Arbitration - Ecuador

International arbitration with Ecuador: a new legal minefield

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Recent opinions issued by the Ecuadorian Constitutional Court declaring several bilateral investment treaties to be unconstitutional have cast a shadow of doubt as to whether Ecuador can legally enter into contracts – as it has been doing lately – in which the government accepts the jurisdiction of international arbitration tribunals. The government is seeking to minimise these doubts by means of legislation.

Ecuador and certain Chinese entities recently signed a number of international contracts in China – including a $1 billion loan agreement and an oil purchase agreement – which contemplated international arbitration before the London Court of International Arbitration (LCIA) should a dispute arise.(1) When the finance minister was asked why Ecuador accepted the jurisdiction of the LCIA, he stated that when "you examine the rulings of this court, you find that they are very flexible and neutral".(2) Although this was a surprising statement in light of the two-year legal battle fought by Ecuador in the English courts trying to nullify an award issued by the LCIA,(3) the official was echoing what appears to be a new policy on international arbitration in Ecuador. In recent months, the government has accepted the positions of certain foreign investors, contractors and creditors and agreed to submit itself to the jurisdiction of international arbitration.(4)

One factor that may have paved the way to this positive attitude towards international arbitration was the fact that the new 2008 Constitution, unlike previous versions, contains no reference to the jurisdictional element of the so-called 'Calvo doctrine'. In its orthodox version – which has been abandoned or weakened in most of Latin America – this doctrine proclaims that only national courts of the host country shall have jurisdiction to settle disputes between the state and foreigners.(5) Some took this omission to be deliberate, rather than a simple lapse.(6) Henceforth, the state would enjoy greater flexibility when negotiating contracts with foreign individuals or entities, as far as the issue of arbitration was concerned.

Yet while the finance minister was justifying the state's submission to the jurisdiction of the LCIA on the grounds that the arbitration awards issued by that court are "flexible and neutral", the Constitutional Court was saying virtually the opposite. In a number of opinions,(7) the court has held that Ecuador is barred from submitting itself to the jurisdiction of international arbitral tribunals unless such tribunals are established within the framework of regional treaties. The court has stated that in the absence of such an exception, the Constitution does not allow the state (or any public entity) to recognise the jurisdiction of international tribunals for settling disputes with foreign individuals or corporations. According to the court, in the traditional Calvo style, such disputes can be heard and settled only by national courts.

One of the opinions goes so far as to argue that the rationale for such limitation lies in the fact that international arbitral awards are not subject to the control of the Constitutional Court for possible violations of the Ecuadorian Constitution. According to the court, under the new constitutional structure adopted by Ecuador in 2008, it is inconceivable that an award which may affect the interests of the state may escape constitutional scrutiny.

The court issued these opinions in response to a request made by the president as a preliminary step to having the Legislative Assembly denounce more than 12 bilateral investment treaties which were entered into by Ecuador during the 1990s. Since the court decided to rule on each of the treaties, there will be as many opinions as treaties to denounce. Hitherto, the court has issued six opinions, only four of which have been published. Different magistrates have drafted these rulings and all the other magistrates concurred on the proposed opinion. As a result, if any variations occur between the opinions, these will be more in terms of style than substance. After all, the court is testing the constitutionality of the arbitration provisions of the treaties (which are very similar to each another) against a single article of the Constitution (ie, Article 422).

As soon as the court notified the assembly of its opinions, the assembly proceeded to denounce the respective treaties. It is expected that the assembly will follow the same procedure with the other treaties.

Pursuant to Article 422, the state is barred from entering into international treaties where Ecuador concedes jurisdiction to instances of international arbitration for the settlement of contractual or commercial disputes with private individuals or corporations. Thus, it is the arbitration mechanism that rendered these treaties unconstitutional, and not any other feature. However, the article also provides that treaties which establish solutions to controversies between the state and citizens in Latin America by instances of "regional arbitration" constitute the sole exception to this prohibition.

It may be argued that these opinions should be ignored, since the court's rulings are limited to the question of whether the treaties accord with the Constitution, and that therefore its rulings should not be taken out of context. However, the problem with this is that the act that regulates the court's functioning(8) and the court itself in other resolutions(9) leaves no doubt that interpretations of the Constitution made by the court go beyond the narrow confines of the cases at hand. Incidentally, this position is shared by most Latin American courts or tribunals that are entrusted with the authority to exercise constitutional control.

Moreover, and setting aside the court's particular view of its own role in the new Ecuadorian constitutional system, the court may have a point in its arguments regarding international arbitration. States generally consent to international arbitration with foreign individuals or corporations, through either treaties or contracts. If the constitution forbids the state from signing treaties that allow the settlement of contractual or commercial disputes with foreign individuals or corporations by means of international arbitration, it is hard to understand why the state would be free to obtain the same result by way of a contract.

This predicament was the result of contradictory forces. Article 422 of the Constitution was the result of an ideological hostility towards bilateral investment treaties held by the coalition that dominated the 2007 Constitutional Assembly. However, after two years in office, the government – which was run by the same leaders who had sponsored that constitutional provision – started to learn that few, if any, foreign investors or lenders were willing to risk the much needed capital without submitting their contracts to the jurisdiction of foreign courts or international arbitration tribunals. Thus, Ecuador started to accept the jurisdiction of international arbitration tribunals in one contract after the other, as it began to feel the need for capital, investments, services and goods from international firms. However, at the same time, the government went ahead with its decision to denounce the bilateral investment treaties to which it was a party on the grounds that they were unconstitutional.

These courses of action were hard to reconcile in the long run. In a way, the language of the Constitutional Court's ruling may be seen as the collision point between these opposing paths. The government is now trying to minimise this uncertainty by including, in a bill dealing with public finances, a provision whereby the state and its instruments are authorised to enter into agreements with foreign individuals or corporations, either private or public, containing international arbitration clauses.(10) It is likely that this provision will become law, not only given the government's majority in the assembly, but also in light of the veto power that the president enjoys under the new Constitution.

At this juncture, it is not easy to ascertain whether the enactment of a statute declaring that the state is free to enter into international arbitration clauses is enough to neutralise the rulings of the Constitutional Court, when precisely these rulings considered the submission of the state to the jurisdiction of international arbitral tribunals unconstitutional. Neither is it clear whether this solution will allay the concerns of some investors.

As difficult as it may appear, the best way out of this entanglement is a constitutional amendment. Time has proved that it was a major mistake to insert a provision such as Article 422 into the Constitution, notwithstanding the hostility towards bilateral investment treaties in certain quarters. That decision was not only unnecessary (since the treaties could have been denounced without the need for a constitutional norm) but has also created unforeseen consequences for a state in need of foreign capital. This is an important lesson to be learnt in Ecuador and by other governments.

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Endnotes

(1) Executive Decree 466, August 27 2010. *Official Registry* 277, September 13 2010.

(2) Seen

www.eluniverso.com/2010/09/04/1/1356/prestamo-chino-hara-garantia-petrolera.html

(3) The arbitration involved Occidental Exploration and Production Company as claimant. London Court of Arbitration Administered Case UN3467, July 1 2004.

(4) In addition to the contracts signed with China, Ecuador has accepted the jurisdiction of international arbitral tribunals in contracts signed with the Inter American Development Bank and the Latin American Reserve Fund. The most categorical endorsement of international arbitration by Ecuador is found in the new oil contract model proposed to the private oil corporations that are currently operating in Ecuador.

(5) See Roffe, "Carlos Calvo y su vigencia en América Latina", UNCTAD, Reprint Series 53, 1984.

(6) See, for example www.globalarbitrationreview.com/reviews/13/sections/51/chapters/504/.

(7) See *Official Register*, Supplement 258, August 17 2010, and *Official Register*, Supplement 249, August 3 2010.

(8) See Organic Law of Jurisdictional Guarantees and Constitutional Control, Article 2 (3).

(9) See Constitutional Court, Resolution 04-10-AD-CC.

(10) The bill was introduced to the Legislative Assembly on September 16 2010 under the name 'Código de Planificación y Finanzas Públicas'. The provision is found in the Fifth General Disposition:

"*with the prior authorisation of the General Attorney it is permitted to accept other jurisdiction and laws for the solution of divergences or controversies connected with contracts, agreement or legal instruments executed by the State and the entities or organs of the public sector with foreign governments, public or private entities*".