on 11-17-09), p 4 [Emphasis added.].

<sup>504</sup> Decision on Jurisdiction, paragraph 130.

<sup>505</sup> Decision on Jurisdiction, paragraphs 127-135.

**A. Law applicable to the claims relating to the Participation Contracts**

318. Under Article 42(1) of the ICSID Convention, parties have full autonomy to designate the rules of law governing any dispute arising between them. In the present case, the parties to the Participation Contracts agreed for Block 7 that:

**22.1 Applicable legislation:** This Contract is governed exclusively by Ecuadorian legislation, and the laws in force at the time of its execution are understood to be incorporated in it.<sup>506</sup>

319. The applicable law provision in the Block 21 Contract is identical (clause 22.1).<sup>507</sup>

320. As a result of these express choices of applicable law, the Tribunal must apply Ecuadorian law.

321. Under the Block 21 Contract, “any technical and/or economic dispute arising out of (“*derivada*”) from the application of the Participation Contract” shall be resolved by ICSID arbitration.<sup>508</sup> The Tribunal has already found that the claim that the Block 21 contract was breached by the enactment of Law 42 and related measures falls within its jurisdiction.<sup>509</sup> It has also found that there are limits on its jurisdiction *ratione materiae* in respect of the contract claims. The Tribunal held that the “alleged violation of the Ecuadorian Constitution, its provisions on confiscation, discrimination and retroactivity of laws concern[ed] essentially legal matters, and cannot qualify as a ‘technical and/or economic dispute relating to [the Block 21] Participation contract.’”<sup>510</sup> Accordingly, these matters were not covered by the Parties’ consent to arbitration, and therefore lie outside the Tribunal’s competence.<sup>511</sup>

322. With respect to the Block 7 Participation Contract, there is no equivalent restriction on the Tribunal’s jurisdiction *ratione materiae*; clause 20.3 records the parties’ agreement to “submit the disputes or differences arising out of or related to the performance of this Participation Contract to the jurisdiction and competence of the International Centre for Settlement of

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<sup>506</sup> Exhibit CE-17, Block 7 Participation Contract, PER 04858.

<sup>507</sup> “**Applicable law.** This Contract is governed exclusively by Ecuadorian legislation, and the laws in force at the time of its execution are understood to be incorporated in it.” (Exhibit CE-10, Block 21 Participation Contract, PER 04722).

<sup>508</sup> Exhibit E-58, Annex XVI (Resubmitted on 11-17-09), p 4.

<sup>509</sup> Decision on Jurisdiction, paragraph 147.

<sup>510</sup> Decision on Jurisdiction, paragraph 137.

<sup>511</sup> *Ibid.*

Investment Disputes...”.<sup>512</sup> The Tribunal has rejected the Respondent’s objections to the Tribunal’s competence over this claim.<sup>513</sup> In doing so, it took note of the Claimant’s statement that it “does not contest the Ecuadorian ‘constitutionality or legality’ of Law 42 and its implementing regulations.”<sup>514</sup>

323. Accordingly, the Tribunal applies Ecuadorian law, recognising that it should refrain from analysing the constitutionality or legality *per se* of Law 42 and related measures.<sup>515</sup> The focus instead is on an alleged breach of contract said to arise out of Law 42’s impact on Perenco’s expected economic benefits resulting from its performance of the Contracts.

## **B. The Tribunal’s approach to the claims of breach of the Participation Contracts**

324. The Tribunal begins by noting its approach to the *Burlington* decision (Decision on Liability of 14 December 2012 in *Burlington Resources, Inc. v. Republic of Ecuador* (ICSID Case No. ARB/08/5)) and the decision of the Ecuadorian Constitutional Court on the constitutionality of Law 42, before turning to the parties’ submissions on Law 42 and its effect on the Contracts.

325. Both parties have directed the Tribunal to certain findings made by the *Burlington* tribunal with a view to either urging the Tribunal to follow or reject such findings. While mindful of the fact that that the *Burlington* tribunal has also considered the Participation Contracts, the Tribunal notes that that tribunal’s jurisdiction differs from its own. The *Burlington* tribunal had jurisdiction over treaty disputes only, and therefore to the extent that it considered the Participation Contracts, it did so incidentally to its treaty jurisdiction and evidently did not consider the Contract within the general framework of Ecuadorian law. There is, for example, no discussion by the tribunal in the Decision on Liability or in the dissenting opinion as to

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<sup>512</sup> Exhibit CE-17, Block 7 Participation Contract, PER 04851-04852. Clause 20.3 provides: “...from the date on which the Convention on the Settlement of Investment Disputes between States and Nationals of other States (‘the Convention’), signed by Ecuador, as a State member of the International Bank for Reconstruction and Development, on 15 January 1986 and published in Official Registry No. 386 of 3 March 1986, is approved by the Ecuadorian Congress, the Parties shall be obliged to submit the disputes or differences arising out of or related to the performance of this Participation Contract to the jurisdiction and competence of the International Centre for the Settlement of Investment Disputes (ICSID) to be settled and resolved in conformity with the provisions of said Convention. Under this system of arbitration, the following provisions shall apply:...”.

<sup>513</sup> Decision on Jurisdiction, paragraph 161.

<sup>514</sup> *Ibid.*, paragraph 158.

<sup>515</sup> Decision on Jurisdiction, paragraph 137.

whether the Contracts are to be characterised as private or administrative contracts, yet this was addressed by the Constitutional Court and was a topic to which the parties' legal experts devoted considerable attention in this proceeding.<sup>516</sup>

326. As this Tribunal must determine any “doubts and disputes that may arise” during the Participation Contracts' terms, specifically any “technical and/or economic dispute”<sup>517</sup>, it is required not only to interpret the Contracts, but also to consider the type of powers that the State may have had under Ecuadorian law in relation thereto and how such powers could be exercised. Every economic claim has to be analysed in a legal context but that in itself does not prevent it from being characterised as an economic dispute. Indeed, extensive evidence has been submitted by both parties on questions of Ecuadorian law bearing on the interpretation and application of salient terms of the Participation Contracts. Given its contractual jurisdiction, the Tribunal considers it appropriate to analyse the issues put before it by the disputing Parties in light of their submissions and all record evidence, without basing its decision on the *Burlington* tribunal's contractual analysis.

327. Both Parties referred to the Constitutional Court's decision. Insofar as the merits of the Court's judgment were concerned, Perenco contended – with reference to Dr. Pérez Loose's criticisms – that it was not a “persuasive and carefully reasoned treatment of the points of law addressed.”<sup>518</sup> This raised questions as to precisely what Perenco sought the Tribunal to do regarding the Constitutional Court's judgment both in relation to the contract and Treaty claims.

328. For its part, the Respondent emphasised that Law 42 had been declared constitutional by the highest court in Ecuador.<sup>519</sup> It pointed out that during the jurisdictional phase, Perenco had stated that it “does not contest the Ecuadorian ‘constitutionality or legality’ of Law 42 and its

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<sup>516</sup> See, for example, 1<sup>st</sup> Expert Report of Hernan Pérez Loose, paragraphs 9, 14-28, 36-48; 3<sup>rd</sup> Expert Report of Juan Pablo Aguilar Andrade, paragraphs 4-29; 80-107; 4<sup>th</sup> Expert Report of Hernan Pérez Loose, paragraphs 3-16, 42-57; 4<sup>th</sup> Expert Report of Juan Pablo Aguilar Andrade, paragraphs 61-77.

<sup>517</sup> Exhibits CE-17, Block 7 Participation Contract, clause 20.3 and E-58, Annex XVI (Resubmitted on 11-17-09); Decision on Jurisdiction, paragraphs 135, 146 and 157-160.

<sup>518</sup> Revised Memorial, paragraph 236.

<sup>519</sup> Counter-Memorial, paragraph 557(v).

implementing regulations”<sup>520</sup> and that as a result of this, the Tribunal had held that the issue raised by the Respondent “if it were to be construed as an objection, has become moot.”<sup>521</sup> Ecuador renewed its objection when the issue evidently reappeared in the merits phase in relation to Perenco’s Revised Memorial’s allegation that “Ecuador’s unilateral modification of the economic provisions of the Participation Contracts through the enactment and application of Law 42 [...] violated key constitutional provisions that were incorporated by reference into the Participation Contracts” and that the “constitutional – and in turn contractual – provisions mimic principles of international law explored above.”<sup>522</sup>

329. In its Reply, the Claimant restated its position that it did not challenge Ecuador’s authority to promulgate Law 42 nor did it request the Tribunal to grant relief that would involve overturning Law 42 or amending it. Rather, it confirmed that it challenged Law 42’s application to the Participation Contracts and Ecuador’s enforcement of Law 42 against Perenco, which in its submission breached Ecuador’s contractual and treaty obligations.<sup>523</sup> Accordingly:

Perenco’s claim that Ecuador breached the Contracts through conduct that was contrary to international law or inconsistent with principles recognized in the Ecuadorian constitution...should be understood in light of this position. To the extent that the assertions in paragraphs 272 to 232 of Perenco’s Revised Memorial are considered to be inconsistent with that position, such assertions should be deemed withdrawn.<sup>524</sup>

330. The Tribunal takes note of this clarification on Perenco’s part.
331. While mindful that the Constitutional Court did not consider Perenco’s Participation Contracts, the Tribunal considers that the Court’s findings provide some guidance as to the meaning and content of Ecuadorian law governing contracts dealing with the exploitation of hydrocarbon

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<sup>520</sup> Claimant’s Rejoinder on Jurisdiction dated 15 January 2010, paragraph 63; Counter-Memorial, paragraph 371.

<sup>521</sup> Counter-Memorial, paragraph 371.

<sup>522</sup> Counter-Memorial, paragraphs 369-372, quoting from paragraph 227 of the Revised Memorial.

<sup>523</sup> Reply, paragraphs 174-176.

<sup>524</sup> Reply, paragraph 176, reference to prior pleadings omitted.

resources. Accordingly, the Tribunal seeks to apply Ecuadorian law consistently with the Court's findings, mindful of what the Court did and did not decide.<sup>525</sup>

332. The Tribunal is also cognisant of the fact that while the Participation Contracts vested a jurisdiction in the Tribunal to decide certain types of disputes, they also conferred jurisdiction over other types of disputes on the Ecuadorian courts.<sup>526</sup> The Tribunal has already held that it does not have jurisdiction over constitutional matters, which are “essentially legal matters.”<sup>527</sup> It is not open to the Tribunal to second-guess the Ecuadorian courts' determination and application of Ecuadorian law in relation to such legal matters.

### C. The submissions of the Parties

#### (1) The Claimant's Position

333. Perenco submitted that Law 42's enactment and enforcement unilaterally amended key terms of the Participation Contracts in breach of its provisions permitting modification by way of agreement only.<sup>528</sup> The Contracts were governed by the *pacta sunt servanda* principle, a principle recognised in Ecuadorian law and incorporated in the Contracts by way of reference to Article 1561 of the Ecuadorian Civil Code and Article 31.1 of the Hydrocarbons Law.<sup>529</sup>

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<sup>525</sup> The Tribunal is alive to the nature and subject of the claims confronted by the Constitutional Court. The Court was asked to consider whether Law 42 violated any of the following constitutional norms and the consequences thereto: legal security, equality, non-retroactivity, respect for the hierarchy of laws, protection of property rights and observance of procedural formalities in its enactment. See Exhibit CA-313, Constitutional Tribunal's Decision on Law 42.

<sup>526</sup> For example, clause 22.1.2 of the Block 7 Participation Contract provides that for claims which arise due to the acts or resolutions of the Ministry of Energy and Mines the Contractor may initiate claims or appeals before the local courts (Exhibit CE-17, PER 04859).

<sup>527</sup> Decision on Jurisdiction, paragraph 137.

<sup>528</sup> Amended Request, paragraph 37; Revised Memorial, paragraphs 201-211; Reply, paragraphs 434-485.

<sup>529</sup> Revised Memorial, paragraphs 201-202. Article 1561 of the Civil Code in Ecuador provides that “[e]very contract lawfully executed is law between the parties and cannot be invalidated unless it be by mutual consent of the parties or for legal causes.” (CA-43, Civil Code, p 13). Clause 22.1 of the Participation Contracts provided that Ecuadorian legislation applied to them (Exhibits CE-17, Block 7 Participation Contract, PER 04858, and CE-10, Block 21 Participation Contract, PER 04722). Article 31.1 of the Hydrocarbons Law provides that “[a]t the State's discretion, contracts for the exploration and use of hydrocarbons may be modified by an agreement of the contracting parties, and upon approval by the Special Bidding Committee (CEL)...” (Exhibit CE-37 (Resubmitted on 04-12-12), Hydrocarbons Law, Decree 2967 of the Supreme Government Council (in Spanish with additional translated excerpt), PER 01542.1).

The principle was incorporated expressly in the Contracts' clause 15.2 which provided that any amendment required the mutual agreement of the parties.<sup>530</sup>

334. Perenco argued that by applying Law 42 and related measures to the Contracts, Ecuador breached this principle because it “effectively modified the Participation Contracts’ economic terms.”<sup>531</sup> The participation it was entitled to receive and freely dispose of as a result of the operation of clause 8.1 of the Contracts constituted its “gross income”, and as a result, formed the “fundamental economic term” of the Contracts.<sup>532</sup> This economic term ensured that both the Contractor and the State had the potential to benefit from increasing oil prices; “the State both through its own Participation percentage and also through the additional tax revenues and other benefits that Perenco paid.”<sup>533</sup> Law 42, however, was intended to, and in effect did, allocate the benefits of increasing oil prices “almost exclusively to the State, and took them away from Perenco.”<sup>534</sup> It created “an *additional* right for Ecuador (and a corresponding additional obligation on Perenco) that the Contracts simply did not grant it.”<sup>535</sup> Perenco submitted that this amounted to a breach of the Contracts’ economic terms.<sup>536</sup> It was a unilateral modification of the Contracts where Ecuadorian law (as incorporated by reference into the Contracts) and the Contracts themselves required any amendment to be by agreement of the parties.<sup>537</sup>

335. Perenco’s rebuttal to the contention that Law 42 was at best “an additional charge of some kind outside the contractual framework”<sup>538</sup> was that it ignored the fact that the types of income accruing to the State from oil activities set out in each Contract was a closed list. Article 44 of the Hydrocarbons Law identified the potential forms of income the State could derive from oil

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<sup>530</sup> Revised Memorial, paragraph 204; citing Exhibits CE-17, Block 7 Participation Contract, PER 04829, and CE-10, Block 21 Participation Contract, PER 04703; Reply, paragraph 435.

<sup>531</sup> Revised Memorial, paragraph 208.

<sup>532</sup> Revised Memorial, paragraph 209; Reply, paragraph 447.

<sup>533</sup> Revised Memorial, paragraph 210.

<sup>534</sup> *Ibid.*; Reply, paragraphs 437-441, 446 and Transcript, Hearing on the Merits, Day 8, pp 1937 *et seq.* The purpose of Law 42 was to “cause oil operators such as Perenco to renegotiate their contracts”, and on Ecuador’s own case, “correct a *contractual* ‘disequilibrium.’” (Reply, para 438 [*italics in original*]).

<sup>535</sup> Reply, paragraph 446 [*italics in original*].

<sup>536</sup> Revised Memorial, paragraphs 210-211; Reply, paragraphs 437-440.

<sup>537</sup> Revised Memorial, paragraph 211; Reply, paragraphs 436-460

<sup>538</sup> Revised Memorial, paragraph 213.

exploitation activities, and this was then reflected with greater particularity in the case of the Participation Contracts.<sup>539</sup> Perenco submitted that “[i]n fact, every one of the potential sources of State income [was] addressed in the Contracts either to require some payment or exempt the Contractor from paying anything in respect of that item.”<sup>540</sup> The Contracts thus comprehensively set out the Contractor’s payment obligations and Law 42, by “creat[ing] for the State an additional source of potential income not previously contemplated in the Hydrocarbons Law or the Contracts”, contravened the parties’ agreement.<sup>541</sup>

336. Perenco acknowledged that while Article 44 of the Hydrocarbons Law could be amended, such amendment was not automatically reflected in the Contracts which, as a result of the *pacta sunt servanda* principle and the terms of the Contracts themselves, required any amendment to be strictly by agreement.<sup>542</sup>

337. Perenco further submitted that the Contracts obliged Ecuador to negotiate a correction factor in the event that any measures it took upset the economy of the Contracts.<sup>543</sup> This was not done.

338. Perenco also contended that the principle of *pacta sunt servanda* could not be displaced by any, as it put it, ‘administrative law doctrine of ‘extraordinary powers’’, and if it could, “any such doctrine would require payment of full compensation to the contractor if the changes affect the economic terms of the agreement, which has not been offered much less paid here.”<sup>544</sup>

339. It similarly rejected any justification by Ecuador on the basis of the *rebus sic stantibus* – or extreme hardship – principle.<sup>545</sup> The circumstances that ostensibly required the enactment of

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<sup>539</sup> Revised Memorial, paragraphs 217-218.

<sup>540</sup> *Ibid.* cf. Rejoinder, section 4.1.1.

<sup>541</sup> Revised Memorial, paragraph 219.

<sup>542</sup> *Ibid.*

<sup>543</sup> Revised Memorial, paragraph 220; Reply, paragraphs 461-495.

<sup>544</sup> Revised Memorial, paragraph 207.

<sup>545</sup> Revised Memorial, paragraphs 233-234; Reply, paragraphs 458-459. Notably, the Claimant in its reliance on the evidence of its expert Dr. Pérez Loose on the *rebus sic stantibus* doctrine seems to conflate its exercise with that of the administration’s *ius variandi* power: Reply, paragraph 458 (“Dr. Pérez Loose has already explained that the *rebus sic stantibus* doctrine does not apply to the Participation Contracts for a number of reasons, and could not justify Law 42 even if it did. See HPL ER V paragraphs 34-44; HPL ER I paragraphs 29-35; see also HPL ER I paragraphs 38, 91 (explaining that the administration’s *ius variandi* cannot apply to deprive the contractor of the economic benefit of the contract signed with the State, that it does not apply to aleatory contracts such as the

Law 42 were not unforeseeable since “price fluctuations were specifically discussed during the Block 7 negotiations” during which the parties agreed “not to include a price band mechanism that would have increased the State’s participation percentage for revenues above a reference price.”<sup>546</sup> Ecuador benefitted greatly from Perenco’s investment and the high price of oil. As a result, it cannot claim that continued performance of the Contracts under these circumstances would have been “excessively” or “unreasonably more burdensome.”<sup>547</sup> Finally, if made out, the principle entitles the invoking party to seek a renegotiation of the contract terms or, if such renegotiation should fail, a decision from the competent court or tribunal to readjust the terms of the contract or rescind it.<sup>548</sup> Ecuador similarly failed to meet this requirement; it did not seek a negotiation or, failing that, a judicial solution.<sup>549</sup>

340. Finally, Perenco submitted that Ecuador’s “relentless efforts to apply Law 42 eventually led it to breach other aspects of the Contracts”, namely, Perenco’s right to freely dispose of and market its share of crude through the State’s seizure of Perenco’s oil through the *coactivas*<sup>550</sup> and its right to operate the Blocks with the State’s forcible seizure and subsequent declaration of *caducidad* in 2009.<sup>551</sup> In this connection, it argued that Ecuador committed a further breach of contract in failing to comply with the Decision on Provisional Measures.<sup>552</sup>

341. Perenco further submitted that by exempting the application of Law 42 to another contractor operating in Ecuador, Andes Petroleum, with respect to its Tarapoa Block Participation Contract with Ecuador,<sup>553</sup> Ecuador breached its contractual undertaking under clause 5.1.28 of

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Participation Contracts, and that Law 42 was not an exercise of *jus variandi*) [italics and internal citations in original.].

<sup>546</sup> Revised Memorial, paragraphs 234 and 237.

<sup>547</sup> *Ibid.*; Reply, paragraph 459.

<sup>548</sup> Revised Memorial, paragraph 233.

<sup>549</sup> *Ibid.*, paragraph 234.

<sup>550</sup> Exhibits CE-17, Block 7 Participation Contract, clause 5.3.2 (PER 04776), 10.1 (PER 04817), 10.2 (PER 04818), and CE-10, Block 21 Participation Contract, clause 5.3.3 (PER 04663), 10.1 (PER 04696), 10.2 (PER 04696-04697); Revised Memorial, paragraphs 209-210; Reply, paragraph 149.

<sup>551</sup> Exhibits CE-17, Block 7 Participation Contract, clause 4.2 (PER 04758), and CE-10, Block 21 Participation Contract, clause 4.2 (PER 04653); Revised Memorial, paragraph 212; Reply, paragraph 433.

<sup>552</sup> Decision on Provisional Measures, paragraph 79; Revised Memorial, paragraphs 222-226; Reply, paragraphs 246-253.

<sup>553</sup> Exhibit CE-12, Modification Contract for the Exploration and Exploitation of Hydrocarbons (Crude Oil) between Petroecuador and City Investing Company Limited, for the Tarapoa Block, 25 July 1995 (in Spanish with English translation of excerpts) (“Tarapoa Block Participation Contract”).

the Block 7 Participation Contract not to discriminate between “Participation Contractors for the Exploration and Exploitation of Hydrocarbons”.<sup>554</sup>

## (2) The Respondent’s Position

342. Ecuador submitted that on a true construction of the Participation Contracts and correct application of Ecuadorian law, Law 42 and its Implementing Regulations cannot be said to have breached the Participation Contracts.<sup>555</sup>
343. The only guarantee that the Participation Contracts offered to the Claimant was “participation” in the form of an entitlement to a physical share in the oil produced.<sup>556</sup> Clause 4.2 (of both Contracts) stipulated that the Contractor would receive a “percentage of the Measured Production as compensation” and this percentage was in turn determined using the formula set out in clause 8.1.<sup>557</sup> Ecuador further relied on clause 5.3.2 of the Contracts in submitting that the “Contractor’s right under the Participation Contract was no more and no less than to [r]eceive the Contractor’s Share of the Production at the Inspection and Delivery Center and freely dispose of the Contractor’s Share of Production.”<sup>558</sup>
344. Ecuador argued that Perenco cannot, in the face of a true construction of these contractual terms, reasonably claim a guarantee to a certain allocation of profit.<sup>559</sup> The purpose and express wording of clause 8.2 of the Contracts supported its interpretation of key terms of the Contracts. Clause 8.2 reflected the “Parties’ agreement to fix, *for income tax purposes*, the gross income deemed to have been generated by the Contractor...Clause 8.2 thus provided: *The*

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<sup>554</sup> Reply, paragraphs 496-501. Clause 5.1.28 of the Block 7 Participation Contract provides “The Parties understand that the treatment received by the Contractor both by the Government of Ecuador as well as by PETROECUADOR shall not be less favorable than that in similar conditions by other Participation Contractors for the Exploration and Exploitation of Hydrocarbons.” (Exhibit CE-17, Block 7 Participation Contract, PER PER 04772). The Tribunal notes that Perenco in its Reply indicated it was not going to pursue its claim of discrimination under the Treaty: Reply, paragraph 5.

<sup>555</sup> Counter-Memorial, sections 6.1-6.3.

<sup>556</sup> Counter-Memorial, paragraphs 375-383, 394-399.

<sup>557</sup> *Ibid*; Exhibits CE-17, Block 7 Participation Contract, PER 04758, and CE-10, Block 21 Participation Contract, PER PER 04653.

<sup>558</sup> Counter-Memorial, paragraph 382, quoting from Exhibit CE-17, Block 7 Participation Contract, PER 04776.

<sup>559</sup> Counter-Memorial, paragraphs 384, 395; Rejoinder, section 4.1.2. Ecuador admitted that the prospect of adjustment factors in the Contracts to the Parties’ respective participation percentages suggested that “Perenco had protection that its Share of Production would generate for it at least the *ex ante* long term average return on cost of capital.” (Rejoinder, paragraph 369).

*Contractor's Share of Production, calculated as an annual average at actual sales prices, which will in no case be less than the Reference Price, plus other income from the Contractor's activities related to this Contract, will constitute the gross income of the Contractor under the terms of this Contract, from which all applicable deductions will be taken and on which income tax will be paid in accordance with the provisions of Clauses eleven point one (11.1) and eleven point two (11.2)."*<sup>560</sup>

345. In Ecuador's submission, this suggested that the Contracts did not intend to realize a guaranteed quantum of gross income in favour of the Contractor since it had to create an artificial construct for income tax purposes and, moreover, the State remained at liberty to apply a rate of tax to the gross income as it saw fit.<sup>561</sup>
346. Alternatively, Ecuador submitted that even if clause 8.2 did guarantee a certain gross income, Law 42 did not alter clause 8.2 since it did not modify the formula for calculating the Contractor's gross income, and in this way cannot be said to have operated to breach clause 8.2.<sup>562</sup>
347. Ecuador similarly rejected Perenco's claim in relation to the triggering of the renegotiation clause in the Participation Contracts.<sup>563</sup> It submitted that it was not triggered because Law 42 and its Implementing Regulations did not upset the economy of the Participation Contracts.<sup>564</sup>
348. Clauses 8.6 and 11.12 of the Block 7 Contract and 11.7 of Block 21 Contract "caught only those modifications which *'have an impact on the economics of'*" the Contracts and a correction factor could only be applied to "absorb *that* 'impact' rather than to absorb any

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<sup>560</sup> Counter-Memorial, paragraph 386 [Emphasis and italics in original.]; citing Exhibit CE-17, Block 7 Participation Contract, PER 04807; Exhibit CE-10, Block 21 Participation Contract, PER 04689.

<sup>561</sup> Counter-Memorial, paragraphs 386-388; 394-395.

<sup>562</sup> Counter-Memorial, paragraph 395(iii). The Claimant in its Reply noted that this submission taken to its logical limits suggested that "there was nothing to stop Ecuador from taking away *all* of Perenco's economic benefit under the Contracts. On Ecuador's argument, it could have taken 100% of all revenue from oil production (without even a reference price threshold), and yet not have breached the Contracts in the slightest." (Reply, paragraph 450 [Emphasis in original.]).

<sup>563</sup> Counter-Memorial, paragraphs 389-392, 409-421; cf. Reply, paragraphs 486-495.

<sup>564</sup> Counter-Memorial, paragraphs 405, 409-421; Rejoinder, paragraphs 356-360.

general increase in the tax burden on the Contractor.”<sup>565</sup> Ecuador’s position was that clause 11.12/11.7 did not “operate as a stabilisation measure which absorbed *any* increased tax burden on the Contractor.”<sup>566</sup>

349. Ecuador contended in this regard that Perenco had failed to discharge its burden of demonstrating that Law 42 and its Implementing Regulations had an impact on the economy of the Participation Contracts, and what the appropriate adjustment would have been.<sup>567</sup> In fact, Perenco “offered no evidence as to the meaning of ‘economics of this Contract’ as a matter of Ecuadorian law”, much less adduced expert or other evidence to show Law 42’s impact on the Participation Contract’s economics (as understood when the Participation Contracts were signed).<sup>568</sup>
350. In Ecuador’s view, the “relevant enquiry [was] whether that measure impacted the long-term average oil price expectations upon which the Contractor’s Share of Production in Clause 8 of the Participation Contracts was set such that, all things being equal, those X factors would continue to generate an IRR of around 15%.”<sup>569</sup> It pointed to evidence that suggested that the Law 42 reference prices were at all times set above the US\$ 15/bbl mark, which it argued was the basis of the economic modeling undertaken in the negotiation of both contracts, and which could be found in the calculation attached to the Block 7 Participation Contract as Annex V.<sup>570</sup>

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<sup>565</sup> Counter-Memorial, paragraph 390 [Emphasis in original.]. The Claimant responded to this in its Reply, contending that it was a selective reading of clause 11.12/11.7: “Ecuador’s argument that the correction factor must ‘absorb *that* ‘impact’ [on the economics of the Contracts] rather than to absorb any general increase in the tax burden on the Contractor’ (ECM, paragraph 390, emphasis in original) inverts the plain language of the Contracts: Clause 11.12 provides, to the contrary, that the correction factor must ‘absorb the impact of *the increase or decrease in the tax . . . burden*’” (Reply, paragraph 465 [Emphasis in original.]).

<sup>566</sup> Counter-Memorial, paragraph 390 [Emphasis and italics in original.].

<sup>567</sup> Counter-Memorial, paragraphs 403, 405, 409-424 cf. Reply, paragraphs 466-495; see also, Rejoinder, paragraphs 366-367, section 4.2.

<sup>568</sup> Counter-Memorial, paragraph 405.

<sup>569</sup> Rejoinder, paragraph 383.

<sup>570</sup> Counter-Memorial, paragraphs 414-419; Rejoinder, section 4.2.1. The Claimant responded that this ignored that there existed a specific mathematical economic equation expressly set out in clause 8.1 of the Contracts, and this did not identify US\$ 15/bbl as its premise. Clause 8.1 was a self-contained representation of the ‘economy’ or ‘equilibrium’ of the Contracts and this was confirmed by the fact that if a correction factor was to be applied to the Contracts as a result of a change in tax which impacted the economy of the Contracts, it would be applied to clause 8.1. See Reply, paragraphs 469-471. The Claimant submitted that Annex V did not purport to be a statement of the ‘economy’ of the Contract, its purpose only extended as far as demonstrating that it was in the interest of the State to convert to participation contracts: Reply, paragraph 473. The Claimant similarly argued vigorously against the imputation of Annex V, which was drawn up in connection with the Block 7 Contract, into the operation of the Block 21 Contract: “It cannot be the case that the ‘economy’ of the Block 21 Contract is

The reference prices for Blocks 7 and 21 at the time of execution of the Contracts were fixed by the Ministry of Energy and Mines at, respectively, US\$ 25.111383/bbl and US\$ 15.358274/bbl.<sup>571</sup> Moreover, there were instances, such as in 2006, as reflected in the Oso Development Plan, that “Perenco’s own economic projections...were premised on a price/bbl below the Law 42 reference price.”<sup>572</sup> This and the 15-20% IRR identified in the 7th Bidding Round, which was representative of the *ex ante* long term economic assumptions underpinning the Participation Contracts, were preserved in the application of Law 42 and its Implementing Regulations.<sup>573</sup>

351. In any event, assuming *arguendo* that Law 42 did affect the economy of the Contracts, Ecuador submitted that the renegotiation provisions at best imposed on the parties an obligation to negotiate and Perenco bore the burden of proving that the failure to agree to a correction factor was Ecuador’s fault.<sup>574</sup> Perenco is “put to proof on the issue of causation”.<sup>575</sup> Ecuador claims it cannot because it failed to “take the most basic steps required even to invoke” the clauses and then failed to secure its Consortium-partner’s consent to the agreement that resulted from the negotiations conducted in 2009.<sup>576</sup>

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contained in a non-existent annex. Still less can it be true that an annex to a different contract, with a different purpose and in different circumstances, drawn up four years *after* the Block 21 Contract was concluded, establishes the ‘economy’ of the Block 21 Contract ‘at the time of contracting,’ as Ecuador claims.” [Emphasis in original.] (Reply, paragraph 475). In its Rejoinder, Ecuador responded by asserting that clause 8.1 was clearly “the product” of the parameters considered and debated in the 7th Bidding Round, and for this reason the price assumption was constitutive of the mathematical-economic equation of the Contracts: Rejoinder, paragraph 381.

<sup>571</sup> Exhibit E-126, Letter from the STET Director (Ministry of Energy and Mines) to Perenco dated 6 July 2006 with enclosures.

<sup>572</sup> Counter-Memorial, paragraph 420 [Emphasis in original.].

<sup>573</sup> Rejoinder, section 4.2.1, in particular paragraphs 397-400. In its Rejoinder, Ecuador submitted there was a fundamental flaw in the economic analysis undertaken by Perenco’s expert; it ignored that Perenco had been enjoying a price upside from the beginning of the Block 7 and 21 phases till Law 42 entered into force, and assumed that Law 42 and Decree 662 operated retroactively: Rejoinder, paragraphs 401-404.

<sup>574</sup> Counter-Memorial, paragraphs 422-423. The Claimant for its part had a different interpretation regarding on whom the burden of the renegotiation provisions rested; “The adjustment clauses create a clear obligation of result on Ecuador: to modify the Contracts to include a correction factor to absorb the consequences of Law 42 on Perenco. This obligation has nothing to do with a mere obligation to negotiate for an uncertain result.” (Reply, paragraph 489). See also, Rejoinder, section 4.3.

<sup>575</sup> Counter-Memorial, paragraph 423.

<sup>576</sup> Counter-Memorial, paragraph 424. The Claimant responded to this in its Reply; it submitted that the 2009 negotiations were not “aimed at agreeing a ‘correction factor’ to the Clause 8 participation formulae but rather at terminating the Participation Contracts altogether and moving to a services contract” and that it did not fail to provide the figures but was not required to do so until the process was initiated by Ecuador which the latter failed to do (Reply, paragraph 487). See also, Reply, paragraphs 490-494. The bottom-line for the Claimant was that the

352. Ecuador similarly denied any suggestion by Perenco that clause 22.1 of the Contracts operated as a stabilisation clause.<sup>577</sup> Rather, that clause must be read as providing that the Contracts “are governed by Ecuadorian legislation ‘and’ such laws as were then in force” at the time the Participation Contracts were concluded “were incorporated by reference”.<sup>578</sup> If this clause was a stabilisation clause, it would render nugatory the renegotiation mechanism of clauses 8.6 and 11.12 of the Block 7 Contract and 11.7 of the Block 21 Contract, which were triggered with an amendment to Ecuadorian law that had an impact on the economy of the Contracts.<sup>579</sup>
353. Moreover, the clauses cannot be stabilisation clauses because under Ecuadorian law a stabilisation clause requires the State “to have expressly excluded the application of laws/and or regulations enacted after the date of the execution of the contracts”, and the clause mirrors a provision in Article 7(18) of the Ecuadorian Civil Code, which means that to find that they are stabilisation clauses would suggest that all contracts governed by Ecuadorian law are governed by its law as frozen at the time of entry into the contract.<sup>580</sup>
354. Finally, Ecuador denied having committed any breach of contract in connection with the Decision on Provisional Measures. It contended that while the parties undertook in the Contracts to submit specified disputes to ICSID arbitration and to abide by a tribunal’s “*final award*”, they did not undertake to, and these obligations could not inferentially amount to an undertaking to, comply with a tribunal’s recommendation of provisional measures.<sup>581</sup>
355. On the matter of Andes Petroleum and the contractual claim under clause 5.1.28 of the Block 7 Contract, Ecuador sought the claim’s dismissal in the first instance because it was introduced late.<sup>582</sup> It was raised for the first time by the Claimant in its Reply; it was not canvassed in its

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failure to reach an amicable solution was due to Ecuador’s conduct; its conduct in negotiations was “inconsistent and increasingly adamant” and “Ecuador among other things terminated negotiations, rebuffed comments from Perenco, and publicly announced that it would take over Perenco’s operations and seize its oil.” (Reply, paragraph 494).

<sup>577</sup> Counter-Memorial, paragraph 397. Ecuador took the same position with respect to clauses 8.6 and 11.7/11.12 (Rejoinder, paragraph 365).

<sup>578</sup> Counter-Memorial, paragraphs 397-398 [Emphasis and italics in original.].

<sup>579</sup> *Ibid.*

<sup>580</sup> Counter-Memorial, paragraphs 398-400.

<sup>581</sup> Counter-Memorial, paragraph 448 [Emphasis added.]; Rejoinder, paragraphs 422-425.

<sup>582</sup> Rejoinder, paragraphs 426-427.

Request, Memorial or Revised Memorial.<sup>583</sup> Ecuador submitted in the alternative that Perenco had failed to discharge its burden of proof in making out this claim, namely that it had failed to demonstrate that Perenco and Andes were in “similar conditions” (the term used in clause 5.1.28), that there was no credible justification for differing treatment and that there was an intention on the part of the state to favour Andes Petroleum in the Tarapoa Block Contract.<sup>584</sup>

#### **D. The Tribunal’s Decision**

##### **(1) The salient terms of the Participation Contracts**

356. The Tribunal begins by noting certain basic features of the Contracts that bear on the contract dispute. Both Contracts were negotiated within the broader context of Ecuadorian law. Clause 22.1 (in both Contracts) stated that the Contract was governed exclusively by Ecuadorian legislation, and the laws in force at the time of its execution were understood to be incorporated in it.<sup>585</sup> The “Legal Framework” then set out a non-exhaustive list of “legal standards” applicable to the Contract (including the Hydrocarbons Law, the Law amending the Hydrocarbons Law and various regulations pertaining thereto, as well as certain other general Ecuadorian laws).<sup>586</sup>
357. Both Participation Contracts contained an exorbitant clause recognising the Ministry of Energy and Mines’ power to declare *caducidad* for the reasons and under the procedure established in Articles 74-76 of the Hydrocarbons Law.<sup>587</sup> (The presence of such a clause was, as the

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<sup>583</sup> *Ibid.*; Reply, paragraphs 496-501.

<sup>584</sup> Counter-Memorial, paragraphs 529-533; Rejoinder, paragraphs 426-428.

<sup>585</sup> Exhibits CE-10, Block 21 Participation Contract and CE-17, Block 7 Participation Contract.

<sup>586</sup> Clause 22.1.4 of the Block 7 Contracts identifies the following: The Hydrocarbons Law, published in the Official Registry No. 711 (November 1978), Law No. 101, published in the Official Registry No. 306 (13 August 1982), Law No. 08, published in the Official Registry No. 277 (23 September 1986), Decree Law No. 24, published in the Official Registry No. 446 (29 May 1986), Law No. 44, published in the Official Registry No. 326 (29 November 1993), Law No. 49 published in the Official Registry No. 346 (28 December 1993), Law amending Hydrocarbons Law, published in the Official Registry No. 523 (9 September 1994), Special Law of the State Oil Company of Ecuador (PETROECUADOR) and its affiliates, published in the Official Registry No. 283 (26 September 1989), Internal Tax Regime law, published in the Official Registry No. 341 (22 December 1989), Law No. 10 on the Fund for Amazonian Regional Eco-Development and the Strengthening of its Departmental Entities, published in the Official Registry No. 30 (21 September 1991) *etc.*

<sup>587</sup> Clause 21 of the Block 7 and Block 21 Contract (basis on which, and the process by which, caducity proceedings may be initiated): Exhibits CE-17, Block 7 Participation Contract, PER 04855, and CE-10, Block 21 Participation Contract, PER 04720.

Claimant's Ecuadorian law expert acknowledged, an indication of the existence of an administrative contract.<sup>588</sup>)

358. Insofar as interpretative guidance was given by the parties, clause 3.1 of each Contract stated that the Contract was to be interpreted "in accordance with the provisions of Title XIII, Volume IV of the Civil Code of Ecuador..."<sup>589</sup> Article 1561 of the Civil Code provides that: "All contracts legally entered into are law for the parties, and can only be invalidated by mutual consent or on legal grounds."<sup>590</sup>
359. Both the Hydrocarbons Law and the Participation Contracts required the mutual consent of the parties to amend the contracts. Article 31-A of Hydrocarbons Law established that oil contracts may be amended, if that is in the interests of the State, provided that, among other things, the contractor's consent is obtained.<sup>591</sup> This statutory premise was subsequently reflected in the Contracts themselves.<sup>592</sup>
360. Both Contracts contained a volume sharing formula as well as other provisions aimed at preserving the parties' respective shares of production. Clause 8 of the Block 7 Contract, the "Participation and Delivery Procedures" clause, for example, contained an "economic stability" clause tied to potential modifications of the tax regime:

**8.6 Economic stability:** If, due to acts of the Ecuadorian Government, or PETROECUADOR, any of the events described below should occur, that has consequences for the economy of this Contract, a correction factor shall be included in the participation percentages that absorbs the increase or decrease in the economic burden:

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<sup>588</sup> 1<sup>st</sup> Expert Report of Hernan Pérez Loose, paragraphs 14, 17 and 37.

<sup>589</sup> Exhibits CE-17, Block 21 Participation Contract, PER 04743, and CE-10, Block 21 Participation Contract, PER 04643.

<sup>590</sup> CA-381, Civil Code, Official Registry No. 46 of 24 June 2005 (in Spanish); Counter-Memorial, paragraph 259.

<sup>591</sup> "At the State's discretion, contracts for the exploration and use of hydrocarbons may be modified by an agreement of the contracting parties, and upon approval by the Special Bidding Committee (CEL). To do so, favorable pre-modification reports will be required from the Attorney General's Office, the Office of the Joint Chiefs of Staff, the Board of Directors of Petroecuador, and the Ministry of Energy and Mines." (Exhibit CE-37 (Resubmitted on 04-12-12), Hydrocarbons Law, Decree 2967 of the Supreme Government Council (in Spanish with additional translated excerpt), PER 01542.1).

<sup>592</sup> Exhibits CE-10, Block 21 Participation Contract, clause 11.7 (PER 04699) and CE-17, Block 7 Participation Contract, clause 11.12 (PER 04823).

a) Modification of the tax regime, as described in clause 11.12...<sup>593</sup>

361. The parties also addressed the relationship between taxation measures and their respective shares of production. Clause 11, paragraphs 1 to 11 in the Block 7 Contract (and clause 11, paragraphs 1 to 6 of the Block 21 Contract) contained a comprehensive list of fiscal measures and was clearly designed to operate such that if a new tax was implemented, or an existing tax was changed, the right to seek a modification of the Contract would be triggered. This is made clear by the final provision of clause 11.12 of the Block 7 Contract (clause 11.7 of the Block 21 Contract) which provides:

**11.12 Modification to the tax regime.** *In the event of a modification to the tax regime or the creation or elimination of new taxes not foreseen in this Contract... on the signature date of this Contract and as described in this Clause, or their interpretation, which have consequences for the economy of this Contract, a correction factor shall be included in the participation percentages, which absorbs the increase or decrease in the tax burden... This correction factor shall be calculated between the Parties and following the procedure set forth in Article thirty-one (31) of the Regulations for Application of the Law Amending the Hydrocarbons Law.*<sup>594</sup>

362. By their own terms, clauses 11.7 and 11.12 of the two Contracts did not preclude the State from introducing new taxes or modifying existing ones, but in the event that such measures

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<sup>593</sup> Exhibit CE-17, Block 7 Participation Contract, PER 04811-04812 [Bolding in original.].

<sup>594</sup> [Bolding in original, emphasis added.] This refers to Decree No. 1417, Regulation for the Application of the Hydrocarbons Law, Official Registry No. 364 of 21 January 1994, found at Exhibit CE-6 (in Spanish with English translation of excerpts). Article 31 provides: "**Competencia de otros órganos:** No requieren de aprobación del CEL las modificaciones contractuales derivadas de modificaciones del sistema tributario aplicable al contrato, así como las que no afecten a la esencia del contrato, calificadas como tales por el CEL, previa consulta a este organismo por parte del Presidente Ejecutivo de PETROECUADOR, las mismas que serán aprobadas por el Consejo de Administración del Petroecuador y se implementarán a través de contratos modificatorios. Se exceptuarán aquellos casos en los que la Ley, en forma expresa, establece la competencia de otros órganos." (PER 00498) (Rough translation: **Competition from other bodies:** No CEL require approval of contract modifications derived from tax changes applicable to the contract, so as to not affect the essence of the contract, classified as such by the CEL, after consultation with the agency by Executive President of Petroecuador, the same that will be approved by the Board of Directors of Petroecuador and modificatorios implemented through contracts. Those cases where the Act expressly provides for the competence of other organs are excepted.") Article 32 follows on to provide in part (Claimant's translation): "Article 32 Procedure [for amending the contracts]: "The modifications which are subject to the Special Bidding Commission (CEL), shall comply the following procedure:" (...) b) Provided that the parties have reached mutual agreement over the proposed modification, Petroecuador's Executive President shall submit the modifications agreed to with the contractor to the Administrative Counsel for consideration and report; (...) d) Should the corresponding Minister agree with the negotiated modifications, it shall issue a favorable report and request reports from the Attorney General's Office and from the Joint Chiefs of Staff respectively." (Exhibit CE-6, PER 00503).

were introduced that had “consequences for the economy of” the Contract, the obligation arose to negotiate a “correction factor” that would absorb the increase or decrease in the tax burden.

363. Clauses 15.2, entitled “Contractual Amendments”, stated in this regard:

**15.2 Contractual amendments:** The negotiation and signing of amending contracts shall take place, by agreement of the Parties, particularly in the following cases:

...

c) When the tax or currency exchange regime or labor participation applicable to this type of Contract in the country has been amended, in order to reestablish the economy of this Contract, in conformity with clause 11.11.<sup>595</sup>

364. The inclusion of the tax modification and contractual amendment clauses thus reflected the parties’ agreement, noted above, to list the applicable taxes, encumbrances, employee profit sharing and contributions that would be required of the contractor.

365. Two points about the foregoing clauses warrant note. First, the predicate for the introduction of any correction factor was the demonstration (and subsequent agreement of the parties) that the new or modified tax had “consequences for the economy” of the contract; a new or modified tax that did not have such consequences would not require a correction factor. Second, clause 11 did not stipulate how the correction factor would be calculated, because the precise nature of a future or modified tax and its potential effect on the Contract could not be known at the time of contracting. Clause 11 did stipulate the ultimate result, namely, a change in the parties’ respective participations “which absorbs the increase or decrease in the tax burden.” The process envisaged was one of the negotiation in good faith of a mutually agreeable offset that would result in an amended contract.

366. While these clauses were clearly designed to protect the contractual bargain, in the Tribunal’s view they do not constitute stabilisation clauses *per se*. By their own terms (e.g. in “the event of a modification to the tax regime or the creation ... of new taxes not foreseen in this Contract...”) the Contracts plainly did not purport to freeze Ecuadorian law as at the time of their signing and prohibit the State from modifying the tax regime.

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<sup>595</sup> Exhibits CE-17, Block 7 Participation Contract, PER 04829, and CE-10, Block 21 Participation Contract, PER 04703. The reference to clause 11.11 appears to be in error; it should be a reference to clause 11.12.

367. In this connection the Respondent pointed out that Ecuadorian legal practice contains examples of stabilisation agreements and they expressly require the State to exclude the application of laws and regulations enacted after the date of the contract’s signing. The Participation Contracts at issue in this case do not do that.<sup>596</sup> Moreover, the Constitutional Court held that the “renunciation of exercise [of the State’s power to modify or reform administrative contracts] must be made expressly in the corresponding administrative contract”.<sup>597</sup> As noted, there is no such waiver in either Contract.
368. The final notable feature of the Contracts is that both contained a broadly worded agreement that the “Parties undertake to use the means set forth in this Contract to resolve *doubts and disputes that may arise during its life...*”.<sup>598</sup> The inclusion of the word “doubts”, combined with the jurisdiction to resolve “economic” disputes, indicates to the Tribunal that the parties wished to ensure that disputes such as the present one could be put before a tribunal such as the present one.

**(2) Did Law 42 amend, modify or change the legal framework applying to the Participation Contracts?**

369. Although Perenco contended that Law 42 amended the Contracts, its pleadings also embraced the possibility that this was not the case. In its Reply, Perenco maintained its primary position that Law 42 unilaterally amended key terms of the Contract, whether by *direct* amendment or by *indirect* amendment with the creation of additional contractual rights that took away from the benefit of performing key terms.<sup>599</sup> It also argued, in the alternative, that Law 42 was an amendment “in effect even if not in terms.”<sup>600</sup>
370. This alternative characterisation of what was effected by Law 42 was – to the Tribunal’s mind rightly – a recognition that Petroecuador, the company’s contractual counterparty, did not

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<sup>596</sup> Counter-Memorial, paragraph 398; Rejoinder, paragraph 365.

<sup>597</sup> Exhibit CA-313, Constitutional Tribunal’s Decision on Law 42, p 25.

<sup>598</sup> Clause 22.2.2 of both Contracts (Exhibits CE-10, Block 21 Participation Contract, PER 04724 and CE-17, Block 7 Participation Contract, 04865) [Emphasis added.].

<sup>599</sup> Reply, part VI, section A.

<sup>600</sup> Reply, paragraph 287.

unilaterally amend the Contracts and therefore did not breach the Contracts' provisions requiring mutual agreement to any amendment of their terms.

371. That however is not the end of the matter. The fact that Petroecuador, as the nominal counterparty to Perenco, did not itself purport to amend the Contracts does not mean that the State did not modify their operation by other means. Law 42 required the contractor to pay to the State a newly declared "participation in windfalls from oil prices not negotiated or anticipated."<sup>601</sup> In doing so, it effectively modified the operation of clauses 5.3.2 (the right to receive the Contractor's share of the production at the Fiscalization and Delivery Center and to "freely dispose of" that share), 8.2.1 (the Contractor's right to opt to receive its share in cash), and 10.2 (the Contractor's right to market the production that belongs to it on the domestic or foreign market) of the Block 7 Participation Contract (and the corresponding clauses of the Block 21 Participation Contract).<sup>602</sup>

372. The Tribunal is fortified in its conclusion that this was a modification of the Participation Contracts' operation by the Constitutional Court's discussion of the *pacta sunt servanda* rule, where the Court described Law 42 as an exercise of "the power to *modify or revise* the agreement...".<sup>603</sup>

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<sup>601</sup> Article 44 of the Hydrocarbons Law was replaced by the following: "At the very least the State will receive the following for the exploration and exploitation of hydrocarbon deposits: access premiums, surface rights, royalties, remediation payments, investments in remediation works, participation in surplus from oil sale prices, and for transportation, a share of rates." Article 55 was amended to add the following clause: "State participation in surplus from oil sale prices not negotiated or anticipated. The contracting companies that maintain participation contracts for the exploration and exploitation of hydrocarbon contracts in force with the Ecuadorian State in accordance with this law, without prejudice to the volume of crude oil from participation corresponding to it, whenever the actual average monthly FOB sale price of Ecuadorian crude oil exceeds the monthly average sale price in force on the date that the contract is signed, and expressed in amounts from the settlement month, will recognize participation by the Ecuadorian State of at least 50% of the surplus generated by the difference in price. For the purposes of this article, extraordinary profits are understood to mean the described difference in price multiplied by the number of barrels produced. The crude price on the contract date used as a reference for calculating the difference will be adjusted by the US Consumer Price Index published by the Central Bank of Ecuador." (Exhibit CA-313, Constitutional Tribunal's Decision on Law 42, pp 23-24).

<sup>602</sup> Exhibit CE-17, Block 7 Participation Contract.

<sup>603</sup> Exhibit CA-313, Constitutional Tribunal's Decision on Law 42, p 24 [Emphasis added.].

373. Technically, as Dr. Pérez Loose pointed out, this was an “act of the prince” (*factum principis*), i.e., an intervention by branches of government other than the contractual counterparty which changed the conditions pursuant to which Perenco performed the Contracts.<sup>604</sup>
374. It follows from this finding that the Tribunal cannot accept Ecuador’s argument that since Law 42 addressed revenues, not participation shares, it therefore addressed a matter which fell completely outside of the Contracts.<sup>605</sup> Until Law 42, the contractor was free not only to take legal title to its share of the production, but also to sell it on the market or take cash in lieu of oil. Law 42 created a new claim by the State to additional revenue above a new reference price and a correlative obligation on the part of the contractor to pay that revenue to the State. This indeed was a ‘conceptual modification’ of the Contracts, to use Mr. Silva Romero’s term.<sup>606</sup>

**(3) Did Law 42 fall within the scope of the taxation modification clauses?**

375. As an amendment to the most directly relevant statute listed in the Contracts’ legal framework, namely, the Hydrocarbons Law, the question arises as to whether Law 42 was a tax and therefore caught by the taxation modification clauses of the Contracts. Perenco argued the point both ways, arguing that Law 42 was not a tax as understood by Ecuadorian law, but in the alternative, if it was, it was caught by the Contracts’ tax modification clauses, which required an adjustment of the parties’ participations in its favour.<sup>607</sup> For its part, Ecuador argued that the Law 42 dues should be treated as a “tax” or a “levy.”<sup>608</sup>
376. The evidence goes both ways: (i) Ecuador’s Attorney General argued before the Constitutional Court that Law 42 was not a tax, but rather an amendment to the Hydrocarbons Law (which it plainly was; that said, in exacting a fiscal charge from private contractors it did not follow the

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<sup>604</sup> 1<sup>st</sup> Expert Report of Hernan Pérez Loose, paragraph 43 and footnote 52. He noted further that the fact that this was done by the legislature as opposed to the contractual counterparty was immaterial as far as the conditions prescribed by Ecuadorian law for the exercise of the *jus variandi* power were concerned.

<sup>605</sup> Rejoinder, paragraphs 368-372, cf. Reply, paragraphs 445-448.

<sup>606</sup> Transcript, Hearing on the Merits, Day 8, p 2133.

<sup>607</sup> Revised Memorial, paragraph 220; Reply, part VI, section B.

<sup>608</sup> Counter-Memorial, section 6.2.1; Rejoinder, sections 4.2.2 and 4.3.

means prescribed by Ecuadorian law for the enactment of a taxation law);<sup>609</sup> (ii) Law 42 created an obligation under Ecuadorian law to pay revenues to the State; (iii) after the law was ruled to be constitutional, Perenco’s letters to Petroecuador described Law 42 dues as a “tax”, and requested the initiation of the tax modification procedures pursuant to the Contracts;<sup>610</sup> (iv) although the evidence is inconclusive, it does not appear that at that time, Petroecuador took the position that such clauses were inapplicable because Law 42 dues were not taxes; and (v) when it came to the two ICSID cases, Ecuador characterised Law 42 as a tax or “levy.”<sup>611</sup>

377. On balance, having regard to its economic effect, the fact that it mandated the payment of monies to the State in accordance with a specified formula, and Perenco’s contemporaneous characterisation of Law 42 as a tax to which the taxation modification clauses of the Contracts applied, the Tribunal considers that Law 42 should be treated as a taxation measure.

378. Accordingly, Law 42 modified the tax regime governing the Participation Contracts with the result that Perenco was entitled to require Petroecuador to engage in negotiations to determine Law 42’s effect on the economy of the Contracts and to arrive at a consequent correction factor (in the event the parties agreed that the tax affected the economy of the Contract).

#### **(4) The request for negotiations**

379. In letters dated 18 December 2006, Perenco requested Petroecuador to “order the commencement of the corresponding administrative process...for which the Consortium will present the numbers which illustrate said economic impact on the Contract.”<sup>612</sup> Such figures would demonstrate Law 42’s impact “in order to determine the percentage of participation

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<sup>609</sup> Exhibit CA-313, Constitutional Tribunal’s Decision on Law 42, p 22: “That the law in question is not a tax, both because it lacks the constitutional elements of a tax law, and because, given that it is an amendment of a principal law, it has the same fate, and the Hydrocarbon Law is in no way a tax law[.]”

<sup>610</sup> Exhibits E-129, Letter from the Consortium to Petroecuador dated 18 December 2006 (Block 21) (in Spanish with English translation), section 4.2 and E-130, Letter from the Consortium to Petroecuador dated 18 December 2006 (Block 7) (in Spanish with English translation), section 4.1.

<sup>611</sup> *Burlington Resources Inc v Republic of Ecuador*, ICSID Case No. ARB/08/5, Decision on Jurisdiction (2 June 2010), paragraphs 132-134.

<sup>612</sup> Exhibits E-129, Letter from the Consortium to Petroecuador dated 18 December 2006 (Block 21) (in Spanish with English translation), pp 7-8 and E-130, Letter from the Consortium to Petroecuador dated 18 December , 2006 (Block 7) (in Spanish with English translation), p 4.

which should be adjusted in favor of the Contractor.”<sup>613</sup> These letters were sent to the Palacios Administration days before it was about to leave office.

380. It is common ground that there was no official response to this request. There is no contemporaneous document evidencing either the outgoing Palacios Administration’s or indeed the incoming Correa Administration’s rejection (or acceptance for that matter) of Perenco’s request.

381. During the hearing, Mr. Laurent Combe was cross-examined on the reasons for the making of this request and the company’s perception of the unofficial reaction occasioned by the letters:

... Previously, during August 2006, we had successful negotiation with the tax authorities to adjust the “X” Factors for a change in the VAT.

So, we thought at the end of 2006 we might want to try the same avenue and see whether the Government would be more responsive to this kind of argument than just an argument of non-constitutionality. So, that’s why we were going through this. We were feeling the door – – feeling the water, sorry, try to get through that avenue, but at the time things were quite tense, so we didn’t want to be too confrontational, which is we [sic] sent the letter, we never had any feedback, official feedback, we had informal feedback, so we felt that just sending the numbers like this without having a proper response from Petroecuador would have been too confrontational, which is why we never sent the data.<sup>614</sup>

382. Mr. Combe then adverted to the impending change of personnel as a result of the governmental transition and the company’s decision to temporise in the fact of a change of administrations:

“What I was about to say is, there was a change in administration in 2007, so actually there were new people coming, so the people that received that letter were probably not the people that were in place later on, and there was a lot of confusion, a lot of things happening, and we had informal feedback that the letter wasn’t well-received, so we thought that it would be prudent to wait a little bit to see whether things would settle down so we could arrange a talk.”<sup>615</sup>

383. Mr. Combe did confirm that the study to which the 18 December 2007 letters referred was in fact performed by Perenco,<sup>616</sup> but testified that it was not submitted to Petroecuador to show

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<sup>613</sup> *Ibid.*

<sup>614</sup> Transcript, Hearing on Merits, Day 2, p 522 (Testimony of Laurent Combe).

<sup>615</sup> Transcript, Hearing on Merits, Day 2, pp 523-524 (Testimony of Laurent Combe).

<sup>616</sup> Transcript, Hearing on Merits, Day 2, pp 521-524; 530-531 (Testimony of Laurent Combe).

the company's view of Law 42's impact upon the economy of the Contracts.<sup>617</sup> The disputing Parties agree that after the letters of 18 December 2006, no further steps were taken by Perenco in relation to its request nor did the new administration propose clause 11 taxation modification negotiations in early 2007.<sup>618</sup>

**(5) Did Perenco sufficiently test the taxation modification process when Law 42 was applied at 50%?**

384. The existence of a taxation modification process is of pivotal importance in considering Perenco's claim that Law 42 at 50% breached the two Contracts. Clause 11 of both Contracts provided the parties, in this case Perenco, with a means to subject new or modified taxes to a negotiating process that could lead to an adjustment of their respective entitlements. Given the fact that the process' initiation was requested but nothing happened thereafter, the Tribunal must decide who bears responsibility for this state of affairs and what legal consequences follow. Put simply, did Perenco do enough?
385. Having reflected on the precise terms of the Contracts and all of the relevant circumstances, the Tribunal considers that since Perenco contended that Law 42 had an impact on its Contracts' economy (a view not shared by President Palacios when he described Law 42's effect to the Congress), it was incumbent upon Perenco to fully pursue the clause 11 remedy. To succeed on this part of its breach of contract claim, Perenco must: (i) satisfy the Tribunal that it took sufficient steps to press for negotiations, or alternatively, that it was futile to press the new administration to engage in taxation modification negotiations; or (ii) had such negotiations occurred with all relevant documentation submitted and the disturbance of the Contracts' economy proven, the State then refused to engage in good faith adjustment of the Contracts.
386. At the hearing, when asked by a member of this Tribunal whether he considered it was futile to invoke clause 11, counsel stated that that was the Claimant's position.<sup>619</sup> For its part, Ecuador's view was that Perenco having stated its intention to deliver the economic case in favour of the

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<sup>617</sup> Mr. Combe testified that for its part, Perenco expected "an acknowledgment of that letter" and "nomination of the focal point so we could...[present] numbers" before matters proceeded further: Transcript, Hearing on Merits, Day 2, pp 530-531 (Testimony of Laurent Combe).

<sup>618</sup> On Perenco's part, see Mr. Combe's testimony: Transcript, Hearing on Merits, Day 2, p 524 ("We never sent another letter in these terms.").

<sup>619</sup> Transcript, Hearing on Merits, Day 8, pp 1974-1975, 2241 (Closing Arguments).

Contracts' readjustment, thereafter did not act on that intention because it recognised that their economy had *not* been disturbed by the establishment of a reference price above US\$ 15/barrel and a continued entitlement to 50% of the so-called "extraordinary revenues."<sup>620</sup> Perenco's riposte was that it was not necessary to do so until the administrative process was formally launched, which it never was.<sup>621</sup>

387. It is undisputed that Perenco did take the first step of requesting negotiations. It is also undisputed that it prepared the study to support its claim that the Contracts' economy had been disturbed, but it did not submit the study to Petroecuador. It is also apparent that although there was never any "official feedback" from the outgoing administration, there was informal feedback that the letter was not "well-received."<sup>622</sup> Finally, it is undisputed that the newly appointed officials of the incoming administration were not contacted by Perenco with a view to asking the administration to act on the request recently made of its predecessor. As Mr. Combe stated forthrightly, based on the unofficial reaction (of unidentified officials), Perenco "...thought that it would be prudent to wait a little bit to see whether things would settle down so we could arrange a talk."<sup>623</sup>

388. Although it is a close call, in the Tribunal's view, insufficient contemporaneous evidence was adduced by the Claimant in support of the claimed futility of pressing for taxation modification negotiations.

389. The evidence against Perenco's claim of futility is first, the company's then recent experience in successfully using the modification clause, second, the absence of any official rejection of the request at a time of transition in government, and third, Perenco's contemporaneous evaluation of the situation in Ecuador.

390. In terms of its prior experience with the remedy, Perenco's Block 7 letter referred to the parties' then-recent experience with the "[i]ncrease in the Amazon Region Ecodevelopment Tax" with respect to the Block 21 Contract and expressed Perenco's view as to what would

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<sup>620</sup> Counter-Memorial, section 6.2.1, paragraph 481.

<sup>621</sup> Reply, paragraph 487.

<sup>622</sup> Transcript, Hearing on Merits, Day 2, pp 523-524 (Testimony of Laurent Combe).

<sup>623</sup> *Ibid.*

occur in relation to the Law 42 “tax” with respect to the Block 7 Contract.<sup>624</sup> At the hearing, Mr. Combe noted that in August of 2006, four months prior to the 18 December letters, “we had successful negotiation with the tax authorities to adjust the ‘X’ Factors for a change in the VAT.”<sup>625</sup> The remedy was thus acknowledged to have been effective in August 2006 (a time when Law 42 had already been enacted and applied and the constitutional challenge was underway).

391. As for the absence of any official rejection of the requests, the Tribunal notes two points. First, the Tribunal considers it to be unrealistic to think that the outgoing administration could resolve a taxation modification negotiations request submitted in the final days of its time in office. Mr. Combe himself recognised that with a change in administrations came a change in government representatives (“...there was a change in administration in 2007, so actually there were new people coming, so the people that received that letter were probably not the people that were in place later on, and there was a lot of confusion, a lot of things happening”).<sup>626</sup> Second, although Perenco stated that it would forward the necessary economic data in support of its request for an adjustment of participation, it did not do so either while the Palacios administration was still in office or after it was succeeded by the Correa administration.
392. Finally, the Tribunal considers that it is important not to permit subsequent events to colour an appraisal of the situation in early 2007. Perenco’s request predated, by over ten months, Decree 662 and the steps taken by the Correa administration to force the conversion of participation contracts into service contracts. There is insufficient contemporaneous evidence before the Tribunal to lead it to conclude that in January 2007, the new Correa administration would have rebuffed a request for modification negotiations.

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<sup>624</sup> Exhibits E-129, Letter from the Consortium to Petroecuador dated 18 December 2006 (Block 21) (in Spanish with English translation), section 4.1 and 4.2, and E-130, Letter from the Consortium to Petroecuador dated 18 December 2006 (Block 7) (in Spanish with English translation), section 4.1. In the letter concerning the Block 21 Contract, the increase in the tax (from US\$ 0.10 to US\$ 0.50 per barrel) was conceded by Ecuador to have an impact on the “economics of the contract”, this calculation having been done and included in the first Amendment to the Development Plan for Block 21. The amended development plan expressly provided that the Contractor, before beginning production in Block 21 under the amended development plan, was required to “present to Petroecuador for consideration a study to determine the correction factor that would absorb the increase of the tax burden caused by the increased tax.” (Exhibit E-129, section 4.1)

<sup>625</sup> Transcript, Hearing on the Merits, Day 2, p 522 (Testimony of Laurent Combe).

<sup>626</sup> Transcript, Hearing on Merits, Day 2, pp 523-524 (Testimony of Laurent Combe).

393. The Tribunal has no illusions that any such negotiations would have been challenging. Petroecuador could have been expected to have advanced the Government's view (expressed by the former President<sup>627</sup>) that Law 42 did not have any impact on the economy of the contracts and the parties would likely have debated the meaning of 'economy of the contract' as they have in this proceeding. Had Perenco submitted its study, Petroecuador would no doubt have scrutinised the company's financial performance, both prior to and after Law 42's enactment, and if Perenco had performed as well as the limited evidence before the present Tribunal suggests, it can be anticipated that Petroecuador would have pressed it on 'how much profit is enough?'<sup>628</sup> Much of the evidence that has been led by both Parties in the current arbitration as to whether or not Law 42 had an impact on the Contracts' economy, including the evidence of the pricing and profitability expectations of the original contracting parties at the time of the Contracts' making, general industry expectations of returns on investment, and so on, could be expected to have been discussed. But the challenges of negotiating a modification cannot be accepted as a basis for deciding not to press the contractual avenue and cannot support a finding of futility.
394. In the end, if Perenco wished to rely on clauses 11.12/11.7, respectively, it was incumbent upon it to make its case with appropriate documentation at that time and its failure to have done so is fatal to this part of its claim.
395. The Tribunal has considered whether, Perenco's having failed to prove the futility of the modification process at the time, the Tribunal should take on the task of attempting to substitute itself for the parties in the contractual modification process. After careful reflection, the Tribunal does not think it necessary or appropriate in the circumstances to pursue the issue of whether or not Law 42 at 50% affected the economy of the Contracts. It might well have,

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<sup>627</sup> At the time that the President submitted Law 42 to the Congress, he asserted that "...all the technical, economic, and legal parameters considered by the companies in their analysis are being respected, and what is being legislated upon are those events that never formed a part of the will of the parties, such as the extraordinary increase in crude oil prices at the international level." Exhibit CE-50, Bill of the Law amending Hydrocarbons Law, presented by President Palacio to the President of Congress, 1 March 2006 (in Spanish with English translation), PER 01721.

<sup>628</sup> In this arbitration, Perenco, as was its right, chose not to engage in that debate, preferring instead to stand on its view of its contractual rights, which did not explicitly refer to any expected return on investment. In its Reply, the Claimant characterised these as "assumptions", "'variables' in a hypothetical model" not to be confused with contractual terms: "Nowhere in the Block 7 or Block 21 Contracts did Oryx 'agree' that the contractor's IRR would not exceed 15% or 22%." Reply, paragraph 479.

but if that was what the Claimant considered, the procedure in clauses 11.12 of the Block 7 Contract and 11.7 of the Block 21 Contract was there to be pursued.

396. The Tribunal's additional reasons for declining to divine what might have happened in a negotiation are threefold. First, the taxation modification clauses required the parties to determine the predicate for making a change to their respective entitlements, i.e. an agreement that the new or modified tax had an impact on the contract's economy. They would do so on the basis of the data submitted by the private contractor in its capacity as the party moving for a change to the contract. The parties would then determine the tax's impact on the contract's economy and calculate an adjustment to absorb that impact. In the Tribunal's view, the clauses dictated the objective, but not the precise means of correction and this could only be determined through negotiations that arrived at a mutually agreeable outcome (or, if such negotiations foundered, thereafter by a tribunal armed with all of the relevant documentation produced by both parties during the negotiations).
397. This leads to the second point. While, as discussed above at paragraph 393, the Tribunal can conceive of the kinds of considerations that would have motivated the parties in the negotiations, with the passage of time and the absence of critical contemporaneous data, it would be wholly speculative for the Tribunal to try to estimate what the parties would have done. Based upon the pleadings and expert reports filed in this arbitration, the Tribunal can make a guess as to the kinds of arguments that both sides would have advanced, but in the end it is only a guess.
398. Finally, the single most important piece of evidence that would necessarily have to be submitted during the negotiations – the analysis that Perenco prepared in order to demonstrate Law 42's impact on the Contracts – has not been produced to the Tribunal.<sup>629</sup> This is the seminal piece of evidence in the whole evaluative exercise.

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<sup>629</sup> Instead of filing this contemporaneous document, Perenco submitted an expert report prepared for this arbitration by Professor Joseph P. Kalt. The Tribunal did not find that report to be of assistance to its consideration of the present question because when it came to modelling the impact of Law 42 on Perenco's 2000 Block 21 Development Plan, for example, Professor Kalt looked at Law 42 as if it had applied at the 99% rate from the date of Perenco's acquisition of its interests in the Contracts. This counterfactual analysis shed no light on the actual situation prevailing from the date of Perenco's operation of the blocks up to the beginning of 2007 – the period of

399. In the end, the Tribunal is left with an untested contractual modification process and an invitation in the form of a breach of contract claim that it insert itself into a negotiation process that could be conducted only by the parties to the contracts armed with all of the relevant financial information. The Tribunal considers that given these factors, and without having the contemporaneous evidence before it, it cannot seek to replicate and adjudge what would have occurred had Perenco pressed for the modification negotiations.
400. In sum, the Tribunal holds that: (i) Law 42 fell within the taxation modification clauses of both Contracts; (ii) as the party claiming that the law had an impact on the Contracts' economy, it was incumbent upon Perenco to pursue negotiations with the new administration at least until they were shown to be futile; and (iii) Perenco did not do so, preferring instead to adopt a 'wait and see' approach with the new Correa Administration. In these circumstances, the Tribunal does not find a breach of clauses 11.12 and 11.7 of the two Contracts.
401. The Tribunal recognises that in requiring Perenco to demonstrate futility in order to succeed on this point it might be regarded as applying too exacting a requirement; but issues such as that which faced Perenco in late 2006, early 2007 frequently arise in commercial affairs and they require difficult decisions to be taken. In the end, Perenco chose not to press its rights, considering instead that it "would be prudent to wait a little bit to see whether things would settle down so [that it] could arrange a talk."<sup>630</sup> It was of course entitled to do so, but it cannot then argue that insisting on its clause 11 rights, which had been so recently shown to be effective, was futile. At the end of the day, the clauses were not tested and found wanting. This part of Perenco's claim is therefore dismissed.

**(6) Law 42 at 99%**

402. The situation in relation to the application of Decree 662 to Perenco is entirely different because of the magnitude of the "extraordinary revenues" claimed by the State and the demands made around the time of the decree's promulgation and thereafter that Perenco migrate to a service contract. In this respect, the Tribunal found Dr. Pérez Loose's analysis of

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time with which the Tribunal is presently concerned. Professor Kalt acknowledged during cross-examination that he had not performed a calculation of Law 42 at 50%. Transcript, Hearing on Merits, Day 7, p 1646 *et seq.*

<sup>630</sup> Transcript, Hearing on Merits, Day 2, pp 523-524 (Testimony of Laurent Combe).

the constraints that Ecuadorian law places on the exercise of the *jus variandi* power to modify an administrative contract to be of assistance.<sup>631</sup> Dr. Pérez Loose asserted that the power could only be exercised in certain ways and subject to certain limits.<sup>632</sup>

403. The principal such limit, in his view, was that the unilateral power to modify administrative contracts existed only in relation to their “non-economic aspects.”<sup>633</sup> In his view, the power must therefore be considered to exist only in relation to the performance of the administrative contract (i.e., the specification of the contractor’s duties) and could not apply to the economic bargain struck by the parties.<sup>634</sup>

404. Dr. Pérez Loose asserted further that the exercise of the power was subject to four conditions which he extracted from the writings of civil law theorists such as Raúl Granillo Campo, Hector Escola, and Miguel Marienhoff<sup>635</sup>:

- (i) the changes must have a reasonable justification (“in other words, they must not respond to a ‘deviation of power’”<sup>636</sup>);
- (ii) the changes cannot distort the contract’s very objective;
- (iii) the contracting entity must respect constitutional guarantees that could be affected by its decision to amend the contract; and

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<sup>631</sup> Although he initially resisted characterising the Participation Contracts as “administrative contracts”, Dr. Pérez Loose ultimately conceded that they could be considered as such: Transcript, Hearing on Jurisdiction, Day 2, pp 165-166, and Transcript, Hearing on the Merits, Day 6, pp 1498-1499.

<sup>632</sup> 1st Expert Report of Hernan Pérez Loose, paragraphs 37-40 and 57. Professor Aguilar did not take issue with Dr. Pérez Loose’s reliance on the principle of *pacta sunt servanda* as applying generally to administrative contracts, and did not address the latter’s characterisation of the power of *jus variandi*. However, since Professor Aguilar did rely upon the Constitutional Court’s view that the *pacta sunt servanda* rule broke down in relation to the Participation Contracts’ economic terms, argued that the power to vary contracts extends to the financial-economic equation, and argued further that the right to seek a rebalancing of the contract inheres in both parties, not just the contractor, it is clear that he took a different view of the law than Dr. Pérez Loose on these key issues (3rd Expert Report of Juan Pablo Aguilar Andrade, paragraphs 34 *et seq.*)

<sup>633</sup> 1st Expert Report of Hernan Pérez Loose, paragraph 41.

<sup>634</sup> 1<sup>st</sup> Expert Report of Hernan Pérez Loose, paragraphs 39, 41.

<sup>635</sup> 1<sup>st</sup> Expert Report of Hernan Pérez Loose, footnotes 43-47.

<sup>636</sup> 1<sup>st</sup> Expert Report of Hernan Pérez Loose, paragraph 38.

- (iv) if the exercise of *jus variandi* negatively affects the economic rights of the contractor, the entity must compensate the contractor, in such a way that the stipulated price does not change.<sup>637</sup>

Only within these limits, in his view, could the administration lawfully exercise the *jus variandi* power.

405. The Constitutional Court has spoken on limbs (iii) and (iv) of this four-limbed test. The Court decided that Law 42 was “fully subject to the rules of the [2008 Constitution]” (although this finding was made prior to the promulgation of Decree 662 and the Tribunal cannot know what the Court’s view of that decree might have been).<sup>638</sup> Given the limits on this Tribunal’s contractual jurisdiction, its duty to apply the governing law, and the Court’s determination of Law 42’s constitutionality (at least as of September 2006), the Tribunal proceeds on the basis that the law was constitutional. Hence limb (iii) of Dr. Pérez Loose’s test is deemed to be satisfied. As for limb (iv), it must yield to the Constitutional Court’s finding that the Participation Contracts’ financial-economic equilibrium could be modified.<sup>639</sup>
406. Turning to limbs (i) and (ii) of the test, in the Tribunal’s view, these types of issues were not considered by the Court (and obviously could not have been considered because the Court’s judgment pre-dated Decree 662 by over a year). The Tribunal accepts Dr. Pérez Loose’s opinion that these two limbs are recognised by Ecuadorian law.
407. The Tribunal is of the view that Law 42 at 99% constituted a breach of contract. Having regard to limb (i), in the Tribunal’s view, there was no possible reasonable justification for the State to claim 99% of “extraordinary revenues” above the reference price. While the nature of a “deviation of power” is not precisely defined, the writings of the civil law theorists cited by Dr. Pérez Loose indicate that it concerns the misuse of power.<sup>640</sup> In the Tribunal’s view, Decree 662 constituted an act of coercion when viewed within the context of the parties’ contractual relations and therefore it can be regarded to be a deviation of power.

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<sup>637</sup> *Ibid.*

<sup>638</sup> Exhibit CA-313, Constitutional Tribunal’s Decision on Law 42, p 27.

<sup>639</sup> *Ibid.*, p 24.

<sup>640</sup> Exhibits CA-113 Granillo Ocampo, Raúl, *Distribución de los Riesgos en la Contratación Administrativa* (1990), p 92, and CA-125 Marienhoff, Miguel, *Tratado de Derecho Administrativo*, Tomo III-A (1978), p 402.

408. Ecuador did not dispute that Decree 662 was intended to prompt re-negotiations with oil companies. Around the time of the Decree's promulgation, the Administration began to speak of converting participation contracts into service contracts.<sup>641</sup> This became a major theme in the Administration's discussion of hydrocarbon exploitation contractual modalities. In his national address on 23 January 2008, for example, President Correa framed the State's actions as intended to return the contracts to "a services contract which always should have been the preponderant figure in the oil industry."<sup>642</sup> In its written pleadings in this arbitration the Respondent described Decree 662 as "*a true incentive for petroleum companies operating in Ecuador to negotiate a new contractual framework that would provide a fairer allocation of the petroleum rent.*"<sup>643</sup>
409. In the Tribunal's view, the application of Decree 662 and the statements of senior officials in relation thereto signaled a new phase in the State's relationship with Perenco (and the other oil companies in similar circumstances). This was no longer a question of the State seeking an adjustment of an otherwise acceptable contractual relationship which, in its view, had been disrupted by price increases of an unanticipated magnitude. Rather, Law 42 at 99% unilaterally converted the Participation Contracts into *de facto* service contracts while the State developed a new model of such contracts which it demanded the contractor to sign.<sup>644</sup>
410. Limb (ii) was also violated. In the Tribunal's view, as of 4 October 2007, Perenco's Contracts were participation contracts in name only; Decree 662 completely modified the Contracts' objective as it was understood under Ecuadorian law. It follows that Decree 662 cannot be justified as a lawful exercise of the *jus variandi* power under Ecuadorian law.

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<sup>641</sup> The Administration's statements about converting contracts to service contracts prompted Perenco to write to the Ministry of Mines and Petroleum on 24 October 2007 requesting a copy of the service contract to which companies were expected to migrate. (Exhibit CE-265, Letter from the Consortium to Ministry of Mines and Petroleum, 24 October 2007 (in Spanish with English translation)).

<sup>642</sup> Exhibit CE-67, Excerpt from the 53rd National Address of President Raphael Correa, San Miguel de Salcedo, 26 January 2008. Reply, paragraphs 287-292.

<sup>643</sup> Counter-Memorial, paragraph 625 [Emphasis added.].

<sup>644</sup> In the 53rd National Address, given on 26 January 2008, President Correa stated that the oil companies would have three choices: comply with the payment of 99% of the "extraordinary income", renegotiate their participation contracts by migrating to a service contract, or leave the country. Exhibit CE-67, Excerpt from the 53rd National Address of President Raphael Correa, San Miguel de Salcedo, 26 January 2008.

411. Thus, in the Tribunal’s view, in moving beyond 50% up to 99% the Respondent breached the Participation Contracts. Whatever might have transpired in clause 11 negotiations on the impact of Law 42 at 50% on the Contracts’ economy (had they occurred), moving from 50% to 99%, in the Tribunal’s view, was no longer an attempt to claim an equitable distribution of the windfall revenues generated by an unexpected and significant increase in oil prices, and could not be justified under the applicable Ecuadorian legal standards for the exercise of the *jus variandi* power.

**(7) The Tribunal’s Decision on Provisional Measures and the defence of *exceptio non adimpleti contractus***

412. Perenco argued that the Respondent committed a further, independent breach of contract in failing to comply with the Tribunal’s Decision on Provisional Measures.<sup>645</sup> This issue assumes importance because if Ecuador was contractually obliged to comply with the decisions of the Tribunal during the course of the arbitration and it failed to do so, the next question would be whether that breach entitled Perenco to treat Ecuador’s non-compliance as a basis for its reciprocal non-compliance when it announced that it would suspend operations.<sup>646</sup>

*a. Was Ecuador contractually obliged to comply with the Tribunal’s Decision on Provisional Measures?*

413. The analysis of this issue starts with the parties’ agreement reflected in clause 22.2.2 of the Contracts that they would “use the means set forth in [the Contract] to resolve doubts and disputes that may arise during its life, and likewise *to observe and comply with the decisions of the competent...arbitrators, judges or tribunals, as the case may be, pursuant to the provisions of this Contract.*”<sup>647</sup> As far as the contract claim is concerned, Perenco argued that Ecuador

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<sup>645</sup> Decision on Provisional Measures, paragraph 79; Revised Memorial, paragraphs 222-226, in particular 224; see also, Reply, paragraphs 507-509. See above at paragraphs 277 to 279, 340 and 354.

<sup>646</sup> Revised Memorial, paragraph 212.

<sup>647</sup> Clauses 22.2.2 of CE-10, Block 21 Participation Contract and CE-17, Block 7 Participation Contract [Emphasis added]. The Tribunal notes that in the original Spanish, the relevant terminology is “*observas y cumplio*” and “*decisiones*” (CE-10, PER 04724; CE-17, PER 04865). Dr. Pérez Loose asserted that this provision reflected the general approach in Ecuadorian law to the binding power of decisions of an arbitral tribunal: under Article 9 of the Arbitration and Mediation Act in Ecuador “arbitrators may grant injunctive relief in accordance with the Code of Civil Procedure provisions, or the relief deemed necessary...” His interpretation of this provision is that it demonstrates that arbitrators are not required to be accorded a separate and specific power to grant injunctive relief, in order for parties to be bound to comply: “The mere agreement to submit disputes to arbitration is

assumed a contractual obligation to comply with all decisions of an arbitral tribunal, including this Decision on Provisional Measures.<sup>648</sup> Perenco's contention was that given the economic impact of Law 42, then at 99%, it was entitled as a matter of Ecuadorian law to suspend its performance of the Contracts until such time as Ecuador brought itself into compliance.<sup>649</sup>

414. Had it done so, the argument went, Perenco would then not have been required to pay Law 42 dues to the State during the pendency of the arbitration, Ecuador would not have commenced the *coactiva* proceedings to seize Perenco's oil and sell it in satisfaction of the claimed Law 42 debt, Perenco would then not have suspended operations, and the grounds for the Contracts' ultimate termination by declaration of *caducidad* arising out of that suspension would not have occurred.<sup>650</sup>
415. Ecuador's position is that while the parties undertook in the Contracts to submit to ICSID arbitration specified disputes and to abide by the Tribunal's "*final award*", they did not undertake to, and these obligations could not inferentially amount to, an undertaking to comply with a tribunal's recommendation of provisional measures.<sup>651</sup> It submitted that clause 22.2.2 was generally worded and, according to principles of contract interpretation in Ecuadorian law, must be "read in accordance with the other clauses of the Participation Contracts which specifically refer to these topics" and which in its view establish "only that the Parties agree to abide *by the final award* rendered by an ICSID tribunal."<sup>652</sup> Where it was intended to give a

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sufficient to bind the parties not only to comply with the award but also to comply with provisional measures." (4th Expert Report of Hernan Pérez Loose, paragraph 28.)

<sup>648</sup> 4<sup>th</sup> Expert Report of Hernan Pérez Loose, paragraph 30. In addition to clause 22.2.2 of the Contracts, Perenco relies on clause 22.2 and 20.3 of the Block 21 and Block 7 Contracts, respectively, which in its submission incorporate the ICSID Convention into the Contracts and by which the parties unambiguously undertook to resolve specified disputes through ICSID arbitration. Perenco submitted that the principle of *pacta sunt servanda* was applicable to the agreement to arbitrate recognised in these provisions, and as such, there was an obligation on Ecuador to comply in good faith with "its contractual obligation peaceably to resolve disputes like this one through ICSID arbitration", in addition to its contractual obligation to observe and comply with any resulting decision of the ICSID tribunal. Its actions amounted to a breach of both contractual obligations: Revised Memorial, paragraphs 223 and 225. 4<sup>th</sup> Expert Report of Hernan Pérez Loose, paragraphs 17 to 35. Reply, paragraph 509.

<sup>649</sup> Revised Memorial, paragraphs 122-123, 127 and 133; 4<sup>th</sup> Expert Report of Hernan Pérez Loose, paragraphs 36-59.

<sup>650</sup> Counter-Memorial, section 6.3.2 (Ecuador's actions in alleged breach of the dispute resolution provisions of the Participation Contracts were not causative of any loss to Perenco); Rejoinder, paragraphs 418 and 421.

<sup>651</sup> Counter-Memorial, paragraph 448 [Emphasis added.]; Rejoinder, paragraphs 422-425.

<sup>652</sup> Counter-Memorial, paragraph 450 [Emphasis in original].

tribunal the power to provide for binding and enforceable provisional measures, the Contracts did so expressly (as was done elsewhere in the Contracts with respect to the power of a domestic arbitral tribunal to order provisional measures).<sup>653</sup>

416. Ecuador argued further that in any event its actions in alleged breach of the dispute resolution provisions of the Contracts did not cause any loss to Perenco as it could have continued to operate the Blocks and made a choice to suspend operations in July 2009.<sup>654</sup> Ecuador drew the Tribunal’s attention to its earlier direction in the Decision urging the parties to establish an escrow account such that Perenco would pay the “sums so accruing into [the] ... account[.]”<sup>655</sup> In the Respondent’s view, Perenco’s willingness to pay Law 42 dues at 99% into such an account showed that the “forced sale of oil to recoup the 2008 Law 42 dues left Perenco in no different economic position than would have prevailed had the Parties acceded to the Arbitral Tribunal’s recommendation of provisional measures.”<sup>656</sup>
417. In the Tribunal’s view, a plain reading of clauses 22.2.2 indicates that the contracting parties agreed that they would comply not only with a final award (i.e., in Spanish, the ‘*laudo*’ issued by a tribunal), but in addition, they would observe and comply with the decisions (i.e., in Spanish, the ‘*decisiones*’) of the tribunal.<sup>657</sup> The latter term constitutes a more capacious category of tribunal decisions of which the final award forms a part. Thus, under the Participation Contracts, Ecuador was bound to comply with the Decision on Provisional Measures and its failure to do so constituted a breach of contract.

*b. Can Perenco invoke the defence of exceptio non adimpleti contractus for its decision to suspend operations?*

418. Having found such a breach by Perenco’s counterparty, one requisite element of the defence of *exceptio non adimpleti contractus* (the defence of non-performance) is established. This then requires the Tribunal to determine whether Perenco is correct to argue that as a matter of

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<sup>653</sup> *Ibid.*

<sup>654</sup> Counter-Memorial, paragraphs 452 to 458; Reply, paragraphs 254 to 266.

<sup>655</sup> Decision on Provisional Measures, paragraph 63.

<sup>656</sup> Counter-Memorial, paragraphs 455 and 457.

<sup>657</sup> Exhibits CE-10, Block 21 Participation Contract, and CE-17, Block 7 Participation Contract. The Tribunal notes that in the original Spanish, the relevant terminology is “*observas y cumplimiento*” and “*decisiones*” (see CE-10, PER 04724; CE-17, PER 04865).

Ecuadorian law it was entitled to respond to this breach by suspending performance of its contractual obligations.<sup>658</sup>

419. Dr. Pérez Loose's evidence was that Perenco was entitled to invoke the *exceptio non adimpleti contractus* defence.<sup>659</sup> (And following from this, Dr. Pérez Loose submitted that Ecuador could not claim that it was justified by Perenco's suspension of operations to subsequently declare the Contracts terminated by operation of *caducidad*.)<sup>660</sup>
420. Dr. Pérez Loose asserted that a corollary of the proposition that the principle of *pacta sunt servanda* fully applied to administrative contracts is that a contractor faced with a situation of non-performance by the public contracting entity may pursuant to Article 1505 of Ecuador's Civil Code "go before a judge or arbitrator, as applicable, to request either: (a) that he declare the contract terminated, or (b) that he order the other party to stop violating the contract and comply as was agreed."<sup>661</sup> Under either option, the contractor has the right to claim damages.<sup>662</sup> In any event, faced with a material breach, the private contracting entity is entitled to withhold performance of its own contractual obligations, recognised in Ecuadorian law under Article 1568 of its Civil Code and known as the "defense of the unfulfilled contract" or by its Roman law expression, "*exceptio non adimpleti contractus*."<sup>663</sup>
421. Article 1568 of Ecuador's Civil Code provides more generally that "[i]n bilateral contracts no party shall be considered to be in default by failing to comply with the agreed terms, while the other party has not complied with its obligations or refuses to comply in due manner and time."<sup>664</sup> During cross-examination, Dr. Pérez Loose asserted that in his view Article 1568 must apply to administrative contracts since it makes no distinction in terms between private

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<sup>658</sup> 4<sup>th</sup> Expert Report of Hernan Pérez Loose, paragraph 57.

<sup>659</sup> 4<sup>th</sup> Expert Report of Hernan Pérez Loose, paragraphs 55 to 57.

<sup>660</sup> 4<sup>th</sup> Expert Report of Hernan Pérez Loose, paragraph 58.

<sup>661</sup> 1st Expert Report of Hernan Pérez Loose, paragraphs 22-28; citing a decision of the Supreme Court of Justice in Ecuador at CA-54, Supreme Court of Justice, *Tecco*, Judicial Gazette Series XIV, No. 3, pp. 679-687.

<sup>662</sup> 1<sup>st</sup> Expert Report of Hernan Pérez Loose, paragraph 23. Dr. Pérez Loose asserted that Perenco did not waive this right, in the Participation Contracts or by submission to Ecuadorian law: "Neither does the Hydrocarbons Law or the Law on Public Procurements, or any other law, prohibit oil contractors such as Perenco from exercising this right." (Paragraph 25).

<sup>663</sup> Pérez Loose, 4<sup>th</sup>, paragraph 36.

<sup>664</sup> CA-296, translated into English at paragraph 36 of the 4<sup>th</sup> expert report of Dr. Pérez Loose.

and administrative contracts, referring only to the generally worded “contracts.”<sup>665</sup> He referred to the defence as a “transitory” or “transient” right<sup>666</sup> intended to exert pressure on the other contracting party to comply with its contractual obligations.<sup>667</sup> In order to invoke this defence, the invoking party must demonstrate: (i) a reciprocal connection between the obligation breached and the obligation it purports to breach;<sup>668</sup> (ii) that the original breach was material in nature (it cannot relate to ancillary, secondary, or obligations relatively insignificant in the larger context of the legal relationship between the parties);<sup>669</sup> and (iii) that it was or is ready to perform its obligations.<sup>670</sup>

422. While he asserted that the defence of *exceptio non adimpleti contractus* applies equally to administrative contracts as it does to private contracts in Ecuador, Dr. Pérez Loose acknowledged some limitations.<sup>671</sup> He noted early resistance to applying the defence at all to administrative contracts because it was necessary to encourage continuity in contracts which commonly provided for the provision of public services, rather than to grant the contractor a right to interrupt performance if it considered itself justified by the other party’s failure to perform its contractual duties.<sup>672</sup>

423. He asserted, however, that this position has “eased into a less rigid stance,” recognising that the State is party to many contracts unrelated to public services. This was the case with the Participation Contracts in this arbitration, and the contractor party to such an administrative contract may invoke the defence if requiring it to continue performance would result in its

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<sup>665</sup> Transcript, Hearing on the Merits, Day 6, p 1507.

<sup>666</sup> 4<sup>th</sup> Expert Report of Hernan Pérez Loose, paragraph 37.

<sup>667</sup> 4<sup>th</sup> Expert Report of Hernan Pérez Loose, paragraphs 38-39.

<sup>668</sup> 4<sup>th</sup> Expert Report of Hernan Pérez Loose, footnote 45: “[t]his does not mean that the obligations necessarily be performed concurrently, but that there should be a correlation between the obligation breached by Claimant and that which he requires the other party to perform. Attention should be paid for this aim not only to the nature of the contract but to what the parties have freely agreed.”

<sup>669</sup> 4<sup>th</sup> Expert Report of Hernan Pérez Loose, footnote 46, where he noted that the breach must not have been provoked by the other party’s actions, and the obligation breached must be material such that otherwise relying on the remaining performance of the contract will not be sufficient to compensate for the breach.

<sup>670</sup> 4<sup>th</sup> Expert Report of Hernan Pérez Loose, paragraph 41.

<sup>671</sup> 4<sup>th</sup> Expert Report of Hernan Pérez Loose, paragraphs 42-54.

<sup>672</sup> *Ibid.*

suffering “serious economic consequences”.<sup>673</sup> He relied on two decisions of the First Civil and Commercial Division of the Supreme Court of Justice in Ecuador<sup>674</sup>, two opinions from the Attorney-General’s office in Ecuador permitting private contractors to postpone performance without penalty under their contracts with a State entity that had defaulted in payments to it,<sup>675</sup> and the writings of civil law theorists such as Marienhoff, Dromi and Cassagne, to support his view that the defence applies to administrative contracts, and may be invoked when the State’s conduct results in a situation that renders it prejudicial for the contractor to perform its obligations.<sup>676</sup> (The threshold of prejudice quoted by Dr. Pérez Loose in an excerpt from Marienhoff is “reasonable inability”, instead of “serious economic consequences” which was Dr. Pérez Loose’s characterisation of the test in his fourth expert report.<sup>677</sup>)

424. For his part, while Professor Aguilar accepted that Article 1568 of the Civil Code and the defence of *exceptio non adimpleti contractus* is of “mandatory application in the field of Private Law,” he rejected the view that it applied equally in the case of contracts entered into by State entities, asserting that it is “only applicable in *extraordinary circumstances* in the field of Administrative law.”<sup>678</sup> He cited French,<sup>679</sup> Spanish<sup>680</sup> and Argentinean<sup>681</sup> legal theorists to

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<sup>673</sup> 4<sup>th</sup> Expert Report of Hernan Pérez Loose, paragraphs 44-45: “It is now accepted that in this area the contractor cannot be required to perform his obligations despite the contracting entity’s breach if such a requirement might result in serious economic consequences for the contractor.”

<sup>674</sup> *Ibid.*, paragraphs 53-54.

<sup>675</sup> 4<sup>th</sup> Expert Report of Hernan Pérez Loose, paragraph 52, referring to CA-319, Official Letter PGE No. 004400 of 11 January 2011, and CA-320, Official Letter PGE 13841 of 5 May 2010.

<sup>676</sup> 4<sup>th</sup> Expert Report of Hernan Pérez Loose, paragraphs 46-50.

<sup>677</sup> 4<sup>th</sup> Expert Report of Hernan Pérez Loose, paragraphs 46 to 50.

<sup>678</sup> 3<sup>rd</sup> Expert Report of Juan Pablo Aguilar Andrade, paragraph 82 [Emphasis added.]. Dr. Pérez Loose in cross-examination highlighted that in his view it was significant that Professor Aguilar was not rejecting the application of *exceptio non adimpleti contractus* to administrative contracts, contending only that it applied under “exceptional circumstances.” Transcript, Hearing Day 6, pp 1502, line 16 to 1503, line 4.

<sup>679</sup> Jean Rivero, *Derecho Administrativo*, Caracas, Universidad Central de Venezuela, 1984, p 137 (3<sup>rd</sup> Expert Report of Juan Pablo Aguilar Andrade, Annex 63): “If the administration is in default, the private law rule that allows the other party to protect itself by opposing the *exceptio non adimpleti contractus* to suspend the performance of its duties is discarded, and the private party is still obliged to perform, regardless of the administration’s default; it can only have resort to the courts to claim compensation for damages and injuries, or request rescission in the event of serious default.” [Emphasis in original.]

<sup>680</sup> Eduardo García de Enterría y Tomás-Ramón Fernández, *Curso de Derecho Administrativo*, Madrid, Civitas, 2001, Vol. I, p 753. (3<sup>rd</sup> Expert Report of Juan Pablo Aguilar Andrade, Annex No. 57): “The exception to the contractual termination mechanism of the Civil Code is even clearer when there is a breach by the Administration. In the meantime, in no case does this breach authorize the contractor to breach the contract itself...” [Emphasis in original.]

this effect; and passages quoted from their administrative law textbooks suggested that the *exceptio* did not carry over, without qualification, to administrative contracts because of the imperative of ensuring continuity of performance under public contracts.<sup>682</sup> He submitted that the texts of civil law theorists relied upon by Dr. Pérez Loose in his fourth expert report, namely Marienhoff, Dromi and Cassagne, may use the phrase *exceptio non adimpleti contractus*, but in their explanation of the doctrine they were actually referring to the “existence of a *force majeure* that excuses the contractor from fulfilling its obligations.”<sup>683</sup>

425. Professor Aguilar asserted further that the writers supported his view that the *exceptio* can only apply to administrative contracts in circumstances where the State’s conduct has made it ‘reasonably impossible’ for the private contracting entity to fulfill its obligations.<sup>684</sup> It is pertinent to note in this regard that Professor Aguilar corrected the relevant threshold articulated by Marienhoff and cited by Dr. Pérez Loose; stating that Marienhoff used the phrase “reasonable *impossibility*”, rather than “reasonable *inability*” as noted above.<sup>685</sup> Professor Aguilar cited as an example of “reasonable impossibility” the situation in which a moratorium in the payment of the amounts owed by the administration to the contractor is

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<sup>681</sup> Héctor Jorge Escola, *Tratado Integral de los Contratos Administrativos*, Buenos Aires, Depalma, 1977, Vol. I, pp 443-444 (3<sup>rd</sup> Expert Report of Juan Pablo Aguilar Andrade, Annex No. 66): “The public administration must fulfill its obligations, and the counterparty, when faced with the administration’s breach, has various alternatives at its disposal to offset or compensate for a mistaken attitude of its counterparty. However, performance of the contract must prevail, and therefore a transfer of the referenced *exceptio* to the field of administrative contracts is not only incompatible with the basics of administrative contracting, but contrary to the public interest in jeopardy.” [Emphasis in original.]

<sup>682</sup> 3<sup>rd</sup> Expert Report of Juan Pablo Aguilar Andrade, paragraphs 83 to 86, 98 to 100: (paragraph 99) “...continuity in contractual performance is considered a highly regarded value which must be protected, because if performance satisfies a collective need, its suspension would affect this need and, therefore, harm society as a whole.”

<sup>683</sup> 3<sup>rd</sup> Expert Report of Juan Pablo Aguilar Andrade, paragraphs 88-90.

<sup>684</sup> *Ibid.* Professor Aguilar adopted the term “impossibility”. He referred to Dromi’s use of “reasonable impossibility” in a sentence which he asserted followed the passage excerpted in the 4th Expert Report of Dr. Pérez Loose, paragraph 48.

<sup>685</sup> 3<sup>rd</sup> Expert Report of Juan Pablo Aguilar Andrade, paragraph 89: “Marienhoff argues that the *exceptio* would apply ‘in favor of the contracting party when the Administration’s conduct translates into a ‘reasonable impossibility’ for said party to fulfill its obligations.’” In the original Spanish text (CA-335, at p 380) the term used by Marienhoff is “*razonable imposibilidad*”. The same can be said for Dromi (3<sup>rd</sup> Expert Report of Juan Pablo Aguilar Andrade, Annex 60, p 384 of the original text) who uses the term “*una razonable imposibilidad de cumplir con las obligaciones contractuales*” in a section titled “[s]uspensión de la ejecución y “*exceptio non adimpleti contractus*.”

“extended in time and is of such nature that it grossly undercapitalizes the contractor and leaves it without the necessary resources to execute the works entrusted.”<sup>686</sup>

426. Professor Aguilar accepted that his view was derived from the views of foreign legal theorists, but asserted that this was necessarily the case as “[t]here has been no explicit development in Ecuador by authors on the subject, nor has a concrete case presented itself that resulted in applicable jurisprudence.”<sup>687</sup> He rejected Dr. Pérez Loose’s reliance on two judicial decisions of the First Civil and Commercial Chamber of the Supreme Court of Justice, stating they demonstrated instead that a claim invoking the *exceptio* will not be entertained when the private contractor is itself in default of its contractual obligations.<sup>688</sup> He similarly asserted that contrary to Dr. Pérez Loose’s submission, the two opinions of the Attorney-General in Ecuador demonstrate that the *exceptio* may be invoked by the private contracting entity to an administrative contract, there was in one case a specific contractual provision providing that no fine would be imposed on the contractor for non-performance if the public contracting entity was in default, and the other case supports his view that the *exceptio* did not apply as the “Attorney General argues that a delay in payment by a public institution does not authorize an extension of the contractual term” in favour of the contractor (i.e., permitting non-performance for a time until payment is received).<sup>689</sup>

427. Professor Aguilar asserted further that his position was buttressed by the fact that it is analogous to the approach to contractual breach under statutory law in Ecuador; first, under Article 96(1) of the National Public Contracting System Law which establishes that breach by the public contracting entity for a duration of more than 60 days entitles the contractor only to

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<sup>686</sup> 3<sup>rd</sup> Expert Report of Juan Pablo Aguilar Andrade, paragraph 87.

<sup>687</sup> *Ibid.*, paragraph 91.

<sup>688</sup> *Ibid.*, paragraphs 91 to 93.

<sup>689</sup> 3<sup>rd</sup> Expert Report of Juan Pablo Aguilar Andrade, paragraphs 94 to 95. During the hearing, on cross-examination, Dr. Pérez Loose acknowledged that in the first case there was a contractual provision that permitted the contractor to stop fulfilling its obligations if there was non-fulfillment by the administration. He stated that he still found this case to be useful because there was an opportunity for the Attorney General to say that for administrative contracts, the *exceptio* was not to be applied, but this is not what the Attorney General did. As for the second case, which concerned a contract for the sale of medicine, on cross-examination it was suggested to Dr. Pérez Loose that this was a private contractor, not an administrative contract, as he had suggested in his opinion. He conceded that it could be characterised as such. He also agreed that in both cases the *exceptio* was invoked by the public sector rather than by the private sector, but maintained that this did not mean that it was not available to the private contractor. (Transcript, Hearing on the Merits, Day 6, pp 1513, line 3 to 1514, line 15, and pp 1517, line 12 to 1518, line 6.

terminate the contract, and second, under Article 74 of the Hydrocarbons Law which does not permit breach by the public contracting entity to be raised as a defence by the private contractor in proceedings leading to the declaration of *caducidad* (although, as Professor Aguilar later noted, it does permit that defence in proceedings for *caducidad* if suspension of operations is by reason of *force majeure*).<sup>690</sup>

428. The Participation Contracts, in Professor Aguilar's view, were contracts where continuity of performance was imperative and was recognised as such by their own terms<sup>691</sup> and by Ecuadorian constitutional law.<sup>692</sup> In his opinion, recognition of hydrocarbons activity as being of public utility suggested that there was a "need to grant priority to contractual continuity over the application of the *exceptio non adimpleti contractus*" to these Contracts.<sup>693</sup> Accordingly, he asserted that it would be inappropriate to permit the application of the defence.

429. Finally, Professor Aguilar asserted that even if the *exceptio* was applicable, rather than permitting the suspension of its contractual obligations it would at best permit Perenco to demand compliance with, or termination of, the Contracts.<sup>694</sup> He referred in this respect to the two judicial decisions of the First Civil and Commercial Chamber of the Supreme Court of Justice as cited by Dr. Pérez Loose. While Professor Aguilar admitted they applied the *exceptio* (though in his view not in the way Dr. Pérez Loose sought to rely on them) he asserted that "[i]n both decisions, judges reason that the plaintiffs, both private persons, could not bring claims against the State because they were in default of their contractual obligations. In other

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<sup>690</sup> 3<sup>rd</sup> Expert Report of Juan Pablo Aguilar Andrade, paragraphs 96 to 97, 102.

<sup>691</sup> Referring to Clause 5.1.3 of the Block 21 Contract: "Without prejudice to any other obligations specified in the Contract, the Contractor undertakes to:...commence operations, within the first six months from the Effective Date, and continue to perform the operations in the Contract Area."

<sup>692</sup> 3<sup>rd</sup> Expert Report of Juan Pablo Aguilar Andrade, paragraphs 96 to 97, 109. Professor Aguilar asserted that non-renewable natural resources are recognised as one of the strategic sectors of the State under Article 313 of the Constitution, and continuity as a characteristic of the sector to be pursued by the National Hydrocarbons Directorate in its mandate under Article 11 of the Hydrocarbons Law. Moreover, Article 326(15) of the Constitution "prohibits paralyzing, amongst other services and activities, hydrocarbon production."

<sup>693</sup> 3<sup>rd</sup> Expert Report of Juan Pablo Aguilar Andrade, paragraph 107.

<sup>694</sup> 3<sup>rd</sup> expert report of Juan Pablo Aguilar Andrade, paragraph 114: "...[it] does not constitute an authorization to breach the contract. Quite on the contrary, the exception intends to prevent the defaulting party from demanding due performance from its counterparty."

words, the contracting party's breach authorized filing a claim, but could not authorize a failure to fulfill its contractual obligations.”<sup>695</sup>

430. In addition to its view of the restrictions on the defence's availability, Ecuador asserted as a matter of fact that even if *exceptio non adimpleti contractus* applied, it would require Perenco to demonstrate that the impugned conduct rendered it impossible for it to fulfill its own obligations. This Perenco could not do since during the provisional measures phase of the proceeding it informed the Tribunal and Ecuador that it was able and willing to pay the amounts claimed by Ecuador under Law 42 (then at 99%) into an escrow account maintained in a neutral location.<sup>696</sup> Ecuador argued that if Perenco could operate under Law 42 at 99% by paying the disputed dues into escrow, it could equally operate by paying the dues to the Government. This demonstrated that Perenco could pay Law 42 dues and that it was not forced to discontinue performance of the Contracts by reason of the alleged breach.<sup>697</sup>
431. Having considered the parties' submissions, although it accepts Professor Aguilar's view that the law is not well developed in this point in Ecuador, the Tribunal finds that the defence may be invoked by a private party to an administrative contract. Article 1568 of the Civil Code is worded in general terms and does not support the position that it may only be invoked by the public contracting entity that is party to the contract.
432. The next issue is whether it was “reasonably impossible” (the test according to the theorists cited by Dr. Pérez Loose) for Perenco to comply with the Contracts during the time that its oil was being seized by Ecuador. The Tribunal considers that the test is concerned with ‘commercial impossibility’ in the circumstances of the particular contracting party. The initial hurdle Perenco must overcome is whether it was commercially impossible for it to carry on operations in accordance with its contractual rights and obligations.

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<sup>695</sup> *Ibid.*, paragraphs 114 to 116.

<sup>696</sup> Exhibits CE-72, Letter from Perenco and Burlington to the Ministry of Mines and Petroleum and Petroecuador proposing an escrow account for transfer of disputed Law 42 payments, 19 June 2008 (in Spanish and English); CE-215, Letter from Perenco to the Ministry of Mines and Petroleum, regarding proposed settlement agreement, 27 May 2009 (in Spanish with English translation). See also, Counter-Memorial, paragraph 496.

<sup>697</sup> 3<sup>rd</sup> Expert Report of Juan Pablo Aguilar Andrade, paragraphs 82 to 117.

433. In this regard, Perenco faced two issues. First, by expressing its interest in the opening of an escrow account into which the Law 42 dues would be paid, Perenco seemed to consider that it could continue to operate both blocks while paying Law 42 dues. Second, if it overcame the first hurdle, Perenco had to then show that Professor Aguilar was incorrect in arguing that the remedies afforded by Ecuadorian law extend to suspension of the plaintiff's own obligations and not just court proceedings seeking termination or damages.
434. After reviewing the fact and expert evidence, the Tribunal considers that Perenco has made out the "commercial impossibility" argument. In the Tribunal's view, the dispute's having been submitted to ICSID arbitration, the Tribunal's then having made the provisional measures recommendation in order to avoid the dispute's aggravation, and Perenco's having had a contractual expectation that Ecuador would comply with such a decision, it was entitled to rely on the prospect of the non-enforcement of the *coactivas* aimed at collecting past sums claimed to be owing or new sums generated by Perenco's exploitation of the Blocks during the pendency of this arbitration. When the *coactivas* were applied to Perenco's production, it became commercially impossible for the company to carry on business because its production was being seized in order to be sold (at a discount to the prevailing market price) in order to pay the debt, while it simultaneously continued to incur Law 42 debt at the market price. For every barrel of oil seized and sold by Ecuador, a new debt was being incurred under the application of Law 42. In all of the circumstances, carrying on production at a loss amounted to 'commercial impossibility'.
435. As for the second point, the Tribunal considers that Ecuadorian law permits the party that is not in breach to suspend performance of its obligations until such time as the party in breach brings itself into compliance. Accordingly, the *exceptio non adimpleti contractus* defence was open to Perenco.

**(8) Was there a breach of clause 5.1.28 of the Block 7 Participation Contract?**

436. The Tribunal recalls that clause 5.1.28 of the Block 7 Participation Contract provides:

"The parties understand that the treatment received by the Contractor both by the Government of Ecuador as well as by PETROECUADOR *shall not be less*

*favorable than that in similar conditions by other Participation Contractors for the Exploration and Exploitation of Hydrocarbons.”*<sup>698</sup>

437. The Claimant contends that by exempting another contractor, Andes Petroleum, from the application of Law 42 with respect to its participation contract for the Tarapoa Block,<sup>699</sup> Ecuador breached clause 5.1.28. Ecuador’s response is two-fold, first, contesting the admissibility of the claim since it was advanced for the first time by the Claimant in its Reply, and second, submitting that Perenco has failed to discharge its burden of proving that Perenco and Andes Petroleum were “in similar conditions”, that there was differential treatment that was otherwise unjustified, and that Ecuador intended to favour Andes Petroleum.
438. On the matter of the claim’s admissibility, the Tribunal cannot accept Ecuador’s submission that the claim was submitted out of time. Rule 40 of the ICSID Arbitration Rules provide that “an incidental or additional claim...arising directly out of the subject-matter of the dispute” “shall be presented *not later than in the reply*”.<sup>700</sup> It is uncontested that the claim was raised in the Reply, and the Tribunal accordingly finds that this objection is unfounded and the claim is admitted for its consideration.
439. On the matter of the merits of the claim of breach, the Tribunal considers that Perenco has failed to prove that it and Andes Petroleum were in “similar conditions” as far as their respective participation contracts were concerned. When Ecuador and City Investing Company (Andes Petroleum’s predecessor) entered into the Modification Contract for the Exploitation and Exploitation of Hydrocarbons in the Tarapoa Block on 25 July 1995,<sup>701</sup> they agreed to supplement their clause 8.1 with the following proviso:

“If the Contract Area crude oil price exceeds seventeen dollars per production unit, the profit surplus from the price’s real increase (calculated over 1995 constant values) will be distributed among the parties in equal shares.”<sup>702</sup>

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<sup>698</sup> Exhibit CE-17, Block 7 Participation Contract, PER 04772 [Emphasis added.].

<sup>699</sup> Exhibit CE-12, Tarapoa Block Participation Contract.

<sup>700</sup> Rule 40(1) and (2) (Ancillary Claims) of the ICSID Arbitration Rules.

<sup>701</sup> Exhibit CE-12, Tarapoa Block Participation Contract.

<sup>702</sup> Exhibit CE-12, PER 00727.

440. Whether Law 42 and its Implementing Regulations should apply to the Tarapoa Block Participation Contract was the subject of a formal opinion requested of Ecuador’s Attorney-General Dr. Diego García Carrión in July 2008 by the then-President of Petroecuador Rear-Admiral Luis Jaramillo. In his opinion of 18 July 2008 the Attorney-General noted that the objective of Law 42 and its Implementing Regulations was to address “non-negotiated and unforeseen windfall” profits.<sup>703</sup> In contrast, in the case of the Tarapoa Block Participation Contract, the parties had considered the event of windfall profits and had turned their minds to an agreed approach to addressing that eventuality.<sup>704</sup> The Attorney-General concluded:

“In light of the foregoing, in the specific case of the Participation Contract for the Tarapoa Block, in force with Andes Petroleum Company Ltd., Law 2006-42 amending the Hydrocarbons Law is not applicable, given that the contract already assures participation for the Ecuadorian state in the economic profits earned from an increase in the price of crude oil exploited in that field.

As regards the distribution percentage, the Participation Contract in effect, which constitutes law for the contracting parties and cannot be modified other than by their agreement, in accordance with the principle established by article 1561 of the Civil Code - *which applies to the Contract since it is subject to Ecuadorian legislation, as stipulated in Clause 22.1* - has established a distribution modality equivalent to what is provided in Law 42, which should be applied in the case of this contract, to the benefit of the principle of legal certainty for the parties.

With Law 2006-42 not applicable to said contract, which expressly refers to the windfalls from the oil sales prices not negotiated or unforeseen in the Participation Contracts, the regulations for said law issued through Executive Decrees numbers 1672 published in the Second Supplement of the *Registro Oficial* no. 312 dated July 13, 2006; and 662 published in *Registro Oficial* no. 193 dated October 18, 2007 also do not apply.”<sup>705</sup>

441. This is evidence of the State’s considered evaluation of whether Law 42 and its Implementing Regulations should apply to the Tarapoa Block Participation Contract. The Tribunal considers that the evidence shows that Perenco and Andes Petroleum were not in “similar conditons” and therefore the required comparator is not present. The Claimant has failed to discharge its

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<sup>703</sup> Exhibit CE-75, Opinion of Ecuador’s Attorney General regarding the non applicability of Law 42 to the Tarapoa contract, 18 July 2008 (in Spanish with English translation), PER 02223, quoting from Decree No. 1672.

<sup>704</sup> Exhibit CE-75, Opinion of Ecuador’s Attorney General regarding the non applicability of Law 42 to the Tarapoa contract, 18 July 2008 (in Spanish with English translation), PER 02223-02224.

<sup>705</sup> Exhibit CE-75, Opinion of Ecuador’s Attorney General regarding the non applicability of Law 42 to the Tarapoa contract, 18 July 2008 (in Spanish with English translation), PER 02224 [Italics in original.]

burden of proving that there was unfavourable treatment accorded to it when compared to another company in similar conditions. This claim is therefore dismissed.

### **(9) Caducity under the Contracts**

442. The Tribunal finds it most efficient to address the issue of caducity after its discussion of the Claimant's expropriation claim. As shall be seen, the Tribunal considers that the declaration of *caducidad* effected an expropriation and by parity of reasoning, it constituted a breach of the Block 21 Contract because, in all of the circumstances, having occupied the blocks and safeguarded the State's interest in maintaining the oilfields and ensuring continuity of operations, without dispossessing Perenco of its contractual rights, Ecuador need not have brought the Contracts to an end.

#### **E. Summary of Tribunal's findings on contract claims**

443. In summary, the Tribunal finds that (i) Law 42 modified the operation of the Contracts and fell squarely within the taxation modification provisions of the two Contracts; (ii) Perenco has failed to make out a breach of contract in relation to Law 42 at 50% due to its decision not to press its contractual rights and its failure to demonstrate that the clause 11 remedy was futile in the circumstances prevailing around the time of its request; and (iii) Perenco has made out its claim that at 99%, Law 42 breached the Contracts.

## **VII. JURISDICTION OVER CLAIMANT'S TREATY CLAIMS**

### **A. The remaining jurisdictional question under the Treaty**

444. In its Decision on Jurisdiction, the Tribunal left open the question of whether Perenco Ecuador Limited has standing to bring the claim under the Treaty.<sup>706</sup>

445. The Tribunal noted that the Claimant was incorporated under the laws of the Commonwealth of the Bahamas.<sup>707</sup> It is the fourth company at the lowest rung of a "ladder" of Bahamian

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<sup>706</sup> Decision on Jurisdiction, paragraph 86.

<sup>707</sup> Decision on Jurisdiction, paragraph 3.

companies with the company at the top of the ladder being PIL.<sup>708</sup> At the time of his death, the late Hubert Perrodo, a French national, owned 92.9% of the shares of PIL. The remaining 7.1% shares are owned by another Bahamian company, Glenmor Energy Limited,<sup>709</sup> which in turn is wholly owned by Mr. Perrodo's eldest son, Mr. François Perrodo.<sup>710</sup>

446. Although it dismissed the primary limb of the Respondent's objections to the Tribunal's jurisdiction to hear the Treaty claims in its Decision on Jurisdiction, the Tribunal deferred its consideration of certain issues pending the filing of additional evidence and further submissions by the Parties. In doing so, the Tribunal expressed two concerns.

447. First, it observed that this appeared to be the first time in which a juridical person, a national of a third State, had invoked treaty rights held and obligations owed by the Treaty parties without there being at least one national of one of the two State parties to the Treaty (or a juridical person incorporated under the law of one of the two State parties) joining to claim under the Treaty.<sup>711</sup> It observed further that it was beyond dispute that ordinarily a Bahamian company could not claim rights under a bilateral treaty to which the Commonwealth of the Bahamas is a stranger.<sup>712</sup>

448. Consequently, the Tribunal was somewhat surprised at the lack of affirmation from any French national, i.e. any heir of the late Mr. Hubert Perrodo, to the effect that such national, either individually or collectively with other French nationals, now controlled PIL and through it the Claimant.<sup>713</sup> In the circumstances of the case, therefore, the Tribunal considered that the

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<sup>708</sup> Due to a corporate reorganisation, the names of various companies in the ladder have changed. For example, what is now Perenco International Ltd was Perenco Limited in 2006. Similarly, what was Perenco S.A was formerly Perenco Oil and Gas S.A. Perenco Gabon S.A was formerly Perenco S.A: See Letter from Debevoise & Plimpton to Dechert dated 8 July 2009, enclosing letter from Debevoise & Plimpton to ICSID dated 28 May 2008 at Exhibit E-1 to Amended Request

<sup>709</sup> Exhibit E-6 to Amended Request, Register of Members of Perenco Limited, Perenco S.A., Perenco Gabon S.A., and Perenco Ecuador Limited.

<sup>710</sup> Exhibit CE-252, Register of Members of Glenmor Energy, undated, p 1.

<sup>711</sup> Decision on Jurisdiction, paragraph 90.

<sup>712</sup> *Ibid.*, paragraph 91.

<sup>713</sup> *Ibid.*, paragraph 90.

evidence of claimed control by French nationals that had been adduced by the Bahamian company by the time of the jurisdictional hearing was meagre.<sup>714</sup>

449. Second, with respect to the second limb of its objection to the treaty claim, the Respondent had advanced the argument that the word “controlled” used in Article 1(3)(ii) of the Treaty in relation to the word “companies” meant “any body corporate” that was *directly* controlled by nationals of a Contracting Party and did not extend to any body corporate that was *indirectly* controlled by such nationals.<sup>715</sup> At the jurisdictional hearing, the Respondent conceded that if it was proved that French nationals controlled PIL, the company at the top of the ladder of Bahamian companies, then that Bahamian company – but, it insisted, *only* that Bahamian company – had the requisite standing to bring a claim under the Treaty because it was the only company that could be said to have been *directly* controlled by the Perrodo family, assuming that they were able to discharge the burden of proving that they did indeed control that company.<sup>716</sup>

450. During the earlier jurisdictional phase, some argument was led in respect of the *travaux préparatoires* of the Treaty and the Tribunal decided to defer its decision on the direct/indirect control issue for the time being.<sup>717</sup> Given that the Respondent apparently had little in the way of the negotiating history within its possession and without expressing a view as to whether it was appropriate or not in the circumstances to have recourse to supplementary means of interpretation pursuant to Article 32 of the Vienna Convention on the Law of Treaties (the “**Vienna Convention**” or the “**VCLT**”), the Tribunal instructed the parties to approach the French authorities with a view to obtaining any *travaux préparatoires* and to return to this issue in the next phase of the proceeding in the light of any such negotiating history.<sup>718</sup>

451. After receiving the further written submissions and evidence from the parties, the Tribunal was in a better position to make a proper determination of the remaining jurisdictional issues.

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<sup>714</sup> Decision on Jurisdiction, paragraphs 104-106. The Claimant was directed to file further evidence in support of its averment that it is controlled by Mr. Perrodo’s heirs.

<sup>715</sup> *Ibid.*, paragraphs 74-79.

<sup>716</sup> Transcript, Hearing on Jurisdiction, Day 1, p 212

<sup>717</sup> Decision on Jurisdiction, paragraph 86.

<sup>718</sup> *Ibid.*, paragraphs 94-95.

**(1) Key factual findings**

452. Before discussing the objections in detail, it is necessary to consider the facts as they emerged from the written and oral testimony of witnesses tendered by the Parties.
453. At the oral hearing in The Hague held from 8 to 16 November 2012, Mr. François Perrodo, Mr. Roland Fox, and Mr. Patrick Spink all testified as to the issue of the control of Perenco Ecuador Limited both during the late Mr. Hubert Perrodo's lifetime and after his death.
454. With respect to the question of whether or not *as a matter of fact* at the material time (17 October 2007)<sup>719</sup> the Perrodo family controlled PIL, and through PIL and two other interposed companies, the Claimant, the following key points warrant noting.
455. The evidence of Mr. François Perrodo was that after his father's untimely death on 29 December 2006, he had to assume the leadership of the Perenco Group and on 12 January 2007 was appointed Director and Chairman of the Board of Directors of PIL.<sup>720</sup> In both his written and oral testimony, he maintained that after his father's death, he and his family controlled PIL, which in turned controlled the subsidiary companies, including Perenco Ecuador Limited, in that significant decisions affecting the Perenco Group or any Group company were made only with the Perrodo family's approval.<sup>721</sup> Mr. Perrodo stated that he continued to follow his late father's management practices in that the directors, officers and managers of the various Perenco Group of companies would consult with him and seek his approval for all kinds of matters, "including potential acquisitions or dispositions, important contracts, commencing or terminating relationships with partners, investment decisions, key personnel, relations with governments and many other issues."<sup>722</sup>
456. During his oral testimony, Mr. Perrodo stated that his father's only heirs were his mother, Mrs. Ka Yee Perrodo, and her three children, Nathalie Samani (née Perrodo), Bertrand Perrodo, and

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<sup>719</sup> On 17 October 2007, Perenco notified Ecuador that it accepted and gave its consent to the offer by the Respondent to submit any dispute relating to any measure which may affect the Claimant's investments in Ecuador to ICSID: see Amended Request for Arbitration dated 30 April 2008, paragraph 15.

<sup>720</sup> Witness Statement of François Perrodo, paragraph 4.

<sup>721</sup> Witness Statement of François Perrodo, paragraph 11.

<sup>722</sup> Witness Statement of François Perrodo, paragraph 13. This factual evidence is a critical premise of the Claimant's position on its standing to pursue claims under the Treaty: see Transcript, Hearing on the Merits, Day 1, pp 176-177 (Opening Statement of Mr. Friedman).

himself.<sup>723</sup> There are no other descendants entitled to make a claim of an interest in the estate.<sup>724</sup>

457. Mr. Perrodo acknowledged that there was a dispute between his mother and her children as to how the estate should be divided.<sup>725</sup> Since her husband had died intestate, Mrs. Perrodo had argued that under the applicable matrimonial regime, 15% of the estate had belonged to her while her husband was alive.<sup>726</sup> This would have a significant impact on the percentage share of the estate that each heir would receive once the estate was administered.<sup>727</sup> As a result of this dispute, on 15 February 2008, Mrs. Perrodo, on the advice of counsel, lodged a caveat in the Bahamian courts. (This was later withdrawn, on 30 March 2009.)<sup>728</sup>
458. Mr. Perrodo testified further that the dispute between the heirs in no way impeded the management of the Perenco Group.<sup>729</sup> It had always been clear that Mrs. Perrodo and the other two Perrodo children completely entrusted him in the running of the company as Executive Chairman.<sup>730</sup>
459. This evidence was consistent with that of Mr. Roland Fox who testified that at all times the Perrodo family controlled the Perenco Group.<sup>731</sup> When Hubert Perrodo was alive, he maintained tight control over the Perenco Group,<sup>732</sup> and this was manifested by his ability as sole shareholder to appoint senior management and the Board of Directors of PIL.<sup>733</sup> All decisions relating to the Perenco Group were made with Mr. Perrodo's approval.<sup>734</sup> He was succeeded by his son François when he was appointed Chairman of PIL shortly after his

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<sup>723</sup> Transcript, Hearing on the Merits, Day 2, p 419 (Testimony of François Perrodo).

<sup>724</sup> *Ibid.*, p 419 and 423 (Testimony of François Perrodo).

<sup>725</sup> *Ibid.*, pp 420-422 (Testimony of François Perrodo).

<sup>726</sup> *Ibid.*, pp 422-423 (Testimony of François Perrodo).

<sup>727</sup> *Ibid.*, p 419 (Testimony of François Perrodo).

<sup>728</sup> *Ibid.*, p 421 (Testimony of François Perrodo).

<sup>729</sup> *Ibid.*, p 423 (Testimony of François Perrodo).

<sup>730</sup> *Ibid.*

<sup>731</sup> 1<sup>st</sup> Witness Statement of Roland Fox, paragraph 21; 2<sup>nd</sup> Witness Statement of Roland Fox, paragraph 5.

<sup>732</sup> *Ibid.*, paragraph 22

<sup>733</sup> 1<sup>st</sup> Witness Statement of Roland Fox, paragraph 25.

<sup>734</sup> *Ibid.*, paragraph 24.

father's death.<sup>735</sup> The authorised signatories on PIL's bank accounts were changed to give François Perrodo the authority to transact on those accounts on the basis of his signature alone.<sup>736</sup> On 24 September 2007, his mother, Ka Yee, and his sister, Nathalie, were also appointed Directors of PIL's Board.<sup>737</sup>

460. Mr. Fox testified further that as of 17 October 2007, six of the nine Directors of PIL's Board were French nationals, consisting of the three Perrodo family appointees and three others, namely, Bernard Castanet, Patrick Reynis and Jean-Michel Runacher.<sup>738</sup>

461. Mr. Fox testified further that Mr. François Perrodo, as Chairman of the Board, was and has remained personally involved in all the significant decisions affecting the Perenco Group, and also consults his family before making such decisions.<sup>739</sup> No significant decision would be taken without his approval.<sup>740</sup>

462. Mr. Fox further testified that the Perrodo family controlled Perenco Ecuador Limited (“**PEL**”). He himself was the President of PEL, which also had two Bahamian Directors. Day-to-day management of PEL was the responsibility of the Ecuador General Manager, supervised by the Regional Manager, but all material and strategic decisions were first brought to the attention of Hubert Perrodo, and after his death, to François Perrodo.<sup>741</sup>

463. Mr. Fox averred that François Perrodo has made significant decisions affecting PEL, including approving PEL's expenditures in the country, its annual work programme and budget, and how to react to the actions of Ecuador which were considered to be detrimental to PEL's operations in Ecuador.<sup>742</sup>

464. Two other aspects of Mr. Fox's testimony warrant note. The first relates to the shareholding of PIL at the time of Hubert Perrodo's death. Mr. Fox confirmed that at the time of Mr. Hubert

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<sup>735</sup> *Ibid.*, paragraph 28; Transcript, Day 2 at p 393, lines 3 – 9.

<sup>736</sup> 2<sup>nd</sup> Witness Statement of Roland Fox, paragraph 6.

<sup>737</sup> 2<sup>nd</sup> Witness Statement of Roland Fox, paragraph 7.

<sup>738</sup> *Ibid.*

<sup>739</sup> 1<sup>st</sup> Witness Statement of Roland Fox, paragraph 29.

<sup>740</sup> *Ibid.*, paragraph 30. Transcript, Hearing on the Merits, Day 2, p 394, lines 4 – 7.

<sup>741</sup> 1<sup>st</sup> Witness Statement of Roland Fox, paragraph 33.

<sup>742</sup> *Ibid.*, paragraph 35.

Perrodo's death, the entire share capital of PIL amounted to 97,414 shares of which Hubert Perrodo owned 90,498 shares, equivalent to 92.9% of the total issued share capital of PIL, and Glenmore Energy Ltd, owned by François Perrodo, owned the remaining 6,916 shares equivalent to 7.1% of PIL's share capital.<sup>743</sup>

465. Mr. Fox testified that in his role as Company Secretary of PIL, he was advised by Mr. Patrick Reynis, a French lawyer on PIL's Board, that the 90,498 shares in PIL formed part of Hubert Perrodo's estate and that under French law, upon his death they became immediately and indivisibly owned by his four heirs.<sup>744</sup> He testified further that on 22 December 2011, the PIL shares that the heirs jointly owned were divided such that each of the four members of the Perrodo family ended up owning 25% of the total issued share capital of PIL.<sup>745</sup> On this date, the transfer and re-registration of 24,353.5 shares were registered in each of the names of Ka Yee Perrodo, Nathalie Samani and Bertrand Perrodo. Some 17,437.5 shares were registered in the name of François Perrodo because he already owned 6,916 shares through Glenmor.<sup>746</sup>

466. Another aspect of Mr. Fox's testimony that warrants note concerned his view as to the voting rights attached to the shares of PIL. In this regard, he testified that in the period between Mr. Perrodo's death and the time that the PIL shares were transferred and re-registered on 22 December 2011 – the period in which the consent to ICSID arbitration was given by PEL – although the shares were held indivisibly by the heirs, there were no voting rights attached to them because nobody was in a position to vote on them.<sup>747</sup> Accordingly, from his perspective as the Company Secretary, François Perrodo's indirect 7.1% shareholding in PIL gave him the right to determine shareholders' decisions until the other shareholders had been registered.<sup>748</sup> The Tribunal will revert to his testimony on this point below.

467. Mr. Patrick Spink also testified as to the issue of control exercised by both Hubert Perrodo and François Perrodo over PIL and PEL.

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<sup>743</sup> *Ibid.*, paragraph 2.

<sup>744</sup> *Ibid.*, paragraph 3; Transcript, Hearing on the Merits, Day 2, pp 373 – 375.

<sup>745</sup> 2nd Witness Statement of Roland Fox, paragraphs 9-10.

<sup>746</sup> *Ibid.*, paragraphs 9-10.

<sup>747</sup> Transcript, Hearing on the Merits, Day 2, pp 401-403, 407 (Testimony of Roland Fox).

<sup>748</sup> *Ibid.*

468. He testified that the Perrodo family’s control extended to more than just acquisitions and that they had a “decisive say over matters as diverse as capital expenditures, relationships with business partners, annual budgets, personnel and other matters.”<sup>749</sup> Mr. Spink also gave evidence as to Hubert Perrodo’s control over PEL, and the investment in Ecuador, which he said was directly supervised by Hubert Perrodo.<sup>750</sup>
469. The expert opinion of Mr. Bernard Reynis, a French notary called by the Claimant, addressed the immediate devolution under French law of interest in Hubert Perrodo’s estate upon his death to his surviving spouse and descendants.<sup>751</sup> Mr. Reynis testified that under French law, in the absence of any last will and testament by the deceased and in the presence of a surviving spouse and descendants, the estate reverts to the surviving spouse and his descendants (i.e. the heirs).<sup>752</sup> The heirs are vested immediately with “capacity” in relation to their interest in the estate “without any need for formalities or ‘probate’ proceedings such as those used in common-law jurisdictions.”<sup>753</sup>
470. Mr. Reynis added that where there are numerous heirs, this results in the creation of a joint ownership, and “[d]uring the joint ownership period, the coheirs hold title to and exercise control over the entire estate, which includes shares of stock held by the deceased in a corporation at the time of death, jointly and indivisibly.”<sup>754</sup> This testimony was consistent with Mr. Fox’s evidence that from his perspective as Company Secretary, the shares were held indivisibly by the heirs. It was also consistent with the Claimant’s position that immediately upon the death of Hubert Perrodo, the Perrodo heirs owned PIL, and through that, PEL.

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<sup>749</sup> 2<sup>nd</sup> Witness Statement of Patrick Spink, paragraph 5.

<sup>750</sup> *Ibid.*, paragraph 6.

<sup>751</sup> Expert Report of Bernard Reynis, paragraphs 8-9.

<sup>752</sup> Expert Report of Bernard Reynis, paragraph 9; Transcript, Hearing on the Merits, Day 5, pp 1297 and 1299 (Testimony of Mr. Bernard Reynis).

<sup>753</sup> Expert Report of Bernard Reynis, paragraph 10; Transcript, Hearing on the Merits, Day 5, pp 1297 and 1299 (Testimony of Mr. Bernard Reynis). Similarly, another expert witness for the Claimant, Mr. Brian Simms QC, testified that, in his view, the heirs were immediately vested with title to the shares in PIL and could have registered the shares at any time, and in any event, for all relevant purposes the heirs were treated as shareholders: Transcript, Hearing on the Merits, Day 6, pp 1130-1131 (Testimony of Mr. Brian Simms QC).

<sup>754</sup> Expert Report of Bernard Reynis, paragraphs 10-11; Transcript, Hearing on the Merits, Day 5, p 1302 (Testimony of Mr. Bernard Reynis).

471. While the Respondent challenged certain aspects of the testimony of each of the foregoing witnesses, it did not successfully challenge the central points of the foregoing testimony going to the issue of the Perrodo family's control *in fact* of PIL (the issue of legal control will be considered separately below).
472. In light of the foregoing, six key factual findings can be made in this respect.
473. First, after two rounds of oral hearings, each of which was preceded by two rounds of written pleadings, there is no evidence that the PIL shares did not form part of the Perrodo estate for the purposes of French law. There is no evidence, for example, that Mr. Perrodo created a testamentary or other trust domiciled outside of France which might have meant that the PIL shares did not form part of the estate which vested in the heirs under French law.
474. Rather, the evidence is that the shares of PIL *did* form part of the estate and in view of Mr. Perrodo's intestacy, they fell to devolve to the heirs in accordance with French law, as indicated in the *Acte de notoriété* and Death Certificate of Hubert Perrodo prepared by Mr. Bernard Reynis on 11 June 2007 (as further confirmed by Mr. Reynis' expert report filed in this proceeding).<sup>755</sup>
475. Second, while evidence emerged which showed that the surviving heirs of Mr. Perrodo disputed their respective shares of the estate (a fact which Mr. François Perrodo freely acknowledged under cross-examination<sup>756</sup>), no evidence was adduced to contradict the Claimant's position that, under French law, the ownership of the estate vested in the heirs immediately upon Mr. Perrodo's death. The Respondent did not seek to contradict Mr. Reynis' expert opinion on French law and its operation in this fashion was accepted by the Respondent's expert on Bahamian law, Mr. Brian Moree QC, as an assumption for his opinion.<sup>757</sup>

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<sup>755</sup> Exhibit CE-200, *Acte de notoriété* and Death Certificate of Hubert Perrodo prepared by Mr. Bernard Reynis (in French with English translation) (also submitted as part of the Claimant's Exhibit RFA-CE-6 on 1 November 2010 and attached to the Expert Report of Bernard Reynis as Exhibit 1).

<sup>756</sup> Transcript, Hearing on the Merits, Day 2, Testimony of François Perrodo at p 419.

<sup>757</sup> Transcript, Hearing on the Merits, Day 6, p 1426, lines 8-10 and 1st Expert Report of Brian Moree QC, p 3.

476. Third, no evidence was adduced to suggest that any other person of French or of any other nationality came forward to contest the heirs' collective entitlement to the estate. It is true that on 15 February 2008, Madame Perrodo filed a caveat in the estate of Hubert Perrodo in the Supreme Court of the Bahamas<sup>758</sup>, but this was explained by Mr. Perrodo as an act taken out of an abundance of caution by his mother and in light of the then-brewing dispute between the heirs.<sup>759</sup> There is no record evidence that any other party – of French or of any other nationality – contested the Perrodo heirs' entitlement to the estate.
477. Fourth, the consistent evidence of the Perenco officers and management was that there was no doubt amongst the Board or the senior officers of the company as to the Perrodo family's ownership and continued control of PIL after Mr. Perrodo's death. Mr. Fox testified that in light of the advice he had received from a French attorney on the board, management did whatever it could to facilitate the transition in the company's governance.<sup>760</sup>
478. In this respect, as already noted, on 12 January 2007, some 14 days after Mr. Perrodo's death, François Perrodo was elected to the Board of PIL and appointed its Chairman.<sup>761</sup> The officers of the Perenco Group testified that they then consulted with François Perrodo in the same way in which they had previously consulted his father.<sup>762</sup>
479. Fifth, François Perrodo also had an existing 7.1% shareholding interest in PIL through his ownership of Glenmor.<sup>763</sup> This shareholding was unaffected by his father's death and continued unabated during the period in which the heirs' respective entitlements to the estate were contested. (There is some debate between the Parties as to whether or not the shares of the late Mr. Perrodo were "disabled" from voting until such time as they were re-registered, and if so, whether François Perrodo therefore controlled PIL by virtue of his company being the only shareholder with the ability to cast a vote at any general meeting of PIL held during the time that the other shares had not been distributed and registered the names of the heirs.) It

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<sup>758</sup> Exhibit E-72, Caveat filed in the Supreme Court of The Bahamas by Carrie (evidently an Anglicisation of Ka Yee) Perrodo in the Estate of Hubert Perrodo, dated 15 February 2008.

<sup>759</sup> Transcript, Hearing on the Merits, Day 2, p 420, lines 5-11 (Testimony of François Perrodo).

<sup>760</sup> Transcript, Hearing on the Merits, Day 2, pp 384-385 (Testimony of Roland Fox).

<sup>761</sup> Witness Statement of François Perrodo, paragraph 4.

<sup>762</sup> 1st Witness Statement of Roland Fox, paragraph 29; 2nd Witness Statement of Patrick Spink, paragraph 4.

<sup>763</sup> Exhibit CE-252, Register of Members of Glenmor Energy, undated, p 1.

should be noted that Mr. Moree QC objected to using the term “disabled” – his point being that the rights still existed but there was no one to exercise them.<sup>764</sup>

480. Six, approximately nine months after François Perrodo assumed the chairmanship, he was joined on PIL's Board by his mother and sister.<sup>765</sup> Thus, when, on 17 October 2007, the Claimant wrote to the Ministry of Foreign Affairs and the Ministry of Mines and Petroleum purporting to accept Ecuador's offer to submit the dispute to ICSID pursuant to Article 25 of the ICSID Convention and Article 9 of the Treaty, three of the four surviving heirs of Hubert Perrodo were members of PIL's Board.<sup>766</sup>

481. The evidence, therefore, as to the *fact* of the heirs' control of PIL, the company at the top of the ladder of Bahamian companies, is substantial and, in respect of the foregoing, not seriously contested and indeed un-contradicted in a number of instances.

482. However, it also remains a fact that what plainly had *not* occurred either at the time that the Claimant consented to ICSID arbitration with Ecuador on 17 October 2007 or on 30 April 2008 when the Board of Directors of Perenco S.A. (now PIL) authorised the filing of the Requests for Arbitration with ICSID, was the registration of the shares previously owned by Hubert Perrodo in the names of the heirs. It was not until 22 December 2011 that Letters of Administration were taken out in the Bahamas directing that the heirs be registered as shareholders of PIL in the proportions agreed by the heirs.<sup>767</sup> This of course is one of the principal remaining objections, to which the Tribunal now turns.

## **(2) Submissions on the issue of control**

483. Quite apart from the issues of fact in respect of which it adduced additional evidence on the issue of control, the Claimant argued against the Tribunal's placing any reliance upon what it

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<sup>764</sup> Transcript, Hearing on the Merits, Day 6, pp 1481-1482 (Testimony of Brian Moree QC).

<sup>765</sup> Exhibit CE-199, Board of Directors Meeting Minutes of Perenco International Ltd, 24 September 2007.

<sup>766</sup> Exhibit CE-264, Letter from Perenco Ecuador Ltd to the Ministry of Foreign Affairs and the Ministry of Mines and Petroleum.

<sup>767</sup> Exhibit CE-294, email correspondence between Mr Roland Fox and Ms Heather Thompson, enclosing instructions from the Perrodo heirs, 22 December 2011.

considered to be “incomplete” parts of the *travaux préparatoires* as they were said to provide no definitive interpretative guidance.<sup>768</sup>

484. For its part, the Respondent filed what was available in terms of the *travaux* (while also complaining that it was evident that the Claimant already had the documents at the time of the earlier jurisdiction proceedings).<sup>769</sup>

485. The Respondent asserted that the *travaux* supported the view that the changes between the original initialled draft and the final text that was signed and ratified by the parties were substantial and the clear interpretative inference to be drawn was that the State parties agreed that a legal person incorporated under the law of a third State would have standing to bring a claim only if it was directly controlled by nationals of one of the two Contracting Parties.<sup>770</sup>

486. Since the Claimant was not directly controlled by French nationals but rather by a Bahamian company, the Respondent argued it follows that it lacked the requisite standing to bring the present Treaty claim.<sup>771</sup>

*a. The Respondent’s objections*

487. With respect to the Respondent’s objections that were not disposed of by the Tribunal’s Decision on Jurisdiction, the Respondent’s case as it stands can be summarised as follows:

488. First, it is clear that the Perrodo heirs had not taken the steps required by Bahamian law to acquire legal title to the shares at the time that consent to ICSID arbitration was given by the Claimant.

489. In the Respondent’s submission, whatever may be said about their ownership of the shares under French law and the fact that Bahamian law recognised their beneficial interest in the PIL

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<sup>768</sup> The Claimant described the *travaux* as “incomplete” and providing “no definitive interpretative guidance”: See paragraph 28 of the Reply. At the hearing, counsel for the Claimant described the *travaux* as “...fragmentary and incomplete. There is in these *travaux* no comprehensive memo of the negotiations, no agreed understandings or Protocols underlying the Treaty, no guides as to why certain language was used or not used. Instead, what Ecuador invites you to do is to look at a couple of drafts with handwritten markings on and imagine what might have been in the minds of the negotiators, and from that impose a limitation on the ordinary meaning of the perfectly clear terms.” Transcript, Hearing on the Merits, Day 1, p 165, lines 16-22, p 166, lines 1-3.

<sup>769</sup> Counter-Memorial, paragraph 105.

<sup>770</sup> Counter-Memorial, paragraphs 99-100, 103-104, 107-111.

<sup>771</sup> Counter-Memorial, paragraphs 136-137.

shares<sup>772</sup>, as a matter of Bahamian law, since they were not registered as shareholders, they lacked the power to participate as shareholders in PIL at the crucial date of consent, and therefore were not in a position to control that company. On this analysis, it was not until December 2011 that they were, as a matter of Bahamian law, in a position to control PIL.<sup>773</sup>

490. The Respondent thus contends that in the absence of the ownership of legal title of the shares, PIL itself was not controlled by French nationals and it follows therefore that PEL – which would derive its right of standing from its being controlled by PIL and it in turn being controlled by French nationals – likewise lacks standing to bring the Treaty claim.<sup>774</sup>

491. Second, the Respondent reaffirms what was originally the second limb of its objection to the Tribunal’s jurisdiction. This objection exists independently of whatever may be decided in respect of the first objection in that even if it is accepted that the Perrodo heirs controlled PIL at the material time, PIL is not the claimant in this arbitral proceeding. Rather, the claim has been brought by a Bahamian company which is separated by three layers of Bahamian companies and is therefore not directly controlled by the Perrodo heirs. The immediate, controlling parent of the Claimant is Perenco S.A. and it is not a French company or national.<sup>775</sup>

492. The essence of the Respondent’s argument in respect of the second objection is that while the phrase “directly or indirectly” was used in connection with “controlled” in the first draft of the treaty negotiated in 1986 – a phrasing that was consistent with the approach taken in French bilateral investment treaty-making practice, that was *not* what was ultimately signed and ratified by the two States in 1994.<sup>776</sup>

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<sup>772</sup> 1st Expert Report of Brian Moree QC, paragraph 6, states that “under Bahamian Law, the heirs only have an equitable right to the shares pending their registration as the owners of the shares.”

<sup>773</sup> On 22 December 2011, the heirs of Hubert Perrodo were formally registered as shareholders of PIL. See exhibit CE-294, email correspondence between Roland Fox and Heather Thompson, enclosing instructions from Perrodo heirs, 22 December 2011.

<sup>774</sup> Counter-Memorial, paragraphs 84-88.

<sup>775</sup> Exhibit CE-6 to Amended Request, Register of Members of Perenco Limited, Perenco S.A., Perenco Gabon S.A., and Perenco Ecuador Limited.

<sup>776</sup> Counter-Memorial, paragraph 99.

493. The 1986 draft followed the French model BIT which provided that “companies” included “... toute personne morale constituée sur le territoire de l’une des Parties contractantes, conformément a la législation de celle-ci y possédant son siège social, ou contrôlée *directement ou indirectement* par des nationaux de l’une des Parties contractantes ...”.<sup>777</sup> Likewise, the draft initialled in October 1986<sup>778</sup> similarly provided in Spanish that “...toda persona jurídica constituida en el territorio de una de las Partes Contratantes conforme a su legislación y que posea en el mismo su domicilio social, o controla *directa o indirectamente* por nacionales de una de las Partes Contratantes...”.
494. However, this is not what the final text states. It is common ground that the 1986 draft text was not finalised and ratified by the two States.
495. After a hiatus of some 8 years, negotiations between France and Ecuador resumed. By that time, Ecuador had developed its own model BIT and the approach taken by that instrument was to confine the standing to bring a claim upon natural persons who were nationals of either of the two Contracting Parties and legal persons that were incorporated under the law of either of the two Contracting Parties and whose seat was located in the territory of a Contracting Party.<sup>779</sup> On this approach, legal persons incorporated under the law of a third State would have no standing to bring a claim.
496. The Respondent emphasised that consistent with this approach, Ecuador had concluded a bilateral investment treaty with the United Kingdom which also contained a different model for establishing the standing of legal persons shortly before the resumption of negotiations with France.<sup>780</sup> That Treaty defined “companies” as “corporations, firms and associations incorporated or constituted under the law in force in any part of the United Kingdom” or “legal

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<sup>777</sup> See Exhibit E-55, *Projet d’Accord entre le Gouvernement de la République Française et le Gouvernement sur l’Encouragement et la Protection Réciproques des Investissements*, UNCTAD, *International Investment Instruments: A Compendium*, Volume VI, 2001 [Emphasis added].

<sup>778</sup> Exhibit E-56, Letter from the Ecuadorian Ministry of Foreign Affairs to the Ecuadorian Ambassador in France dated 16 October 1986 enclosing the Draft Treaty between France and Ecuador Concerning the Encouragement and Reciprocal Protection of Investments [Emphasis added].

<sup>779</sup> Counter-Memorial, paragraph 113, E-56, Letter from the Ecuadorian Ministry of Foreign Affairs to the Ecuadorian Ambassador in France dated 16 October 1986 enclosing the Draft Treaty between France and Ecuador Concerning the Encouragement and Reciprocal Protection of Investments (PER 03541).

<sup>780</sup> Transcript, Hearing on the Merits, Day 1, pp 220-221 (Opening Statement of Mr. Diego García Carrión).

persons constituted in accordance with the law in force in the Republic of Ecuador.”<sup>781</sup> The Treaty essentially adopted a ‘place of incorporation’ test in accordance with the relevant laws of the Contracting Parties rather than a ‘control’ test and thus did not contemplate legal persons incorporated in the law of third States having rights of standing by virtue of their being controlled by nationals of one of the Contracting Parties. A document, evidently prepared by French officials prior to the resumption of negotiations with Ecuador in 1994, referred to the UK treaty and noted the different requirements for the standing of legal persons.<sup>782</sup>

497. Two undated draft texts which evidently preceded the final version of the Treaty were also submitted. Each contained handwritten annotations that either deleted or inserted text. The first undated draft includes handwritten marks in the definition of “companies” as follows:

“the term ‘companies’ shall designate i) Any legal entity organized in the territory of one of the Contracting Parties, in accordance with its legislation, and that ~~possesses~~ **has** its corporate domicile within the same; or ii) ~~If it is~~ **Any legal entity** controlled directly (or indirectly) by nationals of one of the Contracting Parties”<sup>783</sup> [Handwritten additions in bold, deletions indicated by strikethrough]

498. In the second undated draft of the treaty, the relevant paragraph has the words “directly” and “indirectly” crossed out:

“companies shall designate // i) Any legal entity organized in the territory of one of the Contracting Parties, in accordance with its legislation, and that has its corporate domicile within the same; or // ii) Any legal entity controlled ~~directly or indirectly~~ by nationals of one of the Contracting Parties [...]”<sup>784</sup>

499. In the end, the Treaty signed by France and Ecuador contained a different expression of control than the prior drafts or the 1986 initialled version. The words “directly or indirectly” were omitted and, as noted above, the phrase “directly or indirectly” was inserted into the definition of “investment” in Article 1(1). It warrants noting that unlike the then-recently concluded Ecuador–UK Treaty, the Treaty did not restrict rights of standing to legal persons incorporated

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<sup>781</sup> Exhibit E-62, Agreement between the Government of the United Kingdom of Great Britain and the Northern Ireland and the Government of the Republic of Ecuador for the Promotion and Protection of Investments, signed 10 May 1994 and entered into force on 24 August 1995, Article 1.

<sup>782</sup> Transcript, Hearing on the Merits, Day 1, p 221 (Opening Statement of Respondent).

<sup>783</sup> *Travaux préparatoires* in Claimant's Possession as of 5 August 2011 at CE-188 at PER 03573.010.

<sup>784</sup> *Ibid.* at PER 03573.002.

under the law of either of the Contracting Parties, but in addition conferred standing on legal persons incorporated under the law of a third State, provided that such legal persons were “controlled” by nationals of one of the Contracting Parties.

*b. The Claimant’s submission*

500. The Claimant’s submission in response to this objection can be summarised as follows:

501. First, it submitted that on the undisputed facts in the record, Perenco is a company “controlled” by French nationals within the meaning of Article 1(3)(ii) of the Treaty and has been recognised as such by Ecuador.<sup>785</sup> Ecuador’s position that the Treaty’s use of the term “control” required “legal control” and could not extend to the case where the Perrodo heirs had not as yet obtained Letters of Administration in the Bahamas, was “premised on a limiting and formalistic definition of ‘control’ that [was] contrary to the more flexible and fact-dependent approach that international law adopts”.<sup>786</sup> The Perrodo family was in fact in control of the Perenco Group both when Hubert Perrodo was alive and after his death.<sup>787</sup> In particular, François Perrodo was appointed Chairman of PIL and was significantly involved in decisions relating to the management of the Perenco Group, including that of Perenco.<sup>788</sup> Moreover, at the date of consent to arbitration, the Perrodo heirs collectively owned 100% of the shares in PIL and this was sufficient to establish “control” over the company (and through that, its wholly-owned subsidiary).<sup>789</sup> The fact that the Perrodos’ shareholding had not been formally registered in their individual names could not detract from the fact that under French law, upon Hubert Perrodo’s death, his ownership of 92.9% of PIL’s shares automatically vested in his four heirs jointly - they owned the shares.<sup>790</sup>

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<sup>785</sup> Reply, paragraphs 7, 10.

<sup>786</sup> Revised Memorial, paragraph 10; Reply, paragraphs 10, 63, 66-68.

<sup>787</sup> Revised Memorial, paragraphs 75- 79; Reply, paragraphs 12-14, 64, 75-78.

<sup>788</sup> Reply, paragraphs 17 and 75 (“Immediately following Hubert’s death on 29 December 2006, the PIL Board took steps to ensure that the family’s formal control did not lapse. At an emergency meeting on 12 January 2007, approximately two weeks after Hubert passed away, the Board officially recognized François as the new head of Perenco. On that date, the Board appointed François as a director and as Chairman of the company with immediate effect. It also transferred authority to transact ‘any or all business’ involving Perenco’s bank accounts from Hubert to François, so that François was the only member of the Board of Directors authorized to execute transactions on the basis of his signature alone.”).

<sup>789</sup> Revised Memorial, paragraph 80; see also, Reply, paragraphs 80-89.

<sup>790</sup> Revised Memorial, paragraph 83; Reply, paragraph 14.

502. Perenco asserted that even if the Tribunal were to proceed on the narrow approach to control advocated by Ecuador, Perenco was nevertheless legally controlled by French nationals as of 17 October 2007 because approximately 7.1% of the shares in PIL were owned by Glenmor Energy, which in turn, was wholly owned by François Perrodo.<sup>791</sup> This entitled François Perrodo to vote on decisions taken by the management of PIL, even if it was assumed that the beneficiaries of the Perrodo estate could not vote in respect of the shares vested in Hubert Perrodo.
503. Finally, Perenco submitted that the Government of Ecuador has repeatedly and consistently referred to Perenco as a French company.<sup>792</sup> It referred to statements by President Correa, Minister Derlis Palacios and Ecuador’s Attorney General in February and March 2009, where they referred to Perenco as a French company, and the brewing dispute as having implications for its relationship with the French Government.<sup>793</sup> Ecuador’s representatives met with French government representatives, not Bahamian representatives.<sup>794</sup> Perenco submitted that “[a]s Prof. Schreuer has explained, under 25(2)(b) of the ICSID Convention, ‘the host State’s awareness of [the] objective fact [of foreign control] over a local company’ is an element of a control analysis”, and that “the host State’s awareness of the nationality of foreign controllers has been a decisive factor in ICSID jurisprudence.”<sup>795</sup>
504. Second, Perenco contended that Ecuador’s argument that the use of the word “controlled” in Article 1(3)(ii) of the Treaty must be read to mean “controlled directly” should be rejected because it is “refuted by the plain language of the Treaty, by pertinent components of its *travaux préparatoires*, and by prior investment treaty jurisprudence.”<sup>796</sup>
505. The plain meaning of “control” did not, in Perenco’s view, connote “direct control.”<sup>797</sup> It encompassed both direct and indirect forms of control.<sup>798</sup> It submitted that Ecuador had not

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<sup>791</sup> Revised Memorial, paragraphs 90- 9; Reply, paragraphs 10 and 17.

<sup>792</sup> Reply, paragraphs 99-104.

<sup>793</sup> Reply, paragraph 100.

<sup>794</sup> Reply, paragraph 101.

<sup>795</sup> Reply, paragraphs 102-103, citing CA-373, Schreuer, p 314, paragraph 819; and ICSID jurisdictional decisions in *SOABI v. Senegal* (CA-166), paragraphs 45 and 53, and *African Holding v. Democratic Republic of the Congo* (CA-143), paragraph 101.

<sup>796</sup> Reply, paragraph 9.

<sup>797</sup> Reply, paragraph 20.

offered the Tribunal one citation of a dictionary definition of the term which defined it as limited to “direct control.”<sup>799</sup> Indeed, the definitions proffered confirmed that the ordinary meaning of control encompassed both direct and indirect forms of control.<sup>800</sup> For example, a Black’s Law Dictionary definition provided by Ecuador stated that “to control is: To exercise power or influence over...To have a *controlling interest* in[.]”<sup>801</sup> Perenco submitted that to exercise power or influence over a company could not reasonably be said to be “limited to being its direct 100% shareholder.”<sup>802</sup> Moreover, Perenco challenged Ecuador for having failed to provide the full citation of the definition; that it followed on in the same page to refer to “[t]he direct or indirect power to direct the management and policies of a person or entity whether through ownership of voting securities, by contract or otherwise [...]”.<sup>803</sup>

506. Perenco argued that the *travaux* confirmed that the negotiating parties “did not agree to limit the term ‘control’ to direct control.”<sup>804</sup> Perenco in the first instance submitted that recourse to the *travaux* was inappropriate because the text of the Treaty was in its view unambiguous, and that the *travaux* was incomplete and for this reason could not stand as definitive.<sup>805</sup> In the second instance it submitted that if the Tribunal should see fit to refer to the *travaux*, it was significant that “a proposal to limit explicitly the definition of ‘company’ to ‘all juridical persons controlled directly by nationals of one of the Contracting Parties’ was in fact rejected”.<sup>806</sup> This was a reference to the two undated drafts described above at paragraphs 497-498, Perenco placing considerable emphasis on the handwritten qualification of the term “(or indirectly)” in the first undated draft, and then the altogether deletion of the phrase “directly or

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<sup>798</sup> Reply, paragraphs 18-20.

<sup>799</sup> Revised Memorial, paragraphs 21- 26; see also, Reply, paragraphs 21-26.

<sup>800</sup> Reply, paragraph 21.

<sup>801</sup> Reply, paragraph 21, quoting from Counter-Memorial, paragraph 120, in turn citing EL-79 [Emphasis in original].

<sup>802</sup> Reply, paragraph 21.

<sup>803</sup> EL-79, emphasis added by the Claimant. The Claimant also referred to French and Spanish legal dictionary definitions: “The leading French legal dictionary, for example, defines the term “*contrôle*” as applied to corporate entities as “[t]he opportunity for a company to determine directly or indirectly, by means of rights or contracts, the policy of another company . . . .” *Vocabulaire juridique*, CA-178. Likewise, in Spanish, the noun “control” is defined as “domain, order or preponderance.” *Diccionario de la lengua española*, CA-179.

<sup>804</sup> Reply, paragraph 20.

<sup>805</sup> Reply, paragraph 28.

<sup>806</sup> Reply, paragraph 31.

indirectly” in the second which ultimately was the version carried over into the final text.<sup>807</sup> Perenco further contended that if “the parties had wished to restrict the definition of ‘company’ as Ecuador proposes, they could also have adopted the formulation they inserted in Article 9 of the Treaty, which refers to a company ‘a majority of whose shares were held, prior to the dispute, by nationals or companies of the other Contracting Party...’”.<sup>808</sup>

507. Moreover, responding to Ecuador’s contention that the insertion of the phrase “indirectly or directly” in the definition of “investment” and the simultaneous deletion of the same phrase from the definition of company informed its interpretation, Perenco submitted that “[i]f the term ‘investment’ had not been expanded to include investments belonging ‘indirectly or directly’ to nationals or companies of the other Contracting Party, then individuals holding an indirect *minority or non-controlling* interest in the investment would not have been covered by the Treaty”.<sup>809</sup>

508. Finally, Perenco relied on what it termed “a long line of investment arbitration jurisprudence holding that the term ‘control’ is to be construed expansively, in favor of jurisdiction”,<sup>810</sup> citing *Tokios Tokelès*,<sup>811</sup> *Wena Hotels*,<sup>812</sup> and *Siemens*.<sup>813</sup> Perenco argued that they demonstrated an “unwillingness to impose a requirement of ‘direct’ ownership or control where a treaty does not explicitly include that term.”<sup>814</sup> It further relied on decisions in *SOABI v. Senegal* and *AIG v. Republic of Kazakhstan*, characterising them as having recognised the “incongruity of restricting the definition of ‘control’ where that term is unqualified given the complex structures of modern businesses, which frequently make use of intermediate holding companies

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<sup>807</sup> Reply, paragraphs 32-35.

<sup>808</sup> Reply, paragraph 41, referring to Exhibit CE-7, Treaty, PER 00522.

<sup>809</sup> Reply, paragraphs 43-44, 47-50 [Emphasis in original.].

<sup>810</sup> Reply, paragraph 20.

<sup>811</sup> CA-168, Decision on Jurisdiction, paragraphs 31-32 (denying the “Respondents request to restrict the scope of covered investors through a control-test”).

<sup>812</sup> CA-172, Decision on Jurisdiction, p 887.

<sup>813</sup> CA-165, Decision on Jurisdiction, paragraph 137.

<sup>814</sup> Reply, paragraphs 54-55.

in order to structure their investments optimally.”<sup>815</sup> To interpret the term in this case any differently would be “unprecedented” and would ignore “commercial realities.”<sup>816</sup>

### **(3) The Tribunal’s Decision**

509. The Tribunal begins by noting that the State parties included the bare word “controlled” in the Treaty. Had they also retained the word “directly” only, the Respondent’s objection would dispose of the Treaty claim. However, the deletion of the phrase “directly or indirectly” when referring to “controlled” does not materially differ from the unelaborated use of the word “controlled” in that, as the Claimant has shown with numerous examples, legal dictionaries commonly note that courts and tribunals will interpret the word “control” to extend beyond direct control to indirect control.<sup>817</sup>
510. In this respect, the Tribunal is satisfied that the Claimant is correct in asserting that the ordinary meaning of the term “controlled” encompasses direct and indirect control.
511. The Respondent contends that “the interpreter’s task under Article 31 of the VCLT is to select, from amongst the range of possible meanings of the word controlled, the ordinary meaning in the context of the Treaty as a whole.”<sup>818</sup> The Respondent accepts, however, that one of the possible meanings “of the term control ‘encompasses’ both direct and indirect forms of control, including majority equity ownership”.<sup>819</sup> Where it diverges from the Claimant is whether this is the correct meaning when the interpreter follows the Vienna Convention’s requirement that it read the ordinary meaning of the word “controlled” in the context of the Treaty and in light of its object and purpose, and having regard to the Treaty as a whole.
512. In this regard, it is significant that an object and purpose of the Treaty was to attract foreign investment and it is not unusual for foreign investors to use a variety of corporate vehicles to achieve the benefit of an investment. This must have been in the minds of the negotiating

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<sup>815</sup> Reply, paragraph 55; CA-166, Decision on Jurisdiction, paragraph 37; CA-144, paragraph 9.4.8(3).

<sup>816</sup> Reply, paragraph 56.

<sup>817</sup> Claimant’s Counter-Memorial on Jurisdiction, paragraph 11.

<sup>818</sup> Respondent’s Reply on Jurisdiction, paragraph 26.

<sup>819</sup> *Ibid.*

teams on both sides in finalising the Treaty and they chose to retain the possibility that a legal entity incorporated in a third State could claim standing under the Treaty.

513. Nevertheless, it can be accepted that on one reading of the Treaty, on the facts of this case, it could be concluded that the person that controls PEL is Perenco S.A., not the latter's ultimate parent company, PIL, or the Perrodo family. But given that the Respondent "crossed the Rubicon" when it conceded – as was entirely right and proper to do given the plain wording of Article 1(3)(ii) – that PIL, even though a creature of Bahamian law, had a right of standing to bring a claim if it could show that it was controlled by the heirs, one can ask how the Treaty's object and purpose would be undermined by recognising a right of standing in one Bahamian company, but not in another which is plainly and indisputably controlled by the one which the Respondent was prepared to acknowledge did have standing.<sup>820</sup>
514. The Tribunal will revert to the issue of legal title, but for the present it notes that the totality of the evidence, i.e. the Perrodo family's complete ownership of the estate under French law, Bahamian law's recognition of that ownership interest, the steps taken to permit three of the four heirs, in particular François Perrodo, to participate in the overall direction and control of PIL by means of membership in the board prior to PEL's consenting to ICSID arbitration, the eventual registration of all of the late Hubert Perrodo's shares in the names of the heirs, and ultimately the fact that there is simply no evidence of any other person(s) who asserted a claimed interest in the estate taken together is compelling evidence that, quite apart from their legal title to the shares, shows that the Perrodo family was in every other respect plainly the owners of PIL as a matter of fact and as a matter of French law before formalising such ownership as a matter of Bahamian law. In this sense, even though the heirs did not possess legal title to the shares, it is undisputed they were the owners of all of the estate, including the shares, under the law governing the distribution of the late Mr. Hubert Perrodo's estate.
515. This is not to diminish the significance of the fact that at the time that PEL provided its consent to ICSID arbitration none of the shares of PIL, except for the 7.1% shareholding owned by François Perrodo's holding company, Glenmor Energy Limited, were owned by any of the Perrodos in the sense of their holding *legal* title to the shares.

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<sup>820</sup> Claimant's Counter-Memorial on Jurisdiction, paragraphs 37-44.

516. In this respect, the Tribunal accepted the evidence of Mr. Brian Moree QC, as an accurate statement of Bahamian law. However, Mr. Moree QC also acknowledged that Bahamian law recognised French law as being the law applicable to the devolution of the estate, and further that until such time as the Letters of Administration applicable to the re-registration of shares owned by a person who died intestate was effected, under Bahamian law their ownership was deemed to be vested in a judge of the Supreme Court. He readily acknowledged that it was not open to a judge to in any way diminish the estate or distribute it other than in accordance with the law.<sup>821</sup>
517. Mr. Moree QC also agreed with the suggestion that the act of the Supreme Court in authorising the registration of the shares in the names of the heirs was ministerial and would have to be forthcoming in the event of adequate proof of their entitlement.<sup>822</sup> He opined that the fact of registration is one of great legal significance in terms of vesting the shareholders with such rights as accrued to them under Bahamian company law.<sup>823</sup> In the Tribunal's view, there is no doubt that this is the case.
518. It can be fairly asked why an international tribunal which derives its jurisdiction from an international treaty specifically concerned with the reciprocal promotion and protection of investment ought not to be concerned with the formalities of the law of the particular State pursuant to which a company has been incorporated when considering the ownership and governance of that company. Title to the shares of course specifies the precise extent of the shareholder's ownership in the company, establishes each shareholder's right to participate in the making of decisions which can be made by the shareholders alone, and is the means by which shareholders are identified for the purposes of convening meetings.
519. Thus, since the Claimant is a creature of Bahamian law, the Tribunal must look to the operation of that law. The point was made by the International Court of Justice in the *Barcelona Traction* case, where it observed:

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<sup>821</sup> Transcript, Hearing on the Merits, Day 6, p 1481 (Testimony of Mr. Brian Moree QC).

<sup>822</sup> *Ibid.*, p 1482.

<sup>823</sup> *Ibid.*, p 1486.

In this field international law is called upon to recognize institutions of municipal law that have an important and extensive role in the international field. This does not necessarily imply drawing any analogy between its own institutions and those of municipal law, nor does it amount to making rules of international law depended upon categories of municipal law. All it means is that international law has had to recognize the corporate entity as an institution created by States in a domain essentially within their domestic jurisdiction. This in turn requires that, whenever legal issues arise concerning the rights of States with regard to the treatment of companies and shareholders, as to which rights international law has not established its own rules, it has to refer to the relevant rules of municipal law.<sup>824</sup>

520. Both general international law and the applicable bilateral Treaty lack the specificity and particularity of municipal law (e.g. French law, Ecuadorian law, or Bahamian law) in terms of the ordering of corporate relationships and neither purports to regulate such spheres of corporate activity in detail.
521. As a matter of Bahamian law, the Perrodo heirs did not own the PIL shares as of the date of consent. Ought this not to disentitle them from claiming indirect control over PEL? Should the Tribunal not accord significant weight to this legal fact?
522. Given the absence of detailed general or conventional rules of international law governing the organisation, operation, management and control of an enterprise, a tribunal should in principle be guided by the more detailed prescriptions of the applicable municipal law.<sup>825</sup> But at the same time, international law does not tend to permit formalities to triumph over fundamental realities.<sup>826</sup> By way of example, in the field of diplomatic protection (which may, depending

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<sup>824</sup> Case Concerning the Barcelona Traction, Light and Power Company, Limited (Belgium v. Spain), Judgment, I.C.J. Reports 1970, p. 3, paragraph 38 (“*Barcelona Traction*”).

<sup>825</sup> *Barcelona Traction*, paragraph 38.

<sup>826</sup> See *Banro American Resources, Inc and Société Aurifère du Kivu et du Maniema S.A.R.L. v. Democratic Republic of Congo*, ICSID Case No. ARB/98/7, Award (1 September 2000), at paragraph 11; *Tokios Tokelès v. Ukraine*, ICSID Case No. ARB/02/18, Dissenting Opinion of Professor Proper Weil (26 July 2007), paragraphs 24-25. *Aguas del Tunari, S.A. v. Republic of Bolivia*, ICSID Case No. ARB/02/3, Dissenting Declaration of José Luis Alberro-Semerena (21 October 2005), at paragraphs 34-35: “Many cases underline the importance of the Tribunal’s authority to interpret access provisions past formal interpretations to actual relationships...To resort to a mechanistic interpretation of control would be to go against the historical development of the concept.” Campbell McLachlan QC in *International Investment Arbitration: Substantive Principles* (London: OUP, 2010) states at [5.87]: “Perhaps the most striking similarity between the AdT and Tokios dissents is that while they clearly do not at present form part of the development of substantive principles of international investment arbitration, they nonetheless stand as a plausible source of international law scholarship. Such scholarship, in the absence of a system of precedent, may be relied on by future tribunals and could contribute to the reshaping of the international law landscape even as the contours of the landscape are being drawn. The ‘flexible approach’ to

upon the issue, be relevant to the interpretation of a BIT), when claims commissions and arbitral tribunals have determined whether it is a person who holds the legal interest as opposed to a person who holds the beneficial interest in shares that is entitled to seek diplomatic protection, they have consistently found that it is the beneficial interest which is deserving of protection.<sup>827</sup>

523. The diplomatic protection cases are not directly on point because where claims commissions and tribunals have recognised the owners of beneficial interests, it has been in the context of determining whether such beneficial owners were proper claimants even though they lacked legal title to the assets in respect of which they were making a claim.<sup>828</sup> The present case is different in that the beneficial owners of PIL at the material time are *not* claimants, but are rather adducing evidence of their legal interests under French law and their beneficial interests under Bahamian law in order to demonstrate that the Bahamian company that they ultimately control is a proper claimant under the France-Ecuador Treaty.

524. A similar tension between the choices of proceeding on formalities or the fundamental economic facts is evident in ICSID jurisprudence on the scope of the bare use of the word “controlled” when determining the standing of a juridical person.<sup>829</sup> In *Aguas del Tunari, S.A.*

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piercing and to indirect’ has by no means been consigned to the dustbin of international law.” See also, *Occidental Petroleum Corporation and Occidental Exploration and Production Company v. Republic of Ecuador*, ICSID Case No. ARB/06/11, Dissenting Opinion of Professor Brigitte Stern (5 October 2012), paragraph 148: “As far as the position of international law towards beneficial owners, in cases where the legal title and the beneficial ownership are split, is concerned, it is quite uncontroversial, after a thorough review of the existing doctrine and case-law, that international law grants relief to the owner of the economic interest.”

<sup>827</sup> David J. Bederman, *Beneficial Ownership of International Claims* (1989) Int’l & Comp. Law Quarterly, Vol. 38(4) 935 at 936 (“The notion that the beneficial (and not the nominal) owner of property is the real party-in-interest before an international court may be justly considered a general principle of international law.”) and 945; M. Whiteman, *Digest of International Law* (1967), Vol. 8, pp 1261-1262.

<sup>828</sup> *American Security and Trust Company Claim*, (1958-II (26)) International Law Reports (London: Butterworths, 1963) at p 322 (US Foreign Claims Settlement Commission): “It is clear that the national character of the claim must be tested by the nationality of the individuals holding a beneficial interest therein rather than by nationality of the nominal or record holder of the claim. Precedents for the foregoing well-settled proposition are so numerous that it is not deemed necessary to document it with a long list of authorities ...”; *Howard Needles Tammen & Bergendoff v. The Government of the Islamic Republic of Iran* (Case No. 68), Iran-U.S. C.T.R. Vol. 11 (Cambridge: Grotius Publications, 1988) 302 at pp 312-313. Note that an additional distinguishing factor in this jurisprudence is the term used in its constitutive document, usually a settlement agreement, with respect to standing. The term commonly used is “interest”, whether “directly or indirectly, an interest” (Iran-US Claims Tribunal) or “substantial and bona fide interest” (American-Mexican Claims Commission).

<sup>829</sup> *Aguas del Tunari, S.A. v. Republic of Bolivia*, ICSID Case No. ARB/02/3, Decision on Respondent’s Objections to Jurisdiction, (21 October 2005), paragraph 264 (“*Aguas del Tunari*”); see also, Dissenting Declaration of José Luis Alberro-Semerena, paragraphs 24-26 (“*Dissent of Alberro-Semerena*”).

*v. Republic of Bolivia*, the tribunal considered the definition of the phrase “controlled directly or indirectly.” The issue before it did not centre on the significance of “directly or indirectly”, but whether the term “controlled” referred to formal legal ownership or extended to actual exercise of control.<sup>830</sup> The majority of the tribunal concluded that the “ordinary meaning of ‘control’ would seemingly encompass both actual exercise of powers or direction and the rights arising from the ownership of shares.”<sup>831</sup> It added that, as for the legal definition, it “also encompasses both the actual exercise of control and the right to control”.<sup>832</sup> In his dissent, Mr. José-Luis Alberro-Semerena suggested that since the word “controlled” was a past participle, encompassing the effect of an action rather than just the capacity to perform said action, the standing of a juridical person was established with evidence that it has received the effect of actions of the controlling entity.<sup>833</sup> In his view it was “incorrect to equate ‘controlled’ and ‘control’” and “[o]ne should be ‘aware of the general principle of interpretation whereby a text ought to be interpreted in the manner that gives it effect – *ut magis valeat quam pereat*.”<sup>834</sup>

525. The tribunal members in *Aguas del Tunari* stood in agreement in one significant respect; that is, the necessity of considering more than the formal capacity to control the juridical entity. They diverged on whether this, in and of itself, can establish standing.

526. In the exceptional circumstances of this case, where *except* for legal title under Bahamian law, French nationals manifested every indicia of control over the shares of PIL – including legal ownership under the *lex situs* of the estate – the Tribunal is of the view that it cannot take a formalistic approach to the question of control. In this regard, the decision of the NAFTA Tribunal in *International Thunderbird Gaming Corporation v United Mexican States* warrants note. That tribunal found that Article 1117 of the NAFTA which requires that the investor bringing a claim on behalf of an enterprise demonstrate that it “own[s] or control[s]” the enterprise, could be satisfied by a showing of *de facto* control:

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<sup>830</sup> *Ibid.*

<sup>831</sup> *Aguas del Tunari*, paragraph 227.

<sup>832</sup> *Aguas del Tunari*, paragraph 231. The Respondent at the hearing relies on the majority decision, stating “the test for “control” presupposes an ownership interest” (Transcript, Day 1, p 239 (Mr. Gal)). The Tribunal accepts that the majority in *Aguas del Tunari* emphasised the significance of ownership interest, but it did not exclude the relevance of evidence of actual exercise of control (see paragraphs 227 to 231 of *Aguas del Tunari*).

<sup>833</sup> *Dissent of Alberro-Semerena*, paragraph 26.

<sup>834</sup> *Dissent of Alberro-Semerena*, paragraph 32 [footnote omitted].

“The Tribunal does not follow Mexico’s proposition that Article 1117 of the NAFTA requires a showing of legal control. The term “control” is not defined in the NAFTA. Interpreted in accordance with its ordinary meaning, control can be exercised in various manners. *Therefore, a showing of effective or “de facto” control is, in the Tribunal’s view, sufficient for the purposes of Article 1117 of the NAFTA. In the absence of legal control however, the Tribunal is of the opinion that de facto control must be established beyond any reasonable doubt.*

Despite Thunderbird having less than 50% ownership of the Minority EDM Entities, the Tribunal has found sufficient evidence on the record establishing an unquestionable pattern of de facto control exercised by Thunderbird over the EDM entities. Thunderbird had the ability to exercise a significant influence on the decision-making of EDM and was, through its actions, officers, resources, and expertise, the consistent driving force behind EDM’s business endeavour in Mexico.”<sup>835</sup> [Emphasis added]

527. In light of the above, it is significant that the evidence is that as of 17 October 2007, the French nationals had legal ownership of the shares under French law, a fact recognised by Bahamian law, and they have established that at that date they had *de facto* control of PIL and through it the Bahamian subsidiaries.
528. Having regard to the fact that the text of the applicable provision of the Treaty refers simply to “controlled”, the Tribunal is persuaded by the fact that the formal transfer of the shares of the late Mr. Hubert Perrodo to his heirs was an administrative or ministerial act. It is true that it occurred after the consent to ICSID arbitration was given, but it is also true that it could have occurred at any time after the heirs became the owners of the estate under French law, and that occurred at the time of death, namely, 29 December 2006, over 10 months prior to the giving of consent.
529. Moreover, the evidence of French control is so substantial, so compelling and un-contradicted that it is the Tribunal's view that in the circumstances of this case, it is most consonant with the approach taken by international law to give weight to the fact of Bahamian law’s recognition that the heirs owned the shares as a matter of French law and as a result they had beneficial

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<sup>835</sup> *International Thunderbird Gaming Corporation v United Mexican States*, UNCITRAL, Award (26 January 2006), paragraphs 106-107.

ownership of the shares as a matter of Bahamian law prior to their formal re-registration in the names.<sup>836</sup>

530. For the foregoing reasons, the Tribunal dismisses the Respondent's objection to the Claimant's standing to bring the claim under the Treaty.

## VIII. CLAIMS OF BREACH OF TREATY

531. The Tribunal begins by identifying the law applicable to the claims of breach of Treaty, before turning to consider the parties' submissions and its findings on liability.

### A. Law applicable to the claims relating to the Treaty

532. The Tribunal observes that, unlike the Participation Contracts, which specify Ecuadorian law as the applicable law, the Treaty does not contain an express applicable law clause. Accordingly, the Tribunal must apply Article 42(1), second sentence, of the ICSID Convention, which provides as follows:

In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable.

533. This requires the Tribunal to apply Ecuadorian law and international law. It is well-established that the Treaty itself, as conventional law, falls within the phrase "such rules of international

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<sup>836</sup> In some of the commentaries and cases there has been some discussion of the desirability of avoiding undue formalism when it comes to establishing a claimant's standing to bring a claim. For example, in *Banro American Resources, Inc and Société Aurifère du Kivu et du Maniema S.A.R.L. v. Democratic Republic of the Congo*, ICSID Case No. ARB/98/7, Award (1 September 2000), at paragraph 11, the tribunal stated: "These few examples demonstrate that in general, ICSID tribunals do not accept the view that their competence is limited by formalities, and rather they rule on their competence based on a review of the circumstances surrounding the case, and, in particular, the actual relationships among the companies involved. This jurisprudence reveals the willingness of ICSID tribunals to refrain from making decisions on their competence based on formal appearances, and to base their decisions on a realistic assessment of the situation before them." The examples to which the *Banro* tribunal referred were cases where the claimant, as the party requesting arbitration, was not the same entity as the parties consenting to arbitration, and it was suggested by the tribunal that in such cases tribunals are willing to consider the nationalities of the consenting party and the claimant when making their determinations on jurisdiction. *Banro* has been discussed and distinguished from the case before the tribunal in the majority decision in *Tokios Tokelès v. Ukraine*, ICSID Case No. ARB/02/18, Decision on Jurisdiction (29 April 2004) at paragraph 58, and discussed in the dissenting opinion of Professor Prosper Weil in the same case (see his dissenting opinion in paragraphs 25-26), and by the dissenting opinion of Horacio Grigera Naón in *Murphy Exploration and Production Company International v. Republic of Ecuador*, ICSID Case No. ARB/08/4, Award on Jurisdiction (15 December 2010), paragraphs 20-21.

law as may be applicable.” The Report of the Executive Directors on the Convention noted in this regard that the term ‘international law’ as used in Article 42(1), second sentence, “should be understood in the sense given to it by Article 38(1) of the Statute of the International Court of Justice, allowance being made for the fact that Article 38 was designed to apply to inter-State disputes.” A bilateral investment treaty falls within Article 38’s description of international law.<sup>837</sup>

534. The Tribunal therefore finds that the applicable law for the purposes of this claim is Ecuadorian law (as already considered by the Tribunal) and the Treaty. In the event that there is a conflict between the two, on the basis of well-established principle recognised in international judicial and arbitral case law as well as in Article 27 of the Vienna Convention on the Law of Treaties and Article 3 of the International Law Commission’s Articles on Responsibility of States for Internationally Wrongful Acts, international law prevails.<sup>838</sup>

## **B. Fair and Equitable Treatment under Article 4 of the Treaty**

### **(1) The Treaty**

535. Article 4 of the Treaty provides as follows:

Each Contracting Party shall undertake to accord just and equitable treatment, in accordance with the principles of international law, to the investments of nationals and companies of the other Contracting Party and to ensure that the exercise of the right so granted is not impeded either *de jure* or *de facto*.

In particular, but not exclusively, the following shall be considered as *de jure* or *de facto* impediments to just and equitable treatment: any restrictions on the

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<sup>837</sup> Report of the Executive Directors on the Convention, paragraph 40.

<sup>838</sup> As noted by the Permanent Court of International Justice in the *Case of the Greek-Bulgarian Communities*: “... it is a generally accepted principle of international law that in the relations between Powers who are contracting Parties to a treaty the provisions of municipal law cannot prevail over those of the treaty.” PCIJ Series B, No. 17, p 32. It follows from that principle, as recognised the *Case of the Treatment of Polish Nationals in Danzig*, that a State “cannot adduce against another State its own Constitution with a view to evading obligations incumbent upon it under international law or treaties in force.” PCIJ Series A/B. No. 44, p. 24. See also, Vienna Convention on the Law of Treaties, Article 27, Internal law and observance of treaties: “A party may not invoke the provisions of its internal law as justification for its failure to perform a treaty.” Article 3 of the ILC Articles on State Responsibility, entitled, “Characterisation of an act of a State as internationally wrongful,” states: “The characterisation of an act of a State as internationally wrongful is governed by international law. Such characterisation is not affected by the characterisation of the same act as lawful by internal law.” Both Article 27 and Article 3 have been applied consistently by ICSID and other investment treaty arbitral tribunals.

purchase or transportation of raw materials and secondary materials, energy and fuel, and means of production and operation of all kinds, any impediment to the sale or transportation of goods within the country and abroad, and any other measures having similar effect.

Investments made by nationals or companies of one Contracting Party shall be fully and completely protected and safeguarded by the other Contracting Party.

Neither Contracting Party shall in any way impede the management, preservation, use, enjoyment or transfer of the investments of nationals or companies of the other Contracting Party.<sup>839</sup>

## (2) The Parties' Positions

### a. *The Claimant's Position*

536. Perenco submitted that Law 42, both at 50% and at 99%, as well as other measures Ecuador took in relation thereto amounted to a breach of the fair and equitable treatment obligation in Article 4.<sup>840</sup>

537. According to Perenco, the objective of the fair and equitable treatment standard is to:

“...provide to international investments treatment that that does not affect the basic expectations that were taken into account by the foreign investor to make the investment, as long as these expectations are reasonable and legitimate and have been relied upon by the investor to make the investment.”<sup>841</sup>

538. Perenco argued that its basic expectations were largely set forth in the Participation Contracts.<sup>842</sup> It had a legitimate expectation that Ecuador, by entering into the Participation

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<sup>839</sup> Exhibit CE-7, Treaty, PER 00520.

<sup>840</sup> Amended Request, paragraph 34.

<sup>841</sup> Revised Memorial, paragraph 155, quoting from *Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania*, ICSID Case No. ARB/05/22, Award (24 July 2008) (CA-5), paragraph 602. The *Biwater* tribunal articulated this in connection with its explanation of the content of the fair and equitable treatment standard; it identified as components of the standard the “protection of legitimate expectations,” the principle that “contracting parties must act in good faith” and that the “conduct of the State must be transparent, consistent and non-discriminatory.”

<sup>842</sup> Revised Memorial, paragraph 156: “They included the expectation that the fundamental economic deal was settled based on the participation sharing agreed in the Contracts, that this was a stable basis for investing, and that should disputes arise they would be settled by an orderly and peaceable process of international arbitration rather than through local Ecuadorian procedures.” In its Reply, Perenco clarified the relationship between the terms of the Participation Contracts and its legitimate expectations; the Participation Contracts “did not delimit the investor expectations that Ecuador created”, though they “certainly reflected and reinforced these expectations.” (Reply, paragraph 283).

Contracts, agreed to tie the parties' participation exclusively to the volume of production generated by the contractor, thereby isolating it from oil price fluctuations, and that it would not upset the underlying commercial bargain arrived at by taking action which would result in drastic changes to participation percentages in response to price fluctuations in the global market.<sup>843</sup> Ecuador undermined this expectation by enacting and enforcing Law 42.<sup>844</sup> This was compounded by the raising of the percentage of revenues demanded by Law 42 to 99% on 4 October 2007,<sup>845</sup> the purpose of which was to "force companies like Perenco to 'open the profit box' – essentially to take income that Perenco had borne all risk and expense to earn and that by the originally agreed allocation formulae belonged to Perenco."<sup>846</sup>

539. Perenco submitted that it also held a reasonable expectation that the Participation Contracts would not be amended given their clause 15.2 which required the prior agreement of the parties for any amendments, this reinforced by statements of Ecuadorian Government officials in 2005.<sup>847</sup> It relied on this understanding of the underlying commercial bargain when it chose to put enormous capital at risk in Ecuador,<sup>848</sup> combined with the serious steps Ecuador had taken to encourage foreign investment in Ecuador.<sup>849</sup> In this way, Perenco argued it was justified in its "eminently reasonable expectation" that Ecuador "would not take away the reward of the

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<sup>843</sup> Amended Request, paragraph 34; Revised Memorial, paragraphs 156-159, 169. At paragraph 282 of the Reply, Perenco summarised its claim against Ecuador in the following terms: "Ecuador thus deliberately created an environment in which a contractor could expect that it would operate under a production sharing model where the economic benefit was allocated between the contractor and the State based on an agreed percentage of production, that the contractor would not be unilaterally and coercively forced to abandon this model for a less profitable services contract, and that any disputes over such economic matters would be peaceably resolved through binding international arbitration."

<sup>844</sup> Revised Memorial, paragraph 167; Reply, paragraph 287. In this regard, Perenco, at paragraph 287 of its Reply, characterised Ecuador's conduct as having "concede[d] that the motive for these contractual amendments was to achieve the State's goal of imposing services contracts in place of participation contracts, thus undoing what the prior governments had done."

<sup>845</sup> Pursuant to the Second Implementing Regulation: Exhibit CE-64, Decree No. 662, Implementing Law 42. For a description of events leading up to the enactment of Executive Decree No. 662, see above at paragraphs [100] to [109].

<sup>846</sup> Revised Memorial, paragraph 167.

<sup>847</sup> Revised Memorial, paragraph 160–161. Clause 15.2 may be reviewed at PER 04703 of Exhibit CE-10, Block 21 Participation Contract, and at PER 04829 of Exhibit CE-17, Block 7 Participation Contract.

<sup>848</sup> Revised Memorial, paragraph 159.

<sup>849</sup> *Ibid.*, paragraph 162. Perenco claimed that Ecuador in the years preceding its decision to invest actively courted foreign investment "through a wide range of official actions," including though not limited to "liberalization of laws concerning the oil industry, such as the amendment to the [Hydrocarbons Law] that permitted participation contracts" and "active Government support and encouragement for large scale investment required to construct the OCP pipeline": see Revised Memorial, paragraph 162.

investment once it had successfully managed the risk of that investment.”<sup>850</sup> In this connection, Perenco contended that when it sought in good faith to negotiate with Ecuador, Ecuador responded inflexibly and unpredictably, ignoring its obligation to negotiate a correction factor and to abide by the Decision on Provisional Measures.<sup>851</sup>

540. Perenco further submitted that it had a legitimate expectation that disputes regarding the investment would be “resolved peaceably through an international arbitration process at ICSID.”<sup>852</sup> This expectation was buttressed by the Participation Contracts themselves, which expressly called for certain disputes to be resolved by ICSID arbitration.<sup>853</sup> Perenco maintained that the dispute resolution procedure was an important aspect of its agreement with Ecuador (set out in the Participation Contracts), on which it specifically relied.<sup>854</sup> In this connection, Perenco challenged Ecuador’s “defiance” of the Tribunal’s Decision on Provisional Measures as unfair and inequitable.<sup>855</sup>

541. Perenco claimed that Ecuador’s actions in direct contravention of Perenco’s legitimate expectations effectively removed a substantial portion of revenue to which Perenco was entitled and rendered its investment in Blocks 7 and 21 commercially unviable.<sup>856</sup> As such, it requested that the Tribunal issue an award which declares, amongst other things, that Ecuador failed to accord fair and equitable treatment to its investments in the Participation Contracts in breach of its obligations under Article 4 of the Treaty and should be ordered to pay monetary damages.

542. In addition, Perenco submitted that Ecuador breached Article 4 of the Treaty by interfering with the management, use, enjoyment and transfer of its investment in Blocks 7 and 21. That the right “to manage, use and enjoy its investments entailed that it would be permitted, within the contractual parameters, to operate the Blocks, to seek and produce oil, to further invest in

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<sup>850</sup> Amended Request, paragraph 34.

<sup>851</sup> Revised Memorial, paragraph 169.

<sup>852</sup> Revised Memorial, paragraph 163.

<sup>853</sup> *Ibid.*

<sup>854</sup> Revised Memorial, paragraphs 164-165.

<sup>855</sup> Reply, paragraphs 297-300.

<sup>856</sup> Amended Request, paragraph 34.

additional wells and infrastructure, to direct the activities of employees, and to earn and benefit from profits determined according to the agreed participation sharing formulae.”<sup>857</sup>

543. However, as a result of Law 42, the Implementing Regulations and Ecuador’s actions in relation thereto, Perenco contended that Ecuador “progressively and increasingly denied Perenco the various attributes of management, use and enjoyment of its investments”:

*First*, by enacting and enforcing Law 42, Ecuador deprived Perenco of substantial profits and blunted further investment in additional wells. *Second*, by lodging *coactivas* and commencing seizures Ecuador deprived Perenco of all its production, cargoes and revenue. *Third*, by seizing the Blocks themselves and terminating the Contracts Ecuador prevented Perenco from any management, use and enjoyment of the investments whatsoever.<sup>858</sup>

*b. The Respondent’s Position*

544. Ecuador for its part challenged whether the “legitimate expectation” as articulated by Perenco was consistent with the terms of the Contracts:

Where, as in the present case, it is said that the investment is a set of contractual rights conferred by the State, an investor’s purported ‘*expectation*’ within the meaning of Article 4 of the Treaty will neither be reasonable nor capable of reasonable reliance where it is inconsistent with the express terms of the contract between the investor and the State.<sup>859</sup>

545. Ecuador submitted that Perenco has failed to prove that Law 42 modified the economic bargain upon which the terms of the Contracts were premised.<sup>860</sup> It argued Law 42 could not modify the Contracts because on a strict reading of its terms it did not affect the participation in

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<sup>857</sup> Revised Memorial, paragraph 176; Reply, paragraph 328.

<sup>858</sup> *Ibid.* [Italics in original.].

<sup>859</sup> Counter-Memorial, paragraph 465 [Italics in original.]. At paragraphs 272–276 of its Reply, Perenco submitted in this regard that Ecuador improperly contends that its Treaty obligation of fair and equitable treatment is strictly bounded by the terms of the Participation Contracts.

<sup>860</sup> In this regard, Ecuador relies on the evidence of its expert, Dr. Aguilar. Dr. Aguilar at paragraphs 51-53 of his 3<sup>rd</sup> Expert Report states that Law 42 could not have modified the Participation Contracts because they established a participation in crude oil and Law 42 did not change the percentages of participation in oil, only “the benefit that can be obtained from its sale”, and further, that Law 42 was an administrative act which modified the legal framework governing the contracts and was not “an administrative act intended to alter one or more specific contracts.” Dr. Aguilar in his 4<sup>th</sup> Expert Report reiterates this distinction between the change in the legal framework applicable to the Participation Contracts and a modification in its terms, while acknowledging that it is apparent that the change in the legal framework had “an impact on the contractual relationship”: paragraphs 82-84.

volume of oil that Perenco was entitled to receive.<sup>861</sup> The Participation Contracts did not guarantee Perenco a right to a given revenue stream, let alone substantial profits.<sup>862</sup> Thus, Perenco faced an uphill battle in proving that Law 42 affected the economy of the Participation Contracts and further that a correction factor to the Consortium's participation in oil should have been negotiated between the parties.<sup>863</sup>

546. Ecuador suggested that Perenco's submission was in essence an argument that an investor may reasonably expect that the circumstances prevailing at the time it made its investment will remain unchanged.<sup>864</sup> It stressed that this was not just contrary to settled jurisprudence on this issue, but stood in stark contrast to the decision of the contracting parties not to include a stabilisation clause in their contracts.<sup>865</sup>

547. In this connection, Ecuador submitted that, at best, the "only expectation which Perenco could reasonably have entertained given the terms of its Participation Contracts with Ecuador was that the State would negotiate a correction factor to the participation percentages" in the event of a tax modification which disrupted the economy of the contracts.<sup>866</sup> However, in this respect Perenco has failed to discharge its burden of proving that the parties were obliged to negotiate a correction factor as a result of Law 42, and that the failure to negotiate (if it was obliged to do so) was due to the fault of Ecuador.<sup>867</sup> Ecuador argued that it was incumbent upon Perenco

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<sup>861</sup> Counter-Memorial, paragraphs 24, 469.

<sup>862</sup> Counter-Memorial, paragraph 495.

<sup>863</sup> Counter-Memorial, paragraph 24.

<sup>864</sup> Counter-Memorial, paragraph 471, citing *Saluka Investments BV (Netherlands) v. Czech Republic*, UNCITRAL, Partial Award (17 March 2006), paragraph 305 (CA-25). Perenco in its Reply, at paragraph 288, rejects this characterisation of its position, stating "[i]t is not Perenco's position that a State's laws cannot change over time, or that the circumstances prevailing at the time of the investment would 'remain totally unchanged' (citation omitted). However, this does not in and of itself mean that any subsequent regulation is compliant with a State's international obligations, particularly if the State created expectations as to the structure that would govern an investment." [Emphasis in original.]

<sup>865</sup> Counter-Memorial, paragraphs 473-475. Ecuador relies on statements of the tribunal in *Sergei Paushok, CSJC Golden East Company, CJSC Vostokneftegaz Company v. The Government of Mongolia*, UNCITRAL, Award on Jurisdiction and Liability (28 April 2011) (EL-103) which suggests that a tax stabilisation or correction clause is a significant factor when determining whether an investor legitimately held an expectation that it would not be exposed to significant tax modifications in the future (paragraph 302 of the Award).

<sup>866</sup> Counter-Memorial, paragraph 477.

<sup>867</sup> Counter-Memorial, paragraphs 479-484.

to provide the necessary financial impact data to Petroecuador in order for the adjustment process to be initiated.<sup>868</sup>

548. Regarding Perenco's claim that Ecuador breached Article 4 by interfering with Perenco's use and enjoyment of its investment, Ecuador submitted that the Participation Contracts did not preclude the State from enacting and enforcing Law 42 because they did not guarantee Perenco a right to a given revenue stream.<sup>869</sup> Moreover, Law 42 did not 'blunt' further investment as evidenced by the position adopted by Perenco during the provisional measures stage of this arbitration that it could feasibly continue to operate and commit to necessary expenditure in Ecuador if it paid the dues owed to Ecuador into an escrow account.<sup>870</sup>

549. Ecuador further submitted that Perenco could not contend that the events subsequent to the enactment of Law 42 and the termination of the Contracts interfered with the use and enjoyment of its investment since the State was acting pursuant to a lawfully enacted law, and was obliged to respond to Perenco's own illegal conduct.<sup>871</sup>

550. Furthermore, Ecuador submitted that Perenco's claims taken at its highest estimation is that Law 42 prevented its ability to act "within the contractual parameters" of the Participation Contracts, and that this cannot in and of itself constitute a breach of the Article 4 treaty standard because Article 4 requires Perenco to further demonstrate that "any impediment to its ability to exercise its contractual rights by the State was '*obviously arbitrary*' or involved some

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<sup>868</sup> *Ibid.*, paragraphs 478-488.

<sup>869</sup> Counter-Memorial, paragraph 495.

<sup>870</sup> Counter-Memorial, paragraph 496: "...Those dues, amounting to approximately US\$ 327 million were precisely the sums that Perenco offered, and the Arbitral Tribunal recommended at the preliminary measures stage, should be paid into escrow by Perenco. It was Perenco's case that it could perfectly well continue to operate, and make the necessary investments, if it paid those dues into escrow. In those circumstances, Perenco cannot reasonably contend that the manner in which Law 42 was applied in the instant case, including the lodging of *coactivas* and the system of seizures of oil, would have left it in any different position that which *it* proposed and the *Arbitral Tribunal* recommended." [Emphasis in original.]

<sup>871</sup> Counter-Memorial, paragraphs 495-498. In this regard, Ecuador contends that the temporary running of the Blocks and the action seeking the termination of the Participation Contracts were expressly provided for in the Contracts and Ecuadorian law as legitimate responses to Perenco's alleged breach of contract: Counter-Memorial, paragraph 497.

‘*tortuous element*’.”<sup>872</sup> Perenco had failed to substantiate this in its submissions with respect to Article 4.<sup>873</sup>

### (3) The Tribunal’s Decision

551. Although the unofficial English translation of the Treaty published by the United Nations Treaty Series uses the phrase “*just and equitable treatment*,” both disputing Parties have treated the phrase as if it is “*fair and equitable treatment*” and rightly so.
552. As set out above, the Claimant’s submissions focus on two parts of Article 4: (i) what might be called a general fair and equitable treatment argument advanced under Article 4, first paragraph, based upon Perenco’s legitimate expectations; and (ii) a somewhat different argument advanced under Article 4, fourth paragraph, based on the claim that by enacting Law 42 at 50% and by raising it to 99%, the Respondent impeded the management, preservation, use, enjoyment or transfer of Perenco’s investments.
553. Article 4 sets out the general obligation to “accord [fair] and equitable treatment, in accordance with the principles of international law” which is buttressed by the duty to ensure that the exercise of the rights so granted is not impeded (either *de jure* or *de facto*). Examples of such impediments are then set out in a non-exhaustive form in the second paragraph (“... [i]n particular, but not exclusively, the following shall be considered as *de jure* or *de facto* impediments to [fair] and equitable treatment...”). The second paragraph, which has not been emphasised by the Claimant, is evidently designed to elaborate upon the last part of the first paragraph.<sup>874</sup>
554. The fourth paragraph, which has been invoked by the Claimant, also uses the word “impede.” Given the use of this verb, it might also be thought to be, like the second paragraph, an elaboration of the kind of conduct which could constitute a *de jure* or *de facto* impediment. However, it can also be read as a separate obligation of a somewhat broader nature than the fair and equitable treatment obligations set forth in the first paragraph. This is the basis on which

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<sup>872</sup> Counter-Memorial, paragraph 500 [Emphasis in original.].

<sup>873</sup> Counter-Memorial, paragraphs 500-502.

<sup>874</sup> The third paragraph, which also has not been invoked by the Claimant, deals with the issue of full protection and security, and need not be addressed.

the Claimant has argued the case.<sup>875</sup> The Tribunal will proceed on the basis that it is a separate obligation.

555. The Tribunal will first deal with the general fair and equitable treatment claim and then consider the impediment claim.

*a. The general allegation of breach of fair and equitable treatment and the Claimant's legitimate expectations*

556. The Claimant's Article 4 claim has a number of separate, but interrelated strands. For the purposes of analysis, the Tribunal will differentiate between claimed expectations pertaining to the resolution of disputes arising under the Participation Contracts – i.e. the Claimant's entitlement to ICSID arbitration under the two Contracts and the Respondent's conduct in relation thereto – and its expectations of a more substantive nature – i.e. the impact on Perenco's expectations of the enactment of Law 42, the application of Decree 662, and various other measures taken by Ecuador in relation to Perenco's rights under the Participation Contracts. The Tribunal finds it convenient to deal with these expectations separately.

557. With respect to the general approach to be taken to the meaning of the fair and equitable treatment standard, Article 4 of the Treaty requires a Contracting Party to accord “[fair] and equitable treatment, in accordance with the principles of international law”.<sup>876</sup> This particular formulation of the standard is not tethered to the international minimum standard of treatment under customary international law.<sup>877</sup>

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<sup>875</sup> Perenco's rebuttal, at paragraphs 329-336 of the Reply, warrants note. Perenco stated that Ecuador conflates its rebuttal to the claim for breach of fair and equitable treatment with that of breach of the obligation not to impede or impair the investor's right to manage, use and enjoy; that there was in Ecuador's view no breach of the terms of the Participation Contracts. Perenco submitted that the latter obligation is distinct from the obligation to afford fair and equitable treatment, and the observance of contractual obligations (which Perenco disputes occurred in its case in any event) is not a sufficient answer.

<sup>876</sup> Exhibit CE-7, Treaty, Article 4, paragraph 1 (PER 00520).

<sup>877</sup> As noted by the tribunal in *AWG Group Ltd. v. Argentine Republic*, UNCITRAL, Decision on Liability (30 July 2010), which examined a similar treaty between Argentina and France (at paragraph 184): “With respect to the Argentina-France BIT, it is to be noted that the text of the treaty refers simply to ‘the principles of international law,’ not to ‘the minimum standard of customary international law.’ The formulation ‘minimum standard under customary international law’ or simply ‘minimum international standard’ is so well known and so well-established in international law that one can assume that if France and Argentina had intended to limit the content of fair and equitable treatment to the international minimum standards they would have used that formulation specifically. In fact, they did not.”

558. That said, as has been found by many other investment treaty tribunals presented with the task of ascertaining the standard's meaning – even where the applicable treaty contains no reference to customary international law – there is much to be said for the general approach stated by the tribunal in *Waste Management, Inc. v. United Mexican States*, which characterised conduct attributable to the State and injurious to the investor as violating the standard when it is:

...arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial propriety – as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candour in an administrative process.<sup>878</sup>

559. The inclusion of such words as “arbitrary,” the use of the adjectival modifiers “grossly” in relation to “unfair, unjust or idiosyncratic,” and “manifest” in relation to a failure of natural justice and “complete” in relation to a lack of transparency and candour implies a search for the ‘something more’ that distinguishes an act in violation of international law from the perceived unfairness occasioned by many governmental actions that do not rise to a breach of international law. The challenge is to discern between the two.

560. Many cases hold that a central aspect of the analysis of an alleged breach of the fair and equitable treatment standard is the investor's reasonable expectations as to the future treatment of its investment by the host State.<sup>879</sup> This requires the Tribunal to make an objective determination of such expectations having regard to all relevant circumstances.<sup>880</sup> The

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<sup>878</sup> *Waste Management, Inc. v. United Mexican States*, ICSID Case No. ARB (AF)/00/3, Award (30 April 2004), paragraph 98. This passage has been cited with approval by many non-NAFTA tribunals such as *Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania*, ICSID Case No. ARB/05/22, Award (24 July 2008), at paragraph 597: “This threshold is a high one. As stated by the tribunal in *Waste Management v. Mexico (No. 2)*...” (The tribunal then cited paragraph 98 of the *Waste Management II* award). In *Vannessa Ventures Ltd. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB(AF)/04/6, Award (16 January 2013), at paragraph 227, the tribunal commented: “Tribunals in other cases have pointed to be high threshold in this regard. In *Waste Management*, the award referred to ‘a lack of due process leading to an outcome which offends judicial propriety – as might be the case with the manifest failure of natural justice...’ The Tribunal considers that to be the correct approach.” See also *Deutsche Bank AG v. Democratic Socialist Republic of Sri Lanka*, ICSID Case No. ARB/09/2, Award (31 October 2012), at paragraph 420: “In this respect, the Tribunal notes that the standard has been rightly – although not exhaustively – defined in the *Waste Management II* case” (which the tribunal then proceeded to set out).

<sup>879</sup> *EDF (Services) Limited v. Romania*, ICSID Case No. ARB/05/13, Award (8 October 2009), paragraph 216; *El Paso Energy International Company v. Argentine Republic*, ICSID Case No. ARB/03/15, Award (31 October 2011), paragraph 339.

<sup>880</sup> *El Paso Energy International Company v. Argentine Republic*, ICSID Case No. ARB/03/15, Award (31 October 2011), paragraph 356; *EDF (Services) Limited v. Romania*, ICSID Case No. ARB/05/13, Award (8 October

expectations are not those exclusively of the investor and an undue reliance upon a claimant's subjective expectations expressed in the context of adversarial proceedings years after the investment's making, can result in a skewed view of what it could reasonably have expected when it made the investment. In *Saluka Investments BV v. Czech Republic* the tribunal observed, after having reviewed certain statements of prior tribunals, that if taken too literally, they would impose "obligations which would be inappropriate and unrealistic" on the host State.<sup>881</sup> The search is for a balanced approach between the investor's reasonable expectations and the exercise of the host State's regulatory and other powers.

561. In cases where a contract exists between the investor and the host State, the terms of the contract and the State's legislation in relation thereto, assume particular significance in the analysis. As has already been seen, the relevant administrative contracts exist not only as 'law between the parties' in Ecuador, but also within a broader framework of law, including the Civil Code, the Hydrocarbons Law, and the Constitution.

562. Where a State has duly considered a legislative/regulatory policy, as was the case in 1994 when Ecuador resolved that it was in the nation's interest to move from service to participation contracts, governmental decisions taken thereafter must, during the lifetime of such contractual arrangements maintain fidelity to that policy framework. This is not to say that the policy framework is frozen and cannot be changed because this is not so unless the State has expressly stabilised its law *vis-à-vis* its contractual counterparty.<sup>882</sup> But even as in the instant case, where there is no full stability clause in its contracts, any changes to the policy framework must still be made mindful of the State's contractual commitments.

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2009), paragraph 219; *Saluka Investments BV (the Netherlands) v. Czech Republic*, UNCITRAL, Partial Award, (17 March 2006), paragraph 304; *Jan Oostergetel and Theodora Laurentius v. Slovak Republic*, UNCITRAL, Final Award (23 April 2012), paragraph 224.

<sup>881</sup> *Saluka Investments BV (the Netherlands) v. Czech Republic*, UNCITRAL, Partial Award (17 March 2006), paragraph 304. See also *White Industries Australia Limited v. India*, UNCITRAL, Final Award (30 November 2011), paragraphs 10.3.5-10.3.6.

<sup>882</sup> As noted in *Total S.A. v. Argentine Republic*, ICSID Case No. ARB/04/01, Decision on Liability (27 December 2010), paragraph 101: "... Stabilisation clauses are clauses, which are inserted in State contracts concluded between foreign investors and host states with the intended effect of freezing a specific host State's legal framework at a certain date, such that the adoption of any changes in the legal regulatory framework of the investment concerned (even by law of general application and without any discriminatory intent by the host State) would be illegal."

563. The Participation Contracts were anchored in a legislative framework duly considered and enacted by the Nation's Congress.<sup>883</sup> That framework and its rationale set out certain key features of the new contractual regime which were then reflected in the contracts subsequently concluded with oil companies.<sup>884</sup> Consequently, any contractor could reasonably expect that the contracts' structure would not be altered by Petroecuador unilaterally or undone by subsequent State action external to the contract except in accordance with their terms and the State's law.

564. The dramatic rise in oil prices in the last decade should not be permitted to obscure this. Particularly after changes in government occur, States must seek to act consistently with, and governments cannot wilfully repudiate, long-term commercial relationships with foreign investors concluded by their predecessors.<sup>885</sup> New governments must bear in mind why the State engaged in such relationships in the first place, because resource extraction and other capital-intensive investments with substantial 'up-front' costs generally require a medium to long-term period of operations in order to be able to generate a reasonable return on investment. Such investments must be able to withstand deviations in governmental policy that could undermine their contractual framework.

i. What expectations did Perenco have at the time of the making of its investment?

565. There is no record evidence that the Respondent made any specific representations or gave any specific assurances to Perenco that induced it to acquire Kerr McGee's interests in the two contracts.

566. Mr. Patrick Spink, who evaluated the Kerr McGee opportunity for Perenco, testified that the company "took great comfort in the relatively clear terms of key aspects of the Participation

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<sup>883</sup> Exhibit CE-4, Law 44 Legislative Debates, PER 00481: "Third objective of the reforms: Who is going to invest in these [six] exploration capitals? The private companies. In the last five years there has not been a single petroleum exploration contract signed in Ecuador. How do we make the investment in Ecuador more attractive? Through this new type of contract, the participation contract which is used in every country which produces oil."; see also, Exhibit CE-5, Law 44, PER 00487: "That more investments are required for exploration and exploitation of hydrocarbons...it is essential to introduce contractual systems into Ecuador's legislation that will make hydrocarbon exploration and exploitation competitive."

<sup>884</sup> See above at paragraphs [57]-[59].

<sup>885</sup> *Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic*, ICSID Case No. ARB/97/3, Award (20 August 2007), paragraph 7.4.39.

Contracts”<sup>886</sup> and noted that “Ecuador had also sent other signals that it welcomed foreign investment in the oil sector and intended to continue to support a business and legal environment conducive to such investment,” referring in particular to the construction of the OCP pipeline.<sup>887</sup> Mr. Spink testified further that his perception of Ecuador’s commitment to the development of its oil industry in partnership with foreign investors was “reinforced by the limited contact [he] had with Ecuadorian Government officials,” noting that shortly after the signature of the Kerr McGee deal, he had a courtesy meeting with Ecuador’s former Minister of Energy and Mines, Dr. Terán.<sup>888</sup> In short, although Perenco took comfort from the terms of the contracts and the OCP project, Mr. Spink did not claim that he received express commitments from Ecuadorian officials *prior* to Perenco’s making the investment.<sup>889</sup>

567. Thus, Perenco’s expectations were, as the Claimant generally pleaded the case, basically founded upon the Participation Contracts which in turn reflected the provisions of Law 44.<sup>890</sup>

568. With respect to the expectations of Perenco’s predecessor in interest, Oryx/Kerr McGee, the Tribunal recalls that Ecuador’s move from service contracts to participation contracts was motivated by the nation’s inability to adequately develop its petroleum resources.<sup>891</sup> In such circumstances, an investor such as Oryx/Kerr McGee could reasonably expect at the time of the acquisition of its contractual rights that so long as it acted consistently with its legal and contractual obligations, it would be entitled to receive its share of petroleum pursuant to its contract, and that it would be free to dispose of that share with the expectation that, subject to the payment of all taxes and other levies, it would be entitled to make whatever profit remained after the costs of doing business.<sup>892</sup> Given Article 10 of Law 44<sup>893</sup> and Decree 1417<sup>894</sup>, both of

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<sup>886</sup> 1<sup>st</sup> Witness Statement of Patrick Spink, paragraph 12. In his written testimony, Mr. Spink did not address whether Perenco understood the participation contracts to be in the nature of administrative contracts under Ecuadorian law in that they might differ from contracts otherwise governed by the Ecuadorian Commercial Code. For a discussion of their differences, see 3<sup>rd</sup> Expert Report of Juan Pablo Aguilar Andrade, paragraphs 4-14.

<sup>887</sup> 1<sup>st</sup> Witness Statement of Patrick Spink, paragraph 14.

<sup>888</sup> *Ibid.*, paragraph 17.

<sup>889</sup> 1<sup>st</sup> Witness Statement of Patrick Spink, paragraphs 9-16.

<sup>890</sup> Revised Memorial, paragraphs 159-160; Exhibits CE-4, Law 44, PER 00481, CE-5, Law 44, and CE-303, Official Communication No. 93-225, Quito, 29 October 1993, pp 2- 4.

<sup>891</sup> *Ibid.*; Exhibit CE-13, Law 46 on Promotion and Guarantee of Investments, Official Registry 219 of 19 December 1997 (in Spanish with English translation of excerpts), PER 0074.

<sup>892</sup> Reply, paragraphs 284-285. Perenco argued in response it “could not reasonably have expected that it would enjoy the upside from sales of oil at higher oil prices entirely free of any fiscal measure which took a percentage of this

which were expressly incorporated into the Participation Contracts, and both of which stated that amendments “required the prior agreement of the parties,”<sup>895</sup> the contractor could also reasonably expect that the contract would not be unilaterally amended by Petroecuador in a manner which was inconsistent with Ecuadorian law.

569. Consistent with its prior determination that the Contracts were not stabilised as understood by Ecuadorian law, the Tribunal sees force in Ecuador’s argument that without a full stabilisation clause in the contracts, the contractor could not reasonably expect that the contracts would be completely immunised from future legislative or other measures.<sup>896</sup> That said, the contractor could also reasonably expect that the taxation modification clauses could be employed in appropriate circumstances.<sup>897</sup>
570. There is no suggestion that the two Contracts did not operate in accordance with their terms up to the date of the sale of Kerr McGee’s interests to Perenco. Given Kerr McGee’s experience, there was no reason why Perenco should not have held essentially the same expectations as its predecessor in interest.<sup>898</sup> Perenco did not suggest that the Participation Contracts did not

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windfall revenues for the State” (Counter-Memorial, paragraph 471). Perenco states first, that it could and “in fact did” expect that it would “benefit from higher oil prices *in proportion to the contractually agreed participation formula*”, and then follows this by asserting that regardless of whether or not this was the case, it “certainly had every right to expect that Ecuador would not *entirely* deprive it of the upside from sales at higher oil prices” since that was a “fundamental benefit” of participation contracts: Reply, paragraph 285 [Emphasis in original.].

<sup>893</sup> Which provided that “[a]t the State’s discretion, contracts for the exploration and use of hydrocarbons may be modified by an agreement of the contracting parties, and upon approval by the Special Bidding Committee (CEL).” Exhibit CE-5, Law 44 Amending the Hydrocarbons Law, Official Registry No. 326 of 29 November 1993 (in Spanish with English translation of excerpts), PER 0484, 89.

<sup>894</sup> Which stated that the modification process could be commenced “provided that the parties have reached mutual agreement over the proposed modification.” Exhibit CE-6, Decree No. 1417, Regulation for the Application of the Hydrocarbons Law, Official Registry No. 364 of 21 January 1994 (in Spanish with English translation of excerpts), PER 00503.

<sup>895</sup> See clauses 15.2 of the Block 7 and 21 Participation Contracts which describes the circumstances in which the process of negotiating and introducing amendments to the contract should be initiated: Exhibits CE-10, Block 21 Participation Contract, PER 04703 and CE-17, Block 7 Participation Contract, PER 04829.

<sup>896</sup> In its Counter-Memorial, Ecuador included an example of a stability clause contained in a contract between the Ministry of Foreign Trade, Industrialization, and Fisheries and Samedan Oil Corporation: Counter-Memorial, paragraph 398, referring to Exhibit E-125.

<sup>897</sup> See clauses 11.7 (Block 21) and 11.12 (Block 7) at Exhibits CE-10, Block 21 Participation Contract, PER 04699 and CE-17, Block 7 Participation Contract, PER 04823.

<sup>898</sup> Revised Memorial, paragraphs 26-35 for the Claimant’s account of the circumstances surrounding its acquisition of interest in Blocks 7 and 21, and see Exhibit CE-15, Memorandum No. CE-015, Memorandum No. 269-CEF-99, from Petroecuador’s Negotiation Commission for Block 7 to the President and Members of the Special Bidding Commission (CEL), 13 November 1999 (in Spanish with English translation of excerpts), PER 00781-00782. During the negotiation of the Block 7 Contract, it was proposed to Oryx that in light of the behavior of

operate in accordance with their terms up until the first of the impugned measures, the enactment of Law 42 in April 2006 and the initial claim to 50% of the extraordinary revenues made by Executive Decree No. 1672, the law's implementing decree issued on 11 July 2006.

ii. Dispute settlement expectations based on the Participation Contracts

571. Perenco emphasised that quite apart from its expectations as to how the Contracts would operate generally, it had other legitimate expectations, namely, that any disputes arising under the Participation Contracts would be resolved peaceably through arbitration. It noted in this regard:

Perenco also had every reason to expect that disputes regarding the investment would be resolved peaceably through an international arbitration process at ICSID. As the Tribunal has already determined, after the Congress in 1986 had confirmed its ratification of the ICSID Convention, the Contracts themselves expressly called for economic disputes to be resolved by ICSID arbitration... Pursuant to Clause 22.1 of the Block 21 Contract, the parties even incorporated the ICSID Convention as part of the Contract's 'legal framework.'<sup>899</sup>

572. This agreement to resolve disputes through arbitration in Perenco's view "certainly implied an agreement to honor decisions of an arbitral tribunal" and Perenco noted that this expectation was made explicit as a contractual promise in clauses 22.2.2, by which both parties undertook to use the means set forth in the Contract "to resolve doubts and disputes that may arise during its life, *and to observe and comply with the decisions of the competent consultants, arbitrators, judges or courts*, as the case may be, pursuant to the provisions of this Contract."<sup>900</sup>

573. Having set out its expectations based upon the contracts, including their arbitration provisions, Perenco then asserted that Ecuador undermined its expectations of the economic terms of the

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crude-oil prices in the weeks preceding, different prices should be stipulated to apply during the course of the contractual term; namely, "US\$ 17 through 2002; from 2003 to 2006, a price of US\$ 16; and from 2007 to 2010, a price of US\$ 15." This was not accepted by Oryx because, according to the memorandum prepared by Petroecuador's Negotiation Commission, "this parameter was completely uncertain in terms of its behavior, to the point of it being at US\$ 8 in May 1998, when the company accepted it at US\$ 15 and historically the trend had demonstrated it to be below US\$ 15." The memorandum further records that Oryx on the basis of the same reasoning rejecting an alternative proposal; that "an average of US\$ 17 per barrel be set, with the parties equitably sharing the surplus at 50% each."

<sup>899</sup> Revised Memorial, paragraph 163.

<sup>900</sup> *Ibid.*, paragraph 164 [Emphasis in original.]: Exhibits CE-10, Block 21 Participation Contract, PER 04724 and CE-17, Block 7 Participation Contract, PER 04865.

deal by enacting and enforcing Law 42.<sup>901</sup> It also argued that the Respondent's initiation of the *coactiva* process to collect sums claimed to be due, which in turn led to the various requests and orders of the Tribunal in relation to the process of its considering and ultimately granting the provisional measures sought by Perenco, and Ecuador's subsequent disregard of the provisional measures recommendation amounted to an additional breach of fair and equitable treatment (as well as a breach of contract).<sup>902</sup> But for this latter breach, it argued, Perenco would still be operating in Ecuador today and a large escrow balance would have accumulated.<sup>903</sup>

574. Ecuador argued in response that in order to succeed on this argument Perenco would have to demonstrate that the notion of "legitimate expectations" on which it relied was well-founded and consistent with the terms of the Participation Contracts.<sup>904</sup> Ecuador submitted that Perenco failed to do so because its argument presupposed that Ecuador was required contractually to abide by the "*request of 24 February 2009 and the Arbitral Tribunal's recommendation of provisional measures.*"<sup>905</sup> It contended that the Participation Contracts created an expectation that the parties would submit to ICSID arbitration specified disputes and abide by the final award.<sup>906</sup> It could not support the expectation that Ecuador would be bound to comply with the Tribunal's recommendations of provisional measures.<sup>907</sup>

575. Alternatively, Ecuador submitted that should the Tribunal find that such expectation is well-founded, Ecuador's actions in alleged breach could not be said to be causative of any loss to Perenco.<sup>908</sup> In particular, it did not cause Perenco to abandon the Blocks.<sup>909</sup> Ecuador's actions were declared as a consequence of Perenco's actions, and it demanded the payment of dues or

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<sup>901</sup> Revised Memorial, paragraphs 169 and 225.

<sup>902</sup> *Ibid.*

<sup>903</sup> Revised Memorial, paragraphs 224-226; Reply, paragraphs 268 *et seq.*

<sup>904</sup> Counter-Memorial, paragraph 426.

<sup>905</sup> Counter-Memorial, paragraph 428 [Emphasis in original.]

<sup>906</sup> Counter-Memorial, paragraph 448.

<sup>907</sup> *Ibid.*, paragraph 449.

<sup>908</sup> Counter-Memorial, section 6.3.2.

<sup>909</sup> *Ibid.*, paragraph 453.

seized their equivalent in crude that Perenco already agreed to set aside and represented could do so without requiring it to abandon the Blocks (by placing it in escrow).<sup>910</sup>

576. The Tribunal agrees with Perenco that the expectation of peaceable resolution of disputes pursuant to the Contracts' arbitration clauses was a reasonable and legitimate expectation of the private contractor (whether the original contractor or its successor in interest). It will deal with the Respondent's response to the Tribunal's Decision on Provisional Measures separately below, but for present purposes it will consider the general expectation of peaceable settlement of disputes and whether that expectation has been met.

577. Perenco did not move to challenge Law 42 either under the Contracts or under the Treaty until after Ecuador began to apply Decree 662 to it. (Perenco consented to ICSID arbitration on 17 October 2007, some thirteen days after Decree 662 was issued. It filed its Request for Arbitration on 30 April 2008.<sup>911</sup>) Putting to one side for the moment the Respondent's decision not to comply with the Provisional Measures Decision, the arbitration has unfolded in accordance with the Contracts. Ecuador has participated fully herein, has exercised its right to make objections, and has contested the merits of the claims after the Decision on Jurisdiction.<sup>912</sup> Indeed, it has filed a counterclaim against Perenco for alleged environmental damage.

578. In the Tribunal's view, Perenco's claims that Ecuador has denied it fair and equitable treatment in relation to its procedural expectations of access to international dispute settlement *generally* have not been made out.

iii. Expectations with respect to the Decision on Provisional Measures

579. Turning to the narrower question of the Claimant's claimed expectation of Ecuador's compliance with the Decision on Provisional Measures, the Tribunal has already found that as a matter of Ecuadorian law and clauses 22.2.2 of the Contracts,<sup>913</sup> the Respondent agreed to

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<sup>910</sup> Counter-Memorial, paragraphs 455-457.

<sup>911</sup> Exhibit CE-264, letter from Perenco to the Ministry of Foreign Affairs and the Ministry of Mines and Petroleum.

<sup>912</sup> The Tribunal for present purposes makes no evaluation of the reasonableness of mounting any of the objections for the purposes of an ultimate determination of the allocation of costs in this proceeding.

<sup>913</sup> Exhibits CE-10, Block 21 Participation Contract, PER 04724 and CE-17, Block 7 Participation Contract, PER 04865.

comply not only with any award of a tribunal, but also with a broader category of “decisions”. Thus, the Claimant justifiably had a reasonable expectation that if a dispute arose between the parties, the Respondent would comply with all decisions of a tribunal constituted pursuant to the Contracts. Having found that there was a breach of contract for Ecuador’s failure to comply with the Tribunal’s Decision on Provisional Measures, as set out above at paragraphs 413 to 417, the Tribunal considers it is therefore not necessary to deal with arguments regarding the effect of the Decision on Provisional Measures under Article 4 of the Treaty.

iv. Substantive expectations relating to the Contracts

580. In advancing its allegation of breach, the Claimant tended to conflate a series of measures which were taken at different times over a course of some four years. In its pleadings, the Claimant tended to lump together: (i) Law 42 at 50%; (ii) the promulgation and application of Decree 662; (iii) the Correa administration’s demands for the migration of participation contracts to a service contract model; (iv) the subsequent demand for a faster migration to service contracts than that initially sought; (v) the demands for payment of levies claimed to have been owed under Law 42; (vi) the launching of *coactivas*; (vii) the decision to enforce the *coactivas* notwithstanding the Tribunal’s recommendation that it not do so during the pendency of the arbitration; and (viii) the breakdown in negotiations which led to the Consortium’s decision to suspend operations, which in turn led to the initiation of the proceeding resulting in the declaration of *caducidad*.<sup>914</sup>

581. Listing these measures, taken over a period of some four years, illustrates the deepening and intensification of the State’s demands and actions. When evaluating the international lawfulness of Law 42 at 50%, however, the Tribunal will consider this measure separately from the measures which ensued. In the course of this analysis, it will be evident that certain of

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<sup>914</sup> For example, following a proposed settlement offer by Perenco on 21 May 2009, its representatives were summoned to meet Ecuador’s Minister of Mines and Petroleum where, in the evidence of Mr. d’Argentré, they were informed that President Correa was offended by the settlement offer and Ecuador would not comply with the provisional measures recommendation. Subsequently, when Minister Palacios was replaced by Minister Pinto on 8 June 2009, representatives of Perenco met with him to discuss settlement terms. Minister Pinto’s statements, according to Mr. d’Argentré, which were not disputed by Ecuador, maintained Ecuador’s position that in order to cease *coactiva* enforcement measures, the Consortium would have to agree to pay all outstanding Law 42 amounts under a payment plan (amongst other conditions). Perenco did not agree to this. This pattern of interaction continued through to and during the course of the auction of the consortium’s crude on 3 July 2009 and 20 July 2009.

the Tribunal's determinations in regard to the alleged breaches of contract assume importance in the Treaty claim. To some extent, the Treaty analysis mirrors the contract analysis. However, in contrast to its contractual jurisdictional mandate, in exercising its jurisdiction to apply the Treaty, the Tribunal is not bound by Ecuadorian law or by the courts' interpretation of that law, although it will defer to an authoritative interpretation of the domestic law.

*b. Law 42 at 50%*

582. The Tribunal begins with some comments on the relationship between the Constitutional Court proceedings and the Treaty claims, the characterisation of Law 42 for the purposes of international law, and a reference to a prior investment treaty case that has considered windfall taxes. With respect to this latter point, the Tribunal considers that the substantial upwards movement of oil prices in the last decade fell outside of the expectations of the original parties to the Participation Contracts and generated windfall profits. The expert evidence before the Tribunal shows that Ecuador's initial response thereto was not unlike that of many other States.
583. Turning to the Constitutional Court's decision, the fact that the Court has spoken on Law 42's constitutionality does not of course preclude this Tribunal from exercising its jurisdiction under the Treaty to consider the international lawfulness of Law 42. But in applying international law, the Tribunal does not act as a court of appeal on questions of Ecuadorian law. This jurisdictional limit is well-established in the jurisprudence.<sup>915</sup> The Tribunal must recognise the allocation of competencies between adjudicatory bodies at the national and international levels. An international tribunal cannot second-guess the court's interpretation and application of local law.<sup>916</sup> At the same time, under well-established principles of international law, as codified in Article 3 of the ILC Articles on State Responsibility, the fact that a law has been declared

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<sup>915</sup> *Robert Azinian, Kenneth Davitian & Ellen Baca v. United Mexican States*, ICSID Case No. ARB(AF)/97/2, Award (1 November 1999), paragraph 99; *Mondev International Ltd. v. United States of America*, ICSID Case No. ARB(AF)/99/2, Award (11 October 2002), paragraph 126; *Helnan International Hotels A/S v. Arab Republic of Egypt*, ICSID Case No. ARB/05/19, Award (3 July 2008), paragraphs 106-107; *Jan Oostergetel and Theodora Laurentius v. Slovak Republic*, UNCITRAL, Final Award (23 April 2012), paragraph 299; *Mr. Franck Charles Arif v. Republic of Moldova*, ICSID Case No. ARB/11/23, Award (8 April 2013), paragraph 441; *Rompetrol Group Company NV v. Romania*, ICSID Case No. ARB/06/3, Award (6 May 2013), paragraph 238.

<sup>916</sup> As found in the section on the alleged breaches of contract, for this reason, the Tribunal does not accept certain of Dr. Pérez Loose's criticisms.

constitutional by the local courts, even by the highest court of the land, is not dispositive of whether it was in conformity with international law.<sup>917</sup>

584. As for the proper characterisation of Law 42, the Tribunal has already found that for the purposes of the contractual claims, Law 42 is to be characterised as a taxation measure. In the context of the Treaty claim, it has carefully considered Perenco’s complaint as to Ecuador’s “opportunistic” change in the measure’s characterisation between the constitutional court proceedings and this international arbitration:<sup>918</sup>

Ecuador cannot have it both ways: it cannot both insist it is entitled to special deference when exercising its powers of taxation, and insist that it is not engaged in taxation when it desires to sidestep its contractual obligations related to taxation.<sup>919</sup>

585. While it is possible for a measure to be characterised differently under different legal systems, the municipal and international, the Respondent’s inconsistency in characterisation depending upon the forum and applicable law is troubling. In the end, following the approach taken in *EnCana v. Ecuador* when it comes to determining whether a measure is to be characterised as a tax for the purposes of international law, the Tribunal has concluded that it should focus on the Law 42’s substantive effect (i.e., whether a liability was imposed upon a class of persons to pay a portion of “extraordinary revenues” to and for the benefit of the State).<sup>920</sup> It is buttressed in this conclusion by the fact that the law’s characterisation during the Constitutional Court proceeding in no way precluded Perenco itself from characterising it as a tax which gave rise to its right to claim a modification of the Contracts.<sup>921</sup>

586. As a final introductory comment, it is well recognised in investment treaty arbitration that States retain flexibility to respond to changing circumstances unless they have stabilised their

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<sup>917</sup> *Robert Azinian, Kenneth Davitian & Ellen Baca v. United Mexican States*, ICSID Case No. ARB(AF)/97/2, Award (1 November 1999), paragraph 98; *Inceysa Vallisoletana S.L. v. Republic of El Salvador*, ICSID Case No. ARB/03/26, Award (2 August 2006), paragraphs 212-214; *SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan*, ARB/01/13, Procedural Order No. 2 (16 October 2002), paragraph 28.

<sup>918</sup> Reply, paragraph 188.

<sup>919</sup> *Ibid.*, paragraph 191.

<sup>920</sup> *EnCana Corporation v. Republic of Ecuador*, LCIA, Award (3 February 2006) (EL-94), paragraph 142: “A taxation law is one which imposes a liability on classes of persons to pay money to the State for public purposes.”

<sup>921</sup> Exhibits E-129, Letter from the Consortium to Petroecuador dated 18 December 2006 (Block 21) and E-130, Letter from the Consortium to Petroecuador dated 18 December 2006 (Block 7).

relationship with an investor. In *Paushok v. Mongolia*, for example, the tribunal discussed the claimant's expectations in relation to a windfall tax, noting:

There is no doubt that the [Windfall Profit Tax] represented a radical change in the taxation of the gold mining industry in Mongolia and that it had a severe negative impact upon the industry as a whole and upon GEM in particular. But this does not mean that the enactment of such legislation was contrary to the Treaty. An investor, without an agreement which limits or prohibits the possibility of tax increases, should not be surprised to be hit with tax increases in subsequent years and such an event could not be considered as 'unpredictable'. Mongolia is far from being the only country in the world where dramatic unforeseen increases in the price of certain commodities has led to major changes in taxation regimes of those commodities. Before concluding that a particular taxation level alters 'the predictability of the business and legal framework' of a country, an international arbitration tribunal will want to see a clear demonstration that, absent such an agreement, such increase in taxation constitutes a breach of an international obligation of that country.<sup>922</sup>

587. *Paushok's* emphasis on "an agreement which limits or prohibits the possibility of tax increases" underscores the significance of the Tribunal's finding that although there was such an agreement in this case, it was not adequately pursued such as to be shown to have been futile in 2007 (until the application of Decree 662). It further underscores the Tribunal's earlier finding that to the extent that Perenco's expectations are derived from its contractual rights, the Contracts *as a whole*, including their taxation modification clauses, not just the "economic bargain" clauses, must be considered.

588. The Tribunal also sees support in *Paushok* for its view that a consideration of legitimate expectations should include a consideration of industry practices and expectations. Given the oil industry's typically expected returns and its experience with governmental responses to market changes, it would be unsurprising to an experienced oil company that given its access to the State's exhaustible natural resources, with the substantial increase in world oil prices, there was a chance that the State would wish to revisit the economic bargain underlying the contracts.<sup>923</sup> In its pleadings, Perenco itself emphasised its good faith efforts to negotiate with

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<sup>922</sup> *Sergei Paushok, CSJC Golden East Company and CSLC Vostokneftegaz Company v. Republic of Mongolia*, UNCITRAL, Award on Jurisdiction and Liability (28 April 2011) (EL-103), paragraph 305.

<sup>923</sup> In its 1<sup>st</sup> Report, Fair Links commented at paragraph 62: "...as the owners of the non-renewable resources, States will inevitably determine how to share the extractive revenue with the extractive companies. Where the extractive revenues significantly outstrip the reasonable expected returns due to contractors, there is no general assumption in the industry that the extractive company will enjoy the entirety of the windfall profits. On the contrary, States do generally intervene (and have historically intervened) to reassert a proportionate share of extractive revenues

Ecuador.<sup>924</sup> In Perenco's statements and in its conduct, the Tribunal sees evidence of this type of business judgement (albeit one exercised in increasingly difficult conditions). Perenco's repeated efforts to reach a mutually satisfactory adjustment of its relationship with Ecuador is consistent with Fair Links' description of the oil industry's general experience with the renegotiation of oil contracts in changed circumstances.<sup>925</sup>

589. With these points in mind, the Tribunal turns to its consideration of the Article 4 claims.

*c. Did Law 42 violate Article 4?*

590. The Tribunal's three findings in respect to the taxation modification clauses made in its breach of contract analysis apply equally to the Article 4 claim: (i) the Contracts' taxation modification clauses were drafted to encompass new forms of taxation such as Law 42; (ii) new taxes *per se* did not generate an automatic adjustment in the 'X' factor; and (iii) Perenco did not prove that resort to this contractual remedy was futile.

591. The Tribunal is presented with a situation where organs of the State other than Perenco's contractual counterparty modified the Contracts' operation through the exercise of sovereign power not open to ordinary contracting parties. The market conditions in which the State acted were, in the Tribunal's view, quite extraordinary and the widespread array of measures taken by other States during this time satisfies the Tribunal that seeking an adjustment of the economic rent derived from exhaustible natural resources was not *per se* arbitrary, unreasonable or idiosyncratic.

592. It has already been found that Petroecuador was not automatically in breach of contract when the Congress enacted Law 42 or when the Executive fixed the 50% rate. Rather, Perenco was faced with a measure taken by the Congress which *could* give rise to a breach of contract if Petroecuador refused to negotiate or if, its having agreed to negotiate, it refused to accept

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above those which would reasonably be due to contractors for their investment, risk and industrial performance, i.e. their reasonable initial economic expectations." This led it to comment in its Summary 3: "*Since the State is the owner of the non-renewable resources, investors with concession-type contracts inelastic to price would reasonably expect the State to find solutions in a high-price scenario to reassert a proportionate share of extractive revenues above those which would reasonably be due to contractors for their investment, risk and industrial performance, i.e. their reasonable initial economic expectations.*" [Italics in original.]

<sup>924</sup> Revised Memorial, paragraphs 168-169.

<sup>925</sup> 1<sup>st</sup> Expert Report of Fair Links, paragraph 62.

persuasive evidence tendered by Perenco that Law 42 had adversely affected the Contracts' economy and/or refused to agree a correction factor. But just as it could not be found that Petroecuador was in breach of contract until such time as clauses 11.12/11.7 were tested and proven to be futile, subject to what is discussed below, it likewise cannot be found that Ecuador was in breach of Article 4 when it enacted Law 42 and began to collect payment of the amounts claimed to be due. It cannot be said at this point in the chronology of events, that Ecuador's having modified the Contracts' operation, it then foreclosed the exercise of Perenco's intra-contractual recourse (or for that matter precluded it from seeking recourse to contractual and Treaty arbitration). Had the contractual route been pressed and had Petroecuador refused to engage in negotiations as to the claimed disturbance of the Contract's economy or to agree on a correction factor, the situation before the Tribunal would have been different.

593. In addition, the Tribunal would have little difficulty holding that a fully stabilised contract that did not admit of any future legislative or other change cannot be changed unilaterally, but this is not the case here.<sup>926</sup> Insofar as this aspect of the fair and equitable treatment claim is concerned, given the precise expression of the parties' contractual rights and obligations, Perenco has not proven that resort to the taxation modification process would have been futile. Therefore, the Tribunal declines to find the Respondent in breach for enacting and applying Law 42.

594. While Perenco is correct to point out that Article 31-A of Hydrocarbons Law established that oil contracts may be amended provided that the contractor's consent is obtained and that this statutory premise was reflected in the Contracts themselves, if the prior modification negotiations process itself was not pursued, it cannot be held that this common consent could not have been reached. Clause 15.2 of both Contracts shows that the amendment of each Contract *follows* modification negotiations. Had such negotiations been pressed and resulted in

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<sup>926</sup> *El Paso Energy International Company v. Argentine Republic*, ICSID Case No. ARB/03/15, Award (31 October 2011) (EL-165), paragraphs 352, 365-368; *Jan Oostergetel and Theodora Laurentius v. Slovak Republic*, UNCITRAL, Final Award (23 April 2012), paragraph 224; *Total S.A. v. Argentine Republic*, ICSID Case No. ARB/04/01, Decision on Liability (27 December 2010) (CA-357), paragraph 117; *Saluka Investments B.V. (the Netherlands) v. Czech Republic*, UNCITRAL, Partial Award (17 March 2006) (EL-113), paragraph 304.

a satisfactory adjustment of the Contracts' economic terms, the Contracts would have then been amended by consent of both parties.<sup>927</sup>

595. The Tribunal has attached such weight to the availability of the contractual remedy because it believes that, objectively speaking, the oil market conditions in 2006-07 were profoundly different from those prevailing at the time of contracting and that this fact could hardly be denied in negotiations. Perenco had evidently generated good financial returns and it behooved both parties to the Contracts to negotiate with a view to agreeing what impact Law 42 had on the economy of the Contracts in the changed market conditions and what was to be done about it.

*d. The impediment claim*

596. As noted earlier, Perenco also relies upon the prohibition against a Contracting Party's impeding the management, preservation, use, enjoyment or transfer of the investments of nationals or companies of the other Contracting Party. The Tribunal considers that while they were certainly affected by the application of Law 42, the management, preservation, use, etc. of Perenco's investments were not impeded.

597. The Tribunal finds support for its conclusion in the following evidence.

598. First, Law 42 at 50% was restricted specifically to the question of so-called "extraordinary revenues" and did not purport to impede the management, preservation, use, of Perenco Ecuador Ltd. itself or its investments.

599. Second, it did not purport to fundamentally alter the structure of the contracts. Perenco continued to be entitled to the volumes calculated pursuant to the contracts, and 50% of the

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<sup>927</sup> For example, clause 15.2 of the Block 21 Contract provided: "**Contractual amendments:** Amending contracts may be negotiated and executed, by agreement of the Parties, in particular in the following cases:...c) When the tax regime, employee profit sharing or currency treatment applicable to this type of Contract in the country has been modified, in order to restore the economy of the Contract; f) Due to other reasons in the State's interests, duly agreed to by the Ministry of Energy and Mines and the Contractor, in accordance with the Law. In the cases contemplated in items a), b), d), e), and f) above, the modification must be authorized by the Special Bidding Committee, upon prior favorable reports from the Attorney General, the Joint Command of the Armed Forces, PETROECUADOR's Administrative Council, and the Ministry of Energy and Mines. In the case of a modification pursuant to (c) above, only the authorization of PETROECUADOR's Administrative Council shall be required." (Exhibit CE-10, PER 04703) [Bolding in original.]

extraordinary revenues generated therefrom. Throughout this period, Perenco was free to use its investments to generate substantial revenues.

600. Third, there is no persuasive record evidence that Law 42 at 50% “blunted further investment”.<sup>928</sup> The Tribunal has already referred to Mr. Spink’s testimony with respect to Perenco’s expectation that it expected to recover relatively quickly the capital invested if oil remained at US \$20/barrel. If it could do so at US \$20/barrel, it could do so at say, US \$40 or US \$50/barrel with the parties splitting the extraordinary revenues above the reference price. Indeed, in November 2006 (some six months after Law 42’s enactment), the consortium submitted an amendment to the development plan for Block 7 related to the Oso field. The consortium considered three price scenarios for the 2007-2010 period; two of the three considered the price of oil at above the Law 42 reference price of US \$29.6 (i.e., at US \$34/barrel and US \$39/barrel). All three scenarios showed significant positive cash flows to the contractors and in fact higher positive cash flows than would have resulted had the price of oil been below the reference price.<sup>929</sup> After the plan was approved, commencing in April 2006 through to October 2007, the consortium invested an additional US \$61 million and drilled an additional 15 wells in the field.<sup>930</sup> Had Law 42 at 50% truly impeded the management, use, etc. of the investments, the development plan would not have been pursued.

601. On the basis of the available record evidence, therefore, the Tribunal considers that in 2006-2007, with the then-prevailing price of Napo and Oriente crude and with Law 42 at 50%, Perenco was still generating significant cash flows and appeared to be quite profitable. Obviously, it was not enjoying the windfall that it would have enjoyed in the absence of Law 42, but until the amount claimed by the State was increased to 99%, Perenco still generated a greater cash flow than its business case assumed in its due diligence performed when acquiring Kerr McGee’s interests in the two blocks.

602. In all of the circumstances, therefore, the Tribunal finds that Law 42 *per se* did not amount to a breach of Article 4 of the Treaty.

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<sup>928</sup> Revised Memorial, paragraph 176.

<sup>929</sup> Counter-Memorial, paragraphs 601-606, Exhibit E-77, 2006 Oso Development Plan, p 134; Exhibit E-128, Ministry of Energy and Mines Decree No. 40 approving the 2006 Oso Development Plan dated 9 March 2007 (in Spanish with English translation), p 4.

<sup>930</sup> Witness Statement of Laurent Combe, paragraph 20.

*e. Law 42 at 99%*

603. It has already been found that Decree 662 breached the Participation Contracts by increasing Ecuador's participation to 99% of the value of all sales of oil above the reference price and thus effectively removing virtually all of the upside potential above the reference prices. It also marked the beginning of demands for the contractors to make a transition to service contracts.

604. Perenco argued in connection with the effect of Decree 662 that:

There can be no question that this 'change in the legal framework' was fundamental. No dissection of individual contractual provisions or sophisticated economic analysis is required to appreciate that if the State takes 99% of revenue over a given reference price, that is effectively the same thing as a services contract with a fee in the amount of that reference price. In both instances the investor has no opportunity to participate in the upside of higher oil prices.<sup>931</sup>

605. It elaborated upon this point in the course of discussing the *ADC v. Hungary* award:

In the present case Ecuador likewise took aim at the foundations of the contracts and effectively destroyed them. Its unilateral abrogation of one of the essential features of the participation contract – namely, the prospect of upside benefits – is conceptually akin to outlawing contracts containing such provisions altogether. Of course, through *caducidad*, Ecuador rendered impossible any continued operations at all.<sup>932</sup>

606. The Tribunal has already made a finding to this effect (at paragraphs 407 to 410). It agrees with Perenco's argument that the application of the law at 99% rendered a participation contract essentially the same as a service contract. Moreover, Decree 662 marked the beginning of a series of other measures in breach of Article 4 taken in relation to the Participation Contracts, namely: (i) demanding that the contractors agree to surrender their rights under their participation contracts and migrate to what for a considerable period of time was an unspecified model, such that the contractors were unable to discern precisely what they were being asked to move to; (ii) escalating negotiating demands, in particular in April 2008 when the President unexpectedly suspended the negotiations and rejected what had recently been achieved in a Partial Agreement in respect of one of the blocks; (iii) making coercive and threatening statements, including threats of expulsion from Ecuador; and (iv) taking steps to

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<sup>931</sup> Reply, paragraph 290.

<sup>932</sup> *Ibid.*, paragraph 411.

enforce Law 42 against Perenco (and Burlington) for non-payment of dues claimed to be owing, a portion of which has been held to be in breach of Article 4, and when no payments were made, forcibly seizing and selling the oil produced in Blocks 7 and 21 in order to realise the claimed Law 42 debt. This set the stage for the Consortium's suspension of operations and ultimately the declaration of *caducidad* which formally terminated the Consortium's rights in the two blocks.

607. The Tribunal has already noted that Ecuador has not contested the Claimant's assertion that Decree 662 was intended to force a renegotiation of the participation contracts in order to migrate Petroecuador's counterparties to service contracts.<sup>933</sup> In the Tribunal's view, moving beyond 50% to 99% with the application of Decree 662 amounted to a breach of Article 4 of the Treaty and the measures, taken collectively, just listed also constituted breaches of Article 4.
608. Decree 662 had the intended effect of inducing the Consortium to write to Petroecuador setting out a financial proposal for the renegotiation of the two Participation Contracts. Discussions between the parties led Petroecuador and Perenco to sign Minutes of Partial Agreement on 11 March 2008 in relation to Block 7 which, if implemented, would have: (i) permitted Perenco to operate the block under the participation contract model for a period of five years after which it would be migrated to another contract model; (ii) would have extended its contractual term, scheduled to expire in 2010, to 2018; (iii) would have increased the State's participation share for the period 2008-2010 and then have it linked to oil prices for the period 2010-2018; and (iv) would have amended the statutory reference price to US \$42.50/barrel.<sup>934</sup>
609. The Tribunal is hesitant to accord much weight to tentative agreements negotiated under conditions of such duress because Perenco can reasonably say that all such negotiations were intended to make the best of a bad situation. That said, it appears that at least some of the damage which ensued from Decree 662 could have been avoided had the parties been able to put what was agreed in the March 2008 Partial Agreement into a final, executed amending

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<sup>933</sup> Counter-Memorial, paragraph 626; Rejoinder, paragraphs 13-14; Perenco in its Reply, at paragraph 287, asserted that the Respondent had conceded "that the motive for these contractual amendments was to achieve the State's goal of imposing services contracts in place of participation contracts, thus undoing what the prior governments had done."

<sup>934</sup> Exhibit E-84, *Acta de Acuerdo Parcial* signed by Perenco and Petroecuador dated 11 March 2008.

contract for Block 7 (and had they concluded a similar amending contract for Block 21). A review of the terms shows that the arrangement was capable of benefitting both Perenco and the State, and their contractual relationship would have been modified by agreement.

610. However, on 12 April 2008, without advance notice to Perenco (or it appears to any of the other oil companies then engaged in discussions with the State), President Correa announced that the negotiations would be suspended and all existing production sharing contracts would be terminated unilaterally with the result that new contracts would be signed by the oil companies. In making this announcement, President Correa asserted:

I said 45 days, I think in January, for renegotiation of the contracts ... *We were close to a deal, but I stopped it, because, even though we've secured major benefits, I think that we can do better.*<sup>935</sup>

611. Two days after this announcement, Perenco wrote to the Minister of Mines and Petroleum expressing its “deep concern derived from the Ecuadorian Government’s announcement to put an end to the current negotiations.”<sup>936</sup> This was followed two weeks later with the resolution of the Board of Directors of Perenco S.A. to commence ICSID arbitration against Ecuador and Petroecuador.<sup>937</sup> At this point, Perenco and Burlington began to withhold payments of Law 42 dues, depositing the same instead into a segregated account located outside of Ecuador.<sup>938</sup>

612. The evidence suggests that Perenco could have lived with the March Partial Agreement. Obviously, it would have preferred the existing contractual regime and no Law 42, and it was negotiating under the considerable pressure of Decree 662, but the Tribunal considers that

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<sup>935</sup> Exhibit CE-69, *Negotiations with oil companies come to a halt*, El Comercio (online edition), 13 April 2008 (in Spanish with English translation), available at [http://www2.elcomercio.com/noticiaEC.asp?id\\_noticia=184277&id\\_seccion=3](http://www2.elcomercio.com/noticiaEC.asp?id_noticia=184277&id_seccion=3), *Correa proposes “single model” for contracts with foreign oil companies*, El Diario (online edition), 14 April 2008 (in Spanish with English translation), available at <http://www.eldiario.com.ec/noticias-manabi-ecuador/75940>, *Government to propose six month agreement with oil companies*, El Comercio (online edition), 15 April 2008 (in Spanish with English translation), available at [http://www2.elcomercio.com/noticiaEC.asp?id\\_noticia=184439&id\\_seccion=6](http://www2.elcomercio.com/noticiaEC.asp?id_noticia=184439&id_seccion=6), p 8 [Emphasis added.].

<sup>936</sup> Exhibit CE-70, Letter from the Consortium to Petroecuador regarding payment under protest of Law 42 assessment and negotiations of contracts, 15 April 2008 (in Spanish with English translation), PER 02198.

<sup>937</sup> Exhibit CE-202, Extract of Board of Directors Meeting Minutes of Perenco S.A., 30 April 2008.

<sup>938</sup> As noted by the Tribunal at paragraphs 11 and 30 of its Decision on Provisional Measures; Exhibit CE-208, Letter from Perenco to the Ministry of Mines and Petroleum and Petroecuador, regarding the Provisional Measures decision, 11 May 2009 (in Spanish with English translation), PER T-03683.

Perenco's persistent efforts to achieve a mutually acceptable renegotiation of its contracts supports the finding that it would have accepted the terms of the Partial Agreement had they not been repudiated in April.<sup>939</sup>

613. The Respondent acknowledged that the President's decision to hasten the migration of the contracts to service contracts within a year had the effect of suspending negotiations with all of the oil companies, including Perenco.<sup>940</sup> Under increasingly difficult circumstances, Perenco continued to seek a negotiated solution.
614. Negotiations resumed in May 2008 with Ecuador submitting a new draft Transitory Agreement pursuant to which: (i) the parties would make their "best efforts" to migrate to a service contract within 120 days (the model for which had not yet been developed by the State's external legal advisers); (ii) Perenco would be obliged to maintain the levels of investment originally proposed for 2008; and (iii) the ICSID proceedings would be suspended.<sup>941</sup> Perenco objected to these proposed terms.<sup>942</sup> In its view, they were less advantageous than the terms of the March Partial Agreement, and at this time, the draft proposed service contracts was not available for review which meant that the contractors' commitment to the Transitory Agreement would be sight unseen as to the terms of the contract to which they were expected to migrate.<sup>943</sup>
615. On 10 July 2008, Ecuador proposed another draft Transitory Agreement which, if implemented, would require Perenco to migrate to a service contract within one year of its

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<sup>939</sup> In this regard, the evidence of Mr. Eric d'Argentré, the Country Manager for Perenco in Ecuador at the relevant time is that by "April 2008, Perenco was making what [he] considered to be good progress towards a deal with the Government. The deal being discussed would have given Ecuador a greater participation than it was entitled to under the Participation Contracts, but also contained some potential benefits for Perenco and Burlington": see 1<sup>st</sup> Witness Statement of Eric d'Argentré, paragraph 8. Similarly, Mr. Derlis Palacios, who was the Minister of Mines and Petroleum until June 2009, confirms in his written evidence that Ecuador perceived Perenco's intention at this time to be to enter into transitory agreements with the State and that "Burlington was the problem.": 1<sup>st</sup> Witness Statement of Mr. Derlis Palacios, paragraphs 7-10.

<sup>940</sup> Counter-Memorial, paragraph 201; 1<sup>st</sup> Witness Statement of Minister Galo Chiriboga, paragraph 16: the President's decision resulted in "confusion and concern amongst contractors and delayed negotiations for a couple of weeks, while companies consulted with their representatives or head offices."

<sup>941</sup> Exhibit CE-273, Ecuador draft "transitional negotiation agreement," 16 May 2008 (in Spanish with English translation) PER 04502.

<sup>942</sup> Exhibit CE-274, Letter from the Consortium to the Ministry of Mines and Petroleum and Petroecuador, 13 June 2008 (in Spanish with English translation), PER 04507.

<sup>943</sup> Minister Chiriboga in oral testimony before the Tribunal confirmed that as of June 2008, the draft proposed service contracts had not been provided to contractors: Transcript, Hearing on Merits, Day 4, p 992.

execution.<sup>944</sup> This too was rejected by Perenco on the grounds that the new agreement's terms were "substantially similar" to those of the May 2008 Transitory Agreement and were unacceptable.<sup>945</sup>

616. In late July 2008, Minister Chiriboga informed Perenco that he had instructed Petroecuador to terminate the negotiation process.<sup>946</sup>

617. At this point the record shows that Burlington decided that it would prefer to divest itself of its assets in Ecuador rather than migrate to a service contract.<sup>947</sup> This created yet another problem for Perenco. As the consortium operator, Perenco was negotiating on its own behalf but it was also, from the government's perspective, negotiating on behalf of Burlington. Under the terms of its contractual relationship with Burlington, it appears that Perenco could not bind Burlington to a renegotiated contract which might be acceptable to Perenco but not to Burlington.<sup>948</sup> Burlington declined to be bound by Perenco's efforts to arrive at a negotiated solution.

618. The Tribunal can understand why Burlington arrived at this conclusion. In his letter to Perenco dated 18 August 2008, Minister Chiriboga commented:

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<sup>944</sup> This occurred in the midst of attempts by Perenco to reach a compromise with representatives of the Ministry of Mines and Petroleum and Petroecuador regarding the disputed Law 42 payments that had or would become due pending the arbitration or any agreed transitory agreement. For example, Perenco by letter dated 19 June 2008 sought a meeting with Petroecuador to discuss the "possibility of a mutually agreeable solution regarding disputed Law 42 payments that become due" and proposed the option of transferring the disputed payments into an escrow account maintained by an independent escrow agent in a neutral location: Exhibit CE-072, Letter from Perenco and Burlington to the Ministry of Mines and Petroleum and Petroecuador proposing an escrow account for transfer of disputed Law 42 payments, 19 June 2008 (in Spanish and English).

<sup>945</sup> The draft transitory agreement included a "commitment clause" for companies to migrate to a service-model contract within one year, replaced the existing provision which dealt with the modification of the tax regime with a provision subrogating the rights of the contractor to the domestic taxation regime with no exception or contractual review mechanism, and included a clause "modifying the Arbitration Center" to the Permanent Court of Arbitration, requiring parties to go through a series of consultation and mediations before submitting the dispute to arbitration, and excluding disputes which arise from or are connected to taxation matters: Exhibits E-85, Letter from the Minister of Mines and Petroleum to Perenco and other Companies dated 10 July 2008 and CE-74, Letter from Perenco and Burlington to Ecuador showing disagreement with draft agreement proposed by Ecuador, 16 July 2008 (in Spanish with English translation).

<sup>946</sup> Exhibit CE-76, Letter from the Ministry of Mines and Petroleum to Perenco terminating negotiations regarding the amendment of the Participation Contract for Block 7, 28 July 2008 (in Spanish with English translation), PER 02227; Counter-Memorial, paragraph 207; Reply, paragraph 94.

<sup>947</sup> Exhibit E-86, Letter from Burlington to the Minister of Mines and Petroleum dated 10 September 2008.

<sup>948</sup> Exhibit E-91, Letter from Burlington to Perenco dated 16 December 2008: "...wish to clarify that Burlington is not under any legal obligation of any kind to sign the draft agreements. Burlington is entitled to stand on its rights under existing PSCs, and those rights cannot be modified without Burlington's effective participation."

[T]he Ecuadorian State maintains its position of converting all participation contracts to services contracts, which, among other matters, include changing from ICSID arbitration to regional arbitration...fiscal sovereignty, so that tax issues will not be subject to arbitration but to the country's courts; fulfillment of the contractual obligations of the company and of Law 42; and the withdrawal of your claims before the ICSID.<sup>949</sup>

619. This contemplated a very different contractual arrangement from that which had prevailed up to President Correa's announcement in April 2008. Moreover, even though Burlington's refusal to negotiate changes to its contractual rights fell outside of Perenco's control, this was essentially held against Perenco.<sup>950</sup>
620. Notwithstanding the obstacles and the State's shift away from the approach recorded in the first Partial Agreement, Perenco continued to seek a negotiated solution.<sup>951</sup> In October 2008, negotiations resumed and on 3 October and 17 October the two parties reached another Partial Agreement for Blocks 7 and 21, respectively. At this point, the partial agreement contained the following points: (i) the principle of migrating to a service contract; (ii) a higher statutory reference price (US \$42.50/barrel for Block 7 and US \$48/barrel for Block 21); (iii) the application of the LET rate of taxation (70%) in lieu of Law 42 at 99%; and (iv) a guaranteed investment of US \$110 million, supported by a commitment from a parent company guarantee.<sup>952</sup>
621. This Partial Agreement also foundered. Perenco sent comments on the draft agreement on 31 October (for Block 7) and 7 November (for Block 21), and this was followed up with a letter to Petroecuador's negotiating team confirming its agreement with the terms but stating it could

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<sup>949</sup> Exhibit CE-279, Letter from the Ministry of Mines and Petroleum to Perenco and Burlington, 18 August 2008 (in Spanish with English translation), PER 04521.

<sup>950</sup> The evidence of Minister Chiriboga at paragraph 25 of his 1<sup>st</sup> Witness Statement is that was clear by the fourth quarter of 2008 that "Burlington's refusal to accept a new agreement with the State [made] it impossible to reach a definitive agreement with respect to blocks 7 and 21 with Perenco."

<sup>951</sup> Perenco's response to Ecuador's terms of negotiation in a letter in its own name dated 27 August 2008 to the Ministry of Mines and Petroleum, stating it was intent on and ready to begin negotiations with Ecuador on 1 September 2008 with a view to replacing the Participation Contracts with service contracts and with the issue of the pendency of the ICSID arbitration on the table: Exhibit CE-280, Letter from Perenco to the Ministry of Mines and Petroleum, 27 August 2008 (in Spanish with English translation).

<sup>952</sup> Exhibits E-87, *Acta de Acuerdo Parcial* signed by Perenco and Petroecuador dated 3 October 2008 (Block 7) and E-89, *Acta de Acuerdo Parcial* signed by Perenco and Petroecuador dated 17 October 2008 (Block 21).

not sign the draft agreements which had since been approved by Ecuadorian government agencies without its comments having been taken into account.<sup>953</sup>

622. The bigger problem was that after Perenco informed Burlington that following extensive negotiations it had reached a draft transitory agreement that was “acceptable to both Perenco on the one hand, and the Government of Ecuador and Petroecuador on the other” Burlington would not go along with the proposed agreement.<sup>954</sup> Burlington informed Perenco that it would not sign the draft transitory agreement.<sup>955</sup> The agreement could not become effective without Burlington’s participation.
623. Perenco was then informed by the Ministry of Energy and Petroleum that since it had been impossible to reach an agreement due to Burlington’s “intransigent position,” Perenco should appoint a team to negotiate the reversion of Block 7 (then scheduled to expire in August 2010) and that it should “immediately assign its negotiating team to early termination of the Block 21 contract, by mutual agreement” even though that block was not set to expire until 2021.<sup>956</sup>
624. Perenco asked the Minister to reconsider the position in view of the fact that the parties were so close to an amicable solution.<sup>957</sup> However, Minister Derlis Palacios stated publicly on 21 January 2009 that negotiations with Perenco and Burlington were “practically impossible”.<sup>958</sup>
625. As noted below some further negotiations occurred in 2009, but they too foundered. The Respondent argued that their failure was attributable to Perenco.<sup>959</sup> The Tribunal does not see it that way. In its view, the negotiations failed due to the State’s escalating demands and its view

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<sup>953</sup> Exhibit CE-282, Letter from Perenco to Petroecuador, 12 November 2008 (in Spanish with English translation).

<sup>954</sup> Exhibit E-90, Letter from Perenco to Burlington dated 27 November 2008. The minutes of what would become the Partial Agreement for Block 7 were earlier provided to Burlington and on 7 October 2008, Burlington informed Petroecuador that it did not accept those terms, reiterating its intention to sell its interest in Blocks 7 and 21: Exhibit E-88, Letter from Burlington to Petroecuador dated 7 October 2008.

<sup>955</sup> Exhibit E-91, Letter from Burlington to Perenco dated 16 December 2008.

<sup>956</sup> Exhibit CE-81, Letter from the Ministry of Mines and Petroleum to Perenco regarding the process of reverting of Block 7 and early termination of the Participation Contract for Block 21, 23 December 2008 (in Spanish with English translation); 1<sup>st</sup> Witness Statement of Mr. Eric d’Argentré, paragraph 18.

<sup>957</sup> Exhibit CE-289, Letter from Perenco to the Ministry of Mines and Petroleum, 8 January 2009 (in Spanish with English translation).

<sup>958</sup> Minister Derlis Palacios as quoted by Ecuador’s *El comercio* in a 21 January 2009 article entitled, “Government will seek to terminate contract with Perenco after negotiations fail”: Exhibit CE-84, PER 02336.

<sup>959</sup> Counter-Memorial, paragraphs 199, 210-211, 219.

that Perenco was responsible for ensuring that Burlington agreed to the terms of the tentative deals.

626. Insofar as the separate claim of breach of Article 4's impediment provision is concerned, the Tribunal considers that although Perenco's management, preservation, and use of the Blocks was unimpeded by the application of Decree 662, its enjoyment of the investment was impeded. This constitutes a separate breach of Article 4.

627. In sum, the Tribunal finds that: (i) Law 42's enactment did not breach Article 4; (ii) moving beyond 50% to 99% with the application of Decree 662 to Perenco as well as the ensuing measures just discussed breached Article 4. The Tribunal now turns to the events leading up to the declaration of *caducidad*.

*f. The declaration of Caducidad*

628. The Tribunal has already discussed the history of the Decision on Provisional Measures in the Facts and in the course of its decision on Perenco's invocation of the defence of *exceptio non adimpleti contractus*. It is unnecessary to repeat the chronology. Suffice to say that on 13 July 2009 the Consortium gave notice of its intention to suspend operations. This set in train the events that led to the declaration of *caducidad* on 20 July 2010 which brought the Contracts to an end.

629. The Tribunal notes that in contrast to the contractual claims, the carve-out of caducity in Block 7 from the Tribunal's contractual jurisdiction can have no effect on its jurisdiction to consider whether the declarations made in respect of both Contracts amount to a breach of Treaty.

630. Since the declaration of *caducidad* is bound up with the Parties' submissions on whether Perenco suffered an expropriation, the Tribunal will defer its discussion of *caducidad* as a potential breach of fair and equitable treatment until after it has considered the expropriation claim, to which it now turns.

**C. Expropriation under Article 6 of the Treaty**

631. Article 6 of the Treaty precludes a Contracting Party from taking any expropriation or nationalisation measures "or any other measures which would cause nationals and companies

of the other Party to be dispossessed, directly or indirectly, of their investments” unless it has satisfied certain conditions:

1. The Contracting Parties shall not take any expropriation or nationalization measures or any other measures which would cause nationals and companies of the other Party to be dispossessed, directly or indirectly, of their investments (measures hereinafter referred to as ‘expropriation measures’) except for reasons of public necessity and on condition that such measures are not discriminatory or contrary to a specific undertaking made in accordance with the laws of the Contracting Party between those nationals or companies and the host State. The legality of the expropriation shall be verifiable through regular judicial procedure.

Any expropriation measures taken shall give rise to the payment of fair and adequate compensation equivalent to the real value of the investments in question and assessed on the basis of a normal economic situation prior to any threat of dispossession.

Such compensation, its amount and methods of payment shall be determined not later than the date of expropriation. The compensation shall be effectively realizable, paid without delay and freely transferable. It shall yield, up to the date of payment, interest calculated on the basis of the market interest rate.<sup>960</sup>

### **(1) The Claimant’s Position**

632. Perenco submitted that Ecuador’s actions in enacting and implementing Law 42 amounted to an expropriation of its investment in Ecuador because (i) it deprived Perenco of its contractual right to an agreed participation percentage of the crude oil produced in the Blocks, (ii) it deprived Perenco of the benefits accruing from that contractual right; namely, the opportunity to earn further profits from the use of monies that could have been re-invested rather than paid as Law 42 dues; and (iii) as a result of the “cumulative effect” of the *coactiva* process, Ecuador’s take-over of the Blocks, and declaration of *caducidad*, Perenco was divested of its rights and assets in Ecuador (in Perenco’s submission, a “complete taking”).

633. Perenco’s Reply clarified that Law 42 at 50% and at 99% were to be considered differently. Whereas the former was treated as part of a series of measures which culminated in a complete

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<sup>960</sup> Exhibit CE-07, Treaty, PER 00521.

taking, at 99%, Law 42 was said to be “economically devastating to Perenco”, constituting an expropriation “in and of itself.”<sup>961</sup>

634. Perenco contended further that Ecuador had failed to discharge its burden of demonstrating that such measures were taken “for reasons of public necessity”, were applied non-discriminatorily and were accompanied by “fair and adequate compensation ‘equivalent to the real value of the investments’ ...determined ‘not later than the date of the expropriation.’”<sup>962</sup>
635. In Perenco’s submission, a measure qualified as an expropriation measure within the meaning of Article 6 if its effect was to deprive the investor of the fundamental rights of ownership and control of its investment.<sup>963</sup> Put another way, a measure was expropriatory if it “substantial[ly] depriv[ed] or effectively render[ed] useless an investor’s property rights.”<sup>964</sup> In this regard, Perenco asserted that both *Alpha Projektholding v. Ukraine* and *Biwater Gauff v. Tanzania* have recognised that in the case of indirect expropriation it is enough to demonstrate that the effect of the State’s actions is to interfere with the rights of the investor to such an extent that these rights “are rendered useless”, “even though the State does not purport to have expropriated them and the legal title to the property formally remains with the original owner.”<sup>965</sup>
636. Perenco submitted that the ‘rights’ in question could extend to contractual rights, asserting that “[d]eprivation of acquired contract rights is likewise expropriatory.”<sup>966</sup> It cited *Siemens v. Argentina* and *Eureko v. Poland* in support, contending that “when a State exercises its public authority unilaterally to amend the key terms of a contract with an investor, with the effect of

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<sup>961</sup> Revised Memorial, paragraphs 192, 194; Reply, paragraphs 338, 343, 354-374, in particular 356.

<sup>962</sup> Revised Memorial, paragraphs 186-187; Reply, paragraph 426; quoting from Article 6 of the Treaty.

<sup>963</sup> Revised Memorial, paragraph 188; Perenco relies on a number of tribunal decisions in support. For example, it refers to *Phelps Dodge Corp., et al v. The Islamic Republic of Iran*, Iran-US Claims Tribunal, Award (19 March 1987) (CA-285) for the proposition that “the litmus test for determining whether a state action or series of actions rise to the level of expropriation is not the action itself, but rather ‘the effects of the measures on the owner’ and ‘the reality of their impact.’” (Paragraph 22).

<sup>964</sup> Revised Memorial, paragraph 189.

<sup>965</sup> *Ibid.*; *Alpha Projektholding GMBH v. Ukraine*, ICSID Case No. ARB/07/16, Award (8 November 2010) (CA-281), paragraph 408, quoting from the Iran-US Claims Tribunal’s decision in *Starrett Housing Corporation, Starrett Systems Inc, Starrett Housing International Inc v The Islamic Republic of Iran*, Award (CA-29), p 15; see also, *Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania*, ICSID Case No. ARB/05/22, Award (24 July 2008) (CA-5), paragraph 452.

<sup>966</sup> Revised Memorial, paragraph 190.

essentially depriving the investor of the contract's benefits, such a repudiation of acquired contract rights constitutes a measure tantamount to expropriation."<sup>967</sup>

637. To this end, it argued that Ecuador expropriated its investment in the Contracts by depriving it of a "fundamental contract right", defined as its "agreed participation percentage."<sup>968</sup> Moreover, by depriving Perenco of that key term, Ecuador had "correspondingly deprived Perenco of the benefit of the investment, namely the opportunity to earn profits."<sup>969</sup> It relied for this purpose on economic analyses prepared and annexed to the first witness statement of Mr. d' Argentré, and the evidence of its expert, Professor Kalt.<sup>970</sup> Both submitted that in 2008, for example, the Consortium suffered a US \$63 million loss, rather than benefitting from the US \$229 million profit it projected it would have earned (of which Perenco would have enjoyed US \$127,975 million) but for Law 42.<sup>971</sup> Perenco asserted that from 2006 to 2008, the State "increased its take from 58% to 110%", that is, the share of net profits accruing to the State with Law 42 in effect increased from US \$140,448,000 in 2006 (compared to Perenco's US \$38,471,000), to US \$375,800,000 in 2008 (compared to Perenco's US \$34,939,000).<sup>972</sup>

638. Mr. d'Argentré's evidence was that: "Following this analysis, the cumulative effect of Law 42 from its enactment until the present has been to take from the Consortium approximately \$476 million in after-tax profits that it would have been entitled to under the Participation Contracts, and at the same time confer on the Government \$588 million that it was not entitled to under the Participation Contracts."<sup>973</sup> In Professor Kalt's view, the financial consequences of Law 42

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<sup>967</sup> Revised Memorial, paragraph 191. *Eureko B.V. v. Republic of Poland*, Partial Award (19 August 2005) (CA-13), paragraph 241: "There is an amplitude of authority for the proposition that when a State deprives an investor of the benefit of its contractual rights, directly or indirectly, it may be tantamount to a deprivation in violation of the type of provision contained in Article 5 of the Treaty (expropriation). The deprivation of contractual rights may be expropriatory in substance and in effect."; *Siemens A.G. v The Argentine Republic*, ICSID Case No. ARB/02/8, Award (6 February 2007) (CA-28), paragraph 267: "There is a long judicial practice that recognizes that expropriation is not limited to tangible property."

<sup>968</sup> Revised Memorial, paragraph 192.

<sup>969</sup> *Ibid.*

<sup>970</sup> 1<sup>st</sup> Witness Statement of Eric d'Argentré, paragraphs 26-32; Exhibits CE-116, Chart, 2006-2008 "Take" of available profits, and CE-117, Chart, Cost of foregone investment; Expert Report of Joseph P. Kalt, paragraphs 144-161, Figures 18-19.

<sup>971</sup> 1<sup>st</sup> Witness Statement of Eric d'Argentré, paragraphs 27-29, referring to Exhibits CE-116, Chart, 2006-2008 "Take" of available profits, PER 02549 and CE-117, Chart, Cost of foregone investment.

<sup>972</sup> *Ibid.*

<sup>973</sup> *Ibid.*

when the rate was increased from 50% to 99% was that “Perenco was effectively only able to recover expenses and was not even afforded recovery of past or going-forward capital related costs (including a return to capital) [...] Perenco was placed in the position of a service provider and afforded revenues that were not even up to the level that a 100% participation service contract between an *ex ante* willing seller of oil field services and a willing buyer of such services would yield.”<sup>974</sup>

639. The effect of the *coactivas*, subsequent to which Ecuador bought at auction the entire production of Blocks 7 and 21 for half and subsequently two-thirds of its market price, “credit[ing] these sales against Perenco’s alleged Law 42 ‘debt’ – at the reduced auction sale price”, all the while continuing to issue new Law 42 assessments against Perenco, “created the perverse situation that not only was Perenco receiving no revenue at all from its production – not even money to cover operating costs – its Law 42 ‘debt’ actually continued to mount, while Ecuador made significant profits by reselling Perenco’s oil at much higher market prices.”<sup>975</sup>
640. In addition, Perenco relied on its analysis of “foregone profits”, i.e. profits that it would have received and would have been entitled to use, but for Law 42, to further invest and drill new wells in Blocks 7 and 21, to claim an additional US \$214 million.<sup>976</sup>
641. In the third prong of Perenco’s claim, it submitted that the Tribunal must consider the cumulative effect of the measures taken by Ecuador in connection with Law 42, relying on *RosInvest Co UK Ltd v. Russian Federation*, a case in which a taxation investigation initiated by Russia and certain measures taken in relation thereto affected the claimant’s ability to pay the additional taxes and penalties demanded by the State, eventually leading the State to seize

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<sup>974</sup> Expert Report of Joseph P. Kalt, paragraph 147 [Italics in original].

<sup>975</sup> Reply, paragraph 360. Perenco submitted that this placed it in an impossible situation with respect to the remainder of the contractual term of the Block 7 Contract, and the foreseeable future of the contractual term of the Block 21 Contract. It relied on the evidence of Professor Kalt, stating it demonstrated that Perenco would have had a Law 42 burden of US \$146 million when the Block 7 Contract expired, and with respect to the Block 21 Contract, it would have meant that Perenco faced a Law 42 burden of US \$156 million at the beginning of 2009, and an additional US \$163 million by the end of 2010 despite Petroecuador having seized and sold off the Block’s crude for two years by that point. (Reply, paragraphs 361-362; Expert Report of Joseph P. Kalt, Figure 20.)

<sup>976</sup> 1<sup>st</sup> Witness Statement of Mr. Eric d’Argenté, paragraph 27-29; Exhibit CE-117, Table of Profit for Foregone Investment.

and sell the claimant’s assets in Russia.<sup>977</sup> The *RosInvest* tribunal accepted the argument that “‘the totality of Respondent’ [sic] measures were structured in such a way’ as to result in a ‘complete taking of all of the assets of [the investor] [amounting] to a nationalization or expropriation’” of its investment.<sup>978</sup> Perenco argued similarly that “[t]he “cumulative effect’ of Ecuador’s measures, its enactment and enforcement of Law 42 through the seizure and sale of Perenco’s crude, its physical take-over of the Blocks, and its actions to unilaterally terminate the Participation Contract, have equally resulted in a ‘complete taking’ of Perenco’s assets”, amounting to an “‘expropriation measure’ under Article 6.”<sup>979</sup>

642. Perenco’s rebuttal to any claim by Ecuador to the effect that the measures were legitimate regulatory measures was that Law 42 was pursued for an illegitimate public purpose, namely, to coerce oil companies such as Perenco to abandon their Participation Contracts.<sup>980</sup> It relied on the decisions in *ADC v. Hungary* (a “state’s right to regulate within its domestic affairs is not unbounded”)<sup>981</sup> and *AES v. Hungary* (“[i]t cannot be considered a reasonable measure for a state to use its governmental powers to force a private party to change or give up its contractual rights”).<sup>982</sup>

643. In this regard, Perenco challenged Ecuador’s reliance on the ‘police powers’ doctrine, stating it was subject to limitations that “Ecuador fail[ed] to acknowledge”, including the limitation that “[t]he measure in question must also be proportionate to the identified public purpose”.<sup>983</sup> It submitted that the ‘police powers’ doctrine was intended to “recognize a State’s sovereign power to implement regulations for *bona fide* public purposes”, and not as in this case, in

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<sup>977</sup> Revised Memorial, paragraphs 193-194; *RosInvest Co UK Ltd v. The Russian Federation*, SCC Arbitration V (079/2005), Final Award (12 September 2010) (CA-286), paragraph 611.

<sup>978</sup> *Ibid.*, paragraphs 621, 624.

<sup>979</sup> Revised Memorial, paragraph 194 cf. Rejoinder, paragraph 599.

<sup>980</sup> Revised Memorial, paragraph 196; Reply, paragraphs 340, 390-396 cf. Counter-Memorial, paragraphs 178, 625-626; Rejoinder, paragraphs 562-579.

<sup>981</sup> *ADC Affiliate Limited and ADC & ADMC Management Limited v. The Republic of Hungary*, ICSID Case No. ARB/03/16, Award (2 October 2006) (CA-1), paragraph 424; Revised Memorial, paragraph 196.

<sup>982</sup> Reply, paragraph 392; referring to *AES Summit Generation Limited and AES-Tisza Erömu Kft v. the Republic of Hungary*, ICSID Case No. ARB/07/22, Award (23 September 2010) (EL-123), paragraph 10.3.34.

<sup>983</sup> Reply, paragraphs 381, 406-411.

Perenco’s view, to “provide a cover for State action... that is arbitrary, discriminatory, disproportionate, or unreasonable.”<sup>984</sup>

644. Ecuador similarly could not excuse its conduct by “contending that its actions were permitted or even compelled by Ecuadorian law.”<sup>985</sup> This related to Ecuador’s position in its Counter-Memorial that its actions to enforce Law 42 when Perenco halted payments, i.e., through the *coactivas*, intervention in the Blocks and ultimate declaration of *caducidad* were consequent to Perenco’s failure to comply with Ecuadorian law.<sup>986</sup> In response, Perenco submitted that Ecuador “omit[ed] the fact that throughout this period it was acting in open defiance of the Tribunal’s decision on provisional measures. As a matter of international law, it was Ecuador, not Perenco that was acting illegally.”<sup>987</sup>

645. Finally, Perenco contended that Ecuador could not claim that its actions were justified on grounds of necessity.<sup>988</sup> It acted discriminatorily and contrary to its specific undertakings in clause 8.1 of the Contracts.<sup>989</sup> Moreover, it “ha[d] not offered, much less paid, any compensation and ha[d] wielded its sovereign power to violate Perenco’s rights through measures that far exceed[ed] any of its contractual privileges.”<sup>990</sup>

## (2) The Respondent’s Position

646. For its part, Ecuador maintained two objections to the Tribunal’s jurisdiction in relation to the expropriation claims. First, it argued that the Tribunal lacked jurisdiction because the *coactiva* notices were issued by the *Juzgado de Coactivas de Petroecuador*, and the Tribunal had already ruled that it did not have jurisdiction over Petroecuador.<sup>991</sup> Second, Ecuador reiterated

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<sup>984</sup> Reply, paragraphs 376-424 [Italics in original.], in particular 378 cf. Rejoinder, section 5.3.5.4.

<sup>985</sup> Revised Memorial, paragraph 197.

<sup>986</sup> Counter-Memorial, paragraphs 552 -553, and 559 and 561 and 563-565.

<sup>987</sup> Reply, paragraph 340 cf. Ecuador’s Rejoinder, paragraphs 555-559 (“The Provisional Measures Decision may have been intended to hold the ring pending determination of the Parties’ disputes over the enforcement of Law 42 and Decree 662, but a failure to comply with it does not transform an otherwise valid exercise of lawful power following abandonment of the Blocks into an act of expropriation.”).

<sup>988</sup> Reply, paragraph 427.

<sup>989</sup> *Ibid.*

<sup>990</sup> Revised Memorial, paragraph 195.

<sup>991</sup> Counter-Memorial, paragraph 444, fn. 372, citing Decision on Jurisdiction, paragraph 242.3. Cf. Perenco’s rebuttal at paragraph 346 of its Reply: “[t]his argument fails for two reasons: (1) the Tribunal – at the urging of both Ecuador and Petroecuador – found that Petroecuador was an *agent* of the State (Jurisdiction Decision,

its objection to the jurisdiction *ratione materiae* of the Tribunal to consider that part of Perenco's case which extended to claiming that the *caducidad* decrees "completed" the expropriation of Perenco's rights and property (or, alternatively, objected to the admissibility of the same).<sup>992</sup>

647. Turning to the merits, Ecuador submitted in the first instance that Perenco had wrongly conflated the effect of Law 42 and the actions subsequent to it taken in response to Perenco's failure to comply with Ecuadorian law.<sup>993</sup> It asserted that "international law does not require a State to compensate any loss resulting from the taking of valid and legitimate police powers measures to enforce its law in response to a foreign investor's (such as Perenco) [sic] illegal behavior."<sup>994</sup> The *coactivas*, Ecuador's intervention in the Blocks and declaring the *caducidad* of the Contracts were actions "validly and legitimately taken by Ecuador in response to Perenco's own illegal behavior."<sup>995</sup> *Caducidad*, in particular, was declared, not because Perenco had failed to make Law 42 payments, but rather because "Perenco abandoned Blocks 7 and 21 in the face of repeated requests by Ecuador over a period of 12 months to resume operations."<sup>996</sup> This, Ecuador submitted, namely, Perenco's withholding of Law 42 dues starting in 2008 and its decision to leave the Blocks in July 2009, was part of a 'manufactured self-expropriation exit strategy'<sup>997</sup> since it had concluded by this time that "potentially greater value could be had for the Consortium by withholding Law 42 and Decree 662 dues over the short-term", and pursuing a claim for lost profits in an arbitration than could be "gained

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paragraph 214), and it is a basic tenet of law that the actions of the agent may be imputed to the principal; (2) under international law, the actions of a State entity are attributable to the State, *See* ILC Article, CA-22, Art. 5." [Italics in original.]

<sup>992</sup> Cf. Perenco similarly reiterated in response its submissions regarding the arbitrability of the claims relating to *caducidad* at section II.B of its Reply.

<sup>993</sup> Counter-Memorial, paragraph 551; Rejoinder, paragraph 574.

<sup>994</sup> Counter-Memorial, paragraph 552; citing R.A. Bindschedler, "*La protection de la propriété privée en droit international public*", The Hague Academy Collected Courses, 173-306, 211, Vol. 90, 1956-II. (Unofficial translation from French original: "[l]e principe de la protection de la propriété privée n'interdit pas la levée d'impôts sur le patrimoine, ni les amendes, ni les limitations de la propriété pour des motifs de police."), EL-122.

<sup>995</sup> Counter-Memorial, paragraphs 553, and 559 and 561 and 563, 564, 565; Rejoinder, section 5.3.5, paragraph 568, 569, 571. Cf. Claimant's Reply, paragraph 414 ("Ecuador appears to confuse two issues here: first, the so-called principle of legality, which states that investors must comply with local laws, and second, the international limits on a State's ability to punish wrongdoers, including investors, through the exercise of its police powers.").

<sup>996</sup> Rejoinder, paragraphs 555, 559.

<sup>997</sup> Variations on the term used by Ecuador in its pleadings: see Rejoinder, paragraphs 293, 311, 319, 576, section 3.4

through paying Law 42 and Decree 662 dues as required and operating the fields until the scheduled end of the Participation Contracts.”<sup>998</sup>

648. In Ecuador’s view, Perenco had intentionally structured its expropriation claim as one of “cumulative effect” because it recognised that the enactment and application of Law 42 at 50% in and of itself was insufficient to make out a breach of Article 6.<sup>999</sup> It requested that the Tribunal confine its analysis of Perenco’s case with regard to Article 6 to the enactment and application of Law 42 to Perenco.<sup>1000</sup>
649. Ecuador submitted in the alternative that Perenco’s “cumulative case” on expropriation “fail[ed] because Law 42, the *coactiva* process, Ecuador’s temporary intervention following Perenco’s illegal abandonment of the Blocks and *caducidad* [were] all legitimate and *bona fide* regulatory and thus non-compensable measures and, in any event, Law 42 (whether at the 50% or 99% rate) [did] not amount to an expropriation of Perenco’s investment.”<sup>1001</sup>
650. Ecuador contended that Perenco had made a fundamental error in its submissions in this regard; it had failed to address that the enactment of Law 42, Decree 662, the *coactiva* process, Ecuador’s intervention in the Blocks, and *caducidad* were “all *bona fide* and legitimate exercises of Ecuador’s police powers and, under international law, legitimate and *bona fide* State measures within the exercise of the State’s police powers [could not] constitute a compensable expropriation.”<sup>1002</sup> It asserted that it was well-accepted in international investment law jurisprudence that a State was not liable to compensate an investor for *bona fide* regulation promulgated within its police powers.<sup>1003</sup> The power to tax, it submitted, “undoubtedly” fell within the category of a State’s police powers, and “[a]bsent extraordinary

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<sup>998</sup> Rejoinder, paragraph 535; see also, Brattle, paragraph 24.

<sup>999</sup> Counter-Memorial, paragraphs 538-539; Rejoinder, paragraph 574.

<sup>1000</sup> Counter-Memorial, paragraph 539.

<sup>1001</sup> *Ibid.*, paragraph 541.

<sup>1002</sup> Counter-Memorial, paragraphs 544, 568; Rejoinder, section 5.3.5, in particular paragraphs 560-561.

<sup>1003</sup> Counter-Memorial, paragraphs 544, 568. In support of this proposition, Ecuador relies on the following decisions: *Saluka Investments BV (The Netherlands) v. The Czech Republic*, UNCITRAL, Partial Award (17 March 2006) (EL-113), paragraphs 255, 262; *Técnicas Medioambientales Tecmed, S.A. v. United Mexican States*, ICSID Case No. ARB (AF)/00/2, Award (29 May 2003), paragraph 119 (Spain/Mexico BIT) (EL-115); *Telenor Mobile Communications A.S. v. Republic of Hungary*, ICSID Case No. ARB/04/15, Award, (13 September 2006) (EL-116), paragraph 64; *Lauder v. Czech Republic*, UNCITRAL, Award (3 September 2001) (EL-117), paragraph 198; *Methanex v. United States*, UNCITRAL, Final Award (3 August 2005), paragraph 7, (EL-111) (NAFTA).

circumstances – such as discrimination, arbitrariness, denial of due process or abuse of powers – the burden imposed on a foreign investment by the State’s levies [did] not entitle the alien to claim compensation for the appropriation of its property which is the natural result of the levies’ application.”<sup>1004</sup>

651. Ecuador asserted moreover that the power to tax received “special treatment in the international law of expropriation given that they result from the exercise of one of the attributes of sovereignty (the right to tax aliens and their property located in its territory).”<sup>1005</sup> It further submitted that customary international law “not only recognizes the sovereign power to tax as part of the State’s police powers”, it did “not impose limits to this power” and “[s]uch limits cannot be found in investment treaties either.”<sup>1006</sup> To tax is a “presumptively non-compensable” regulatory act in the exercise of a State’s sovereign power.<sup>1007</sup>
652. Ecuador submitted that to accept Perenco’s case, which it characterised as the contention that a tax which reduces the economic benefits of a contractual arrangement for an investor is expropriatory, would be to “[negate] a State’s sovereign power to tax.”<sup>1008</sup> It cited *Paushok v. Mongolia*, which considered the legality of a 68% windfall profits tax and the claimant’s argument that it exceeded “international standards” limiting the right of the State to tax.<sup>1009</sup> The tribunal concluded that the “[c]laimants ha[d] not established the existence of such standards. At best, they ha[d] succeeded in demonstrating that such legislation went beyond the taxation levels in application at the time in most countries of the world [...] The fact that a particular country happens to have, at a particular time, the highest taxation level affecting a certain industry does not automatically mean that there has been a breach of a BIT.”<sup>1010</sup> The tribunal also concluded that an ‘excessive’ tax was not presumptively an arbitrary and unreasonable one.<sup>1011</sup>

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<sup>1004</sup> Counter-Memorial, paragraphs 546, 549.

<sup>1005</sup> Counter-Memorial, paragraph 546.

<sup>1006</sup> Counter-Memorial, paragraph 547.

<sup>1007</sup> Counter-Memorial, paragraph 550.

<sup>1008</sup> Counter-Memorial, paragraphs 547-548 cf. Reply, paragraph 377.

<sup>1009</sup> Counter-Memorial, paragraph 548.

<sup>1010</sup> Counter-Memorial, paragraphs 548 and 550.

<sup>1011</sup> *Ibid.*

653. In this light, Ecuador submitted that Perenco was required to demonstrate first that Law 42 was arbitrary and unreasonable, falling outside of the bounds of a State’s police powers, and second, that it had a direct or indirect expropriatory effect on its investment in Ecuador, and finally, that it had been applied discriminatorily, was abusive in purpose or involved a denial of due process.<sup>1012</sup> It asserted that Perenco’s submission fell far short; characterising it as limited to arguing that “*any* measure taken by a State even in a legitimate exercise of its regulatory powers and in response to the investor’s illegal behavior, could amount to an expropriation if it [affected] the investor’s property rights [...] an absurd proposition, which [found] no support in international law.”<sup>1013</sup>
654. Responding to Perenco’s reliance on *ADC v. Hungary* for the proposition that a State’s right to regulate “is not unbounded”, Ecuador distinguished that case on its facts, stating that that tribunal considered legislation that did not just “radically alter” the regulatory regime applicable to the contractual relationship between the parties, but “rendered the object of such contract illegal under Hungarian law.”<sup>1014</sup> Ecuador instead drew the Tribunal’s attention to two other decisions, *AES Summit Generation Limited and AES-Tisza Erömü Kft v. The Republic of Hungary*<sup>1015</sup> and again *Paushok v. Mongolia*<sup>1016</sup>, which it submitted more analogously dealt with the implementation of ‘luxury’ or ‘windfall’ profits and rightly found that it was necessary for the claimant to demonstrate that the tax was arbitrary or unreasonable, bringing it outside the bounds of the legitimate exercise of regulatory police powers.<sup>1017</sup> It stated that Perenco had not discharged this burden and would fail to do so because Law 42 was enacted in the *bona fide* exercise of Ecuador’s police powers as evidenced by the following:<sup>1018</sup>

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<sup>1012</sup> Counter-Memorial, paragraph 551; Rejoinder, paragraphs 602-605.

<sup>1013</sup> Counter-Memorial, paragraph 554-556 [Emphasis in original.].

<sup>1014</sup> Counter-Memorial, paragraph 555, citing *ADC (CA-1)* at paragraphs 181 and 186: Following the issuance of the decree, ADC was informed that “further performance of the contracts have been rendered impossible, and thus the [contracts] shall lapse and become void as of 1 January 2002.” Perenco in its Reply, at paragraph 380 contends that distinguishing *ADC v Hungary* on the facts does not “detract from its point of principle”, namely that a State is bound to honour the investment-protection obligations it undertakes in an investment treaty.

<sup>1015</sup> *AES Summit Generation Limited and AES-Tisza Erömü Kft. v. Hungary*, ICSID Case No. ARB/07/22, Award (23 September 2010) (EL-123), paragraph 10.3.34.

<sup>1016</sup> *Sergei Paushok, CSJC Golden East Company, CJSC Vostokneftegaz, Company v. the Government of Mongolia, UNCITRAL*, Award on Jurisdiction and Liability (28 April 2011) (EL-103), paragraph 319.

<sup>1017</sup> Counter-Memorial, paragraph 555; Rejoinder, paragraphs 562-566, section 5.3.5.4.

<sup>1018</sup> Counter-Memorial, paragraphs 557-558; Rejoinder, paragraph 575, 602-604.

- (i) Ecuador had a constitutional mandate to seek a fair allocation of revenues derived from its hydrocarbons resources “and a duty to legislate to deal with the unexpected and excessive increase in oil prices.”<sup>1019</sup>
- (ii) The legislative intent of Law 42 was to remedy a disequilibrium “caused by a massive and unforeseen increase in oil prices.”<sup>1020</sup>
- (iii) Law 42 was not discriminatory, it was a general measure adopted by Ecuador to “restore the economics of its participation contracts with all private companies in like circumstances in light of the unexpected increase in oil prices” and “was not specifically aimed at Perenco or at foreign investors exclusively.”<sup>1021</sup>
- (iv) Law 42 was duly enacted, in accordance with Ecuadorian law.
- (v) The Constitutional Court in Ecuador affirmed Law 42’s constitutionality. In Ecuador’s submission, it “affirmed the constitutionality of all of the substantive provisions of Law 42 and the fact that it did not modify the Participation Contracts.”<sup>1022</sup>

In this regard, Ecuador further reiterated that the purpose of Law 42 and Decree 662 should be considered separately from that of the *coactiva* process and *caducidad*, which Ecuador submitted did “not have the same public purpose”, namely, the enforcement of Ecuadorian law.<sup>1023</sup>

655. Should the Tribunal find that Law 42 was an “illegitimate and compensable regulatory measure”, Ecuador submitted in the alternative that Perenco had failed to prove that “Law 42 *permanently* deprived [it] of its contractual rights or rendered worthless [its] investment in Ecuador.”<sup>1024</sup> Perenco had “not demonstrated – nor could it – that Law 42 unilaterally amended the Participation Contracts, in particular the participation percentage agreed in Clause 8.1 of the Participation Contracts (i.e., the allocation of volumes of crude to the contractor).”<sup>1025</sup> It reiterated its submissions in its breach of contract claim, emphasising its contention that there was no stabilisation clause or its equivalent in the Ecuadorian Constitution restraining the State

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<sup>1019</sup> Ecuador cites in support of this Article 247 of the 1998 Ecuadorian Constitution. Article 247 provides that non-renewable natural resources are considered the “inalienable and imprescriptible property of the State”, to be “exploited in light of national interests.” (Exhibit EL-128)

<sup>1020</sup> 1<sup>st</sup> Expert Report of Fair Links, paragraph 81.

<sup>1021</sup> Counter-Memorial, paragraph 557-558.

<sup>1022</sup> *Ibid.*

<sup>1023</sup> Rejoinder, paragraphs 576, 593, 597, 605-608, 609-623.

<sup>1024</sup> Counter-Memorial, paragraph 569 [Emphasis in original.].

<sup>1025</sup> Counter-Memorial, paragraphs 571-573. In the course of this submission, Ecuador reiterates and refers to its arguments on the breach of contract claims in section 6.2 of its Counter-Memorial.

from exercising its “sovereign right to enact new laws and/or regulations that could affect the legal framework of the Participation Contracts”,<sup>1026</sup> and submitting that “[i]f the Arbitral Tribunal finds that there was no breach under the Participation Contracts, Perenco’s expropriation claim under the Treaty should be rejected.”<sup>1027</sup>

656. However, should the Tribunal find that Law 42 did breach the Participation Contracts, Ecuador submitted that that could not automatically amount to an expropriation of Perenco’s contractual rights. Perenco had to additionally demonstrate, and Ecuador contended it accepts this burden in its written pleadings, that the breach had the effect of essentially depriving the investor of the benefits of the Contracts.<sup>1028</sup> To succeed on a claim of “indirect expropriation”, the investor must prove that the measure, or a series of measures, has effectively and permanently deprived it of “the economic use, enjoyment or benefits of its investment.”<sup>1029</sup> Ecuador asserted that Perenco failed to put forward any credible economic analysis to prove that Law 42 had such an effect.<sup>1030</sup> In this regard, Ecuador pointed to evidence that it submitted countered any suggestion that Law 42 caused a near-total loss of value or control of Perenco’s rights under the Contracts:

- (i) The first was Perenco’s offer to place monies into escrow in June 2008 (six months after the enactment of Decree 662 and the application of Law 42 at the 99% rate). It was Perenco’s own position at the time that its “operations in Ecuador *generated enough cash to deposit the amounts due under Law 42 into an escrow account and still continue to operate the Blocks.*”<sup>1031</sup>

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<sup>1026</sup> Counter-Memorial, paragraph 575.

<sup>1027</sup> Counter-Memorial, paragraph 573.

<sup>1028</sup> Counter-Memorial, paragraph 579, referring to Revised Memorial, paragraph 191.

<sup>1029</sup> Counter-Memorial, paragraph 586. Quote taken from *Methanex Corporation v. United States*, UNCITRAL, Final Award (3 August 2005), paragraph 6, (EL-111) (NAFTA). The Respondent also referred to *Pope & Talbot Inc. v. The Government of Canada*, UNCITRAL, Interim Award (26 June 2000) paragraph 102, (EL-140) (NAFTA); *LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc. v. Argentine Republic*, ICSID Case No. ARB/02/1, Decision on Liability (3 October 2006), paragraph 191, (EL-142).

<sup>1030</sup> Counter-Memorial, paragraph 580, section 7.4.2.2.

<sup>1031</sup> *Ibid.*, paragraph 583 [Emphasis of Respondent.] Cf. Reply, paragraphs 368-370: Perenco argued that it did not offer to place into escrow *past* Law 42 assessments (emphasis of Claimant at paragraph 370 of its Reply), only “*future* disputed assessments” [Emphasis in original]. For this reason, Perenco’s offer should not be characterised as an admission that there was “no economic difference between a scenario in which Ecuador enforced *coactivas* against Perenco and a scenario in which Ecuador complied with the Provisional Measures Decision” (Reply, paragraph 367; see also, Provisional Measures Decision, paragraph 80). Ecuador responded that Perenco’s counsel

- (ii) The second was Perenco’s failure to “put forward any clear and compelling evidence of what effects Law 42 had, in practice, on its investment.”<sup>1032</sup> Ecuador disputed the probative value of Mr. d’Argenté’s evidence and the economic analyses appended in table-form in Exhibits CE-116 and CE-117 to his witness statement because “(i) they do not even indicate the source for the figures mentioned therein and (ii) they are unsupported by any independent economic analysis.”<sup>1033</sup>
- (iii) The third was the economic analysis produced by Perenco at Exhibit CE-116, which purportedly demonstrated the effect of Law 42 at 99% in 2008 and suggested that Perenco suffered a loss for the first time in 2008 when it should have earned a profit of US \$127,975,000. This conceded that “when Law 42 was applied at a 50% rate, Law 42 did not devastate Perenco’s investment.”<sup>1034</sup>

657. Ecuador submitted that while it did not bear the burden of proof in this respect, it could demonstrate that Law 42, whether at 50% or 99%, did not in fact amount to an expropriation of Perenco’s investment.<sup>1035</sup> It drew the Tribunal’s attention to the following: “(i) the Blocks 7 and 21 Consortium’s tax records after the passage of Law 42; (ii) the Fair Links Expert Report; (iii) the Consortium’s own economic valuation as of the end of 2006 for additional investment in Block 7; and (iv) ConocoPhillip’s (Perenco’s partner’s – i.e., Burlington’s – mother company) annual reports following the adoption of Law 42.”<sup>1036</sup>

658. The Consortium’s tax records showed that the Consortium reported earning gross profits of US \$100 to 200 million in the years 2006 and 2007 (i.e., while Law 42 in effect), and that these

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in the Provisional Measures hearing made it “perfectly clear that his client was prepared to put into escrow the entirety of the disputed amounts assessed under Law 42 and Decree 662”, this including “further escrow of the past accrued disputed payments.” In this way, Perenco admitted that it was financially able to continue to operate the Blocks under either escrow scenario. (Rejoinder, paragraphs 548 and 554; Transcript, Hearing on Provisional Measures, pp 83-84.)

<sup>1032</sup> Counter-Memorial, paragraph 588.

<sup>1033</sup> *Ibid.*

<sup>1034</sup> *Ibid.*, paragraph 591.

<sup>1035</sup> *Ibid.*, paragraphs 590-637; Rejoinder, paragraphs 518-520.

<sup>1036</sup> Counter-Memorial, paragraph 593-637.

figures were greater than the profits the Consortium reported having earned in 2005, before Law 42 was enacted.<sup>1037</sup>

659. Fair Links concluded that while the “State’s revenues derived from the 50% levy [increased] in greater proportions than the contractor’s revenues”, the contractor’s take “still benefit[ed] from a higher market price environment through an increased return on investments”, in this way it always preserved the initial expectations parties had in the negotiation of the Contracts.<sup>1038</sup> Fair Links presented a ‘free cash flows analysis’ over a period of ten years (i.e., the cash that a company is able to generate after spending the resources required to maintain its capital expenditure) with Law 42 and Decree 662 in effect, determining that “it did not alter the global trend of positive cash flows” and “the Consortium’s operations [would have] generated a compounded surplus of more than \$8/bbl.”<sup>1039</sup>
660. Perenco challenged the credibility of this analysis, arguing it did “not include the impact of the *coactivas*” and reflected “an entirely hypothetical situation.”<sup>1040</sup> It relied on the evidence of Professor Kalt, which it stated accounted for the effect of the *coactivas*, and demonstrated at Figure 19 that it caused the free cash flow result to move from positive to negative.<sup>1041</sup>
661. Ecuador submitted in response that the evidence of both of its experts, Brattle and Fair Links, demonstrated that the effect of the *coactivas* on the Consortium was only that it created a greater financial incentive for the Consortium to withhold payments and suspend operations rather than to pay the dues and continue to operate the Blocks.<sup>1042</sup> Law 42 and Decree 662 applied only to revenues above the statutory reference price and only took effect after Perenco had an opportunity to benefit from a significant windfall from increasing oil prices.<sup>1043</sup>

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<sup>1037</sup> *Ibid.*

<sup>1038</sup> 1<sup>st</sup> Expert Report of Fair Links, paragraphs 102-103; Counter-Memorial, paragraph 598; Rejoinder, paragraph 521.

<sup>1039</sup> 1<sup>st</sup> Expert Report of Fair Links, paragraphs 109-114, Figures 14 and 15.

<sup>1040</sup> Reply, paragraph 366.

<sup>1041</sup> *Ibid.*

<sup>1042</sup> Rejoinder, paragraphs 522-527; Brattle, paragraphs 59-60; 1<sup>st</sup> Expert Report of Fair Links, paragraphs 109-119; 2<sup>nd</sup> Expert Report of Fair Links, p 5, paragraphs 47, 54.

<sup>1043</sup> Rejoinder, paragraphs 523, 527; Brattle, paragraphs 66(c), 105-112. Brattle asserts that by April 2006 when law 42 was introduced, “Perenco would have expected to have earned an IRR of close to 64%.” (Brattle, paragraph 64).

662. Ecuador emphasised the significance of the amendment of the Block 7 development plan relating to the Oso field in November 2007 (i.e., more than sixteen months after the enactment of Law 42). (This is discussed above in relation to the claim under Article 4 of the Treaty.) Perenco’s response was that Professor Kalt’s evidence suggested that “not having the benefit of the upside change[d] the midpoint”,<sup>1044</sup> and that the Oso field was “but one field of many, and not the most expensive at that.”<sup>1045</sup>
663. Ecuador also noted that the 2006 to 2008 Annual Reports of ConocoPhillips (Perenco’s consortium partner’s parent company) recorded no write-down on the book value of its Ecuadorian assets during those years, something it was required to report under US GAAP regulations. Ecuador submitted this suggested that there was no such impairment resulting from the enactment and implementation of Law 42.<sup>1046</sup>
664. Finally, Ecuador argued that there can be no permanent deprivation of Perenco’s investment because Law 42 only applied in the event the market price of Ecuadorian crude exceeded the Law 42 reference price. There were periods of time where Law 42 had no effect whatsoever on the Consortium’s profits.<sup>1047</sup>
665. Ecuador submitted that this evidence was similarly probative when considering whether Law 42 at 99% was expropriatory.<sup>1048</sup> It claimed that Perenco for its part again offered no objective evidence to demonstrate that Law 42 at 99% crippled its operations in Ecuador:

[I]t is worth noting that [Perenco] deliberately omitted any economic assessment by an independent economic expert of the impact of Law 42 on the Blocks 7 and 21 Consortium’s overall profitability. Accordingly, because Perenco has failed to sustain its burden of proof, this Arbitral Tribunal need not go any further. It should dismiss Perenco’s claims on this basis alone.<sup>1049</sup>

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<sup>1044</sup> Expert Report of Joseph P. Kalt, paragraphs 80-82, Figure 7B.

<sup>1045</sup> Reply, paragraph 374.

<sup>1046</sup> Counter-Memorial, paragraphs 610-612 cf. Reply at paragraph 372.

<sup>1047</sup> Counter-Memorial, paragraphs 616-617. For example, Block 7 in January and February 2009, as reflected in the letter sent by Petroecuador at E-139, Letter from Petroecuador to the Consortium dated 16 March 2009, p 1.

<sup>1048</sup> Rejoinder, section 5.3.3.

<sup>1049</sup> Counter-Memorial, paragraph 627.

666. Ecuador contended that Perenco could not succeed in its claim that Law 42 at 99% amounted to a permanent deprivation of its benefits under the Contracts<sup>1050</sup> because Law 42 applied only above a certain reference price, preserving the returns the Contractor could expect from the base price contemplated in the negotiations up to the Law 42 reference price.<sup>1051</sup> The “test for indirect expropriation as a matter of international law [was] high”, and the “mere loss of value, which [was] not the result of an interference with the control or use of the investment, [was] not an indirect expropriation. Were it otherwise, every breach of contract which [led] to a loss of value would constitute an expropriation.”<sup>1052</sup>
667. Ecuador argued that it could prove that “there was neither a total loss of value of Perenco’s investment nor a loss of control over it.”<sup>1053</sup> It relied on the findings of Fair Links and Brattle that “[t]he operations of Perenco were still generating positive cash flows after the enactment of Law 42 and Decree 662”,<sup>1054</sup> Perenco’s offer to place Law 42 monies into escrow,<sup>1055</sup> similarly the amendment to the Block 7 development plan relating to the Oso field, and ConocoPhillips’ annual reports for the period 2006 to 2008.<sup>1056</sup> In this connection, Ecuador highlighted that the only impairment recorded by ConocoPhillips was in its 10-K form for 2009, a consequence of Perenco’s allegedly unlawful suspension of operations in July

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<sup>1050</sup> Rejoinder, section 5.3.3. Ecuador submits that the “test for indirect expropriation as a matter of international law is high” (Rejoinder, paragraph 541).

<sup>1051</sup> Counter-Memorial, paragraphs 629-631; Rejoinder, paragraph 543.

<sup>1052</sup> Rejoinder, paragraphs 541 to 542, citing *El Paso Energy International Company v. Argentine Republic*, ICSID Case No. ARB/03/15, Award (31 October 2011), paragraph 256, (EL-165).

<sup>1053</sup> Rejoinder, paragraphs 542-554.

<sup>1054</sup> 1<sup>st</sup> Expert Report of Fair Links, paragraphs 109-119; 2<sup>nd</sup> Expert Report of Fair Links, paragraph 47, 54; Expert Report of Brattle, paragraphs 16, 60-91, 109. See also, Rejoinder, paragraphs 528-531 (“As of October 2007, when Decree 662 came into force, oil prices had increased even further still. The net effect of the price rises and the windfall accumulated pre-April 2006 meant that even when combined with the application of Decree 662 at 99% the Contractor would have expected the Block 7 Contract to generate an IRR of 64% over the life of the Contract. With the full use of hindsight, in July 2012, the built-up windfall and prices actually realized meant that, against the initial modelling, the Contractor even paying Decree 662 dues at 99% would still have generated an IRR of around 63.9%. The position for Block 21, updating the 2000 development plan for actual oil prices and holding the other ex ante assumptions unchanged, was similar. The Contractor looking out in April 2006 when Law 42 came into force, would still have expected an IRR of close to 50%. By October 2007, when Decree 662 came into effect, the pre-April 2006 windfall when combined with increasing prices would still have led a contractor to expect an IRR of 43% on its investment in Block 21 even applying Decree 662 at 99%. By July 2012, looking back with hindsight, and applying the actual prices realized to the ex ante model, a contractor would have been expected to generate an IRR of 43% on Block 21 even if Decree 662 at 99% applied to it.”)

<sup>1055</sup> Rejoinder, paragraphs 546-551.

<sup>1056</sup> Counter-Memorial, paragraphs 629-636.

2009.<sup>1057</sup> While Perenco submitted that it had no alternative but to suspend operations and leave the Blocks, Ecuador relied on the evidence of Brattle to assert that it was because Perenco was earning “extraordinary returns off the back of the sustained period of extraordinary and unexpected oil prices” that it “ha[d] an incentive to breach the participation contracts if it could make more money in the short term withholding Law 42 and Decree 662 dues than it could expect to make over the long-term through continued production over the remaining life of the Blocks.”<sup>1058</sup>

668. Finally, Ecuador submitted that should the Tribunal find that the measures complained of by Perenco constituted an expropriation of its investment within the meaning of Article 6 of the Treaty, such expropriation was lawful in the circumstances.<sup>1059</sup> Law 42 served a public purpose and was necessary.<sup>1060</sup> Perenco had not demonstrated that Ecuador’s measures were discriminatory.<sup>1061</sup> There had been moreover no violation of “specific undertakings” since Ecuador maintained that the Contracts were not breached or modified.<sup>1062</sup> It submitted it was not required to pay compensation since this condition in Article 6 was triggered only by an expropriatory action having already taken place and a finding of the same (whether in the form of acceptance by the State or a declaration by an arbitral tribunal).<sup>1063</sup>

### (3) The Tribunal’s Decision

#### *a. The remaining jurisdictional objections*

669. The Respondent’s jurisdictional objections can be dealt with summarily. It will be recalled that Ecuador argues that the Tribunal lacks jurisdiction because the *coactiva* notices were issued by the *Juzgado de Coactivas de Petroecuador* and the Tribunal has already ruled that it does not

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<sup>1057</sup> 1<sup>st</sup> Expert Report of Fair Links, p 41.

<sup>1058</sup> Rejoinder, paragraphs 533-540, citing Expert Report of Brattle, paragraphs 93, 99-101, Figures 12-13.

<sup>1059</sup> Counter-Memorial, paragraphs 649-651.

<sup>1060</sup> Rejoinder, paragraph 623.

<sup>1061</sup> *Ibid.*

<sup>1062</sup> *Ibid.*

<sup>1063</sup> Counter-Memorial, paragraphs 649-651 cf. Reply, paragraph 428: Perenco submits that since Article 6 stipulates “such compensation...shall be determined not later than the date of expropriation”, the “obligation to pay compensation for an expropriation is concomitant, not subsequent, to the taking of the expropriation.”

have jurisdiction over Petroecuador.<sup>1064</sup> In the Tribunal's view, the determination that the Republic, not Petroecuador, was the proper party to the claim does not in any way restrict the Tribunal's jurisdiction to consider measures taken by Petroecuador in the context of this treaty claim. The *coactivas* were measures taken to enforce Law 42 and are attributable to the State for the purposes of international responsibility. Distinctions between different agencies of the Ecuadorian State which may be relevant to a contract claim governed by Ecuadorian law may not be relevant when it comes to an international law claim based on a treaty. The Tribunal considers that this is such a case and that it therefore has jurisdiction to consider the *coactivas*' consistency with the Treaty. The objection is dismissed.

670. As for Ecuador's objection to the Tribunal's jurisdiction *ratione materiae* to consider that part of Perenco's case which extends to claiming that the *caducidad* decrees "completed" the expropriation of Perenco's rights and property (or, alternatively, the objection to the admissibility of the same), the Tribunal considers that the initiation of the *caducidad* proceedings and the ultimate declarations made by the Ministry are likewise attributable to the State. The fact that the Block 7 Contract excluded the arbitrability of *caducidad* under that Contract cannot preclude the Tribunal from considering the declaration's consistency with Ecuador's obligations under the Treaty. This objection is also dismissed.

*b. Law 42 at 50%*

671. It appears that although the Claimant saw Law 42 at 50% as the first of a series of measures that culminated in the expropriation of the investment, it did not press the point that at 50% Law 42 was itself an expropriation.<sup>1065</sup> The Tribunal agrees that at 50%, Law 42 did not constitute a deprivation within the meaning of Article 6.

672. While like any other windfall tax, Law 42 reduced Perenco's profitability, it did not deprive the Claimant of its rights of management and control over the investment in Ecuador, nor did it reach the requisite level of a substantial diminution in the value of that investment. The

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<sup>1064</sup> Counter-Memorial, paragraph 444, fn. 372, citing Decision on Jurisdiction, paragraph 242.3. Cf. Reply, paragraph 346.

<sup>1065</sup> Reply, paragraph 356: "At 50%, Law 42 constituted a breach of the Participation Contracts and of the fair and equitable treatment and non-impairment standards under the Treaty...At 99%, it was also economically devastating to Perenco, and, contrary to Ecuador's contention, constituted an expropriation in and of itself."

Tribunal is mindful in this regard of the point made in a number of awards that a distinction is to be drawn between a partial deprivation of value, which is not an expropriation, and a “complete or near complete deprivation of value”, which can constitute an expropriation.<sup>1066</sup> Thus, for example, in *Tecmed v. Mexico*, the tribunal adverted to measures that “radically deprived [the investor] of the economical use and enjoyment of its investments, as if the rights related thereto... had ceased to exist” or, to put it another way, “the assets involved have lost their value or economic use for their holder...”.<sup>1067</sup> In *CME v. Czech Republic*, the tribunal noted that an indirect expropriation can arise where there are measures that do not involve an overt taking but that *effectively neutralize the benefit* of the property of the foreign owner...”.<sup>1068</sup>

673. These formulations as to the amount of deprivation of value required to be shown before an indirect expropriation will be found to exist tend in the direction of positing a very substantial amount of deprivation. It need not be complete, but it must be very substantial. The point was also made by the tribunal in *EnCana v. Ecuador*, where the tribunal found that a denial of VAT refunds did not amount to an indirect expropriation because there was no evidence to suggest that the measure “brought the companies to a standstill or rendered the value to be derived from their activities so marginal or unprofitable as effectively to deprive them of their character as investments.”<sup>1069</sup>
674. Using the standards employed in prior cases, it is plain that Law 42 at 50% did not substantially deprive the Claimant of its investment, or effectively neutralise the benefit of the investment or rights related thereto, nor did it render Perenco’s activities so marginal or unprofitable as to effectively deprive them of their character as investments. Reference to, for example, the Consortium’s tax returns for 2006 and its Oso Development Plan, discussed previously, demonstrates this clearly.

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<sup>1066</sup> *Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic*, ICSID Case No. ARB/97/3, Award (20 August 2007), paragraph 7.5.11.

<sup>1067</sup> *Técnicas Medioambientales Tecmed S.A. v. United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award (29 May 2003), paragraph 115 [Emphasis added].

<sup>1068</sup> *CME Czech Republic, B.V. (the Netherlands) v. The Czech Republic*, UNCITRAL Partial Award (13 September 2001), paragraph 604 [Emphasis added].

<sup>1069</sup> *EnCana Corporation v. Republic of Ecuador*, LCIA Case No. UN 3481, Award (3 February 2006), paragraph 174.

*c. Law 42 at 99%*

675. With respect to Decree 662, it is to be noted that other than the claim to 99% of the “extraordinary revenues” – which the Tribunal has already found to be a breach of Article 4 – the State did not attempt to interfere with the normal attributes of management and control over the investment. This part of the claim turns entirely on the question of whether the State’s demand of payment of 99% of the “extraordinary revenues” amounted to such a substantial diminution of Perenco’s investment such as to amount to an indirect expropriation.
676. Perenco argued that it plainly was; taking away 99% of the Contracts’ upside benefits amounted to an indirect expropriation of its investment, even if it retained the ability to generate income at and below the reference price, and otherwise continue to operate the business. Ecuador looked at it from the other end of the telescope: since Decree 662 applied only above the reference price for each Contract, there could be no finding of expropriation because the revenues generated by sales up to the reference price were broadly what the parties expected would be generated when the Contracts were entered into, and there was no interference with the management and control of the business.
677. The Tribunal has already rejected Ecuador’s contention that Perenco’s contractual expectations were satisfied by its obtaining the kind of revenues that were anticipated at the time of contracting. This goes against the very notion of a participation contract and fails to accord sufficient weight to Perenco’s assumption of risk. That said, there is merit in Ecuador’s argument that Decree 662 did not interfere with the management and control of the business.
678. As for Decree 662’s impact on Perenco’s operations, Ecuador referred to the evidence of its expert, Fair Links. Figure 14 in Fair Links’ first Report, which charted Block 21’s historical free cash flow<sup>1070</sup> analysis, suggested that both the cumulative and annual free cash flow of the Consortium should have remained steadily positive throughout the enactment and implementation of Law 42 and Decree 662.<sup>1071</sup> Figure 15 charted the historical cash flow analysis for Block 7, and similarly posited a steady increase of the annual and cumulative free

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<sup>1070</sup> The term ‘free cash flow’ is defined by Fair Links as “the cash that company is able to generate after spending the resources required to maintain or expand its asset base (free cash flows are calculated as operating cash flow minus capital expenditures)”: 1<sup>st</sup> Expert Report of Fair Links, p 39, paragraph 109.

<sup>1071</sup> 1<sup>st</sup> Expert Report of Fair Links, Figure 14, p 40.

cash flow that the Consortium should have had the benefit of during that time.<sup>1072</sup> Fair Links found that for both Blocks “the most significant annual cash contributions over the life of the [Blocks] [were] either in 2007 (Block 21) or 2008 (Block 7), i.e., when Law 42 then Decree 662 were fully applicable.”<sup>1073</sup> It is pertinent to note that the charts recorded a dip in the annual free cash flow for Block 21 in 2008 as compared to 2007 (though it remained positive).<sup>1074</sup> The same cannot be said for the amount of annual free cash flow in Block 7; Figure 15 recorded a rise in 2008 (though not as significant as the increase in positive free cash flow from 2006 to 2007 in Block 7).<sup>1075</sup>

679. The evidence of Perenco’s expert, Professor Kalt, was that the effect of Law 42 and Decree 662 should be considered from the perspective of “field viability”, i.e., the balance between the revenues associated with operating the field as weighed against the capital costs already incurred and the operational costs associated with continuing production. Perenco made significant investments in Blocks 7 and 21 after it bought its interest in 2002, totaling approximately US \$364 million.<sup>1076</sup> The effect of the tax at 99% could not be weighed solely against the current operating costs of the contractor but additionally had to account for sunk capital costs.<sup>1077</sup> He responded to Fair Link’s evidence that the Consortium continued to generate positive annual free cash under Decree 662 by challenging whether the margin was “‘reasonable’ and/or ‘enough’...to make it rational for Perenco to continue to operate under” the Participation Contracts from the contractor’s perspective, i.e., a perspective of field viability, and submitting that the “economic character” of Contracts under Decree 662 had taken on the “most extreme form of government participation – i.e., a service contract.”<sup>1078</sup> He further contended that “Fair Links’ own ‘free cash’ analysis implicitly recognize[d] [that under Decree 662] Perenco was effectively only able to recover expenses and was not even afforded recovery of past or going-forward capital related costs (including a return on capital).”<sup>1079</sup> In

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<sup>1072</sup> 1<sup>st</sup> Expert Report of Fair Links, Figure 15, p 40.

<sup>1073</sup> 1<sup>st</sup> Expert Report of Fair Links, p 39, paragraph 111.

<sup>1074</sup> 1<sup>st</sup> Expert Report of Fair Links, Figure 14.

<sup>1075</sup> 1<sup>st</sup> Expert Report of Fair Links, Figure 15, p 40.

<sup>1076</sup> Expert Report of Joseph P. Kalt, paragraph 145.

<sup>1077</sup> *Ibid.*

<sup>1078</sup> Expert Report of Joseph P. Kalt, paragraph 146 [italics in original].

<sup>1079</sup> Expert Report of Joseph P. Kalt, paragraph 147.

this regard, Figure 17 of his report opined that under Decree 662 and before *coactivas* were issued, Perenco would have reported a loss of net income from combined Block 7 and 21 operations of US \$60.6 million, when it should have earned a projected profit of US \$272 million (in the absence of Law 42).<sup>1080</sup>

*d. The Tribunal's Decision*

680. In the Tribunal's view, although it contravened Article 4 of the Treaty for the reasons previously explained, Decree 662 did not amount to an indirect expropriation. The Tribunal's reasons are threefold.

681. First, the Tribunal recalls Perenco's expectations of relatively stable oil prices at the time of the acquisition of its interests in the Contracts. As Mr. Spink testified, at US \$20/barrel, Perenco considered that it could achieve a return on its investment in a relatively short period of time. Subject to what the Tribunal has to say about the impact of the *coactivas* on the Consortium's cashflow, which is dealt with separately below, if this was so prior to Decree 662, it remained the case thereafter. Perenco continued to operate the Blocks and there was no impairment of any rights of ownership or control.

682. At paragraph 672 above, the Tribunal referred to three cases in which other tribunals focused on whether the effect of the alleged expropriatory measures came close to extinguishing the investor's business. To these can be added other cases. In *Grand River Enterprises Six Nations, Ltd., et al. v. United States of America*, the tribunal found that a measure was not expropriatory when it did not cause a "complete or very substantial deprivation of owners' rights in the totality of the investment" and the claimant remained in possession of an "ongoing business".<sup>1081</sup> It made these remarks with regard to Article 1110 of the NAFTA, highlighting several decisions which bear some resemblance to the facts of the present case:

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<sup>1080</sup> *Ibid.*, and Figure 17 of 2<sup>nd</sup> Expert Report of Fair Links, paragraphs 48-52: "...in 2008, assuming that Perenco had paid Decree 662 dues for the whole year...Perenco's operations would have generated a compound surplus (free cash flow) of more than US \$8/bbl". It alleged that Professor Kalt "confuse[d] cash flows and accounting income and fail[ed] to consider that the main source of losses for Block 21 was the accounting treatment of amortizations (close to \$70 million)."

<sup>1081</sup> *Grand River Enterprises Six Nations, Ltd., et al. v. United States of America*, UNCITRAL, Award (12 January 2011), paragraph 148.

148. Other NAFTA tribunals have regularly construed Article 1110 to require a complete or very substantial deprivation of owners' rights in the totality of the investment, and have rejected expropriation claims where (as here) a claimant remained in possession of an ongoing business. The *Pope & Talbot* Interim Award rejected a claim that the disputed measures interfered with the claimants' business sufficiently to constitute an expropriation, where the claimant continued to make profitable exports of logs. As the *S.D. Myers* tribunal explained, '[a]n expropriation usually amounts to a lasting removal of the ability of an owner to make use of its economic rights.'

149. The tribunal in *Feldman v. Mexico* rejected a claim of expropriation where the claimant remained in possession and able to conduct other lines of business.

'[H]ere, as in *Pope & Talbot*, the regulatory action (enforcement of longstanding provisions of Mexican law) has not deprived the Claimant of control of the investment, CEMSA, interfered directly in the internal operations of CEMSA or displaced the Claimant as the controlling shareholder. The Claimant is free to pursue other continuing lines of export trading, such as exporting alcoholic beverages, photographic supplies, or other products ... although he is effectively precluded from exporting cigarettes. Thus, this Tribunal believes there has been no "taking" under this standard articulated in *Pope & Talbot*, in the present case.'

150. *Glamis Gold* is to similar effect.

'[A] panel's analysis should begin with determining whether the economic impact of the complained of measures is sufficient to potentially constitute a taking at all: '[I]t must first be determined if the Claimant was radically deprived of the economical use and enjoyment of its investments, as if the rights related thereto ... had ceased to exist.' The Tribunal agrees with these statements and thus begins its analysis of whether a violation of Article 1110 of the NAFTA has occurred by determining whether the federal and California measures "substantially impair[ed] the investor's economic rights, i.e. ownership, use, enjoyment or management of the business, by rendering them useless. Mere restrictions on the property rights do not constitute takings.'<sup>1082</sup>

683. The *Grand River* tribunal added that this was consistent with the approach of non-NAFTA tribunals who have "held that an expropriation requires very great loss or impairment of all of a claimant's investment":

151. ...ICISD tribunals have rejected expropriation claims involving significant diminution of the value of a claimant's property where the claimant nevertheless retained ownership and control. Thus, the Tribunal in *CMS v. Argentina* rejected a claim of expropriation where the claimant retained full ownership and control

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<sup>1082</sup> *Grand River Enterprises Six Nations, Ltd., et al. v. United States of America*, UNCITRAL, Award (12 January 2011), paragraphs 149-150 [Internal citations omitted].

of the investment, even though its value was reduced by more than 90%. *LG&E v. Argentina* is similar: ‘Interference with the investment’s ability to carry on its business is not satisfied where the investment continues to operate, even if profits are diminished.’<sup>1083</sup>

684. Having regard to the strict tests posited by the foregoing cases, the Tribunal considers that although Decree 662 breached the fair and equitable treatment standard, it did not amount to an indirect expropriation. It came close to, but did not cross the line.
685. Second, throughout the period following the application of Decree 662 and until the suspension of operations in July 2009, Perenco continued to operate the fields and either paid Law 42 dues at 99% (until it submitted the claim to ICSID arbitration following the President’s suspension of the negotiations in April 2008) or thereafter deposited the disputed amounts into a bank account located outside of Ecuador. Even after the arbitration started in earnest, Perenco stated its willingness to comply with the Tribunal’s suggestion that the Parties agree an escrow account arrangement such that future payments of the disputed sums could be set aside pending a decision from the Tribunal on the merits. Thus, the financial burden of paying 99% of the revenues above the reference price, while disadvantageous to Perenco, did not bring its operation to a halt or, to revert to the tests previously cited, effectively neutralise the investment or render it as if it had ceased to exist.<sup>1084</sup>
686. Third, throughout 2008 and into 2009, Perenco continued to negotiate with Ecuador with a view to arriving at a mutually satisfactory adjustment of their relationship. It has already been found that it did so in an atmosphere of coercion, and was seeking to make the best of a worsening situation, and for this reason the Tribunal does not attach much weight to this point,

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<sup>1083</sup> *Ibid.*, paragraph 151.

<sup>1084</sup> After the Tribunal had substantially completed its deliberations in this phase of the proceeding, on 28 May 2014, Ecuador filed a letter together with a document that it proposed to put before the Tribunal. The document, that Ecuador sought to have admitted as Exhibit E-376, was an internal ConocoPhillips email exchange entitled “Drilling Plan Proposal from Ecuador”, dated 9 October 2007. In this document, employees of ConocoPhillips (the parent company of Perenco’s fellow consortium member, Burlington) referred to communications with Perenco after Decree 662 had been promulgated in which Perenco expressed views as to the economics of proceedings with certain drilling plans in the changed circumstances. By letter dated 14 June 2014, Perenco objected to the admission of the document at this stage of the proceeding. After considering the document and the Parties’ submissions, on 19 June 2014, the Tribunal informed the Parties that due to the lateness of the request and the requirements of procedural fairness, it would not admit the document to the record. In the Tribunal’s view, given its analysis of the Treaty claims, the document, had it been admitted, would have made no difference to the outcome of this Decision.

but it does provide some basis for the Tribunal's view that Decree 662 did not bring the investment to an end.

687. In arriving at this conclusion, it need hardly be said that it is obvious that the constraints imposed by Decree 662 made its operating conditions highly sub-optimal for Perenco. The immediate impact of Decree 662 (and subsequent statements from Ecuadorian ministers as to the State's intention to convert participation contracts into service contracts) likely led to a reduction in investment, increased the demands placed on management, and caused substantial stress to the business generally. But the central focus of the expropriation analysis is not on whether a claimant's business was optimal, but rather on whether it was effectively taken away from it.
688. The Tribunal has focused primarily on the effect of Decree 662 on Perenco. The Claimant made additional arguments going to the legitimacy and proportionality of the decree in terms of its purpose. Indeed, one can reasonably ask whether it was appropriate for the State to claim 99% of the extraordinary revenues and whether this was disproportionate to the State's public policy objective. As Perenco pointed out, Ecuador had the benefit of "far less Draconian measures" as evidenced by the enactment of *Ley de Equidad Tributaria* and its offer of a 70-30 split over higher reference prices than the one Law 42 employed.
689. This argument has some merit, but at the end of the day, the Tribunal does not believe that a measure which may be disproportionate tips the balance to a finding of expropriation where the evidence of effect indicates otherwise. The disproportionality point was relevant to the finding that Decree 662 constituted a breach of the fair and equitable treatment standard, but it does not get the Claimant over the hurdle of proving an indirect expropriation in this case.
690. In sum, the Tribunal holds that Decree 662 did not effect an indirect expropriation. This, of course, is not the end of the matter. There remains the combined effect of Decree 662, the initiation of the *coactivas*, Ecuador's decision not to comply with the Decision on Provisional Measures, the suspension of operations and the initiation of *caducidad* proceedings. At the end of the day, Perenco's contractual rights were formally terminated by the declaration of *caducidad* and the investment in Blocks 7 and 21 was effectively brought to an end as of the date of that declaration.

*e. The combined effect of Decree 662, the coactivas, and the declaration of caducidad*

691. Ecuador argues that the Consortium pursued a kind of “self-expropriation” strategy whereby Perenco and Burlington, having calculated the costs of continuing to operate the Blocks and complying with Law 42 versus surrendering the Blocks, holding onto the monies which they had paid into an account outside the territory of Ecuador, and suing for damages in this arbitration, knowingly took action that would provoke the authorities to intervene and exercise their statutory duties.<sup>1085</sup>
692. Perenco rejected the “self-expropriation” allegation, noting firstly, that it expressed its willingness to pay the disputed Law 42 sums into escrow during the pendency of the arbitration (specifically future payments that would otherwise be due after the escrow account’s establishment) and secondly, that after the seizures of its production led it to suspend its operations, it offered to resume operations if Ecuador brought itself into compliance with the Tribunal’s Decision on Provisional Measures.<sup>1086</sup> This of course did not occur.
693. The decision as to whether or not the measures, starting with the *coactivas* and continuing through to the declaration of *caducidad*, amount to an expropriation of Perenco’s investment is not as straightforward as either party suggests.
694. The Tribunal has already found that Perenco had a reasonable expectation under the Participation Contracts that Ecuador would comply with any decision of the Tribunal. This contractual expectation was buttressed by the general expectation that any disputing party has that once the dispute is submitted to arbitration, both parties will seek to conform their conduct to the Tribunal’s directives, particularly with respect to the non-aggravation of the dispute.
695. Ecuador found itself unable to comply with the Tribunal’s Decision in this case. The Tribunal can well understand why in 2009, in applying a domestic law, Ecuador would wish to liquidate the amounts claimed to be owing for 2008. However, when the matter was put before the Tribunal, Ecuador’s duty to enforce the law conflicted with its contractual obligation to comply with decisions of the Tribunal. The Tribunal recommended what it considered to be a reasonable way to protect both Parties’ rights pending a final determination of their dispute.

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<sup>1085</sup> Rejoinder, paragraphs 290, 306-311, 533-540.

<sup>1086</sup> Reply, paragraphs 254-266.

Regrettably, this was not possible in the circumstances. Perenco is correct to point out that had the State stayed its hand in relation to the *coactivas*, the dispute would not have been aggravated in the way in which it was.

696. The Tribunal is therefore presented with a situation in which the Respondent seized Perenco's oil production and put it to auction in order to retire the claimed Law 42 debt for 2008. When Perenco (and Burlington) declined to use the monies located outside of Ecuador to pay the claimed debt, it was obvious that Ecuador's decision to employ the *coactivas* would have a serious impact on the Consortium's cashflow.

697. When it came to the auctioning of the seized oil, both Parties contributed to the situation. The State held auctions and Perenco, it appears, threatened suit against any person who bought the oil that had been seized from it.<sup>1087</sup> As a result, the prices achieved by Petroecuador's purchasing the oil in the absence of any other bidder were substantially less than the market price. Perenco was in turn credited with a lower value than would have obtained had the oil been sold at market prices. Ecuador bought the production of Blocks 7 and 21 for half and subsequently two-thirds of its market price.<sup>1088</sup> It credited these sales against Perenco's Law 42 debt, but did so at the reduced auction sales price rather than at the market price of the crude.<sup>1089</sup>

698. Perenco submits that under both Contracts, with Law 42 at 99% in effect, and its crude being seized and auctioned off at less than its international market price, it was being asked to use its operational revenue not caught by Law 42 to pay off remaining old and future Law 42 assessments.<sup>1090</sup> It asserted that while it could have "continued operating for a limited amount of time...by drawing down cash reserves, it could only continue to erode its overall return on

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<sup>1087</sup> Exhibit E-57, "Perenco Will Protect Its Rights in Ecuadorian Oil Seized in Defiance of International Arbitration Tribunal Orders," PR Newswire, London, 3 July 2009; Transcript, Hearing on the Merits, Day 2, p 316 (Opening Statement of Respondent).

<sup>1088</sup> Reply, paragraph 356; Exhibits E-92 (table of auctions of Block 7 crude) cf. CE-290 (PER 04597) (2009 DNH audit of Block 7) and CE-291 (PER 04606) (2009 DNH audit of Block 21).

<sup>1089</sup> Reply, paragraph 360.

<sup>1090</sup> Reply, paragraphs 360-362.

the substantial capital investments it had already made in the Blocks...by continuing to operate with no revenue inflows[.]”<sup>1091</sup>

699. Relying on the evidence of Professor Kalt, Perenco submitted that the manner and price at which Ecuador chose to auction its crude placed it in an “economically devastating position.”<sup>1092</sup> In this connection, Professor Kalt challenged Fair Link’s conclusions regarding the free cash flow that the Consortium would have benefited from in 2008 and 2009 despite the effect of *coactivas*<sup>1093</sup> as flawed because it failed to account for the effect that the *coactivas* had on “the Contractor’s incentives to continue operating.”<sup>1094</sup> He stated that the “impact of Ecuador’s decision to seize production share as compensation for past Law 42 assessments can be readily illustrated by the fact that these seizures were large enough to reduce Perenco’s actual sales volumes to zero by early 2009. Thus, in reality, by 2009 Perenco could not have had positive free cash flow since it was receiving no cash inflows from sales of oil. At the same time, it continue[d] to incur significant out of pocket costs to continue operating the field and to transport the production to the market place. In such circumstances, net free cash flow ha[d] to be negative, not positive as claimed by Fair Links.”<sup>1095</sup> For example, for Block 7 in 2009, Professor Kalt submitted that instead of free cash flow of US \$32 million, the Consortium would have suffered a loss of US \$66 million as a result of Law 42, Decree 662 and the *coactivas*.<sup>1096</sup>

700. In its second report, Fair Links responded to Professor Kalt’s points, contending that the “impact of the *Coactivas* procedures is different to an assessment of Law 42 (including Decree 662) in 2009.”<sup>1097</sup> In its First Report, Fair Links concluded that, assuming that Perenco paid its Decree 662 dues for 2008, it should have nevertheless benefited from a “compound surplus (free cash flow) of more than \$8/bbl”.<sup>1098</sup> Fair Links argued in this regard that Decree 662 and the *coactivas* were two separate measures, and to add them would be to “distort the impact of

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<sup>1091</sup> Reply, paragraph 363.

<sup>1092</sup> Rejoinder, section 5.3.2; Brattle, paragraph 93.

<sup>1093</sup> 1<sup>st</sup> Expert Report of Fair Links, pp 39-40.

<sup>1094</sup> Expert Report of Joseph P. Kalt, paragraph 153, p 78.

<sup>1095</sup> Expert Report of Joseph P. Kalt, paragraph 155, p 79.

<sup>1096</sup> Expert Report of Joseph P. Kalt, Figure 19, p 80.

<sup>1097</sup> 2<sup>nd</sup> Expert Report of Fair Links, paragraphs 55, p 21.

<sup>1098</sup> *Ibid.*, paragraph 48, p 19.

Law 42.”<sup>1099</sup> It clarified its meaning in the course of the report, explaining that since the *coactiva* procedures were meant to enforce Law 42, to request what should have been paid under Law 42, its design was not to impose “an additional burden beyond Law 42” but to collect “sums that Perenco already received as revenues in 2008 but had withheld.”<sup>1100</sup> It challenged Professor Kalt’s analysis as “distorted by the impact of the discounts from the actual auction procedures”, stating that since it had been “instructed that these discounts resulted from Perenco’s own actions to hamper the auction process rather than from *Coactivas’s* (sic) legal procedures”, its approach was that the “impact of *Coactivas* should be assessed independently from discounts that were caused by Perenco itself.”<sup>1101</sup>

701. Ecuador’s second expert, the Brattle Group, took a different tack and responded by extrapolating from the Annex V and development models Professor Kalt employed before concluding that “[i]f we isolat[ed] the impact of the auction results...the evidence appear[ed] entirely consistent with [its] analysis of the consortium’s financial incentives in April 2008, namely that potentially greater value could be had for the consortium by withholding Law 42 and Decree 662 dues over the short-term than could be gained through paying the dues and operating the fields until the scheduled end of the contracts.”<sup>1102</sup> Figures 12 and 13 of the Brattle report suggest that in August 2008, when oil market prices hit a peak,<sup>1103</sup> the cumulative value of Law 42 dues began to exceed the continuation value of operations to the Consortium. Ecuador emphasised repeatedly that Law 42 and Decree 662 only applied to revenues above statutory reference prices beyond the *ex ante* price assumptions of the parties.<sup>1104</sup> Brattle’s evidence is that since neither Law 42 nor Decree 662 reduced the expected price net of taxes below the originally anticipated levels, neither measure reduced the cash flows, internal rate of return or net present value of the financial models for Block 7 and 21

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<sup>1099</sup> *Ibid.*, paragraph 55, p 21.

<sup>1100</sup> *Ibid.*, paragraph 57, p 21.

<sup>1101</sup> 2<sup>nd</sup> Expert Report of Fair Links, paragraph 58, p 21.

<sup>1102</sup> Expert Report of Brattle, paragraph 24.

<sup>1103</sup> 2<sup>nd</sup> Expert Report of Fair Links, Figure 7.

<sup>1104</sup> Counter-Memorial, paragraphs 185, 419; Rejoinder, paragraph 8, 523 etc.

below the original estimates.<sup>1105</sup> Indeed, “the cash flows, internal rate of return or net present value of these financial models were all much greater than the original estimates.”<sup>1106</sup>

702. Ecuador made the further point that Law 42 and Decree 662 came into effect after oil prices had already begin to rise; in other words they did not “deprive Perenco of the massive windfalls it had already generated in a period of skyrocketing oil prices before 2006.”<sup>1107</sup> The suggestion is that this should be accounted for in any analysis of whether the IRR of 15% was being met over time (i.e., challenging Professor Kalt’s IRR of 13% as ignoring the upsides that Perenco had already received).<sup>1108</sup>

703. In the end, the narrow question for the Tribunal is whether Perenco, having sought the aid of the Tribunal, could then take comfort that its refusal to pay the 2008 Law 42 dues to Ecuador would protect it in this arbitration without any potentially adverse consequences. The Tribunal has carefully considered the Parties’ positions. It considers that Perenco had a right to expect that Ecuador would desist from enforcing the *coactivas* during the pendency of the arbitration. It also considers that in deciding to withhold all Law 42 amounts claimed in 2008, Perenco assumed that the Tribunal would accept its claims that none of the Law 42 dues claimed by the State were permissible under the Contracts or the Treaty. Given that Perenco has not made out its claims in respect of Law 42 at 50%, the Tribunal holds that even though Ecuador should have complied with the Decision on Provisional Measures, the *coactivas* ought not to be included in the Tribunal’s analysis of the measures said collectively to constitute an indirect expropriation. (Quite apart from the expropriation issue, the Tribunal considers that Petroecuador’s decision to credit the Consortium’s tax debt with only the price received in the auction was unfair and inequitable. It can be safely assumed that Petroecuador would have sold the oil at the market price and by crediting Perenco with the depressed auction price instead of the prevailing market price, it would plainly take longer for the seizures to pay down the debt claimed to be owing. In addition, to the extent that Perenco has succeeded in its claim that the application of Decree 662 at 99% violated Article 4 of the Treaty, as found at paragraphs 606-607 above, the enforcement of the *coactivas* to collect the claimed additional 49% constituted a

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<sup>1105</sup> Expert Report of Brattle, paragraphs 9-11.

<sup>1106</sup> Expert Report of Brattle, paragraph 12.

<sup>1107</sup> Rejoinder, paragraphs 525-527.

<sup>1108</sup> Rejoinder, paragraphs 526-527 cf. Expert Report of Joseph P. Kalt, paragraphs 106-108, Figure 10.

breach of the fair and equitable treatment standard, but it was not an expropriation of the investment.)

*f. The suspension of operations and the State's response thereto*

704. This takes the Tribunal to the suspension of operations which can be addressed summarily. Perenco argued that the State's decision to intervene and operate the blocks after it decided to suspend operations amounted to an expropriatory act. While the Tribunal has accepted that the defence of *exceptio non adimpleti contractus* was available to Perenco under Ecuadorian law, and therefore it could lawfully suspend operations when faced with a breach of contract without itself being found to be in breach, this does not dictate the conclusion that when faced with suspension of operations, the State was powerless to intervene and that any such intervention constituted an expropriation.

705. Here the Tribunal accepts the Respondent's argument that when the Consortium announced its intention to suspend operations, there were good and valid reasons for the State to intervene in order to operate the Blocks, thereby ensuring their continuity and maintaining their productivity.<sup>1109</sup> The Respondent has demonstrated the potential production losses and other technical problems that could have ensued had operations been suspended. The Tribunal therefore accepts that the State had the right to operate and maintain the Blocks after the Consortium withdrew.<sup>1110</sup> This intervention – which cannot be said to have interfered with the Consortium's rights of management and control over the Blocks because the Consortium had voluntarily surrendered such rights on a temporary basis – did not amount to an expropriation and cannot be counted towards one.

*g. The declaration of caducidad*

706. The Tribunal now turns to the Respondent's decision to initiate *caducidad* proceedings.<sup>1111</sup> This too can be dealt with summarily. While it accepts that the State had the right to intervene and operate the blocks, the Tribunal does not accept that the State was bound to bring the Claimant's contracts to an end by means of a *caducidad* declaration. The Tribunal notes in this

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<sup>1109</sup> Rejoinder, paragraphs 313-317, 614-617.

<sup>1110</sup> Rejoinder, paragraphs 614-617; 2<sup>nd</sup> Expert Report of PRS, paragraphs 7-8.

<sup>1111</sup> Rejoinder, paragraphs 611-623.

regard that under Chapter IX of the Hydrocarbons Law, Article 74, the Ministry “*may* declare the *caducidad* of contracts, if the contractor” engages in any of thirteen different types of acts including suspending operations “without cause justifying it, as determined by PETROECUADOR.”<sup>1112</sup> The Tribunal attaches particular importance to the fact that the opening phrase of Article 74 is expressed in permissive rather than mandatory terms. That is, the Ministry is empowered to declare the caducity of contracts in any of the specified circumstances, but it is not obliged to do so.

707. The Tribunal accepts Ecuador’s submission that this was not done without fair warning to the Consortium.<sup>1113</sup> The Ministry and Petroecuador wrote to the Consortium on four occasions requesting it to resume operations and warned that a failure to do so could lead to the termination of their Contracts.<sup>1114</sup>

708. But in all the circumstances of the case, the Tribunal considers that the Ministry should have stayed its hand and awaited the outcome of this arbitration. It was not contrary to Article 6 for Ecuador to have continued to operate the oilfields in the face of the Claimant’s refusal to return until the *coactiva* matter had been addressed to its satisfaction. But the decision to initiate caducity proceedings and thereby bring Perenco’s contractual rights to an end during the midst of this arbitration leads the Tribunal to find a breach of Article 6.

709. In this regard, the Tribunal notes that when Ecuador first indicated its inability to comply with the Decision on Provisional Measures, it stated that it had no intention to terminate the Participation Contracts:

...Nevertheless, Ecuador is committed to furthering the central goal of the Decision, namely to avoid any actions that would undermine the effectiveness of any potential award that might be issued (should the Tribunal ultimately affirm its jurisdiction and proceed to the merits). *To that end, Ecuador intends to carry out the enforcement of Law 42 in such a way as to avoid any disruption of Perenco’s business. In particular, Ecuador does not intend to seize any assets of the Consortium beyond oil equivalent in value to the outstanding debt. Nor does*

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<sup>1112</sup> Exhibit EL-90 Unofficial translation of Article 74 of the Hydrocarbons Law [Emphasis added.].

<sup>1113</sup> Rejoinder, paragraph 312.

<sup>1114</sup> Exhibits E-132/CE-236, Letter from Petroecuador to Perenco regarding suspension of operations, 21 July 2009 (in Spanish with English translation); E-107, Letter from Petroecuador to Perenco and Burlington dated 24 July 2009; E-133/CE-239, Letter from Petroecuador to Perenco requesting Perenco to resume operations, 18 August 2009; E-124, Letter from the Ministry of Mines and Petroleum to Perenco dated 19 August 2009.

*Ecuador intend to terminate the relevant Participation Contracts, or take legal action against Perenco representatives.”*<sup>1115</sup>

710. The Tribunal recognises that this statement of intention was made prior to the Consortium’s suspension of its operations and the ensuing correspondence between the Parties. Be that as it may, the Ministry had the discretion not to commence *caducidad* proceedings and it is the Tribunal’s judgment that this discretion should have been exercised in favour of not pursuing *caducidad* while the Parties’ respective rights and obligations were being determined in this proceeding. Accordingly, the Tribunal finds that as of the date of *caducidad* having been declared and the Consortium’s interests were finally brought to an end, the Respondent effected an expropriation of Perenco’s contractual rights contrary to Article 6 of the Treaty. This is the date of the expropriation; for the reasons given above, the Tribunal rejects the creeping expropriation argument advanced by Perenco.

711. This declaration of caducity was for the same reason equally a breach of the Block 21 Contract because, having occupied the blocks in order to safeguard the oilfields, it was unnecessary for the Ministry to then bring the Contract to an end.

## **IX. COSTS**

712. The issue of costs is reserved for the final award.

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<sup>1115</sup> Exhibit CE-212, Letter from Respondents regarding the Tribunal's Decision on Provisional Measures and Law 42, 15 May 2009 [Emphasis added.].

## X. DECISION

713. For the reasons set forth above, the Tribunal decides as follows:

- (1) The Tribunal has jurisdiction over all breach of contract claims as technical and/or economic disputes with the exception of the claim regarding the declaration of *caducidad* in respect of the Block 7 Contract. This falls outside of the Tribunal's contractual jurisdiction.
- (2) The Tribunal has jurisdiction over the claims of breach of Treaty.
- (3) The claim of breach of contract in respect of Law 42 at 50% is rejected.
- (4) The claim of breach of contract in respect of Law 42 at 99% is upheld.
- (5) The claim of breach of the Block 7 Contract in respect of alleged discriminatory treatment of Perenco in comparison to Andes Petroleum is rejected.
- (6) The claim of breach of the Block 21 Contract as a result of the declaration of *caducidad* is upheld.
- (7) The claim of breach of Article 4 of the Treaty in respect of Law 42 at 50% is rejected.
- (8) The claim of breach of Article 4 of the Treaty in respect of Law 42 at 99% is upheld.
- (9) The claim that Decree 662 constituted a breach of Article 6 of the Treaty is rejected.
- (10) The claim that the enforcement of the *coactivas* constituted a breach of Article 6 of the Treaty is rejected.
- (11) The claim that the Respondent's intervention in Blocks 7 and 21 in order to operate the oilfields after the Consortium suspended operations constituted a breach of Article 6 of the Treaty is rejected.

- (12) The claim that the declaration of *caducidad* constituted a breach of Article 6 of the Treaty is upheld.
- (13) Since the Respondent has brought a counterclaim which has already been the subject of pleadings and a hearing, the Tribunal is not in a position to consider granting the relief sought by the Claimant at paragraph 511 of its Reply, namely, a declaration that Perenco has no further obligation of any kind, to Ecuador, Petroecuador or any other Ecuadorian department or instrumentality, whether under the Participation Contracts or otherwise, with respect to Blocks 7 and 21; and
- (14) Having found the Respondent to be in breach of the Participation Contracts and the Treaty, it is necessary to move to the damages phase of this arbitration. The Tribunal will lay down a briefing schedule as well as propose dates for a hearing on damages for the parties' consideration.

[signed]  
Judge Peter Tomka  
President of the Tribunal

[signed]  
Mr. Neil Kaplan, C.B.E., Q.C., S.B.S.  
Arbitrator

[signed]  
Mr. J. Christopher Thomas, Q.C.  
Arbitrator