Why Did Ecuador Terminate All Its Bilateral Investment Treaties?

By Cecilia Olivet
Global Research, August 16, 2017
Transnational Institute 25 May 2017

Region: Latin America & Caribbean
Theme: Global Economy, History, Intelligence, Law and Justice, Oil and Energy

Featured image: Cecilia Olivet hands over the report to Rafael Correa, president of Ecuador (Source: Transnational Institute)

On 16 May, Ecuador became the fifth country to terminate all its Bilateral investment treaties (BIT). Why did it make this decision? TNI researcher Cecilia Olivet, and president of the Ecuadorian Citizens Commission that audited the country's investment protection treaties, shares her insider perspective.

How did the Ecuador investment treaties audit commission (CAITISA) come about?

On 5 October 2012, an investment arbitration tribunal ordered the government of Ecuador to pay 2.3 billion USD to US oil company Occidental. It was the largest amount a State had been ordered to pay by an investor-State tribunal up to that point. For Ecuador, that sum represented 59% of the country's 2012 annual budget for education and 135% of the country's annual healthcare budget.

The decision taken by three private lawyers under the auspices of the World's Bank arbitration centre shocked the world and the Ecuadorian government. The government's move that prompted Occidental's litigation had hardly been extreme. Ecuador terminated the oil concession with Occidental when it found out that the company sold 40 percent of its production rights to another investor without government approval. The contract signed by Occidental with the government in 1999 explicitly stated that sale of Occidental's production rights without government pre-approval would terminate the contract. The arbitrators in the case justified their decision, calling Ecuador's cancellation of the contract a disproportionate response.

On 6 May 2013, 7 months later, President Correa created the investment treaties audit commission (CAITISA). Its purpose was to audit the whole Ecuadorian investment regime in a comprehensive way. The Commission was to determine the legality and legitimacy of Ecuador's Bilateral Investment Protection Treaties (BITs) and the investment cases filed against the country. The Commission was also expected to assess whether the BITs have helped to attract foreign direct investment (FDI) to Ecuador and/or contributed to the quality of investment in terms of national development. Finally, the Commission would propose legal and policy alternatives to BITs and the international arbitration system.

US Occidental Petroleum Corporation's (OXY) industrial plant in the Ecuadorean Amazonia

Creating this Commission was not just a reaction to the Tribunal decision in the Occidental case. By that time investors had sued the government based on international investment treaties 24 times. So, the government saw the need to assess the costs vis-a-vis the benefits of the 26 international treaties in force which they inherited when President Correa took office.

How did you get involved?

A few months before the Commission was created, I co-authored a report focusing on the role of arbitrators and law firms as drivers of an investment arbitration boom. This report had exposed some key flaws of the investment arbitration system. Government officials in Ecuador who read the report asked me to join the Commission.

What was unique about the Commission?

This Commission sets an incredible precedent. It contributed towards the ongoing international assessment of the necessity for and impact of the international investment regime on the development of countries in the Global South. It also contributed to a public debate about the legitimacy and "benefits" of the current investment protection framework.

The Commission is unique in two ways. First, it is the first time a government decided to organise a review of its investment protection system in the form of an auditing process carried out by a Citizens Auditing Commission. It was inspired by the experience of the Debt Auditing Commission. CAITISA was formed by a mix of investment lawyers, civil society representatives and government officials. It included a majority (8 out of 12) of people from outside the government, most of whom are not from Ecuador. The inclusion of non-governmental experts and civil society representatives among those carrying out the review has ensured a higher level of transparency and has allowed for broader public participation. Besides the Commissioners, the auditing task was supported by a large group of other experts (including several members of a group of social activists in Latin America focusing on investment protection), who helped to develop the terms of reference and also assisted with the audit itself.

Secondly, the scope of the audit was comprehensive. Other review efforts have been more constrained in their content. CAITISA, on the other hand, was given a mandate to audit not only the the Bilateral Investment Treaties of Ecuador (including the conditions under which these treaties were signed, its clauses and the compatibility of BITs with national and international law), but also the Investment Arbitration System and cases against Ecuador (including how have BITs been used by foreign investors, the role of the arbitrators that decided on Ecuador's cases; and the costs of cases); and the relationship between Bilateral Investment Treaties, Foreign Investment and Ecuador's development plan (including the correlation between signing BITs and attracting FDI).

What were its main findings?

The findings of the Commission that audited Ecuador's investment regime were conclusive. The BITs have not brought benefits to the country, they only brought risks and costs.

In particular, the Commission found that the Bilateral Investment Treaties (BITS) signed by Ecuador failed to deliver promised foreign direct investment. Also, Ecuador's BITs contradict and undermine the development objectives laid out in the country's constitution and its National Plan for Living Well (Buen Vivir). It was also established that the companies that sued the government at international investment tribunals left behind enormous social and environmental liabilities/debt.

Investors have disproportionately benefited when suing Ecuador using bilateral investment treaties. In particular the financial costs for Ecuador have been immense. The total amount disbursed so far by the state has been $1.498 billion dollars, equivalent to 62% of health spending. The government has also spent 156 million USD in payments to international law firms for its defence.

The Commission also established that officials who signed Ecuadorian BITs did not try to negotiate terms that would preserve the state's regulatory capacity. None of the BITs signed by Ecuador underwent a negotiation process. Also, legislators who ratified these treaties did not consider the risk for the country. Congress ratified most treaties without a legislative debate.

Finally, the Commission found that majority of the arbitrators nominated to decide cases against Ecuador cannot be considered fully impartial.

[For more details of the findings, see factsheet at the end]

What was the most shocking or surprising thing for you in terms of Ecuador's experience with ISDS/BITs?

Once the audit was complete, and all the findings were put together, it was shocking to see how government officials have signed on to these powerful instruments without any consideration of risks. It was shocking how investors could launch lawsuit after lawsuit attacking legitimate government measures. It was shocking to see how arbitration tribunals sided with investors making investor-friendly interpretation of the clauses in this biased treaties. It was shocking to see a rigged system in action.

Why do you think so many countries like Ecuador signed BITs?

Most countries signed BITs during the 1990s when there was little awareness of the risks. At the time, all governments would hear from the "international community" was the importance of protecting investment for development. International organisations, governments from capital exporting countries and academics were pushing the idea that signing BITs was the only way countries would be able to attract foreign investment and that it was a condition for development. In an orchestrated effort, organisations like the WTO, UNCTAD, OECD, the World Bank and others, encouraged governments from the Global South to sign as many investment treaties as possible.

Lauge Poulsen, in his thesis "Sacrificing sovereignty by chance", probably explained it better than anyone: "By overestimating the benefits of BITs and ignoring the risks, developing country governments often saw the treaties as merely 'tokens of goodwill'. Many thereby sacrificed their sovereignty more by chance than by design, and it was typically not until they were hit by their first claim, that officials realised that the treaties were enforceable in both principle and fact."

What were the main recommendations of CAITISA?

The Commission gave detailed recommendations that covered 11 pages. But, the key one was the termination of all bilateral investment treaties.

We also recommended to exclude the investor-state dispute settlement mechanism from any future treaty, and provide legal security to investors in national courts.

The Commission also advised the government to only sign new investment treaties based on an alternative investment model. This new model would highly restrict the rights of investors, it would protects the rights of the government to regulate and to direct investment by applying performance requirements and, it would impose binding obligations for the investor to secure they respect national and international human, social and environmental rights.

[For more details of the recommendations, see factsheet at the end]

How did the Ecuadorian government respond to your recommendations?

The recommendations of the Commission were non-binding. However, on 17 May (9 days after CAITISA publicly presented the final report), the government announced that it had proceed to terminate the remaining 16 BITs that were still in force.

The government also announced that is planning to renegotiate investment treaties with several countries under a different model. CAITISA made some very specific recommendations as to how that new model treaty should look. Ecuador's new model BIT has not yet been made public so we don't know if the recommendations have been followed in that regard. Hopefully, Ecuador will consider an investment treaty model that restricts investment protection while it enlarges the capacity of government to regulate and direct investment, in particular including investor obligations to safeguard the public interest.

How have investors and the governments that signed BITs with Ecuador responded to the government's announcement?

Similarly to the situation when South Africa or Indonesia or India terminated investment treaties, the European Commission was quick to "warn" Ecuador (and in the past the others) about the risk of losing European investment. The scaremongering game is aimed at deterring governments from completing the termination process. It did not work in the past, and it has not worked with Ecuador either.

What do you say to those who will argue that this will discourage foreign investment?

In the same way that the need to sign investment treaties to attract foreign investment was discredited as a myth, the idea that investors will leave when countries terminate their treaties is unsubstantiated.

Foreign investors will remain in the country as long as they can make profit, even after governments terminate Investment protection agreements. So far, governments like South Africa, Indonesia, Bolivia, Ecuador, and Venezuela, which terminated many of their BITs, did not experience a mass exodus of foreign investors, as predicted by politicians and investment lawyers.

For example, only one year after the termination of the Germany-South Africa BIT in 2013, research led by Germany's KfW Development Bank found that South Africa is still 'a favoured destination for German direct investment' with more than €600 million flowing into the country in the fourth quarter of 2014. Similar to the case of South Africa, in March 2014, the government of Indonesia discontinued 17 out of 64 IIAs, including agreements with the Netherlands, Italy, France, Spain, and China. 2014 was the year in which foreign direct investment (FDI) to Indonesia hit a record high of US$78.7 trillion, according to the latest data by the Indonesian Investment Coordinating Board (BKPM)'. Also, in 2015, Dutch FDI to Indonesia increased by 19.2 per cent in relation to 2014 and the Netherlands remained the fourth leading investor.

What alternatives are there to the ISDS approach?

Investors have numerous options to protect their investment. However, only investment arbitration gives them the opportunity to challenge government public interest measures.

There is a wide array of options, beyond investment arbitration, available to foreign investors who feel that they have been mistreated by the state's arbitrary and discriminatory actions.

First and foremost, foreign companies are entitled to seek compensation for wrongdoings at national courts, as with national companies and citizens in the countries in which they operate. Using domestic legal remedies should be the norm. The lack of judicial independence in a few countries cannot be the excuse to promote investment arbitration worldwide. It is important to note that most ISDS lawsuits are brought against democratic countries with a strong rule of law.

If investors want to have further 'insurance', they can resort to: Private political risk insurance, insurance from the Multilateral Investment Guarantee Agency (MIGA) of the World Bank, or insurance offered by the investor's home country.

Finally, if none of these reassurances are enough for investors, they can always negotiate access to investor-state arbitration in specific contracts. But then the government can assess if offering that possibility is justified for the specific investment instead of giving a blank check to all investors from a certain country.

What are your recommendations to other governments?

Twenty years after most of these treaties were signed, it would be advisable that governments around the world carry out a review or audit process of the treaties that already exists. It is also imperative that governments undertake a cost-benefit analysis before signing new treaties.

For the review to be meaningful, it should include: an analysis of the economic benefits to assess whether signing of investment treatie has helped to increase the volume of FDI flows into the country; an analysis of the exposure of the government to costly investor-state arbitration disputes, and finally an analysis of political costs to assess the constraints on the government from regulating in the public interest without the risk of being sued.

The main benefit of carrying out a review process is that the governments can take an evidence-based and informed decision on what to do with its current International investment agreements (IIAs) and with future IIAs negotiations.

Factsheet

ECUADOR INVESTMENT TREATIES AUDIT COMMISSION (CAITISA): Findings and recommendations

SUMMARY OF FINDINGS

1.The Bilateral Investment Treaties (BITS) signed by Ecuador failed to deliver promised foreign direct investment:

- Ecuador, which has more BITS than many countries in the region, only received 0.79% of global FDI that flowed to Latin America and the Caribbean
- The principal sources of FDI flows into Ecuador are from Brazil, Mexico and Panama, none of which have a BIT with Ecuador

2. Ecuador's BITs contradict and undermine the development objectives laid out in the country's constitution and its National Plan for Living Well (Buen Vivir). The Ecuadorian constitution of 2008 requires the state to regulate foreign investment to ensure it plays a positive role in achieving the country's Plan for Living well. However, BITS include clauses that erode these state competences.

3. The companies that sued the government at international investment tribunals left behind enormous social and environmental liabilities/debt. Furthermore, It was noted that the companies did not contribute productive growth, job creation, or technology transfer as was expected from foreign investment.

4. Investors have disproportionately benefited when suing Ecuador using bilateral investment treaties:

- Ecuador has faced 26 cases in international tribunals based on the Bilateral Investment Treaties. 73% of these cases were filed between 2006-2016.
- In 2014, Ecuador was fifth in the world in terms of investment protection arbitration cases; today it is in tenth place.
- In the 15 cases where the tribunal has made judgements on jurisdiction, the investor has been favoured in 13 cases (87%) and the state only twice.
- Only in 6 of the 18 cases where there is a known final outcome (award or settlement), the State did not had to compensate the investor.

5. While promises of investment and development have failed to materialise, the costs for Ecuador have been immense:

- A total of 21.2 billion US dollars has been demanded as compensation from Ecuador by corporations for supposed violations of investment protection agreements.
- The total amount disbursed so far by the state has been $1.498 billion dollars, equivalent to 62% of health spending.
- Additionally, there are 3 cases (Burlington, Copper Mesa and Murphy III) where the tribunal has ordered the government to pay a total of 377 million USD, but the decisions are being contested in annulment procedures.
- Of the cases that are currently open, the State runs the risk of having to disburse 13.4 billion USD. This is equivalent to 52% of the General State Budget for 2017.
- Finally, Ecuador has so far paid 156 million USD to international law firms to defend itself in different cases.

6. The signature and ratification of the investment protection treaties of Ecuador was vitiated by anomalies. After detailed historical analysis, the Commission also established that:

- None of the BITs signed by Ecuador underwent a negotiation process. This means that the officials who subscribed to the BITs did not try to negotiate terms that would preserve the state's regulatory capacity.
- Most investment treaties were ratified by Congress without a legislative debate prior to approval. That is, they were ratified without a risk assessment for the country. In some cases, they did not even pass by Congress for ratification despite this being required by the Constitution.

Given that the BITs signed by Ecuador were signed without a careful analysis of their costs vis a vis their benefits, it is not surprising that they follow a model of clauses largely in favor of the investor.

7. The majority of the arbitrators nominated to decide cases against Ecuador cannot be considered fully impartial:

- 64% come from developed countries and 58% are part of what is considered an elite club – arbitrators with high influence and with repeated nominations
- The majority (69%) comes from commercial arbitration and private legal practice, and have little or no experience in international public law
- The analysis of the investment treaty cases against Ecuador shows that, in most of them, the arbitrators have interpreted the clauses in an expensive way, which has resulted in decisions favorable to investors, both at the stages of jurisdiction and the merits.

SUMMARY OF RECOMMENDATIONS

1- Termination of all bilateral investment treaties

2- Negotiation of new instruments between the State and Investors such as:

- a) international investment contracts with restricted rights and investors' obligations

- b) Investment treaties based on an alternative investment model. The Commission has made the recommendation to:
    - highly restrict the definition of investment
    - exclude certain rights for investors commonly found in investment treaties such as: FET, indirect expropiation, national treatment, most favoured nation, umbrela clause, survival clause.
    - a list of rights for the State that would be included, such as: rights of the State to impose obligations on foreign investors, apply performance requirements, impose taxes, secure technology transfer, force investors to respect human rights, among others.
    - key obligations for the investor, such as: respect for national and international human and social rights, contribute towards national development according to pre-determined criteria, among others.

3- Regarding the international investment arbitration system

- Exclude investor-state dispute settlement mechanisms from any future treaty
- Provide legal security to investors in national courts

4- Develop a comprehensive national policy and specific rules for foreign investment.

5- Consolidate the powers and the institutional governance of foreign investment in one agency

The original source of this article is Transnational Institute

---

Comment on Global Research Articles on our Facebook page

Become a Member of Global Research

Articles by: Cecilia Olivet