Neutral Citation Number: [2006] EWHC 345 (Comm)

Case No: 04/656

IN THE HIGH COURT OF JUSTICE
QUEEN'S BENCH DIVISION
COMMERCIAL COURT

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 02/03/2006

Before :

MR JUSTICE AIKENS

- -

Between :

The Republic of Ecuador	**Claimant**
- and -	
Occidental Exploration & Production Co	**Defendant**

- -
- -

Mr M Cran QC, Mr D Bethlehem QC and Mr S Birt (instructed by **Weil Gotshal & Manges, LLP, London**) for the **Claimant**
Mr C Greenwood QC and Mr T Landau (instructed by **Debevoise & Plimpton, LLP, London**) for the **Defendant**

Hearing dates: 12th, 13th, 14th, 15th and 16th December 2005
Further written submissions sent by Claimant on 19th December 2005.

- -

Judgment

Mr Justice Aikens :

A. The Story so far.

1. This is the second stage of proceedings in the English courts in which the Republic of Ecuador ("Ecuador") challenges an arbitration award dated 1 July 2004. The arbitration was held under the Arbitration Rules of UNCITRAL and the seat of the arbitration was London. The dispute between Ecuador and the Occidental Exploration and Production Company ("OEPC") which gave rise to the arbitration award arose in connection with a Bilateral Investment Treaty between the USA and Ecuador signed on 27 August 1993 ("the BIT") and a contract between OEPC, Ecuador and Empresa Estatal Petroleos de Ecuador ("Petroecuador"), a state-owned corporation of Ecuador, dated 21 May 1999 ("the Contract"). The Contract granted OEPC the exclusive right to carry out the exploration and exploitation of hydrocarbons in an area called Block 15 in the Ecuadorian Amazon basin region.[1]

2. The dispute giving rise to the arbitration was whether OEPC was entitled to obtain refunds of VAT payments that it had made. The VAT payments were on purchases of

[1] **Clause 4.2 of the Contract: Core Bundle ("CB")/Tab 9/page 54.**

goods and services made both locally and imported, in connection with the production of oil which was subsequently exported in accordance with the Contract. The dispute originally arose between OEPC and Ecuador's Internal Revenue Service.[2] But that could not be resolved. So, in 2002, OEPC invoked the arbitration procedures set out in the BIT and started an arbitration against Ecuador. OEPC alleged that the actions of the SRI (for which it said the Republic of Ecuador was responsible) amounted to breaches of Ecuador's obligations under the BIT, ie. were a breach of Ecuador's treaty and public international law obligations.

3. The award was in OEPC's favour. Ecuador then issued proceedings in the Commercial Court to set aside the award, relying on ***sections 67 and 68*** of the ***Arbitration Act 1996*** ("the Act")**.** The principal argument of Ecuador is that the arbitrators had exceeded their jurisdiction, as defined in the terms of the BIT. OEPC challenged the right of Ecuador to question the arbitrators' jurisdiction under ***section 67*** of the Act,[3] asserting that the issue of the arbitrators' jurisdiction was not "justiciable" before the English courts. OEPC said that such a challenge could not be dealt with by the English Courts because the arbitration arose out of a Treaty between States and was on the plane of public international law.

4. Colman J ordered that the "justiciability" point should be determined as a preliminary issue. I heard the matter and gave judgment on 29 April 2005**.** I held that Ecuador's challenge to the award under ***section 67*** of the Act was "justiciable". I gave OEPC permission to appeal. The appeal was heard by Lord Phillips of Worth Matravers MR and Clarke and Mance LJJ (as they all then were). The Court of Appeal handed down judgment on 9 September 2005, dismissing the appeal.[4]

5. Ecuador's challenge to the award under ***section 67*** of the Act is, in essence, that the arbitrators made an award on claims of OEPC that were "*matters of taxation"* and, under the terms of ***Article X*** of the BIT, such matters fell outside the ambit of the BIT and so could not be the subject of a claim in arbitration under the dispute resolution procedure set out in ***Article VI*** of the BIT. Alternatively, Ecuador says that the arbitrators exceeded their powers in such a way as to constitute a serious procedural irregularity in the arbitral proceedings, which has resulted in a substantial injustice to Ecuador. Therefore the award can be challenged under ***section 68*** of the Act.

6. OEPC disputes both these allegations. It also has a contingent cross – application, which asserts that the arbitrators wrongly concluded that they lacked jurisdiction to determine a claim of OEPC based on alleged expropriation. OEPC wishes to challenge that conclusion of the Tribunal, under ***section 67*** of the Act. But OEPC will do so only if Ecuador is successful in its challenges. For its part, Ecuador submits that OEPC's contingent challenge would be invalid, because it is a thinly disguised attempt to challenge the award on the merits, which is impermissible without leave to appeal on a point of law under ***section 69*** of the Act. Neither OEPC nor Ecuador has applied to obtain leave to appeal under ***section 69***.

---

2 Known as the "*Sevicio de Rentas Internas"* or "SRI".

3 But not the right to challenge the award for "serious irregularity" under ***section 68.***

4 Judgment of 29 April 2005 reported at ***[2005] 2 Lloyd's Rep 240;*** CA's judgment reported at ***[2006] 2 WLR 70***

7. It is now well – established that a challenge to the jurisdiction of an arbitration panel under ***section 67*** proceeds by way of a re – hearing of the matters before the arbitrators. The test for the court is: was the Tribunal correct in its decision on jurisdiction? The test is not: was the Tribunal entitled to reach the decision that it did. The ***section 68*** application in this case was much bound up with the ***section 67*** challenge. The hearing of all the applications took place before me between 12 – 16 December 2005.[5] Both parties very sensibly concentrated their evidence and submissions on the key areas of dispute. Therefore it was not necessary to call any oral evidence, either factual or expert. There was a great deal of documentary material before the court, including seven bundles of authorities. I was greatly assisted by the full written and oral argument of Mr Mark Cran QC and Mr Daniel Bethlehem QC for Ecuador, and Mr Christopher Greenwood QC for OEPC. I am grateful to them, their juniors and their teams. I reserved judgment.

B. The Bilateral Investment Treaty between the USA and Ecuador

8. As I pointed out in my judgment on the "justiciability" issue, Bilateral Investment Treaties have been developed as a mechanism to encourage investment between States, by using "investors" that are non – governmental organisations. It is a long – standing principle of public international law that States owe duties to other States to protect their citizens. This is known as the "doctrine of diplomatic protection".[6] Effectively, BITs are treaties that acknowledge this principle of public international law, apply it to particular circumstances between two States and develop the protection of investors by giving them "standing" to pursue a State directly in "investment disputes" between an investor and a State Party in ways that are set out in the BIT.[7] By the end of 2002 there were 2,181 BITs in force.[8]

9. In its judgment on the "justiciability" issue, the Court of Appeal held that the present BIT confers or creates direct rights in international law in favour of investors. The point at which these rights are created or conferred might be in issue; but, at the least, it is at the point when investors pursue claims in one of the ways provided by Article VI of the BIT.[9]

10. The USA/Ecuador Treaty was signed in Washington on 27 August 1993. At that time there were 13 BITs in force for the USA. BITs concluded by the USA were based on a prototype model which went through several editions. At the time of the USA/Ecuador Treaty, the current prototype (also called the BIT Model Negotiating Text) was the September 1987 Draft.[10]

11. When the USA/Ecuador Treaty was submitted to President Clinton by Secretary of State Warren Christopher, recommending that the Treaty be submitted to the Senate for its advice and consent to ratification, the "***Letter of Submittal***" set out the

---

5 Ecuador sent written reply submissions on its ***section 68*** application on 19 December 2005.

6 See: E de Vattel, *Le Droit des gens ou les principes de la loi naturelle*, vol 1, 309 (1758).

7 ***Paulsson: "Arbitration without Privity" (1995) 10 ICSID Rev – Foreign Investment LJ 232 at pages 255 – 6.***

8 UNCTAD, *World Investment Report for 2003, 17;* quoted in ***Douglas, "The Hybrid Foundations of Investment Treaty Arbitration" (2003) BYIL 151.***

9 ***[2005] 1 WLR 70 at 83, para 18.***

10 Text annexed to "***United States Investment Treaties Policy and Practice" by KJ Vandevelde (1992): DWR/vol 6/Tab 122/p 2717.***

objectives of the BIT and summarised its principal provisions. In the present case both parties relied on statements in the Submittal Letter describing the ambit of ***Article X*** of the BIT, (which deals with tax matters), as an aid to the proper construction of that Article. That passage in the Submittal Letter states:

> "***Article X (Tax Policies)***
>
> *The Treaty exhorts both countries to provide fair and equitable treatment to investors with respect to tax policies. However, tax matters are generally excluded from the coverage of the prototype BIT, based on the assumption that tax matter are properly covered in bilateral tax treaties.*
>
> *The Treaty, and particularly the dispute settlement provisions, do apply to tax matters in three areas, to the extent they are not subject to the dispute settlement provisions of a tax treaty, or, if so subject, have been raised under a tax treaty's dispute settlement procedures and are not resolved in a reasonable period of time.*
>
> *The three areas where the Treaty could apply to tax matters are expropriation (Article III), transfers (Article IV) and the observance and enforcement of terms of an investment agreement or authorization (Article VI (1) (a) or (b)). These three areas are important for investors, and two of the three--expropriatory taxation and tax provisions contained in an investment agreement or authorization--are not typically addressed in tax treaties.*"

12. In my judgment on the "justiciability" issue I described the scheme of the USA/Ecuador BIT . That general description is not controversial and it may help to set it out again here to get an overall view of the BIT's scope and content:

    (1) The Preamble sets out the aim of the Treaty, which is to promote greater economic cooperation and investment between the Contracting Parties (ie. the two signatory States), but on a defined and agreed basis.

    (2) Article I sets out various definitions. "Investment" is defined broadly and this definition is relevant in the current dispute.[11]

    (3) Article II sets out the basis on which each Contracting Party will permit and treat investment. The general principle is that investments of nationals and companies of either Party will receive either "*national treatment or most favoured nation treatment*" whichever is the better. Article II also provides that the Parties will ensure that investment will have fair and equitable treatment according to international law standards. This Article was central to the arbitration and relevant to the current challenge.

---

[11] The definition starts: *"Investment means every kind of investment in the territory of one Party owned or controlled directly or indirectly by nationals or companies of the other Party, such as equity, debt, and service and investment contracts"*. It then enumerates various examples.

(4) Article III deals with expropriation or nationalisation of investments. Expropriation or nationalisation of investments is not to take place either directly or indirectly except for a public purpose and on defined conditions. Article III is relevant to OEPC's contingent cross – challenge to the arbitration tribunal's apparent conclusion that it did not have jurisdiction to deal with OEPC's allegations of expropriation.

(5) Article IV deals with transfers, particularly of funds, that are related to an investment. The State Parties agree to permit transfers to be made freely and without delay in and out of their territories.

(6) By Article V the Parties agree to consult promptly to resolve any disputes in connection with the Treaty.

(7) Article VI deals with the resolution of "*investment disputes*" between a State Party and a national or company of the other State Party. Its terms, together with those of Article X, are central to these applications.

(8) Article VII concerns the resolution of disputes between the two Parties to the treaty, ie. USA and Ecuador. If necessary, disputes are to be submitted to an arbitral tribunal, for binding decision "*in accordance with the applicable rules of international law*".[12]

(9) Article X deals with the tax policies of each Party and provides that the tax policies of each State Party should strive to accord fairness and equity in the treatment of investments of nationals and companies of the other Party. Article X states that the provisions of the Treaty, in particular Articles VI and VII will not apply to matters of taxation except only to a limited extent, as set out in the Article. This Article is central to the disputes I have to rule on.

13. I have set out the wording of all the relevant Articles of the BIT in Appendix 1 to this judgment. I will refer to particular Articles as necessary in the body of the judgment. The final words of the BIT state that the Treaty was done in duplicate, in the Spanish and English languages, both texts being equally authentic.

C. The Participation Contract for Block 15.

14. Petroecuador's business is the exploration and exploitation of hydrocarbons. Since 1985, OEPC had concluded contracts with Petroecuador for the exploration and exploitation of hydrocarbons in Block 15 of the Amazon region of Ecuador. But in the earlier contracts OEPC had only rendered ***services*** to Petroecuador in relation to exploration and exploitation. OEPC had received a fee for its services and virtually all of its expenses were reimbursed, including any VAT that OEPC had paid on purchases made to provide services. Prior to the revision of the contract with Petroecuador in 1999, it was Petroecuador that received all the crude oil that was produced. That was because, prior to 1993, Ecuador's Hydrocarbons Law gave Petroecuador a monopoly over oil produced in Ecuador.

---

12 *Article VII (1).*

15. In 1993 Ecuador's Hydrocarbons Law was amended. This enabled foreign companies to engage in production sharing agreements with Petroecuador. In 1999 the existing contract between OEPC and Petroecuador was modified. The modified Participation Contract[13] became effective on 1 July 1999. Its key change was that OEPC would in future participate as a principal in the production of oil in Block 15. The basis for OEPC's participation and its extent is set out in Clause 8 of the Participation Contract. In summary, OEPC assumed virtually all the costs of its exploration and exploitation activities and had to pay VAT on expenses it incurred.[14] But the question of any refund of VAT is not dealt with expressly in the Contract. In return for providing its services OEPC received a percentage of the oil produced and it was enabled to export that oil.

16. Clause 8.1 of the Participation Contract sets out the method for calculating OEPC's "*Contractor Participation"*. That includes a "Factor X". Factor X is itself calculated using an elaborate formula. Broadly speaking, once the Factor X figure has been computed, it is multiplied by the production figure and then divided by 100. That exercise produces the proportion of the total oil production to which OEPC is entitled under the Participation Contract.

17. OEPC submitted to the Tribunal and submits now that when the modified Participation Contract was being negotiated, a critical element in reaching agreement on the formulation of Factor X and so the level of OEPC's participation in the production of oil in Block 15, was the parties' joint understanding on how VAT payments would be treated. OEPC submits, as it did in the arbitration,[15] that its investment was based on an agreed economic model by which VAT would be paid by OEPC but would then be reimbursed by the Ecuadorian authorities. This underlying basis is challenged by Ecuador.

18. Clause 1 of the Participation Contract states that "*the following are the contracting parties: on the one hand the Republic of Ecuador, through…PETROECUADOR…and on the other [OEPC]"*. OEPC submits that this makes it clear that Ecuador is a party to the Participation Contract.

19. Each side relied on a number of the terms of Participation Contract. I have set out the relevant ones in Appendix 2 of this judgment. The principal relevant clauses are 4.2, 5.1.5, 5.1.17, 8.1, 8.6, 11.1, 11.11 and Annexes 14 and 16.

D. The source of the dispute between the parties: Ecuador's tax legislation.

20. Under the law of Ecuador before 30 April 1999, there was no general right of an exporter to obtain a refund of VAT that it had paid on inputs in making an export. ***Article 65*** of Ecuador's ***Internal Tax Regime Law ("ITRL")*** granted a right to a *tax credit* in some circumstances, in respect of VAT that had been paid. But it did not grant a right to a refund of VAT paid. However, the ***Law for the Reform of Public Finance 99 – 24*** introduced ***Articles 69A, B and C*** into the ITRL**.** ***Article 69A*** provides that individuals and corporations that have paid VAT on the acquisition or importation of goods which are used in the production of goods that are exported have

---

13 **CB/Tab 9.**

14 **Clause 5.1.17** obliges OEPC to pay taxes as may be required by the laws and regulations of Ecuador.

15 **Award para 108.** This is disputed by Ecuador.

the right to have the VAT reimbursed. ***Article 69A*** does not allow for refunds of VAT paid on services.

21. OEPC made local purchases of goods and imported goods that were required for the production of oil pursuant to the Participation Contract. OEPC's share of the oil was later exported. OEPC applied to the *Servicio de Rentas Internas* ("***SRI***") for a refund of the VAT paid on these purchases. At first the repayments were made. Then the Ecuadorian authorities changed their position. By Resolution 664 of 28 August 2001, the SRI denied OEPC's claim for a refund of VAT for the period from October 2000 to May 2001. The precise basis on which the SRI refused to make a refund was in dispute in the arbitration. Ecuador's position, at least initially, was that the cost of the VAT that was paid by OEPC was taken into account in evaluating "Factor X", so was a factor in calculating the participation percentage of the oil production to be allowed to OEPC. Therefore the provisions of Article 69A were inapplicable and OEPC could not claim a refund.[16]

22. On 1 April 2002, the SRI passed a further Resolution, number 234. This "Denying Resolution" annulled previous "Granting Resolutions" whereby OEPC had been permitted to recover VAT that it had paid. It also instructed the relevant branch of the SRI to recoup the VAT that had been refunded to OEPC.[17] More Denying Resolutions were passed subsequently.[18] OEPC decided it was not worthwhile submitting further VAT refund applications.

23. OEPC then filed four law – suits against the SRI in the Tax Court of District No 1 of Quito. In those proceedings OEPC alleged that these "Denying Resolutions" were contrary to Ecuadorian Law, in particular Articles 65 and 69A of the ITRL. The fact that OEPC pursued these law – suits in the Tax District Court gave rise to one of the issues that the arbitrators had to decide when determining their jurisdiction. This was the so – called "fork in the road" issue.

24. In 2002 OEPC invoked the arbitration procedure provided for in Article VI of the BIT and the arbitration under UNCITRAL Rules was begun.[19] OEPC's complaint against Ecuador was that the actions of the SRI (for which OEPC said the Republic of Ecuador was responsible) amounted to breaches of Ecuador's obligations under the BIT, ie. were in breach of Ecuador's treaty and public international law obligations.

25. OEPC alleged[20] that Ecuador's refusal to refund the VAT constituted a breach of Ecuador's BIT obligations in four ways. First, Ecuador was in breach of Article II.1, ie. the obligation to afford equal treatment to that of other investors, both domestic and foreign, in like circumstances. Secondly, it was in breach of Article II.3(a), ie. the obligation to grant fair and equitable treatment and treatment no less favourable than that required by international law. Thirdly, it was in breach of Article II.3(b), ie. the obligation that neither Party would in any way impair the operation or

---

16 **Resolution 664 para 7, "Matters of Law" (f): EO2/vol 3/Tab 11/page 821.**

17 **Resolution 234:** paras 1 and 2 of formal resolution: **EO2/vol 3/Tab 12/page 842.**

18 Resolutions 406 of 31 January 2003 and 026 of 6 March 2003.

19 On 4 April 2002 OEPC gave notice under Article VI.2 and VI.3(a) of the BIT that a dispute had arisen. After the requisite 6 months, on 11 November 2002 OEPC sent Ecuador a Notice of Arbitration and Statement of Claim.

20 OEPC's Notice of Arbitration and Statement of Claim dated 11 November 2002 paras 20 – 40: ***EO2/vol 2/Tab 4/pp 357 – 364.***

management of an investment by arbitrary or discriminatory measures. Lastly, OEPC said that Ecuador was in breach of Article III.1, ie. the obligation not to expropriate an investment either directly or indirectly, except in the circumstances identified in the Article, which OEPC said were inapplicable.

E. The Arbitration and the Award.

26. The parties nominated their arbitrators[21] and a chairman, Professor Francisco Orrego Vicuna, was appointed under Article 7 of the UNCITRAL Rules. All three are well – known and respected public international law specialists. Having decided that the seat of the arbitration should be London, the tribunal then had to deal with Ecuador's challenge to the tribunal's jurisdiction and the admissibility of OEPC's claims. The tribunal received extensive submissions on those issues from the parties, but then decided to join those issues to the merits of the case.[22] The Award published on 1 July 2004 therefore dealt with both jurisdiction and the merits.

The objections to jurisdiction as set out in the award and the Tribunal's answers to them.

27. The Award records[23] that Ecuador raised three objections to the Tribunal hearing Occidental's claims. Ecuador's arguments were:

    (1) that Occidental had submitted four lawsuits to Ecuadorian courts on the question of the VAT refund, so that Occidental had irrevocably chosen to submit its claims to the courts or administrative tribunals of Ecuador in accordance with Article V.2(a) of the BIT. That choice precluded submission of the disputes to arbitration under Article VI.3.[24] The tribunal dismissed this argument and it is not relevant to the present hearing, except, perhaps, to understand how various other arguments were put to the Tribunal.

    (2) In any event, Occidental's claims were precluded by the terms of Article X of the BIT, because the claims for breaches of the BIT arising out of the alleged failure to refund VAT (save for the claim of expropriation) did not fall within the matters of taxation embraced in paragraphs (a), (b) and (c) of Article X.2. Therefore the claims based on Article II of the BIT could not be pursued, because, as they concerned matters of taxation, they were outside the scope of the Treaty and outside the arbitration provisions of Article VI of the BIT.

    (3) Occidental's submission that there had been an expropriation of its investment by means of the taxation measures adopted by Ecuador[25] was unarguable, so that even if the claim fell within Article X.2, the Tribunal should not admit it as a claim.

28. On the second jurisdictional issue, the Tribunal concluded that the key was the proper construction of Article X of the BIT. The arbitrators described Ecuador's argument that all matters of taxation were outside the Treaty, apart from the specific categories

---

21 The Hon. Charles N Brower by OEPC; Dr Patrick Barrera Sweeney by Ecuador.
22 Decision of 26 November 2003.
23 At para 37.
24 The "fork in the road" argument.
25 Contrary to Article III of the BIT.

mentioned in Article X.2(a), (b) and (c), as "*not persuasive*".[26] Nevertheless, the arbitrators went on to consider whether the dispute fell within one of the three paragraphs of Article X.2(a), (b) or (c). They said the relevant question in this dispute was: "*…whether the observance and enforcement of the terms of an investment agreement concerning matters of taxation is at issue in this dispute*".[27]

29. The Tribunal concluded that the Contract was an "*investment agreement*" for the purposes of Article X. They held that the dispute found its origin in the Contract, "*insofar as it is disputed whether VAT reimbursement is included in Factor X*".[28] The arbitrators said that this point had been brought up by Ecuador itself. It meant that there was a dispute "*concerning the observance and enforcement of the contract, which brings the tax dispute squarely within the exceptions of Article X and hence within the jurisdiction of the Tribunal*".[29]

30. The arbitrators emphasised that, at the heart of the dispute between the parties was the issue of what had been taken into account in calculating Factor X in the Participation Contract. Had the VAT refund been secured by the calculation of Factor X in the Participation Contract, so that it was fair of the SRI to pass Resolutions that denied Occidental the right to a refund of VAT (as Ecuador argued)? Or had the refund not been secured by Factor X, in which case the denial of a right to a refund in accordance with Ecuador's Tax Law was unfair (as OEPC argued).[30]

31. The Tribunal concluded that the dispute, "*one way or the other, [thus] is clearly subject to the dispute settlement provisions of the Treaty*". That conclusion "*automatically*" brought in the standards of treatment of Article II, including "*fair and equitable treatment*" [31] as required under Article II.

32. On this second jurisdictional question the award concludes, at paragraph 77, that:

> "*The Tribunal accordingly finds that, because of the relationship of the dispute with the observance and enforcement of the investment Contract involved in this case it has jurisdiction to consider the dispute in connection with the merits insofar as a tax matter covered by Article X may be concerned, without prejudice to the fact that jurisdiction can also be affirmed on other grounds as respects Article X as explained above*".[32]

33. On the third point the Tribunal commented that, normally, a claim of expropriation should be considered on the merits. But it concluded that it was so clear in this case that there had been no expropriation, that the expropriation claim was "*inadmissible*".[33] Before me there was argument on whether this conclusion on the

---

[26] Paragraph 68 of the award.
[27] Paragraph 71 of the awared.
[28] Paragraph 72 of the award.
[29] Paragraph 72 of the award. In the hearing before me, Mr Cran QC underlined the fact that the award does not reproduce the exact wording of Article X.2(c), which states: "*the observance and enforcement **of the terms of** an investment agreement…*".
[30] Paragraph 74 of the award.
[31] Paragraph 75 of the award.
[32] Mr Cran also relied on what he described as misquotation of the terms of Article X.2(c) in this paragraph.
[33] Award para 92.

expropriation claim constituted a ruling on the jurisdiction of the Tribunal, or one on the merits of the claim (or lack of them).

The Award's conclusions on the merits of OEPC's claim

34. The arbitrators concluded[34] that: (1) the VAT refund was not within Factor X as calculated in accordance with the Participation Contract. (2) Accordingly, Occidental was entitled to have the VAT refunded under both Ecuadorian law and also Andean Community Law. (3) Because the VAT refunds had not been made, Ecuador was in breach of its obligation (under Article II.1 of the BIT) to accord Occidental a treatment no less favourable than that accorded to nationals or other companies. (4) Ecuador had also breached its obligations concerning fair and equitable treatment as required by Article II.3(a) of the BIT. (5) The claim that Ecuador had impaired the operation of Occidental's investment by arbitrary measures (contrary to Article II.3(b) of the BIT) was only partially upheld. This was because the SRI had not acted deliberately to deprive Occidental of the VAT refunds; rather this had resulted from "*an overall rather incoherent tax legal structure*". That confusion and lack of clarity resulted in "*some form of arbitrariness, even if not intended by the SRI"*. However, the Tribunal concluded that this arbitrariness had not caused any impairment of the management, operation, maintenance, use, enjoyment, acquisition, expansion or disposal of the investment of OEPC, so could not give rise to any further claim for breach of the BIT by OEPC.[35]

35. The Tribunal concluded that the breaches of Articles II.1 and II.3(a) had caused OEPC damage. The arbitrators held that OEPC could retain the VAT refunds it had obtained and that it was entitled to be paid VAT refunds of over US$73 million for the period up to 31 December 2003. Interest was also awarded, so that the total of VAT refunds and interest due to Occidental was US$75,074,929.[36]

F. The provisions of *sections 67 and 68* of the Arbitration Act 1996 and the parties' applications.

36. ***Sections 67*** and ***68*** of the 1996 Act provide:

> **"67.** Challenging the award: substantive jurisdiction.
>
> (1) A party to arbitral proceedings may (upon notice to the other parties and to the tribunal) apply to the court-
>
> (a) challenging any award of the arbitral tribunal as to its substantive jurisdiction; or
>
> (b) for an order declaring an award made by the tribunal on the merits to be of no effect, in whole or in part, because the tribunal did not have substantive jurisdiction.

---

[34] Award paras 199 – 200.
[35] Award paras 161 – 166.
[36] Because of the extant claims before the Ecuadorian Courts, the Tribunal made provision to prevent any double recovery by Occidental.

A party may lose the right to object (see section 73) and the right to apply is subject to the restrictions in section 70(2) and (3).

…….

(3) On an application under this section challenging an award of the arbitral tribunal as to its substantive jurisdiction, the court may by order-

(a) confirm the award,
(b) vary the award, or
(c) set aside the award in whole or in part.

(4) The leave of the court is required for any appeal from a decision of the court under this section.

68. Challenging the award: serious irregularity.

(1) A party to arbitral proceedings may (upon notice to the other parties and to the tribunal) apply to the court challenging an award in the proceedings on the ground of serious irregularity affecting the tribunal, the proceedings or the award.

A party may lose the right to object (see section 73) and the right to apply is subject to the restrictions in section 70(2) and (3).

(2) Serious irregularity means an irregularity of one or more of the following kinds which the court considers has caused or will cause substantial injustice to the applicant-

(a) failure by the tribunal to comply with section 33 (general duty of tribunal);

(b) the tribunal exceeding its powers (otherwise than by exceeding its substantive jurisdiction: see section 67);

(c) failure by the tribunal to conduct the proceedings in accordance with the procedure agreed by the parties;

(d) failure by the tribunal to deal with all the issues that were put to it;

……..

(f) uncertainty or ambiguity as to the effect of the award;

……

> (3) If there is shown to be serious irregularity affecting the tribunal, the proceedings or the award, the court may-
>
> > (a) remit the award to the tribunal, in whole or in part, for reconsideration,
> >
> > (b) set the award aside in whole or in part, or
> >
> > (c) declare the award to be of no effect, in whole or in part.
>
> The court shall not exercise its power to set aside or to declare an award to be of no effect, in whole or in part, unless it is satisfied that it would be inappropriate to remit the matters in question to the tribunal for reconsideration.
>
> (4) The leave of the court is required for any appeal from a decision of the court under this section."

Ecuador's Applications

37. The particulars of the relief sought by Ecaudor and the grounds for that relief are set out in a detailed document called "Particulars for Arbitration Claim Form". That was served as part of the Arbitration Claim Form issued by Ecuador on 11 August 2004. It challenged the Tribunal's conclusions on jurisdiction as summarised above. It also alleged that insofar as the Tribunal might have founded jurisdiction on the basis of Article X.1 of the BIT, that was also a misconstruction of that Article. Ecuador submitted that Article X.1 did not create any enforceable obligations as between the State Parties to the BIT and did not create any treaty rights in favour of investors.

38. Ecuador therefore sought to set aside the whole of the award save for those parts that relate to OEPC's claim under Article III.1 of the BIT, alleging expropriation.[37]

39. In respect of the challenge under ***section 68,*** Ecuador alleged in the Particulars for Arbitration Claim Form that the Tribunal had exceeded its powers under the Treaty and the UNCITRAL Rules. It had done so by holding that the Resolutions of the SRI or the actions and proceedings before the courts of Ecuador are of no legal effect or should have no legal effect. Ecuador also alleged the tribunal exceeded its powers by ordering that Ecuador should desist from attempting in its courts or tribunals from attempting to recover the VAT that had been refunded to OEPC and by declaring that any such actions and proceedings would have no legal effect.[38] It was submitted that in making these decisions and orders the Tribunal had exceeded its powers and so there was a serious irregularity within ***section 68(2)(b)*** of the Act. An allegation that the Tribunal had failed to comply with its duty to act fairly under ***section 33*** of the Act, so that there was a serious irregularity within ***section 68(2)(a)*** was not pursued before me.

---

[37] Paragraphs 79-92 of the award and paragraphs 1 and 15 of the Decision in so far as they deal with "expropriation".

[38] Award, paragraph 202, last sentence; para 209, last sentence, point (iii); Decision 10 (ii) and (iii).

40. Under the ***section 68*** challenge, Ecuador sought to set aside the final sentence of paragraph 202 of the award; sub – paragraphs (ii) and (iii) of the final sentence of paragraph 209 of the award and paragraphs 6 and 10 (ii) and (iii) of the Decision of the Tribunal.

OEPC's contingent application.

41. OEPC issued an Arbitration Claim Form on the same day as Ecuador, ie. 11 August 2004. OEPC was aware that Ecuador intended to challenge the award. So, in paragraphs 10 and 11 of the particulars of the remedy claimed, OEPC states that if the court "*is minded to disrupt any of the findings in paragraphs 68 – 77 of the award or any conclusions on pages 72 to 74 of the award"*, then OEPC would wish to challenge paragraphs 80 to 92 of the award, pursuant to ***section 67*** of the 1996 Act. Paragraphs 80 to 92 of the award are in Section F, which sets out the Tribunal's findings concerning expropriation. As I have already noted, the Tribunal concluded that "*the claim concerning expropriation is inadmissible"*.

42. OEPC's case was that this was a conclusion on the Tribunal's jurisdiction in relation to the "expropriation" claim and that it was wrong and so was open to challenge under ***section 67.***

G. Ecuador's *section 67* challenge to the Tribunal's Award on Jurisdiction: the arguments of the parties

(i) *Common Ground*

43. When OEPC served its Notice of Arbitration and Statement of Claim dated 4 November 2002, it stated, in paragraph 20, that it related to a dispute "*arising out of or relating to […] an alleged breach of any right conferred or created by this Treaty with respect to an investment"*. The paragraph then referred to the SRI Resolutions 664 and 234 and related actions and asserted that Ecuador had failed to honour its obligations under the Treaty and international law. The Notice alleged that Ecuador had committed four particular breaches of its obligations under the BIT and international law: (i) a breach of Article II.3(a) – (duty to accord fair and equitable treatment etc); (ii) breach of Article II.3(b) – (duty not to impair by arbitrary or discriminatory measure); (iii) breach of Article III – (duty not to expropriate directly or indirectly); and (iv) breach of Article II.1 – (duty to give no less favourable basis for investment compared with others).

44. There can be no dispute, therefore, that OEPC's claim before the Tribunal involves "matters of taxation". The claim relates to Ecuador's refusal to make refunds of a tax, VAT, to OEPC, to which OEPC said it was entitled under Ecuador's tax laws.

45. Ecuador accepts that the Participation Contract is an "*Investment Agreement"* for the purposes of Article VI.1(a)[39] and therefore Article X.2(c).

---

[39] Although there is a definition of "*investment"* in Article I.(a) of the BIT, there is no definition of an "*investment agreement"*.

46. It is also agreed between the parties that Article X.2 of the BIT does have the effect of excluding "*matters of taxation"* from the scope of the treaty. The real issues before the court are the extent of that exclusion and how the exclusion operates in the context of the current dispute.

(ii) Ecuador's Case

47. For Ecuador, Mr Cran submits that it is important at the outset to characterise the nature of the dispute between OEPC and Ecuador and the claim by OEPC. He submits that the dispute is an investment dispute "*…arising out of or relating to…(c) an alleged breach of any right conferred or created by this Treaty with respect to an investment",* in the words of Article VI.1(c). But it concerns matters of taxation. He argues that the BIT as a whole and Article VI in particular do not apply to matters of taxation except to the very limited extent set out in Article X.2(a), (b) and (c) and the proviso to Article X.

48. Mr Cran submits that, effectively, the BIT would apply to matters of taxation only with respect to ***claims*** for expropriation (under Article III); transfers (Article IV); and claims in respect of the "*observance and enforcement of terms of an investment agreement or authorisation",* as referred to in Article VI.1 (a) or (b).

49. Mr Cran submits that if OEPC's argument based on breach of Article III (expropriation) is put to one side, then, the only possible way that OEPC could properly put forward its claim is if it comes within the terms of Article X.2(c). In other words, OEPC's claim would have to concern "*matters of taxation*", which are "*with respect to….. the observance and enforcement of terms of an investment agreement…. as referred to in Article VI.1(a)..…".*

50. Ecuador's primary submission is that OEPC never advanced a case before the Tribunal that its claim was a matter of taxation that came within Article X.2(c). Ecuador says that OEPC did not submit to the Tribunal, either orally or in writing, that Ecuador's tax laws or the actions of the SRI violated the Participation Contract. Indeed, Mr Cran submits that in the course of the oral hearing before the Tribunal, OEPC's counsel expressly disavowed any reliance on Article X.2(c).

51. In order to make good this argument, Mr Cran analysed the characterisation of the case put forward by OEPC at various stages in the arbitration process. He submits that this exercise demonstrates that OEPC's case to the Tribunal was wholly based on a breach of treaty rights. Ecuador points first to paragraph 17 of the Notice of Arbitration and Statement of Claim itself. This states:

> "*17. Pursuant to Article VI(1), OEPC can submit for settlement by binding arbitration an "investment dispute", which includes a dispute arising out of or relating to "an alleged breach of any right conferred or created by this Treaty with respect to an investment". Article I(1)(a) of the Treaty defines "investment" to include every kind of investment in a territory of a Party, including investment contracts and tangible and intangible property, such as rights, a claim to money associated with an investment, and any rights conferred by law or contract. In addition to OEPC's investments in personnel, equipment, machinery, technology, and other goods and services necessary for the performance of its*

> *exploration, exploitation and other contractual activities in Ecuador, OEPC's investment within the meaning of the Treaty therefore also includes, without limitation, its right to VAT tax credits and corresponding reimbursements conferred by inter alia, Articles 65 and 69A of the ITR law, as well as its related claims to money (collectively, "OEPC's investment")".*[40]

52. Secondly, Mr Cran relies on the way OEPC put its case in its Answer on Jurisdiction and Admissibility, following the Jurisdictional Objections of Ecuador. In particular he notes paragraph 13 of OEPC's Answer, which states:

> "*Accordingly, OEPC has submitted to the jurisdiction of this Tribunal an investment dispute relating* ***exclusively*** *to "an alleged breach of any right conferred or created by this Treaty with respect to an investment". Specifically, OEPC claims that the Denying Resolutions are in breach of Ecuador's obligations under Articles II(1), II(3)(a), II(3)(b) and III of the Treaty, which include an obligation to accord OEPC's investment treatment not less than that required by international law."*[41]

53. Thirdly, Mr Cran refers to OEPC's Memorial on Jurisdiction, Admissibility and the Merits, dated 28 October 2003. In particular, it is submitted that OEPC's case at paragraphs 69 to 80 and 89 all argue that the refusal of Ecuador to permit VAT refunds constitutes a breach of its Treaty and international law obligations.[42]

54. Fourthly, Mr Cran points to the way OEPC's case is put in its Rejoinder on Jurisdiction and Admissibility, dated 13 November 2003.[43] In a number of places this states that the claim is not based on allegations of a breach of the Participation Contract.[44]

55. Fifthly, Mr Cran notes how OEPC's case was put orally at the hearing on jurisdiction, admissibility and the merits, which was held in Washington DC on 26 – 30 January 2004.[45] Mr David W Rivkin, of Debevoise & Plimpton LLP, presented OEPC's case on jurisdiction. In his oral submission he stated:

> "*It is important for the panel to remember that it is the Government of Ecuador that has raised the contract terms of the participation contract as a defence to its unlawful withholding of the VAT refunds, not us. And this is where their entire argument fails. Their entire argument has to rest upon this dispute arising out of the investment agreement. But as we've pointed out, it fails for the simple reason, because we've not made any claims under the investment agreement.*

---

40 **Ex.EO2/vol 2/tab 4/page 356 - 7**

41 **Ex. OE2/vol 2/Tab 7/page 418.**

42 **Ex OE2/Vol 6/Tab 42/pages 2039 – 2040 and 2045.**

43 **Ex. OE2/Vol 2/Tab 8.**

44 Paragraphs 3, 20, 39, 44, 45 and 84 are all noted in the first witness statement of Eric Ordway of Weil, Gotshal & Manges LLP, attorneys for Ecuador, at para 43: **Bundle 3/Tab 1/page 21.**

45 The Tribunal heard oral submissions on jurisdiction first. Mr Eric Ordway presented the case for Ecuador, then Mr Rivkin made his submissions.

Rather, what we challenge is the unlawful actions which they've taken in failing to provide our rights to the tax refund".[46]

56. Ecuador also relies on a further characterisation of OEPC's claim which was given by Mr Rivkin in his oral submissions when answering a question from one of the arbitrators, Dr Sweeney:

"Now, with respect to Article X(2)(c), and the observance and enforcement of an investment agreement, as I said, our claim under the treaty, and in fact the claim in the Quito courts, does not arise out of the participation contract, the investment agreement. It arises out of the right to the refund under Ecuadorian law, which is consistent with the international principle with respect to VAT of the Destination Principle. It is the SRI which has tried to inject the participation contract into the dispute by saying that somehow the participation contract already provided for a tax refund, notwithstanding the fact that the SRI itself says that it is the only authority which may properly engage in the enforcement of the tax laws. So as a result, our claim here does not arise out of the observance and enforcement of the terms of the investment agreement, it arises out of a breach of the treaty obligation".[47]

57. Mr Cran submits that, despite these clear statements by OEPC that it was not basing its claim on Article X.2(c), the Tribunal wrongly concluded that, on the proper construction of Article X, it had jurisdiction to consider the claim based on that Article. The Tribunal used that conclusion on jurisdiction to deal with the merits of OEPC's claims under Article II of the BIT.

58. Mr Cran's second main submission is that even if OEPC did purport to make a case before the Tribunal based on Article X.2(c) of the BIT, then, on the facts, the way OEPC put its case in the arbitration and on the proper construction of Article X.2(c), the claim was not a matter of taxation "*….with respect to…the observance and enforcement of terms of an investment agreement"*. He submits that Article X.2(c) limits severely the type of claim that an investor can make on a matter of taxation with respect to an investment agreement. Its terms limit an investor's rights to claiming that a State Party's tax laws violate the observance and enforcement of an investment agreement. But OEPC's claim was not so limited. Therefore the arbitrators exceeded their jurisdiction.

59. Mr Cran submits that this construction of the scope of Article X.2(c) is supported by three distinguished commentators. First, by Professor Kenneth J. Vandevelde,[48] in his book ***United States Investment Treaty Policy and Practice (1992).*** He states, at page 218:

"*The third part of the BIT's applicable to taxation measures is the provision of the investor – to – state disputes article which authorises the use of that article to enforce the terms of an investment agreement*

---

46 **Transcript of 26 Jan 2004: pages 111 – 112: Ex DWR 169A/page 4542.**

47 **Transcript of 26 Jan 2004: pages 132 – 133: Ex DWR 169A/pages 4547 – 8.**

48 Professor Vandevelde had been a lawyer at the State Department who had negotiated many BITs.

> *or authorisation. That is, an investor contending that the host state's tax laws violate an investment agreement or authorisation may seek a remedy through the investor – to state disputes article"*[49].

Mr Cran submits that it is implicit in this passage that there must be a claim by the investor in which it alleges that the tax law of the Party concerned violates the terms of the investment agreement. That would make it a claim "*with respect to…the observance and enforcement of terms of an investment agreement….as referred to in Article VI.1(a)"*, within Article X.2(c).

60. Mr Cran also relied on statements of Sir Ian Sinclair, former Legal Adviser to the Foreign and Commonwealth Office, who gave expert evidence for OEPC in the arbitration.[50] Mr Cran further relied on statements of Ms Gann, Professor at Duke University Law School, in an article on the "US Bilateral Investment Treaty Program" in the Stanford Journal of International Law.[51] Mr Cran submits that Ms Gann's interpretation of the terms of a previous version of the US Model BIT in similar terms to the current BIT is consistent with the comments of Professor Vandevelde and his submission on the limited ambit of Article X.2(c).

61. Ecuador's third submission relates to Article X.1 of the BIT. It is submitted that, before the Tribunal, OEPC did not argue that Article X.1 created separate and enforceable obligations on the Parties, so that the arbitrators therefore had jurisdiction to deal with a claim asserting a breach of that Article. Mr Cran notes that the Award does not record that Ecuador was in breach of Article X.1. Thus, because OEPC did not assert before the arbitrators a breach of Article X.1 to found any claim against Ecuador, OEPC cannot now retrospectively assert that it had a claim under Article X.1 and the arbitrators had jurisdiction to deal with it.

62. In his reply, Mr Cran put forward an argument based on an alternative construction of Article X.2 of the BIT. He analysed the opening part of Article X.2, which reads:

> "*Nevertheless, the provisions of this Treaty, and in particular Articles VI and VII, shall apply to matters of taxation only with respect to the following:…"*

Mr Cran submitted that, on the true construction of the Article, the words "…*only with respect to the following…"* referred back to the words "…*shall apply…"*, rather than following on from or being descriptive of the words "…*matters of taxation…."*. Therefore the introductory words of Article X.2 (before the paragraphs (a), (b) and (c)) should be read:

> *"Nevertheless, the provisions of this Treaty, and in particular Articles VI and VII, shall apply only in respect of the following, in respect of matters of taxation…".*

---

49 **EO2/vol 5/tab 27/page 1596.**

50 ***DWR1/vol 1/Tab 1 page 37 at paras 71 to 78.*** The opinion was given on the question of whether the "tax matters exclusion" of Article X of the BIT related to all types of tax matters, ie. direct and indirect taxation, or just ***direct*** taxation. That ceased to be an issue in the course of the hearing before me.

51 **21 Stan.J. International Law page 373 (1985) at 426 – 8: *DWR1/vol 5/Tab 101 page 2152 to 3.*** Professor Gann was commenting on a previous version of the US Model BIT extant in 1985.

63. Mr Cran submitted that this was the correct construction and it made it clear that Article X.2 (a), (b) and (c) are only relevant where there are claims concerning the matters set out in those paragraphs. He submitted eight reasons why this construction must be correct. The essence of these points is that if the wording of Article X.2 (a), (b) and (c) is analysed carefully, then it is clear that the draftsmen intended that if an investor party has a claim concerning "*matters of taxation*", it can only invoke the the BIT to a very limited extent. In particular, Mr Cran submits, if an investor party has a claim under Article X.2(c), then although it can invoke Article VI of the Treaty, it cannot use the fact that it has a claim falling within Article X.2(c) to enable it to make a claim under Article II of the BIT.

64. Mr Cran analysed Section D of the Award, where the Tribunal dealt with the meaning of Article X of the BIT and its jurisdiction with respect to OEPC's claims based on breach of Article II of the BIT. Mr Cran concentrated on the central paragraphs on this issue, ie. paragraphs 72 to 75 and 77 of the Award. They state:

> "72. *It was concluded above that the Modified Participation Contract between OEPC and Ecuador indeed qualifies as an investment agreement. Although, as also explained, the Claimant has not invoked here contract-based rights, but rather has pursued the interpretation of domestic law in the courts of Ecuador and treaty rights before this Tribunal, the fact is that in part the dispute finds its origins in that Contract insofar as it is disputed whether VAT reimbursement is included in Factor X. This view has been brought up by the Respondent itself as one of its defences and has been invoked by the SRI as the specific reason for denying reimbursement of VAT. To this extent, the Respondent itself appears to accept that there is a dispute concerning the observance and enforcement of the Contract, which brings the tax dispute squarely within the exceptions of Article X and hence within the jurisdiction of the Tribunal. There is here a typical situation of* ***forum prorogatum***.
>
> *73. That being so, and as the Tribunal has a duty to examine the submissions by both parties, it can only come to the conclusion that a tax matter associated with an investment agreement has been submitted to it for its consideration. Even if the Claimant had not characterised the dispute as one concerning the Contract,*[52] *the fact is that the Contract is central to the dispute. Together with the question of the observance of the Contract, however, there is one other issue that the Tribunal needs to keep in mind. That is the Claimant's alleged right to reimbursement under Ecuadorian law, Andean Community law and international law, an issue which is broader than that concerning the observance of the contract.*
>
> *74. This dispute has also a very particular meaning for the parties. In spite of it having been extensively discussed as a tax matter, a closer look might lead to the conclusion that what is really disputed is whether there is a right to refund of taxes unchallengedly due and owing and in fact paid, and, if so, how to achieve such reimbursement. In fact, the parties do not dispute the existence of the tax or its percentage. What the parties really discuss is whether its refund has been secured under Factor X of the Contract, as claimed by the Respondent, or if*

[52] I think that this would, more accurately, be expressed as: *"Even if the Claimant had characterised the dispute as one* ***not*** *concerning the Contract…."*

> *that is not the case, whether, as argued by the Claimant, it should be recognized as right under Ecuadorian Tax Law.*
>
> *75. The dispute, one way or the other thus is clearly subject to the dispute settlement provisions of the Treaty. This automatically brings in the standards of treatment of Article II, including fair and equitable treatment. Paragraph 1 of Article X thus acquires in this context its full meaning. This does not prevent of course other aspects of the dispute concerning Treaty rights from being also considered in this arbitration, independent of the meaning of the Contract, nor does it prevent this Tribunal from interpreting the Contract to the extent relevant to decide on the alleged Treaty violations.*
>
> …..
>
> *77. The Tribunal accordingly finds that, because of the relationship of the dispute with the observance and enforcement of the investment Contract involved in this case, it has jurisdiction to consider the dispute in connection with the merits insofar as a tax matter covered by Article X may be concerned, without prejudice to the fact that jurisdiction can also be affirmed on other grounds as respects Article X as explained above.***".**

65. Mr Cran was critical of much of the Tribunal's reasoning in this part of the Award. In particular, first, he criticised the arbitrators' treatment of Article X.1, especially their conclusion (at paragraph 70) that Article X.1 imposed obligations "*no different from that of fair and equitable treatment in Article II*". Mr Cran submitted that this was not borne out by the language of Article X.1, which was, he said, purely hortatory.

66. Secondly, he noted that the Tribunal did not accurately reproduce the wording of Article X.2(c) in the penultimate sentence of paragraph 72. Therefore, he submits, the Tribunal applied the wrong test to see if the claim fell within Article X.2(c).

67. Thirdly, he submits that the Tribunal was wrong to assert, in paragraph 72, that Ecuador had raised as a defence the question of whether the reimbursement of VAT was included in Factor X. In any event the Tribunal was wrong to determine jurisdiction on the basis of a defence raised, rather than the nature of OEPC's claim.

68. Fourthly, he submits that the Tribunal wrongly analysed the dispute between the parties as one concerning "*the observance and enforcement of the contract*",[53] because that was not the way OEPC put its claim. Lastly, he said that the Tribunal characterised the central dispute as "*whether [the VAT] refund has been secured under Factor X of the Contract*",[54] then concluded it had jurisdiction over the claim "*because of the relationship of the dispute with the observance and enforcement of the investment Contract involved in this case….insofar as a tax matter covered by Article X may be concerned…*".[55] But, Mr Cran submits, it is not enough for there to be a "*relationship*" between the dispute and the observance and the enforcement of the

---

53 para 72
54 para 74
55 Para 77

investment contract. He submits that the Tribunal would only have jurisdiction to deal with a dispute concerning matters of taxation if that dispute was "*in respect to the observance and enforcement of terms of the investment agreement*". That was not what this dispute was about at all, so it was not within the BIT or the arbitrators' jurisdiction.

(iii) OEPC's case

69. Mr Greenwood, for OEPC, accepts that the question is: does this dispute fall within Article X.2(c) of the BIT? He accepts that the dispute relates to "*matters of taxation*". But, in his submission, if the question of whether Ecuador was in breach of its obligations under the BIT (in particular the obligations set out in Article II), "*depended on the interpretation, observance and enforcement of OEPC's bargain, as embodied in the Participation Contract*",[56] then the dispute would fall within Article X.2(c).

70. He further submits that the dispute inevitably falls within Article X.2(c) because of Ecuador's case, on the merits, that OEPC had received the full value of VAT payments it had made through the level at which OEPC's participation was set under the Contract, using the mechanism of the multiplicand "Factor X". Therefore, Ecuador's defence to OEPC's allegations of breach of treaty obligations was to say: there is no unfairness, nor impairment of the operation of OEPC's "*investment*", nor failure to give "most favoured nation" treatment to OEPC by the action of refusing to make refunds of VAT payments. Mr Greenwood submits that Ecuador's defence argument inevitably put the Participation Contract at the centre of the dispute. That therefore brought the dispute within Article X.2(c), because it concerned a "*matter of taxation with respect to…the observance and enforcement of terms of…*" the Participation Contract.

71. In Mr Greenwood's submission, Articles X.2 (a), (b) and (c) are "gateways". So, if a dispute between an investor and a State Party comes within the ambit of one of those paragraphs, the consequence is that all the provisions of the BIT, and in particular all the provisions of Article VI (the dispute resolution provisions) are then effective. That means that a tribunal can determine whether, in relation to a matter falling within Article X.2(c) (for example), the State Party has been in breach of its treaty obligations under Articles II and III. Article VI will determine the scope of the jurisdiction of a Tribunal; there is no further limitation on what it can consider.

72. The consequence of putting the argument this way, as Mr Greenwood accepts, is that the Tribunal will have to delve into the merits of the dispute in order to come to a conclusion on whether the dispute fell within its jurisdiction. That is what the arbitrators decided must be done in this case. It is clear that the arbitrators had the evidence on the merits very much in mind when considering the jurisdictional aspect of their Award.

73. In support of this submission, Mr Greenwood invited me to consider some of the evidence that was before the Tribunal concerning the negotiation of the Participation Contract, to show the economic basis on which OEPC and Petroecuador had concluded the Contract terms; in particular those relating to the amount of OEPC's

---

[56] Mr Greenwood's wording: para 50 of OEPC's Opening Submissions.

share of the oil production from Block 15.[57] He submitted that this evidence showed two things. First, that OEPC and Ecuador had negotiated the Contract on the understanding that VAT would be reimbursed by the SRI, so that the cost of VAT would be something that OEPC would not have to bear. Therefore the economic model on which the contract terms, particularly Factor X, was based, assumed VAT would be repaid to OEPC.

74. Secondly, Mr Greenwood submitted that this evidence showed that the dispute between OEPC and Ecuador related to matters of taxation (ie. the VAT refund) "*with respect to…the observance and enforcement of terms of*" the Participation Contract. That was because, on OEPC's case, the terms and "the bargain" of the Contract would only be observed and enforced if VAT was refunded, whereas Ecuador was arguing the contrary.

75. Mr Greenwood showed me evidence that was before the Tribunal concerning the SRI Resolutions and the reasoning behind them. The first relevant SRI Resolution, number 664 of 28 August 2001,[58] does state that the reason why OEPC is not entitled to a refund of VAT is that it had already been accounted for in the calculation of Factor X in the Contract. Mr Greenwood submitted that the subsequent SRI Resolutions[59] are all based on the same reasoning. Ecuador disputed this. But Mr Greenwood submitted that whether it was in fact the case was irrelevant. The point is that there was a dispute before the Tribunal on the question of whether the SRI's refusal to refund VAT was consistent with the observance of the terms of the Contract or the enforcement of them.

76. Mr Greenwood also drew my attention to the evidence before the Tribunal of Ms De Mena, the Director of the SRI.[60] In her evidence Ms De Mena did make numerous references to the Participation Contract as the basis for the SRI's Resolutions. Mr Greenwood submits that this also shows that the crux of the dispute between Ecuador and OEPC is a matter of taxation with respect to the observance and enforcement of terms of an investment agreement.

H. Discussion and conclusion on Ecuador's *section 67* challenge on the Tribunal's jurisdiction in relation to the claims under Article II of the BIT.

77. The Award deals with both the Tribunal's jurisdiction and the merits of the dispute between the parties. The arbitrators decided the jurisdiction points first and held that it had jurisdiction to deal with the claims under Article II. The Tribunal then went on to rule in favour of OEPC on the merits on the Article II claims. Therefore, plainly, this is an "*award made by the tribunal on the merits",* to which ***section 67(1)(b)*** of the 1996 Act applies.[61]

---

[57] I was referred to the evidence of Mr Larrea: **DWR/vol 1/Tab 3;** Mr Carillo: **DWR/vol 11/Tab 169;** (both called by OEPC although they worked for Petroecuador at the time); Mr Berrazeuta: **DWR/vol 2/Tab 14;** and Mr Baquero: **DWR/vol 2/Tab 15:** both called for Ecuador.

[58] **EO2/vol 3/Tab 11.**

[59] That is: Resolution 234 of 1 April 2002; Resolution 406 of 31 January 2003 and Resolution 26 of 6 March 2003

[60] **DWR/Vol 2/Tab 17.**

[61] See: ***LG Caltex Gas Co Ltd v China National Petroleum Corpn [2001] 1WLR 1892 at paras 70 and 71, per Lord Phillips of Worth Matravers MR.***

78. In this case Ecuador has challenged the substantive jurisdiction of the Tribunal on the basis that the claims made by OEPC based on breaches of Article II of the BIT are not matters that can be properly determined by the arbitrators. That is because, Ecuador argues, they are "*matters of taxation*" and, on the facts of this case, the claims of OEPC fall outside any part of Article X.2 on its proper construction.

79. So what should the court consider in order to decide whether the arbitral tribunal had "*substantive jurisdiction*" to determine the Article II claims of OEPC? Given the structure of the BIT and the nature of OEPC's claim in the arbitration, it is inevitable that the court must examine not only the scope of the dispute resolution provisions in the governing instrument, ie. the BIT, but also the way in which the parties have presented the dispute to the Tribunal. Therefore the court will need to have regard to the factual aspects concerning the merits of OEPC's claim and Ecuador's defence to it, whilst taking care not to deal with the merits of OEPC's claims. Logically, it seems to me, the court has to consider first the nature of the dispute between the parties. Then it must decide whether, on the true construction of the BIT, and Article X.2 in particular, the Tribunal has jurisdiction to determine the dispute.

The nature of the dispute

80. The dispute arose because of the action of the SRI in passing the various Resolutions that resulted in OEPC not being able to recover VAT paid on local purchases and on the import of goods made in connection with export activities. This action appeared to be contrary to the provision of Article 69A of the ITR which establishes a right to request the refund of VAT on such purchases.[62] The SRI concluded (in Resolution 664), that the provisions of Article 69A were not applicable, so OEPC could not claim a refund of VAT, because:

> *"..inasmuch as the Ecuadorian State, in issuing a reimbursement for the investments, costs and expenses through the participation percentage, included in those reimbursements the VAT and other taxes assessed on such activity".*[63]

In short, the SRI in that Resolution concluded that Factor X in the Contract took account of the VAT paid so Article 69A was not applicable.

81. The same argument, in more elaborate form, was set out in Resolution 234 of 1 April 2002. The Resolution also refers to Clause 8.6 of the Contract. That was said to demonstrate that OEPC was "*perfectly aware that the VAT represented a determining economic factor in the proposal and therefore, in the percentage of participation to be received, which implies that said value directly affects the profitability of the project and its corresponding economic stability*".[64]

82. The SRI shifted its argument in the later two Resolutions which were passed on 31 January 2003 and 6 March 2003,[65] but by then OEPC had served its Notice of Arbitration on 4 November 2002. When the Director of the SRI, Senora Elsa de Mena, gave her written and oral evidence at the hearing in January 2004, she

---

62 The Article is quoted in para 3 of the SRI Resolution 664 of 28 August 2001.

63 **Resolution 664: para 7; Matters of Law (f): EO2/vol 3/Tab 11 page 821**

64 See in particular para 7(s): **EO2/vol 3/Tab 12 page 839.**

65 Resolutions 406 and 26 respectively.

reverted to the argument that under the petroleum laws of Ecuador, the state had the power to negotiate with petroleum companies. Therefore, she stated, the tax system applicable to the contract with that company could be changed by virtue of the terms of the Participation Contract. Senora de Mena also reiterated the view that the payment of VAT had been compensated in the Participation Contract. So, her evidence was that the SRI's actions had been both legal and just.[66]

83. In many of its written submissions to the Tribunal, Ecuador emphasised that the case turned on the relationship between the Participation Contract and Ecuador's tax laws. This point was made partly in support of the "fork in the road" argument that, because OEPC had begun actions in the Quito courts, it could not pursue the ***same*** claim through the arbitration mechanism set out in Article VI.3 of the BIT.[67] But in its submissions on the merits, Ecuador made arguments about the relationship between the terms of the Contract and the liability of OEPC to pay VAT. The point was made in Ecuador's Statement of Defence of 12 September 2003, which dealt with the merits of the claim.[68] Similar points were made in Ecuador's Memorial on the Merits.[69]

84. On its side, OEPC's case on the merits was set out in detail in the Claimants' Memorial dated 28 October 2003.[70] This asserted that the new Article 69A of the ITRL was introduced after the negotiations for the modified Participation Contract, but before execution. The Claimants' Memorial argues that:

> "*because Ecuadorian law provides [an] unequivocal right to a tax credit and reimbursement for VAT paid on the acquisition or importation of goods and services that are used for the production of goods for export, both parties knew in the negotiations of the participation contract that VAT "was not considered a source of revenue for Ecuador"*.[71]

85. The Memorial then asserts that the negotiations relating to the Contract focused on the costs that would be incurred by OEPC, because OEPC would be responsible for the operational and capital expenditures in the fields. Paragraph 29 of the Memorial continues:

> "*Witnesses who participated in the negotiations both for OEPC and for Petroecuador confirm that VAT was never included in such costs. The reason for this was simple: any VAT paid by OEPC had to be refunded by Ecuador pursuant to the law described above*".

---

66 Statement of 18 December 2003: **DWR/vol 2/Tab 17/para 30 page 606. See evidence in chief on 29 January 2004: pages 4827; 4828 and 4829, particularly lines 9 – 13.**

67 See: eg. **Ecuador's Rejoinder on Jurisdiction and Admissibility of 27 October 2003: paras 19, 33 and 34: EO2/vol 6/Tab 41 at pages 1940, 1948 and 1949.**

68 **Ecuador's Statement of Defence: para 13(c):** *"The Modified Participation Contract in Annex XVI clearly contemplates that OEPC is responsible for payment of VAT. In addition, pursuant to clauses 8.6 and 11.11 as well as Annex XIV of the Contract, payment and collections of VAT, including any adjustments in such payments and collections due to changes in the tax rate, were factored into the percentage of participation enjoyed by OEPC".*

69 Ecuador's **Memorial on the Merits** of 18 December 2003 at paras 53 and 95 to 102: **EO2/vol 2/Tab 9, pages 538 and 560 to 566.**

70 **EO2/vol 6/Tab 42.**

71 Para 27 of the Memorial.

References are then made to witness statements of people who subsequently gave evidence at the hearing in writing and, in some cases, orally.

86. The Memorial also deals with what it calls "Ecuador's Contract Theory", ie. Ecuador's case that OEPC would receive the VAT refund "in kind" from Petroecuador through its share of oil, rather than as a credit voucher from the SRI.[72] OEPC's case, as set out, is that this "Contract Theory" is wholly discredited by Petroecuador's own documents, officials and the evidence of its personnel who negotiated the Participation Contract.[73] OEPC's Memorial on the Merits also joined issue on Ecuador's argument on the effect of Clause 8.6 of the Contract.

87. OEPC's Memorial on the Merits also makes allegations about many other acts or statements of Ecuador and Petroecuador. These points are all made in the context of OEPC's case that Ecuador's conduct of denying OEPC the VAT refunds violated the terms of the BIT and international law.[74]

88. This attempt to summarise the very elaborate and lengthy written and oral presentations of the two parties' case demonstrates that Mr Greenwood is correct in his submission that, if the Tribunal was to determine whether Ecuador was in breach of its obligations under the BIT, if must have to consider the basis on which OEPC made its investment in Ecuador. It had to investigate and determine what OEPC's legitimate expectations were by the time the Participation Contract was concluded in May 1999; in particular the Tribunal had to investigate what Ecuador and OEPC understood the position was on the repayment (if any) of VAT paid by OEPC. In order to consider these questions there is, in my view, no doubt that the Tribunal would have to look into the factual background of the negotiations of the Participation Contract and it also had to analyse the terms of the Contract itself.

89. Having examined the cases of the parties put to the Tribunal, I would respectfully agree with the Tribunal's summary of the dispute at paragraph 29 of the Award:

> "*The dispute between the parties to this arbitration centres on the question whether Factor X includes in the participation formula a reimbursement of VAT paid by OEPC, as the Respondent contends is the case, and the related question whether, if it is not, OEPC is entitled to VAT refunds under Ecuador's tax laws, as OEPC argues. As will be noted in connection with jurisdiction, the Claimant has not brought to this arbitration claims of a contractual nature, but rather only claims concerning its rights under the Treaty. The respondent however, is of the opinion that the claims are contractual in nature.*"[75]

The construction of the Bilateral Investment Treaty

90. The rules on Treaty interpretation are set out in the ***Vienna Convention on the Law of Treaties 1969.*** It is agreed that these Rules represent customary internationallaw

---

72 Paragraph 91 of the Memorial.

73 Paragraph 95 et seq of the Memorial.

74 See: **paragraphs 69 – 80 of the Memorial: EO2/vol 6/Tab 42 pages 2039 – 2041.**

75 Mr Cran submitted that the last sentence inaccurately characterised the position of Ecuador. It is accurate so far as the "fork in the road" argument on jurisdiction is concerned and that appears to be the point the Tribunal is making here.

and so are part of English law which I must apply.[76] Section 3 of the Convention is headed "*Interpretation of Treaties*". ***Article 31*** paragraph 1 states:

> *"1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.*
>
> ……
>
> *3. There shall be taken into account, together with the context:*
>
> *(a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;*
>
> *(b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;*
>
> *(c) any relevant rules of international law applicable in the relations between the parties.*
>
> *4. A special meaning shall be given to a term if it is established that the parties so intended."*

Article 32 is headed "*Supplementary means of interpretation*". It states:

> *"Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:*
>
> *(a) leaves the meaning ambiguous or obscure; or*
>
> *(b) leads to a result which is manifestly absurd or unreasonable".*

91. It is clear that, were it not for the fact that the current dispute concerned the question of refunds of a tax, ie. VAT, the dispute between the parties would fall within Article VI.1(a) and (c) of the BIT. That is because it is common ground that the Participation Contract falls within the phrase "*investment agreement*" as used in Article VI.1(a)[77] and OEPC claims that Ecuador has breached rights conferred or created by the BIT with respect to an "*investment*", within Article VI.1(c) of the BIT. But the dispute does involve "*matters of taxation*". So the question is whether, on the correct construction of Article X, in particular Article X.2, it takes the present dispute outside the scope of the BIT and therefore the jurisdiction of the Tribunal.

92. In my view the Parties to the BIT intended that, generally, all matters of taxation should be outside the scope of the BIT. I think that this is clear from the way Article

---

[76] see: R v Secretary of State for the Home Department, ex parte Adam [2001] 2 AC 477 at 516D-E, per Lord Steyn

[77] "*Investment agreement*" is not defined in either Article I or Article VI of the BIT, but Ecuador accepts that it must include the Participation Contract.

X.1 is phrased and the opening words of Article X.2. By Article X.1 each State Party undertakes to the other, "*with respect to its tax policies…to strive to accord fairness and equity in the treatment of investment of nationals and companies of the other party*". If any obligation is imposed between the State Parties to the BIT, the obligation is to "*strive*" in respect of "*tax policies*". It may be that if one State Party does not so strive, it would be in breach of an obligation to the other State Party. Whether Article X.1 also imposes an obligation on a State Party the breach of which can give rights to an investor does not matter for the present case. This is because OEPC accepts that Article X.1 would not give it any rights in addition to those set out in Articles II and III. Nor does OEPC attempt to found the Tribunal's jurisdiction on the terms of Article X.1.

93. But although each State Party agrees with the other to "*strive*" with respect to its "*tax policies*", Article X.2 expressly states that "*nevertheless, the provisions of this Treaty, and in particular Articles VI and VII, shall apply to matters of taxation only with respect to the following…*". To my mind that wording makes it clear that, apart from matters of taxation that come within the three identified exceptions, all matters of taxation are outside the ambit of the BIT.[78] The Submittal Letter of the Secretary of State to President Clinton explains that this general exclusion is based on the assumption that tax matters are properly covered in bilateral tax treaties between States. That explanation seems plausible. Therefore, in my view, unless a particular "*matter of taxation*" comes within the ambit of Article X.2 (a), (b) or (c), then the dispute resolution provisions of the BIT in Article VI cannot apply to any dispute that arises between a State and an investor in relation to that "*matter of taxation*".

94. To the extent that the Tribunal appeared to conclude that matters of taxation were within the scope of the BIT on some broader basis, I must respectfully disagree.[79] In my view the wording of Article X.2 is clear and does not permit any more general admission of tax matters within the scope of the BIT.

95. So, what is the ambit of the three exceptions in Article X.2? I note that the Submittal Letter explains why these exceptions are put in.[80] The letter states:

> "*These three areas are important for investors, and two of the three – expropriatory taxation and tax provisions contained in an investment agreement or authorisation – are not typically addressed in tax treaties*".

This suggests that there must be some link between investor and/or the investment (including an investment agreement) and taxation.

96. Because of the specific reference to the dispute resolution aspects of the BIT in the opening words of Article X.2 , (ie. the words "*and in particular Articles VI and VII…")*, it is clear that the framers of the BIT contemplated that the matters comprised in paragraphs (a), (b) and (c) could be the subject of disputes between a State and an investor. Disputes might need to be resolved by one or other of the

---

[78] At the start of the hearing before me, OEPC intended to argue that the opening words of Article X.2, on their true construction, were limited to matters of "direct" taxation. On the third day of the hearing Mr Greenwood announced that the argument would not be pursued. He was plainly right to make that concession.

[79] This appears to be the suggestion in paragraph 68 of the award.

[80] Neither side suggested that these statements were incorrect; or that I could not take them into account in interpreting Article X.2.

mechanisms set out in Article VI or those of Article VII; hence the reference to those Articles in particular. However, in my view Article X.2 is not concerned solely with defining three particular types of dispute involving matters of taxation that can be resolved using the mechanisms of Articles VI and VII. On its correct construction, if a "*matter of taxation*" falls within the scope of paragraphs (a), (b) or (c), then the whole Treaty applies to that "*matter of taxation*". The opening words of Article X.2 say "*..the provisions of this Treaty…*". Those words are clear and so must be given their ordinary meaning. Moreover, this interpretation accords with the object of the BIT. The Treaty sets out rules on how the Contracting Parties will treat investors and their investments. Article X.2 accepts that, within a limited and defined scope, "*matters of taxation*" will affect both investors and investments and so need to be within the BIT provisions. Therefore it is logical that, to the extent of the scope defined in Article X.2, the Contracting Parties should agree that all the rules set out in the BIT, including those in Articles II and III, should apply to such "*matters of taxation*" as are covered by Article X.2(a), (b) and (c).

97. It follows that I cannot accept the construction of Article X.2 that Mr Cran advanced with skilful arguments in his reply. There is no need to rewrite the opening part of Article X.2. I therefore accept Mr Greenwood's "gateway" argument: ie. that once a claim comes within the ambit of Article X.2 (a), (b) or (c), that means that "*..the provisions of this Treaty, and in particular Articles VI and VII, shall apply….*", which includes the provisions of Article II.

98. The next question, therefore, is what is embraced by the phrase "*…matters of taxation only with respect to….(c) the observance and enforcement of terms of an investment agreement….as referred to in Article VI.1(a)…."?* First, as is now correctly conceded by OEPC, "*matters of taxation*" must include all types of taxation. That phrase is not limited to "direct" taxation only. Secondly, in my view the words "*matters of taxation*" convey the sense of "affairs of taxation" and are broad in their scope, except to the extent qualified by the content of paragraphs (a), (b) and (c) of Article X.2. Thirdly, the effect of the words "*only with respect to*" demonstrate that there has to be a link between a matter (or affair) of taxation and "*the observance and enforcement of terms of an investment agreement*". To my mind "*with respect to*" indicates that the link can be both direct and indirect. The words "*with respect to*" in their ordinary meaning connote "as concerns", or "with reference to", or "in connection with" and so are broad in effect.

99. Fourthly, the matters of taxation must concern, or have reference to, either "*the observance…of terms of an investment agreement*" or "*the….enforcement of terms of an investment agreement*". So the relevant matter of taxation must concern either the performance ("*observance")* of terms of the investment agreement; or the compulsion of the performance ("*enforcement")* of terms of the investment agreement. A test of whether something comes within paragraph (c) could be: does a matter of taxation touch upon or affect the performance of terms of the investment agreement; or does a matter of taxation touch upon or affect enforcement of terms of the investment agreement?

100. That leads on to the next question: what is meant by "*terms*" of an investment agreement? Mr Cran argued that "*terms*" should be given its ordinary meaning and that indicated either the express or implied terms of the investment agreement concerned. Mr Greenwood argued for a broader interpretation. He submitted that, as

the BIT was based on the USA's model BIT, it was intended for use with States having both civil law and common law systems. So "*terms*" should not be given the literal meaning that a common lawyer would give it. He submitted that the word would embrace the whole contractual bargain, including the general principle of civil law that the parties must deal with one another in good faith in relation to the performance of the agreement.

101. I agree with Mr Greenwood's interpretation of the word "*terms*". The USA's model BIT was not drafted with either common law or civil law systems in mind. Common lawyers often analyse contractual obligations in terms of express or implied terms of the contract. Other systems of law are not so schematic. Parties to a contract may owe duties to one another according to the general law to be applied. So, if, under the investment agreement in question, the contractual bargain means that parties are under an obligation of good faith or fair dealing according to the applicable law and if, under the applicable law that obligation should be performed and is capable of enforcement, then it is logical to call that obligation a "*term*" of the investment agreement. In short, I think that, on its proper interpretation, the phrase "*terms of the investment agreement*" means "the contractual bargain embracing all the parties' obligations pursuant to the investment agreement".

102. Lastly, the words *"…an investment agreement…as referred to in Article VI.1.(a)…"* at the end of Article X.2(c) are there to identify the type of investment agreement with which Article X.2(c) is concerned. "*Investment Agreement*" is not defined in Article I of the BIT or anywhere else in the Treaty. But for the purposes of Article VI, an "*investment agreement*" has to be one that is between a State Party and a national or company of the other State Party. Article X.2(c) is limited in its effect to such types of investment agreements.

Application of the interpretation of Article X.2 of the BIT to this case

103. Under the Contract, OEPC was obliged to carry out "*on its own account and risk*" the activities of oil exploitation in Block 15.[81] It was obliged, on its own account and risk, to provide the necessary investments for production activities within Block 15. This meant, if necessary, building all necessary civil works and oil facilities to produce and measure the oil.[82] OEPC also had to pay such taxes as might be required by the laws and regulations of Ecuador.[83] In return OEPC obtained a "Contractor Participation" which was calculated on the basis set out in Clause 8.1, including the so – called Factor X.

104. It is clear from the wording of Clause 8.6 of the Contract that the parties had considered the "*economy of this Participation Contract*", because that clause prescribes what is to happen if one of the events identified in the clause has an impact on "*the economy of this Participation Contract*". One of the events identified is the collection of Value Added Tax on any imports of equipment, machinery, materials and other consumable supplies that OEPC would have to undertake. The question of what VAT would be paid on those items had been raised by OEPC in the course of the negotiations for the Participating Contract. The SRI had given its answer in the

---

81 Clause 4.2 of the Participation Contract.
82 Clauses 5.1.5 and 5.1.6 of the Participation Contract.
83 Clause 5.1.17 of the Participation Contract.

"*Consulta"* dated 5 October 1998, which then formed Annex 16 to the Contract. Clause 8.6 contemplates that if something happens in relation to VAT on the items identified in the "*Consulta"*, then a "*correction factor shall be included in the participation percentages, to absorb the increase or decrease of the economic burden, in accordance with Annex XIV"*.[84]

105. The precise way in which the mechanism in Clause 8.6 is triggered in relation to VAT on imports is not relevant to my decision. But it is relevant that there is a contractual provision to make corrections if tax changes have an impact on the "*economy"* of the contract. That is because Clause 8.6 assumes and is intended to give effect to the underlying understanding of the parties as to what the proper "*economy"* of the Contract must be. Clause 8.6 creates an express obligation to make a correction factor if the identified events have an impact on the Contract's proper "*economy"*.

106. Clause 11.11 of the Contract also stipulates for a similar type of obligation to make a correction factor if there is an unforeseen modification in the tax regime which has an impact on the economy of the Contract. Again that presumes that the parties had considered and decided on what was "*the economy"* of the Contract.

107. The dispute between Ecuador and OEPC that was before the Tribunal was whether, in the circumstances, Ecuador's decision that OEPC was not entitled to have a refund of VAT was a breach of Ecuador's obligations under Articles II and III of the BIT. That dispute involved a matter of taxation, ie. the VAT payments. But in my view, the dispute also involved a matter of taxation that "had reference to" the "performance" of the "obligations of the Contract."

108. I have reached this conclusion for three particular reasons. First, the matter of the right to a VAT refund or not had reference to the obligations of OEPC to do all that was necessary to exploit the oil in Block 15, including the obligation to build all systems needed for that exploitation, because the VAT was paid in respect of purchases made in pursuance of that obligation of OEPC. Secondly, the question of a VAT refund had reference to the performance of OEPC's contractual obligation to pay all taxes according to Ecuador's laws. The dispute was whether that contractual obligation was concluded on the assumption or understanding that there would be a refund of VAT paid. Thirdly, the VAT refund question had reference to the underlying assumptions of the parties as to the "*economy"* of the Contract which formed the basis of the bargain contained in the Contract's terms: was the assumption that VAT would be repaid or not? The underlying assumptions of the parties as to the "*economy"* of the contract was fundamental to how the Contract terms were to be observed and enforced.

109. Mr Cran argued that the consequence of this conclusion was that in cases arising under Article X.2 (c) of the BIT, it would inevitably mean that a tribunal dealing with a dispute would have to investigate the merits before it could decide whether it had jurisdiction. That may be so in some cases. But this is not so unusual in arbitrations. Sometimes the principal issue on the merits is whether a contract has been formed; and the putative contract has an arbitration clause as one of its terms. One party says the contract is valid and binding; the other says not. If the matter is considered by an arbitral tribunal then its jurisdiction will depend on whether the contract is indeed

---

84 Annex XIV sets out an elaborate formula for making an adjustment to take account of VAT on imports.

valid and binding. So, of necessity the tribunal will have to go into the merits in order to decide its jurisdiction. That situation is expressly contemplated by ***section 67(1)(b)*** of the ***1996 Act.*** That is what had to be done here.

Conclusion on Ecuador's section 67 challenge

110. For these reasons, I conclude that the Tribunal was correct in holding that it had jurisdiction to consider the dispute between OEPC and Ecuador on whether, in the circumstances, Ecuador had been in breach of its obligations under Article II of the BIT. For, once the dispute came within Article X.2(c), the "gateway" to the rest of the BIT, including Articles VI.1 (c) and the obligations of Article II, is opened. All the provisions of the BIT, and in particular Articles VI and VII, will apply and can be relied upon by OEPC.

111. I must deal specifically with Mr Cran's point, forcefully argued, that, before the Tribunal, OEPC did not rely on Article X.2(c) as a foundation of the arbitrators' jurisdiction. I accept that this appears to be the case from the material I have been shown. However the matter is made complicated by the fact that OEPC had to deal at the same time with two jurisdictional objections by Ecuador. The first was the "fork in the road" argument of Ecuador. Ecuador argued that the claims of OEPC before the Quito courts related to an investment agreement between Ecuador (via Petroecuador) and OEPC and so fell within the terms of Article VI.1(a) of the BIT. Ecuador submitted that as OEPC had exercised its right under Article VI.2(a) of the BIT to raise its claim before the Quito courts, then OEPC could not raise the same claim against Ecuador under the BIT arbitration procedure, because that would raise the same claim as that before the Quito courts. Therefore OEPC was precluded from pursuing its claim under the BIT by virtue of the terms of Article VI.3: in short, OEPC had taken a "fork in the road".[85]

112. In the written and oral submissions on the question of jurisdiction, OEPC was at pains to emphasise that its claim in the BIT arbitration was not a claim under the investment agreement, but was a claim for a breach of a right conferred on OEPC by the BIT in respect of its investment, within Article VI.1(c) of the BIT.[86] I suspect that is why OEPC did not put forward a positive case that, for its claim under the BIT, OEPC could rely on Article X.2(c) to found the Tribunal's jurisdiction.

113. But the fact that OEPC did not put forward the particular plea that there was jurisdiction under Article X.2(c) but, instead, there was a more general basis for it, did not preclude the Tribunal from holding, as it did, that it had jurisdiction by virtue of Article X.2(c). It was, after all, Ecuador's own case that only Article X.2(c) might apply but it argued that, on the proper interpretation of that provision and the facts, the dispute did not fall within it. The Tribunal disagreed with Ecuador's construction of Article X.2(c) and held it had jurisdiction.

---

[85] Article VI.3(a) states: *"3(a) Provided that the national or company concerned has not submitted the dispute for resolution under paragraph 2(a) or (b)…."* the arbitration procedure set out in Article VI.3 can be used to settle disputes within the scope of Article VI.1 of the BIT.

[86] This is reflected in the Tribunal's summary of the arguments on this point in paragraphs 38 to 42 of the award.

114. Before me, OEPC specifically based its jurisdiction case on Article X.2(c). Mr Cran did not argue that OEPC were debarred from putting that case forward now. He could not do so.

115. For these reasons the challenge of Ecuador to the award based on ***section 67*** of the Act must be dismissed.

I. Ecuador's *section 68* challenge

116. In its ***section 68*** application, Ecuador focuses on particular parts of the award in which the Tribunal: (i) makes statements about SRI Resolutions and their effect; (ii) makes orders that OEPC should desist from carrying on its claims against the SRI in the Ecuador courts; and (iii) declares that those proceedings shall have no legal effect.[87] Ecuador submits that in making these pronouncements and orders, there was a serious irregularity affecting the tribunal and the award, because the tribunal exceeded its powers (other than by exceeding its substantive jurisdiction), contrary to ***section 68(2)(b)*** of the Act.

117. Ecuador submits that these pronouncements and orders of the Tribunal purport to interfere with the sovereign, internal affairs of Ecuador. They therefore constitute a serious irregularity affecting the tribunal or the award because the tribunal has no powers to interfere with the internal affairs of Ecuador. This interference has caused or will cause a substantial injustice to Ecuador. Mr Bethlehem QC, who argued this point for Ecuador, emphasises that the *bona fides* of the Tribunal is not being questioned or challenged.

118. The parts of the award that are criticised are all in Section VII, which is headed "***Remedies***". The first sub – heading is "*A. Compensation Due"*. Having stated its conclusion that Ecuador is in breach of its treaty obligations under Articles II.1 and II.3, the Tribunal says that those breaches "*…have a causal link to four separate but related situations in which the rights of the Claimant have been affected and damage has ensued"*. The award then continues, in paragraph 202:

> *"The first situation concerns the amounts refunded under the Granting Resolutions. The Respondents cannot order the Claimants to return the amount of VAT refunded by the Granting Resolutions as OEPC had a right to such refunds because no alternative mechanism was included in the Contract as the SRI believed. The Tribunal accordingly holds that the Claimant is entitled to retain the amounts so refunded and that the SRI Denying Resolutions requiring the return of those amounts are without legal effect".*

119. In paragraph 209 of the award, the Tribunal notes again that OEPC has pursued its claims in Ecuador's courts "*…separate from the claims brought to this Tribunal for breaches of Treaty rights"*. The Tribunal thought that there might be a risk of double recovery by OEPC. In order to forestall that, the Tribunal said, in the last sentence of paragraph 209 that:

---

[87] Paragraph 202 last sentence; paragraph 209 last sentence, items (ii) and (iii) and Decisions paragraphs 6 and 10 (ii) and (iii) of the award.

> "*…the Tribunal: (i) holds that OEPC shall not benefit from any additional recovery; (ii) directs the Claimant to cease and desist from any local court actions, administrative proceedings or other actions seeking refund of any VAT paid through December 31, 2003; and (iii) holds that any and all such actions and proceedings shall have no legal effect*".

Those conclusions and orders are reflected in the terms of paragraphs 6 and 10 of the Decision of the Tribunal to which I have already referred.

120. The steps in Mr Bethlehem's arguments are as follows: first, it is a basic principle of public international law that international tribunals are not competent to declare the internal validity of national rules or procedures unless States expressly give a tribunal the competence to do so. This is because the international legal order must respect the reserved domain of domestic jurisdiction.[88] Secondly, States are free to determine the manner in which they will comply with their international obligations.[89] Thirdly, it is the task of an international tribunal such as the tribunal in the present case, which was acting under UNCITRAL Rules, to determine the rights and obligations of Ecuador and OEPC in accordance with the terms of the BIT. That involves determining the rights and obligations of the parties to the arbitration as a matter of international law. Fourthly, it is accepted that the tribunal was competent to order injunctive relief or specific performance against a party to the arbitration. But the tribunal cannot exercise such powers if, in doing so, the effect of these orders is to purport to determine the internal validity and legal effect of measures of national law and to make orders that are directed at internal Ecuadorian legal procedures. Fifthly, the orders made in paragraphs 6 and 10 of the Decision violate Ecuador's right, in international law, to determine how it will fulfil its international law obligations towards OEPC under the BIT, as the tribunal have determined. Therefore, sixthly, the tribunal exceeded its powers under international law. In doing so it committed a "*serious irregularity*" within ***section 68.*** Lastly, this serious irregularity has caused and will cause "*substantial injustice"* to Ecuador, because of the effect of the orders made, by virtue of their interference with the internal affairs of Ecuador.

121. Mr Greenwood submits, for OEPC, that the scope of the tribunal's powers to grant remedies is governed by English law, not international law. He submits that the parties have not expressly agreed what powers the tribunal will have to grant remedies and there is nothing in the UNCITRAL Rules to define the scope of their powers. Therefore the matter is governed by ***section 48*** of the Arbitration Act 1996. It is clear, he submits, that the tribunal has the power to grant declarations (***section 48(3)),*** and also injunctions (***section 48(5)).*** There is no general rule of public international law which prevents the tribunal from making the orders it has done in this case. Therefore the tribunal acted within its powers. Furthermore, there is no substantial injustice to Ecuador, because any orders made by the tribunal of a positive nature were made against OEPC, not Ecuador.

Discussion and conclusion.

122. In its judgment on the "justiciability" issue, the Court of Appeal concluded that, at least from the moment when an investor submits a dispute with a State Party to

---

88 See eg: ***Brownlie, Principles of Public International Law (6th Ed.2003) at page 39.***

89 See eg: ***Oppenheim's International Law (9th Ed.1992, by Jennings and Watts) at para 21 pp 82 – 3.***

arbitration under Article VI of the BIT, the BIT confers or creates rights in international law in favour of the investor.[90] The tribunal was therefore dealing with the rights of OEPC in international law and the obligations that Ecuador owed to OEPC as a matter of international law. It must follow, in my view, that if the tribunal concluded that international law rights of OEPC had been violated by Ecuador, or the latter was in breach of its international law obligations, then the tribunal will have to consider what remedies are available in international law to repair any damage caused to OEPC by Ecuador's breach of OEPC's international law rights.

123. In the absence of any express agreement between the parties to the arbitration in which the international law rights and obligations of the parties are to be determined, the remedies that the tribunal can grant must be those that are generally available to deal with breaches of international law as determined by the tribunal. A tribunal must be entitled to make a declaratory judgment of the rights and obligations of the parties in international law. It has been described as a power that is "*necessarily inherent in the tribunal"* that is dealing with rights and obligations under international law.[91] That is the "*implicit foundation"* of an award of monetary damages. There can also be no doubt that a tribunal that has the power to determine rights and obligations in international law has the power to award monetary compensation to a party to the proceedings before the tribunal.[92]

124. In Section VII of the award, at paragraph 201, the tribunal states that the breaches of the BIT by Ecuador, (which were listed in the previous paragraph), "*have a causal link to four separate but related situations in which the rights of the Claimant have been affected and damage has ensued"*. The arbitrators deal with the first situation in paragraph 202 of the award. I have already set out that paragraph. The second sentence of paragraph 202 refers to the fact that, in the SRI's Resolution 234, it had ordered that the appropriate unit of the SRI should begin legal actions with the intention of collecting the VAT that had been reimbursed to OEPC.[93] As I read that sentence in paragraph 202, the tribunal is declaring the rights of OEPC, as a matter of international law. That is how I read the third and fourth sentences also. The tribunal is declaring that the statements in SRI Resolutions ordering the return to the SRI of VAT that has been reimbursed to OEPC are in breach of OEPC's international law rights. It must be within the powers of the tribunal to declare that the statements by the SRI are in breach of international law, and so, as a matter of international law, "*are without legal effect"*.

125. In paragraph 209 of the award, the tribunal is dealing with the consequences of its order that OEPC is entitled to monetary compensation from Ecuador, as set out in paragraph 207. In paragraph 209, which I have also set out above, the tribunal notes that OEPC has made claims in the Ecuadorian courts for refunds of VAT and so the two sets of claims (ie. under the BIT and in the Courts) might give rise to the possibility of double recovery. It seems to me that the three numbered orders of the tribunal in the last sentence of paragraph 209 are consequential declarations that follow from the tribunal's decision that OEPC is entitled to monetary compensation

---

90 ***[2005] 1 WLR 70 at 83 para 19.***

91 ***Collier & Lowe: The Settlement of Disputes in International Law (1999) page 250.***

92 ***Ibid. page 252***

93 See para 7(z) and Resolution 2 of Resolution 234: **EO2/vol 3/Tab 12/pages 841 and 842.**

from Ecuador for breaches of the BIT. In principle, it seems to me, the tribunal must have the power to make orders that are intended to give proper effect to its primary order granting OEPC monetary compensation.

126. The first numbered order is directed at OEPC. It is not directed at Ecuador. It is not declaring "*the internal invalidity*"of any rule of Ecuador's national laws. Nor is it directing Ecuador to perform its international law obligations in any particular way. The same is true of the second numbered order. In fact, I was told by Mr Greenwood that OEPC has withdrawn all but one of the proceedings in Ecuador and would be ending the last one soon.

127. The third numbered order is also directed at OEPC. In the light of the other two orders it is not strictly necessary. But, as I read it, the order is making no declaration on the effect or validity of any national law of Ecuador; nor is it ordering Ecuador to perform its international law obligations in any particular way. The only effect of the order is to make a declaration as regards OEPC's attempts to make claims in the Ecuadorian courts. It is an order which is consequential to the order granting OEPC monetary compensation, and is made so as to ensure that OEPC does not obtain a double recovery.

128. The same analysis applies to Decisions 6 and 10 of the award. Therefore I conclude that the tribunal has not acted in excess of its powers in the statements identified by Ecuador. It has certainly not been in breach of the principles of public international law to which Mr Bethlehem referred. Moreover, even if the third order in Decision 10 of the Award might possibly be regarded as made in excess of the tribunal's powers, that order cannot possibly be said to have caused "*substantial injustice*" to Ecuador. On the contrary, the order, together with all the others that are criticised, were made so as to protect Ecuador. They cause Ecuador no injustice whatsoever.

129. Therefore I must dismiss Ecuador's ***section 68*** application.

J. OEPC's contingent *section 67* application concerning the tribunal's decision on OEPC's "*expropriation*" claim.

130. As I have concluded that both of Ecuador's applications must fail, OEPC's contingent application does not arise for decision. The matter was argued in detail, however, so I will deal with it very briefly.

131. OEPC's case is that, in the arbitration, it submitted that the VAT refunds to which OEPC was entitled were part of its "*investment*", within Article I of the BIT. OEPC argued that Ecuador expropriated that part of OEPC's investment by "*unlawfully, arbitrarily, discriminatorily and retroactively taking OEPC's rights to VAT refunds*",[94] so that Ecuador was in breach of its treaty obligations under Article III of the BIT.

132. In the award, at paragraph 80, the tribunal stated:

> "*A claim of expropriation should normally be considered in the context of the merits of a case. However, it is so evident that there is no*

[94] The phraseology quoted in para 81 of the award.

expropriation in this case that the Tribunal will deal with this claim as a question of admissibility".

133. Mr Greenwood submits that the tribunal dealt with the expropriation issue as a matter of its jurisdiction and concluded that it did not have jurisdiction to consider that claim. He says that this is clear from the terms of the award dealing with this aspect of the case at paragraphs 78 to 92. He submits that the wording of the award in this section is such that it is not an award on the merits of OEPC's expropriation claim. Mr Greenwood notes that under Article 21(4) of the UNCITRAL Rules,[95] a tribunal has power to deal with jurisdiction arguments, but does not have power to deal with the merits summarily. He submits that, in this award on public international law issues, the tribunal's characterisation of the expropriation claim being *"inadmissible"* is an indication that it is dealing with the matter as a question of jurisdiction. This is because, in international law, issues of jurisdiction and inadmissibility are both treated as pre – merits questions.

134. Mr Cran took me through the parties' written submissions on the issues of jurisdiction and the merits which were lodged before the decision of the tribunal to deal with the jurisdiction and merits issues at one hearing.[96] At the time Ecuador's Jurisdictional Objections were submitted on 12 September 2003, it is unclear whether Ecuador was arguing that the tribunal had no jurisdiction to decide the "expropriation" claim because it fell outside Article X.2 of the BIT, or whether Ecuador was submitting that the tribunal should reject jurisdiction over that claim because it was hopeless on the merits.[97] However, when Ecuador submitted its Rejoinder on Jurisdiction and Admissibility, on 27 October 2003, it stated, at paragraphs 159 and 161, under Heading IV, *"Claimant's Expropriation Claim is Inadmissible"*: [98]

> "*159. Ecuador agrees with Claimant that Article X.2 does not exclude expropriation claims with respect to tax matters. Therefore, if there were no fork in the road provision, the Tribunal would have jurisdiction over a proper expropriation claim. However, as Ecuador has pointed out, what Claimant has alleged could not be an expropriation within the meaning of the Treaty or international law, even assuming all of Claimant's factual allegations in its Statement of Claim were true (as is not the case).*
>
> ….
>
> *161. In any event, Ecuador freely agrees that tribunals normally do not reject claims on grounds of admissibility, prior to the airing of the factual issues. Nevertheless, it is clear that in unusual circumstances, tribunals have dismissed claims on a preliminary basis on grounds that the claimed facts could not amount to a violation of the Treaty provisions invoked."*

---

95 This provides: *"In general, the arbitral tribunal should rule on a plea concerning its jurisdiction as a preliminary question. However, the arbitral tribunal may proceed with the arbitration and rule on such a plea in their final award".*

96 That decision was made on 26 November 2003.

97 See: ***Jurisdictional Objections of Respondent Republic of Ecuador para 33: EO2/vol 2/Tab 6/page 401.***

98 **EI2/vol6/Tab 41/page 2006.**

135. It is thus clear that, by the time of the hearing on jurisdiction and the merits, Ecuador had conceded that the tribunal had jurisdiction to deal with OEPC's expropriation claim. However, Ecuador was submitting that the expropriation claim was hopeless as a matter of fact and law.

136. It is, in my view, equally clear that the Tribunal was dealing with the merits of the expropriation claim in paragraphs 78 – 92 of the award. The phraseology of paragraphs 86 to 89 make this plain. The Tribunal decided that, because it was "*so evident that there is no expropriation in this case*", therefore it should deal with this claim as a matter of "*admissibility*". English lawyers may find that a curious word to use in the circumstances. But that does not matter. In my view it is evident, looking at the substance of paragraphs 78 – 92 of the award, that the tribunal was making an award on the merits of the expropriation claim. It did not decide it had no jurisdiction to entertain the claim.

137. Accordingly, there is no basis on which OEPC can mount an application to challenge this part of the award under ***section 67.*** OEPC wanted the tribunal to consider the expropriation claim on its merits. In effect it did so, and it dismissed the claim.

K. Conclusions.

138. I will summarise my conclusions:

i) The tribunal had jurisdiction to determine OEPC's claims based on Ecuador's alleged breaches of Article II of the BIT. The dispute fell within the terms of Article X.2.(c) of the BIT. Therefore Ecuador's application challenging the jurisdiction of the tribunal under ***section* 67** of the ***Arbitration Act 1996*** must fail.

ii) Ecuador's application under ***section 68*** of the Act also fails. The tribunal did not exceed its powers (within the terms of ***section 68(2)(b)***). In any event, Ecuador has been caused no "*substantial injustice*" even if the tribunal did exceed its powers.

iii) If it had been necessary to decide the issue, OEPC's jurisdictional challenge (under ***section 67)*** to the tribunal's conclusion on the expropriation claim would have failed. Ecuador had conceded jurisdiction and the tribunal's award on this claim dismissed it on the merits.

APPENDIX 1:

Wording of the relevant parts of the Letter of Submittal to the President of the USA and the relevant Articles of the Treaty between the United States of America and the Republic of Ecuador

Submittal Letter.

"Investment

The Treaty's definition of investment is broad, recognizing that investment can take a wide variety of forms. It covers investments that are owned or controlled by nationals or companies of one of the Treaty partners in the territory of the other. Investments can be made either directly or indirectly through one or more subsidiaries, including those of third countries. Control is not specifically defined in the Treaty. Ownership of over 50 percent of the voting stock of a company would normally convey control, but in many cases the requirement could be satisfied by less than that proportion.

The definition provides a non-exclusive list of assets, claims and rights that constitute investment. These include both tangible and intangible property, interests in a company or its assets, "a claim to money or performance having economic value, and associated with an investment," intellectual property rights, and any right conferred by law or contract (such as government-issued licenses and permits). The requirement that a "claim to money" be associated with an investment excludes claims arising solely from trade transactions, such as a simple movement of goods across a border, from being considered investments covered by the Treaty.

Under paragraph 2 of Article I, either country may deny the benefits of the Treaty to investments by companies established in the other that are owned or controlled by nationals of a third country if 1) the company is a mere shell, without substantial business activities in the home country, or 2) the third country is one with which the denying Party does not maintain normal economic relations. For example, at this time the United States does not maintain normal economic relations with, interalia, Cuba or Libya.

Paragraph 3 confirms that any alternation in the form in which as asset is invested or reinvested shall not affect its character as investment. For example, a change in the corporate form of an investment will not deprive it of protection under the Treaty."

"Article X (Tax Policies)

> The Treaty exhorts both countries to provide fair and equitable treatment to investors with respect to tax policies. However, tax matters are generally excluded from the coverage of the prototype BIT, based on the assumption that tax matter are properly covered in bilateral tax treaties.
>
> The Treaty, and particularly the dispute settlement provisions, do apply to tax matters in three areas, to the extent they are not subject to the dispute settlement provisions of a tax treaty, or, if so subject, have been raised under a tax treaty's dispute settlement procedures and are not resolved in a reasonable period of time.
>
> The three areas where the Treaty could apply to tax matters are expropriation (Article III), transfers (Article IV) and the observance and enforcement of terms of an investment agreement or authorization (Article VI (1) (a) or (b)). These three areas are important for investors, and two of the three--expropriatory taxation and tax provisions contained in an investment agreement or authorization--are not typically addressed in tax treaties."

The Treaty Wording:

> "TREATY BETWEEN
>
> THE UNITED STATES OF AMERICA
>
> AND THE REPUBLIC OF ECUADOR
>
> CONCERNING THE ENCOURAGEMENT
>
> AND RECIPROCAL PROTECTION OF INVESTMENT
>
> The United States of America and the Republic of Ecuador (hereinafter the "Parties");
>
> Desiring to promote greater economic cooperation between them, with respect to investment by nationals and companies of one Party in the territory of the other Party;
>
> Recognizing that agreement upon the treatment to be accorded such investment will stimulate the flow of private capital and the economic development of the Parties;
>
> Agreeing that fair and equitable treatment of investment is desirable in order to maintain a stable framework for investment and maximum effective utilization of economic resources;

Recognizing that the development of economic and business ties can contribute to the well-being of workers in both Parties and promote respect for internationally recognized worker rights; and

Having resolved to conclude a Treaty concerning the encouragement and reciprocal protection of investment;

Have agreed as follows:

ARTICLE I

1. For the purposes of this Treaty,

(a) "investment" means every kind of investment in the territory of one Party owned or controlled directly or indirectly by nationals or companies of the other Party, such as equity, debt, and service and investment contracts; and includes:

(i) tangible and intangible property, including rights, such as mortgages, liens and pledges;

(ii) a company or shares of stock or other interests in a company or interests in the assets thereof;

(iii) a claim to money or a claim to performance having economic value, and associated with an investment;

(iv) intellectual property which includes, inter alia, rights relating to:

literary and artistic works, including sound recordings;

inventions in all fields of human endeavor;

industrial designs;

semiconductor mask works;

trade secrets, know-how, and confidential business information; and

trademarks, service marks, and trade names; and

(v) any right conferred by law or contract, and any licenses and permits pursuant to law;

……

(d) "return" means an amount derived from or associated with an investment, including profit; dividend; interest; capital gain;

royalty payment; management, technical assistance or other fee; or returns in kind; "……

"ARTICLE II

1. Each Party shall permit and treat investment, and activities associated therewith, on a basis no less favorable than that accorded in like situations to investment or associated activities of its own nationals or companies, or of nationals or companies of any third country, whichever is the most favorable, subject to the right of each Party to make or maintain exceptions falling within one of the sectors or matters listed in the Protocol to this Treaty. Each Party agrees to notify the other Party before or on the date of entry into force of this Treaty of all such laws and regulations of which it is aware concerning the sectors or matters listed in the Protocol. Moreover, each Party agrees to notify the other of any future exception with respect to the sectors or matters listed in the Protocol, and to limit such exceptions to a minimum. Any future exception by either Party shall not apply to investment existing in that sector or matter at the time the exception becomes effective. The treatment accorded pursuant to any exceptions shall, unless specified otherwise in the Protocol, be not less favorable than that accorded in like situations to investments and associated activities of nationals or companies of any third country.

2. (a) Nothing in this Treaty shall be construed to prevent a Party from maintaining or establishing a state enterprise.

(b) Each Party shall ensure that any state enterprise that it maintains or establishes acts in a manner that is not inconsistent with the Party's obligations under this Treaty wherever such enterprise exercises any regulatory, administrative or other governmental authority that the Party has delegated to it, such as the power to expropriate, grant licenses, approve commercial transactions, or impose quotas, fees or other charges.

(c) Each Party shall ensure that any state enterprise that it maintains or establishes accords the better of national or most favored nation treatment in the sale of its goods or services in the Party's territory.

3. (a) Investment shall at all times be accorded fair and equitable treatment, shall enjoy full protection and security and shall in no case be accorded treatment less than that required by international law.

(b) Neither Party shall in any way impair by arbitrary or discriminatory measures the management, operation,

maintenance, use, enjoyment, acquisition, expansion, or disposal of investments. For purposes of dispute resolution under Articles VI and VII, a measure may be arbitrary or discriminatory notwithstanding the fact that a party has had or has exercised the opportunity to review such measure in the courts or administrative tribunals of a Party.

(c) Each Party shall observe any obligation it may have entered into with regard to investments.

……

6. Neither Party shall impose performance requirements as a condition of establishment, expansion or maintenance of investments, which require or enforce commitments to export goods produced, or which specify that goods or services must be purchased locally, or which impose any other similar requirements."

……

"ARTICLE III

1. Investments shall not be expropriated or nationalized either directly or indirectly through measures tantamount to expropriation or nationalization ("expropriation") except: for a public purpose; in a nondiscriminatory manner; upon payment of prompt, adequate and effective compensation; and in accordance with due process of law and the general principles of treatment provided for in Article II(3). Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriatory action was taken or became known, whichever is earlier; be calculated in a freely usable currency on the basis of the prevailing market rate of exchange at that time; be paid without delay; include interest at a commercially reasonable rate from the date of expropriation; be fully realizable; and be freely transferable.

2. A national or company of either Party that asserts that all or part of its investment has been expropriated shall have a right to prompt review by the appropriate judicial or administrative authorities of the other Party to determine whether any such expropriation has occurred and, if so, whether such expropriation, and any associated compensation, conforms to the principles of international law.

3. Nationals or companies of either Party whose investments suffer losses in the territory of the other Party owing to war or other armed conflict, revolution, state of national emergency, insurrection, civil disturbance or other similar events shall be

accorded treatment by such other Party no less favorable than that accorded to its own nationals or companies or to nationals or companies of any third country, whichever is the most favorable treatment, as regards any measures it adopts in relation to such losses."

"ARTICLE IV

1. Each Party shall permit all transfers related to an investment to be made freely and without delay into and out of its territory. Such transfers include: (a) returns; (b) compensation pursuant to Article III; (c) payments arising out of an investment dispute; (d) payments made under a contract, including amortization of principal and accrued interest payments made pursuant to a loan agreement; (e) proceeds from the sale or liquidation of all or any part of an investment; and (f) additional contributions to capital for the maintenance or development of an investment. [*38]

2. Transfers shall be made in a freely usable currency at the prevailing market rate of exchange on the date of transfer with respect to spot transactions in the currency to be transferred.

3. Notwithstanding the provisions of paragraphs 1 and 2, either Party may maintain laws and regulations (a) requiring reports of currency transfer; and (b) imposing income taxes by such means as a withholding tax applicable to dividends or other transfers. Furthermore, either Party may protect the rights of creditors, or ensure the satisfaction of judgments in adjudicatory proceedings, through the equitable, non-discriminatory and good faith application of its law."

"ARTICLE VI

1. For purposes of this Article, an investment dispute is a dispute between a Party and a national or company of the other Party arising out of or relating to (a) an investment agreement between that Party and such national or company; (b) an investment authorization granted by that Party's foreign investment authority to such national or company; or (c) an alleged breach of any right conferred or created by this Treaty with respect to an investment.

2. In the event of an investment dispute, the parties to the dispute should initially seek a resolution through consultation and negotiation. If the dispute cannot be settled amicably, the

national or company concerned may choose to submit the dispute, under one of the following alternatives, for resolution:

(a) to the courts or administrative tribunals of the Party that is a party to the dispute; or

(b) in accordance with any applicable, previously agreed dispute-settlement procedures; or

(c) in accordance with the terms of paragraph 3.

3. (a) Provided that the national or company concerned has not submitted the dispute for resolution under paragraph 2 (a) or (b) and that six months have elapsed from the date on which the dispute arose, the national or company concerned may choose to consent in writing to the submission of the dispute for settlement by binding arbitration:

> (i) to the International Centre for the Settlement of Investment Disputes ("Centre") established by the Convention on the Settlement of Investment Disputes between States and Nationals of other States, done at Washington, March 18, 1965 ("ICSID Convention"), provided that the Party is a party to such Convention; or
>
> (ii) to the Additional Facility of the Centre, if the Centre is not available; or
>
> (iii) in accordance with the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL); or
>
> (iv) to any other arbitration institution, or in accordance with any other arbitration rules, as may be mutually agreed between the parties to the dispute.

(b) Once the national or company concerned has so consented, either party to the dispute may initiate arbitration in accordance with the choice so specified in the consent.

4. Each Party hereby consents to the submission of any investment dispute for settlement by binding arbitration in accordance with the choice specified in the written consent of the national or company under paragraph 3. Such consent, together with the written consent of the national or company when given under paragraph 3 shall satisfy the requirement for:

(a) written consent of the parties to the dispute for purposes of Chapter II of the ICSID Convention (Jurisdiction of the Centre) and for purposes of the Additional Facility Rules; and

(b) an "agreement in writing" for purposes of Article II of the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, done at New York, June 10, 1958 ("New York Convention").

5. Any arbitration under paragraph 3(a)(ii), (iii) or (iv) of this Article shall be held in a state that is a party to the New York Convention.

6. Any arbitral award rendered pursuant to this Article shall be final and binding on the parties to the dispute. Each Party undertakes to carry out without delay the provisions of any such award and to provide in its territory for its enforcement."

……

"ARTICLE X

1. With respect to its tax policies, each Party should strive to accord fairness and equity in the treatment of investment of nationals and companies of the other Party.

2. Nevertheless, the provisions of this Treaty, and in particular Article VI and VII, shall apply to matters of taxation only with respect to the following:

(a) expropriation, pursuant to Article III;

(b) transfers, pursuant to Article IV; or

(c) the observance and enforcement of terms of an investment agreement or authorization as referred to in Article VI (1) (a) or (b),

to the extent they are not subject to the dispute settlement provisions of a Convention for the avoidance of double taxation between the two Parties, or have been raised under such settlement provisions and are not resolved within a reasonable period of time."

APPENDIX 2

The Wording of the Relevant clauses of the Participation Contract

"THREE: INTERPRETATION, LANGUAGE AND DEFINITIONS **OF THIS** PARTICIPATION CONTRACT.

3.1 Conventional Interpretation.- The Parties agree that this Participation Contract shall be interpreted in accordance with the provisions of Title Xffl, Book Four of the Ecuadorian Civil Code, and stipulate that the titles and order of Clauses and sub-clauses are only for the purposes of identification and reference.

3.1.1 Any tolerance of the Parties which refers to lack of compliance with the obligations established in this Participation Contract, in no case shall imply a change or alteration of its stipulations and said event shall not constitute a precedent for the interpretation of this Participation Contract, nor shall it constitute a source of any rights in favor of the Party that did not comply with its obligations."

3.1.2 In case of discrepancies, the stipulations contained in this Participation Contract shall prevail over any provisions contained **in other** documents, which due to their legal, technical or financial nature, maybe considered of a secondary **order.**

3.1.3 The Parties agree and expressly note that in case of discrepancies between the provisions of this Participation Contract and legal provisions and regulations, said legal provisions and regulations shall prevail; nevertheless, the provisions of this Participation Contract shall prevail insofar as they determine, specify, clarify and **or apply said legal** provisions and regulations.

3.1.4 Invalidity or impracticability **of** performance of any stipulation of this Participation Contract shall not cause nullity, nor affect the performance and enforceability of the remaining contractual stipulations in this Participation Contract."

…….

"4.2 Contractor shall have the obligation and exclusive right to carry out, on its own account and risk, the activities for Crude Oil exploitation **in the Participation Contract** Area, as **well as** Additional **Exploration of the** Participation Contract **and** eventual exploitation of Crude Oil in the same area, including minimum Additional Exploration activities agreed to in the Amended Contract and ratified in Annex XV of this Participation Contract."

……

"5.1.5 On its own account and risk, proceed with the estimated investments for production activities within the Participation Contract Area, as well as with all the expenditures needed to comply with this Participation Contract. Additionally, if necessary, Contractor shall build all civil works and oil facilities and, on its own account, acquire and install the equipment to carry out volumetric measurements and determinations, temperature adjustments, water and sediment contents and other measurements that may be necessary in order to determine Fiscalized Production."

…….

"5.1.17 Pay the taxes, contributions and customs duties as may be required by the laws and regulations of Ecuador. Contractor shall comply with the requirements established bylaw, especially with reference to the presentation of declarations, determination and withholding of taxes, maintenance and exhibition of books and registers."

……..

"**5.3 Rights of Contractor.** In addition to what has been stipulated in this Participation Contract and the provisions of the Hydrocarbons Law and its regulations, Contractor shall have the right to:

5.3.1 Perform in the Participation Contract Area, all activities set forth as the objective in Clause Four of this Participation Contract.

5.3.2 Receive and freely dispose of Contractor Participation as established in Clause 8.1 of this Participation Contract.

5.3.3 Use and have access to all technical and operating information related to the Participation Contract Area, such as geologic, geophysical, well drilling, production and any other information that Contractor may require from PETROECUADOR or the Corresponding Ministry for the Participation Contract Area. The costs of copying said information shall be borne by Contractor.

5.3.4 Use, in accordance with the law and the provisions of this Participation Contract, roads, means of transport and communication in existence or to be built, as well as the water and natural building materials required for hydrocarbon operations.

5.3.5 At any time during the term of this Participation Contract, introduce partial reductions of the Participation Contract Area, keeping the continuity of parcels, in accordance to the law, without affecting the 1992 Development Plans and other plans, Yearly Programs and Budgets in force or other obligations under this Participation Contract.

5.3.6 Besides the rights provided by Law and in this Participation Contract, said Contract does not grant Contractor other rights of any nature over the soil, subsoil or over any other natural resources existing there, nor over areas expropriated in favor of PETROECUADOR for the performance of this Participation Contract, nor its easements, nor over works carried out on them. The delimitation of the Participation Contract Area only serves the purpose of determining the surface on which Contractor has the right to execute activities covered by this Participation Contract.

5.3.7 To use at no cost the Crude Oil and Natural Gas forthcoming from the Participation Contract Area that may be needed for its field operations, in accordance with the provisions of Clause 10.4, including but not limited to electric power generation for its operation. In the case of Natural Gas, said use shall be subject to prior authorization by the Corresponding Ministry.

5.3.8 Obtain from the Corresponding Ministry the timely incorporation of the Contract Area fields into national production."

"EIGHT: PARTICIPATION AND DELIVERY PROCEDURES.-

8.1 Calculating Contractor Participation.- Contractor Participation shall be calculated according to the following formula:

$$PC = \frac{XQ}{100}$$

Where:

PC = Contractor Participation

Q = Fiscalized Production

X = Average factor, in percentage, rounded out to the third decimal, corresponding to Contractor Participation, calculated according to the following formula:

$$x = \frac{Xl.pl + X2.g2 + X3.q3}{q} + Y$$

Where:

q = is average daily Fiscalized Production for the corresponding Fiscal Year.

qi = is the partofq lower than LI

q2 = is the part of q between Ll and L2.

q3 = is the part ofq greater than L2.

8.1.1 **BASE AREA**: Is that area comprising the Laguna., Jivino, Napo, Itaya and Indillana fields.

Parameters Ll, L2, Xl, X2 and X3 for the Base Production of the Base Area are the following:

LI = 14.000 Barrels per day.

L2 = 20.000 Barrels per day.

Xl = 83.50 %

X2 = 79.00 %

X3 = 70.00 %

The "Y" factor shall not be used for the Base Area in the formula indicated under numeral 8.1, inasmuch as the Parties know the quality of the Crude Oil of this Area.

8.1.2 Possible Reserves.- The term possible reserves of Block 15 shall be understood as the volume of hydrocarbons that Contractor could discover as a result of Additional Exploration works under the Amended Contract and the Participation Contract in Block 15, excluding the volumes corresponding to the Base Area and the Limoncocha and Edén-Yuturi Unitized Fields, which have their own factors to establish the Participation of the Parties.

For Possible Reserves, parameters Ll, L2, Xl, X2, X3, shall be the following:

L1 = 30.000 Barrels per day.

L2 = 60.000 Barrels per day.

X1 = 80.00 %

X2 = 75.00 %

X3 = 60.00 %

For Possible Reserves, in the event that commercially **exploitable hydrocarbons** are found within the Participation Contract Area of an API quality lower or higher than the current average (22.54 ◦ API), the "Y" factor shall be included in the formula for calculating Contractor's percentage of Contractor Participation, in accordance with the following definition and formula:

"Y" is a parameter for correction of quality (C) of the Crude Oil produced in the Participation Contract Area, expressed as a percentage. If the Crude Oil of the Participation Contract Area is of a quality that is less than 22.54 ◦ API but greater than 15 ◦ API, there shall be a compensation in favor of Contractor. When the Crude Oil from the Participation Contract Area has a quality greater than 22.54 ◦ API but less than 35 API this compensation shall be in favor of the Ecuadorian State, and shall be calculated in the following manner:

a) If 15° API<C<22.54°API, thenY2.Ox(22.54°-C)

b) If 22.54° API <C <35° API, then Y = 1.0 x (22.54°-C)

c) If C>35° API Y-10.

"C" being the average yearly quality of Crude Oil from the Participation Contract Area, measured in degrees API.

State Participation in the cumulative production of the Base Area and in Possible Reserves of Block 15 shall not be less than that determined in Art. 9 of the Regulations for the Application of the Reformatory Law to the Hydrocarbons Law No. 44.

8.1.3 To establish the Participation of the State and the Contractor Participation, factors **"Q"** and "C" shall be estimated by the Parties on an advanced quarterly basis. To determine the final Participation of the State and Contractor Participation, actual values of Fiscalized Production and degrees API for the corresponding Fiscal Year shall be used. Factor "X" will be estimated within the first ten (10) days following the corresponding Quarter, on the basis of daily Fiscalized Production and quality of same in the immediately preceding Quarter.

8.2 Contractor's Gross Income Under this Participation **Contract.-** Is Contractor Participation, calculated at the annual average of the actual selling price, which in no event shall be lower than the Reference Price of the Crude Oil from the

Participation Contract Area, plus other income from Contractor's activities relative to this Participation Contract.

In the event that Contractor decides to receive its participation in cash for a period of not less than one year, under prior agreement with PETROECUADOR for which the Parties shall sign the corresponding agreement which shall not imply an amendment of this Participation Contract, the Parties shall determine the amount and terms of the negotiation. However, for tax reasons, in this case, Contractor's gross income shall be the actual selling price negotiated with Contractor.

From said gross income, deductions will be made and income tax shall be paid, in accordance with clauses 11.1 and 11.2.

8.3 Reference Price:

8.3.1 In the event that PETROECUADOR has not made foreign sales during the immediately preceding calendar month, the Reference Price shall be established on the basis of a average sale of a basket of crudes, mutually agreed to by the Parties, the prices of which shall be obtained from specialized publications of recognized prestige. The Parties shall sign an agreement which will determine the basket of crudes and the procedure used to obtain the Reference price of the Crude Oil.

8.4 Quality Adjustment for Crude Oil Reference Price (degrees API). In order to determine the Reference Price for Participation Contract Area Crude Oil, the Parties shall make an adjustment for the quality of said Crude Oil Reference Price based on the following formula:

$$Pc = \frac{PM(1 + K.DC)}{100}$$

Where:

Pc = Reference Price of the Crude Oil of the Participation Contract Area. (Adjusted for quality)

PM = Crude Oil Reference Price (Without adjustment for quality)

DC = Difference between the quality of the Participation Contract Area Crude Oil and the average weighted quality of the Crude Oil used to calculate the Reference Price. This is measured in degrees API and calculated according to the following expression.

DC = CC - CM

CC = API Gravity of Crude Oil produced in the Participation Contract Area.

CM = Average API Gravity of the Crude Oil used to calculate the Reference Price (PM).

In the event that the Reference Price (PM) were established in accordance with the basket of crudes, CM shall correspond to the average degrees API of said basket.

K = Quality correction factor for the Reference Price

K = 1.3 if 15 °API <CC<25 °API.

K = l.1 if 25°API <CC<35°API

K = l.l and DC = 1O if CC>35°API

If Correction Factor K does not reflect the reality of the market during a continuous period of twelve (12) months, it may be revised by agreement between the Parties. If controversies should arise on this matter, same shall be submitted to resolution by a consultant.

8.5 State Participation iii Production.-Once production has started, State Participation shall be calculated as follows:

$$PE = \frac{(100-X)\,Q}{100}$$

Where:

PE = State Participation.

X and Q are defined in Clause 8.1.

8.5.1 In the event that PETROECUADOR should come to an agreement with Contractor for the. commercialization of State Participation through Contractor, the effective selling price shall be applied.

8.5.2 Other Income.- The Ecuadorian State shall receive income tax and other taxes in accordance with pertinent laws.

8.6 Economic Stability: In the event that, due to actions taken by the State of Ecuador or PETROECUADOR, any of the events described below occur and have an impact on the economy of this Participation Contract:

a. Modification of the tax regime as described in clause 11.11.

b. Modification of the regime for remittances abroad or exchange rates, as described in clause 12.1 and 12.3 respectively.

c. Reduction of the production rate, as determined in clause 6.8.3.

d. Modification of the value of the transport rate described in clause 7.3.1 in accordance with the procedure established in Annex XIV.

e. Collection of the Value Added Tax, VAT, as set forth in Official Letter No. 01044 of October 5, 1998, which appears as annex number XVI, pursuant to which the Directorate of Internal Revenue Service states that the imports by the contractor for the operations of block 15 under the structure of the participation contract, are subject to said tax.

In the cases indicated in letters a) and b), the Parties shall enter into amending contracts as indicated in clause 15.2, in order to reestablish the economy of this Participation Contract When the events indicated in letters c), d) and e) occur, a correction factor shall be included in the participation percentages, to absorb the increase or decrease of the economic burden, in accordance with Annex No XIV."

"ELEVEN: TAXES, LABOR PARTICIPATION AND CONTRIBUTIONS.-

11.1 Tax Regime and Labor Participation.- Contractor shall pay income tax in accordance with the provisions of Title I of the Internal Tax Regime Law. Contractor shall also pay the contributions and taxes described in clauses 11.3, 11.4, *11.5*, 11.6 and 11.7 of this Participation Contract, as well as the labor participation of *15%* stipulated in the Labor Code.

……

11.11 Tax Regime Modification: In the event that: a) there is a modification of the tax or labor participation regimes in effect as of the signing date of this Participation Contract, as these are described in this Clause; and/or (b) of their legal interpretation; and/or (c) the creation of new taxes or levies not foreseen in this Participation Contract, which have an impact upon the economy of same, a correction factor shall be included in the participation percentages that shall absorb the increase or decrease of the aforementioned tax burden or labor participation. This correction factor shall be calculated between the Parties, following the procedure outlined in Art. Thirty-one

(31) of the Regulations for the Application of the Reformatory Laws to the Hydrocarbons Law. The modification of this Participation Contract will take into account the date on which the corresponding modification or legal interpretation of the indicated tax or labor regimes went into effect, or the date on which the new taxes not covered in this Clause were created."

"TWENTY TWO: APPLICABLE LAW, DOMICILE, JURISDICTION AND PROCEDURE

22.1 Applicable Legislation.- This Participation Contract is governed exclusively by **Ecuadonan law,** which is understood **to** include all laws in effect at the time of its signing.

22.1.1 Contractor expressly declares that it has full knowledge of Ecuadorian Law applicable to Participation Contracts for the Exploration and Exploitation of Hydrocarbons.

22.1.2 In any claims resulting from actions or resolutions of the National Direction for

Hydrocarbons, the Corresponding Minister shall be the highest administrative instance. However, Contractor shall have the right to go directly before the District Tribunal No. 1 of Administrative Law, the competent legal body to hear direct claims or to resolve appeals against the decisions of the Corresponding Ministry. In claims arising from acts or resolutions issued by the General Direction of the Internal Revenue Service, said organization shall be the higher administrative instance. After this, Contractor have the right to appeal before the Fiscal District Tribunal No.1, the competent jurisdictional body for hearing review direct claims or resolving appeals regarding decisions made by the Minister of Finance.

22.1.3 In compliance with the provisions of Art. Three (3) of Law No. 44, the Parties have agreed to submit controversies arising from the interpretation or execution of this Participation Contract to arbitration in accordance with the provisions of Clauses 20.2, 20.3 and 20.4.

22.1.4 Legal Framework: Norms applicable to this Participation Contract, at the time of its execution, include but are not limited to the following:

The Hydrocarbons Law, published in Official Gazette No. Seven hundred and eleven. (711) of November fifteenth (15), nineteen hundred and seventy eight (1978).

Law No. One hundred and one (101), published in Official Register No. three hundred and six (306) of August thirteen (13), Nineteen hundred and eighty two. (1982).

Law No. Zero eight (08), published in Official Register No. Two hundred and seventy seven (277) of September twenty three (23), Nineteen hundred and eighty five (1985).

Decree Law No. twenty four (24), published in Official Gazette No. Four hundred and forty six (446) of May twenty nine (29), nineteen hundred and eighty six. (1986).

Law No. forty four (44), published in Official Register No. Three hundred and twenty six (326) of November twenty nine (29), Nineteen hundred and ninety three (1993). Corrected by Errata, published in Official Gazette No. Three hundred and forty four (344) of December twenty four (24), Nineteen hundred and ninety three (1993).

Law No. Forty Nine (49), published in Official Gazette No. Three hundred and forty six (346) of December twenty eight (28) Nineteen hundred and ninety three (1993).

Reformatory Law to the Hydrocarbons Law, published in Official Gazette No. Five hundred and twenty three (523) of September nine (9), Nineteen hundred and ninety four(1994).

Special Law of the Ecuadorian State Petroleum Company (PETROECIJADOR) and its Affiliated Companies, published in Official Register No. Two hundred and eighty three (283) of September twenty six (26), Nineteen hundred and eighty nine (1989), its amendments and pertinent regulations.

Law No .Zero zero six (006), of Financial and Tax Control, published in Official Gazette No. Ninety seven (97) of December twenty nine (29), Nineteen hundred and eighty eight. (1988).

Internal Tax Regime Law, published m Official Gazette No Three hundred and forty one (341) of December twenty two (22), Nineteen hundred and eighty nine (1989) and its amendments.

Law No. Ten 0) that creates the tax for the Amazon Region Eco-development Fund, published in Official Gazette No. Thirty (30) of September twenty one (21), Nineteen hundred and ninety two (1992), and its reform in Law No. Twenty (20), published in Official Gazette No. one hundred and fifty two *(152),* of September fifteen, (15), Nineteen hundred and ninety seven (1997).

Law No. Forty (40), creation of Substitute Revenues for the Napo, Esmeraldas and Sucumbios Provinces, published in the supplement of the Official Gazette No. 248, of August 7, 1989.

Arbitration and Mediation Law, published in Official Gazette No. One hundred and forty five (145), of September four (4), Nineteen hundred and ninety seven (1997).

General Insurance Law, published in Official Gazette No. 290 of April 3, 1998.

Basic Customs Law, published in Official Gazette No. 359 of July 13, 1998.

16.- Regulations for the Application of Law No. forty four (44), issued by Executive Decree No. One thousand four hundred and seventeen (1417), published in Official Gazette No. Three hundred and sixty four (364) of January Twenty one (21), Nineteen hundred and ninety four (1994) and its reforms.

Cost Accounting Regulations for Participation Contracts for the Exploration and Exploitation of Hydrocarbons, issued through Executive Decree No. One thousand four hundred and eighteen (1418), published in Official Gazette No. Three hundred and sixty four (364) of January Twenty one (21), Nineteen hundred and ninety four (1994). and its reform which appears in Executive Decree No. one thousand two hundred and thirty three (1233), published in Official Gazette No. Two hundred and eighty five (285) of March Twenty seven (27), Nineteen hundred and ninety eight (1998).

Hydrocarbons Operations Regulations, issued through Ministerial Decision No. six hundred and eighty one (681), of May eight (8), Nineteen hundred and eighty seven (1987), reformed through Ministerial Decision No. One hundred and eighty nine (189), published in Official Gazette No. One hundred and twenty three (123) of February three (3), Nineteen hundred and eighty nine (1989).

Environmental Regulations for Hydrocarbon Operations In Ecuador, published in Official Gazette No. Seven hundred and sixty six (766) of August twenty four (24), Nineteen hundred and ninety five *(1995).*

Executive Decree No. Five hundred and forty three (543), published in Official Gazette No. One hundred and thirty five (135) of March one (1), Nineteen hundred and eighty five *(1985).*

Executive Decree No. Eight hundred and nine (809), published in the Official Gazette No. one hundred and ninety seven (197),

of May thirty one (31), Nineteen hundred and eighty five (1985) and its reforms.

Ministerial Decision No. Zero ninety nine (099), published in Official Gazette No. two hundred and fifty seven *(257),* of February 13, Nineteen hundred and ninety eight (1998).

In the event of a conflict between the above mentioned documents, the order of priority amongst them shall be the following: Laws, Regulations and this Participation Contract.

22.2 Domicile, Jurisdiction and Competence.- The Parties submit to Ecuadorian laws, and controversies shall be substantiated by the provisions of clauses 22.1.2 and 22.1.3. of this Participation Contract. This provision shall prevail even after the termination of this Participation Contract, up to the time when the operating permit of Contractor in Ecuador is legally canceled, regardless of the causes for termination.

22.2.1 In the event of controversies that may arise as a result of the performance of this Participation Contract, in accordance with Ecuadorian Law, Contractor expressly waives its right to use diplomatic or consular channels, or to have recourse to any national or foreign jurisdictional body not provided for in this Participation Contract, or to arbitration not recognized by Ecuadorian law or provided for in this Participation Contract. Lack of compliance with this provision shall constitute grounds for the forfeiture **of** this Participation Contract.

22.2.2 The Parties agree to use the means set forth in this Participation Contract to settle questions or controversies that may arise during the term hereof, as well as to observe and comply with decisions issued by experts, arbiters, judges or competent tribunals in all applicable cases, according to the provisions of this Participation Contract.

22.3 Communications and Notices.-

22.3.1 The Documents presented by Contractor to PETROECUADOR or the Corresponding Ministry by virtue **of** this Participation Contract shall be subject to the provisions of Art. Eighty Two (82) of the Hydrocarbons Law.

22.3.2 Notices to be served between the Parties shall be in writing, in Spanish and will be sent to the following addresses:

PETROECUADOR MINISTRY OF ENERGY ANDMINES

Empresa Estatal Petróleos del Ecuador Santa Prisca 223

Ediflcio Matriz — Fax: 570-350

Alpallana y 6 de Diciembre — Quito, Ecuador

Telex: 2213 CEPE ED

Apartado Postal 5007, 5008

Quito Ecuador

CONTRACTOR

OCCIDENTAL EXPLORATION**AND**PRODUCTION COMPANY

Ediflcio Vivaldi

Av. Amazonas No.3837

Telephone: 467 500

FAX (593 2) 468 850

Quito, Ecuador

22.3 The Parties may indicate new addresses, and timely written notice shall be served for this matter.

22.4 For all the effects of this Contract, its shall be understood that a communication was received by the other Party when there is record of receipt by the notified Party"

"ANNEX XIV

PETROECUADOR .OEPC
BLOCK 15: CONVERSION FROM A SERVICE CONTRACT
TO A PARTICIPATION CONTRACT

ADJUSTMENT PARAMETERS

ADJUSTMENT FOR PAYMENT OF VALUE-ADDED TAX (VAT) ON IMPORTS

dIVA = dX*Q*P

Xc = Xo+dX

$$dX = \frac{dIVA}{Q * P}$$

$$Xc = Xo + \frac{dIVA}{Q * P}$$

ADJUSTMENT FOR CHANGE IN THE OIL PIPELINE TARIFF

$$dT = dt * Q * Xo$$

$$PCc = Pco + dT$$

$$PCc = Xc * Q * p$$

$$PCo = Xo * Q * P$$

$$PCc = Xo * Q * P + dt * Q * Xo$$

$$PCc = Xc * Q * P = Xo * Q * P + dt * Q * Xo$$

$$Xc * P = Xo * P + dt * Xo$$

$$Xc = Xo + \frac{dt * Xo}{P}$$

201 **v**

page 2

DEFINITIONS:

dIVA = Variation in the amount of VAT paid on imports

dX = Variation in the average weighted Factor X for one Fiscal Year

Q = Production of the Contract Area

P = Crude Oil Reference Price

Xo = Average weighted Factor X, uncorrected, for one Fiscal Year

Xc = Average weighted Factor X, corrected, for one Fiscal Year

dT = Variation in the total amount due to a change in the oil pipeline tariff

dt = Variation in the oil pipeline tariff. The first value of dt that appears in the Participation Contract shall be calculated according to the following expression:

dt = Tpe — Tac

where:

Tpe = Tariff actually paid by the Contractor, expressed in dollars, at December 31, 1997.

Tac = Tariff agreed upon in the Participation Contract, i.e., $1.30 per barrel, expressed in dollars at December 31, 1997.

As indicated in the Participation Contract, the Nelson-Farrar index shall be used to express *Tpe in dollars at December 31, 1997.

The adjustment shall be made whenever the absolute value of dt/Tac is greater than or equal to 15%.

For subsequent variations in dt, Tac shall be replaced by the most recent tariff actually paid by the Contractor, expressed in dollars at December 31, 1997.

PCo = Contractor's Participation, uncorrected

PCc = Contractor's Participation, corrected

Explanatory note: The Law for the Reform of Public Finances, published in issue No. 181 of the Official Gazette, which became effective on May 1, 1999, was not taken into consideration in the negotiations for establishing the economics of the Participation Contract for Block 15. Therefore, in the event a formal clarification is not provided by the competent authorities, to the effect that said Law does not eliminate the exemption contemplated in Article 87 of the Hydrocarbons Law, the Contractor shall be entitled to request a revision of the "X" factors, in accordance with the provisions of Section 11.11 of the Participation Contract"

ANNEX XVI

[seal]
REPUBLIC OF ECUADOR

[logo]
INTERNAL REVENUE SERVICE 202v

Internal Revenue Service
Case No. 19980814604
Subject: Reply to question
Official Communication No. 01044

Quito, October 5, 1998

Dr Alberto Gómez de la Torre, Legal Representative
OCCIDENTAL EXPLORATION AND PRODUCTION COMPANY (OEPC) ECUADOR
Avenida Amazonas 3837 y Corea, Edificio Vivaldi, or
Casillero Judicial No. 545
Quito

I refer to your communication of August 26, 1998, in which you informed us that on January 25, 1985, CEPE (now PETROECAUDOR) and OCCIDENTAL, signed a Contract for the Provision of Services for the Exploration and Exploitation of Hydrocarbons in Block 15 of the Ecuadorian Amazon Region.

Petroecuador and Occidental are currently in the final negotiations for converting the Contract for the Provision of Service in Block 15 to a Participation Contract for the Exploration and Exploitation of Hydrocarbons in that block, which contract will become effective on January 1, 1999.

You also stated that in the said Participation Contract, the State, acting through Petroecuador, delegates to the contractor the right to explore for, and exploit, for hydrocarbons in the

contract area, making and incurring, on its own behalf and at its own risk, all of the investments, costs, and expenses required for exploration and exploitation. Once production starts, the contractor shall be entitled to a participation of the production of the contract area, which shall be calculated on the basis of the percentages offered and agreed to in the said contract, based on the volume of hydrocarbons produced.

When the change from the Contract for the Provision of Services to the Participation Contract is made, Occidental shall cease to be Petroecuador's operator, and shall not receive any reimbursement for its investments, costs, and expenses, which shall be charged directly to the account of Occidental, who therefore, shall be entitled to a participation negotiated with the State, which participation shall constitute its gross income, from which it must make the appropriate deductions and on the basis of which it ,must pay the corresponding income tax.

On the basis of the foregoing information, you have asked whether the imports of equipment, machinery, materials and other consumable supplies that Occidental will have to make pursuant to the Participation Contract (which imports will allow Occidental to continue to fulfill its contractual obligations) after the Contract for the Provision of Services has been converted to a Participation Contract, which contract is tentatively expected to become effective on January 1, 1999, will be taxed at the 10% VAT rate or at the zero rate for this tax .
On this matter, I must state the following:

Article 54 of the Internal Tax Regime Law contains a limitative list of the goods whose purchase, whether domestic or through imports, is taxed at the zero VAT rate. Accordingly, if your principal purchases or imported goods that are not listed in the said article, those goods will be taxed at the 10% VAT rate .

On the other hand, although paragraph a) of Section 13 of Article 54 of the above -mentioned law imposes a zero tax rate on goods brought into Ecuador by companies, such as Petroecuador, that are in the public sector, Decree Law No. 05, as published in issue No. 396 of the Official Gazette, dated March 10, 1998, imposes a 10% VAT on goods brought in by public-sector companies whose earnings are subject to the payment of income tax, in accordance with the provisions of the second part of Section 2 of Article 9 of the Internal Tax Regime Law pursuant to which the public companies that are subject to income tax are different from companies that provide public services, inasmuch as the companies subject to income tax compete with the private sector, engaging is commercial and industrial activities, mining, tourism, and services in general, and therefore are subject to the 10% VAT rate.

> Consequently, Petroecuador falls into this legal category, given that its name and those of its affiliates appear on the list of public -sector companies that are required to pay income tax, which list is published by the Tax Administration in accordance with the provisions of Article 10 of the Implementing Regulations for the Internal Tax Regime Law. Therefore, regardless of whether the contract in question is a Contract for the Provision of Services or a Participation Contract, the goods that are brought in by your client in order to fulfill its contractual obligations are subject to the said tax at the 10% rate."