Neutral Citation Number: [2007] EWCA Civ 656

Case No: A3/2006/1116

IN THE SUPREME COURT OF JUDICATURE
COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE HIGH COURT OF JUSTICE
QUEENS BENCH DIVISION
Mr Justice Aikens
[2006] EWHC 345 (Comm)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 04/07/2007

Before :

SIR ANTHONY CLARKE MR
LORD JUSTICE BUXTON
and
LORD JUSTICE TOULSON

- -

Between :

THE REPUBLIC OF ECUADOR	**Appellant/ Applicant**
- and -	
OCCIDENTAL EXPLORATION & PRODUCTION COMPANY	**Respondent**

- -
- -

Mark Cran QC, Simon Birt and Vaughan Lowe (instructed by Weil Gotshal & Manges) for the Appellant/Applicant
Christopher Greenwood QC and Toby Landau (instructed by **Debovese & Plimpton LLP**) for the Respondent

Hearing dates : 26 & 27 February 2007

- -

Judgment

Sir Anthony Clarke MR:

This is the judgment of the court.

Introduction

1. This is an appeal from an order of Aikens J made on 2 March 2006 dismissing an application by the Republic of Ecuador ('Ecuador') under section 67 of the Arbitration Act 1996 ('the 1996 Act') to set aside an award of arbitrators for want of substantive jurisdiction. The appeal is brought with the permission of the judge, whose judgment is reported at [2006] 1 Lloyd's Rep 773. The arbitration was held under the UNCITRAL Rules and the seat of the arbitration was London. The arbitration award was dated 1 July 2004. By their award, the arbitrators held that they had jurisdiction, made various declarations and directed that Ecuador pay the Occidental Exploration and Production Company ('OEPC') US$71,533,649 together with interest amounting to US$3,541,280. As the judge observed, all three arbitrators are well - known and respected public international law specialists, namely the Hon Charles N Brower and Dr Patrick Barrera Sweeney, who were appointed by OEPC and Ecuador respectively, and the chairman, Professor Francisco Orrego Vicuna, who was appointed under article 7 of the UNCITRAL Rules.

2. The dispute between Ecuador and OEPC which gave rise to the award arose in connection with a Bilateral Investment Treaty ('BIT') between the USA and Ecuador signed on 27 August 1993 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 Amazon basin region of Ecuador.

3. 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 goods and services (both made 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 ('the SRI'). When that dispute could not be resolved, OEPC invoked the arbitration procedures set out in the BIT and started an arbitration against Ecuador. OEPC's case was that the actions of the SRI (for which it said Ecuador was responsible) amounted to breaches of Ecuador's obligations under the BIT, which it is common ground is governed by public international law.

4. Ecuador issued proceedings in the Commercial Court to set aside the award, relying on sections 67 and 68 of the 1996 Act**.** Ecuador's principal case was (and is) that the arbitrators exceeded their jurisdiction under the BIT. In its turn OEPC challenged the right of Ecuador to question the arbitrators' jurisdiction under section 67. It said that the issue of the arbitrators' jurisdiction was not 'justiciable' before the English courts on the ground that the arbitration arose out of a treaty between states and was on the

plane of public international law. On 29 April 2005 Aikens J rejected that challenge and his decision was upheld by this court on 9 September 2005. Those decisions are reported at [2005] 2 Lloyd's Rep 240 and [2006] QB 432 respectively. The interested reader can learn much more about all that in those reports.

5. So it was that the judge came to hear Ecuador's challenge to the award under section 67. Ecuador also challenged the award under section 68 on the ground that the arbitrators had exceeded their powers in such a way as to constitute a serious procedural irregularity in the arbitral proceedings, which it said had resulted in a substantial injustice to Ecuador. OEPC accepted that the court had jurisdiction to hear and determine that challenge and the judge determined the issues under section 67 and section 68 at the same time. The judge rejected both challenges and upheld the award. There is no appeal from his decision under section 68. We should add that OEPC had a contingent cross-application under section 67 which failed before the judge and in respect of which the judge refused permission to appeal. In these circumstances this appeal arises solely out of the rejection by Aikens J of Ecuador's challenge to the jurisdiction of the arbitrators under section 67 of the 1996 Act.

6. Ecuador's essential case is that the arbitrators made an award in respect of claims by OEPC that were "matters of taxation" and that by reason of the exclusion clause in 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. In response, the only ground upon which OEPC now says that the arbitrators had jurisdiction is by reason of the exception to that exclusion contained in Article X.2(c).

The BIT

7. The nature of a BIT treaty is now well known and is described in some detail in the reports of the judgments of both Aikens J and this court on 29 April and 9 September 2005. We do not repeat those descriptions here save so far as is necessary to determine the narrow question in dispute in this appeal. As the judge put it at [8] of his judgment, BITs are effectively treaties that acknowledge the principle of public international law called the 'doctrine of diplomatic protection'. They give investors, here OEPC, protection by giving them 'standing' to pursue a state directly in 'investment disputes' between an investor and a state party to the BIT in ways that are set out in the BIT.

8. This court has previously held that the BIT confers or creates direct rights in international law in favour of OEPC. As the judge said at [9], those rights come into existence, at the least, at the point when investors pursue claims in one of the ways provided by Article VI of the BIT. The BIT was signed in Washington on 27 August 1993 and came into force on 22 April 1997. It was in the form of the then current prototype US model and was submitted to President Clinton for approval. Both parties relied upon the Letter of Submittal which included the following:

> "**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 matters 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."

9. In his judgment the judge correctly summarised at [12] the structure of the BIT, as he had done in his earlier judgment, as follows:

> "(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.
>
> (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.
>
> (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".
>
> (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."

The judge noted that in Article I the definition of 'Investment' provided:

> "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."

10. The judge set out large parts of the BIT in Appendix 1 to his judgment. The interested reader can study them there; so we do not reproduce them again here. The critical articles for present purposes are Articles VI and X. Article VI(1) provides that investment disputes between a party to the BIT (Ecuador) and a national of the other party (OEPC) may be submitted to arbitration in accordance with the provisions of the Article. Article VI(1) defines an investment dispute as

> "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 ."

Article X(2) provides, so far as relevant:

> "… 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 observation and enforcement of terms of an investment agreement or authorization as referred to in Article VI(1)(a) or (b),
>
> to the extent that 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."

11. Both the arbitrators and the judge held that the dispute concerned the observance and enforcement of terms of an investment agreement within the meaning of Article X(2)(c), with the consequence that the provisions of the BIT, including in particular Article VI were applicable. The question in this appeal is whether the arbitrators and the judge were correct so to hold. We note in passing that at [111] the judge accepted that OEPC had not relied upon Article X(2)(c) before the arbitrators. The matter was however argued because (as the judge said at [113]) it was Ecuador's own case that only Article X(2)(c) might apply but that on its true construction it did not apply on the facts. The arbitrators disagreed with Ecuador's case on construction and held that they had jurisdiction. It was not argued before the judge that OEPC could not rely upon Article X(2)(c): see [111] to [114]. Nor was it argued before us.

The Contract

12. The background facts are set out at [1] to [36] of the award and [1] to [35] of the judgment. It is not necessary to repeat them here in any detail. OEPC had a long-standing commercial relationship with Petroecuador and its predecessor. Under the

Contract OEPC obtained the exclusive right to carry out the exploration and exploitation of hydrocarbons in Block 15 and assumed virtually all the costs of doing so. It also had to pay VAT on any expenses it incurred. In return for its obligations under the Contract, it received a percentage of the oil, which it was permitted to export. This was called "Contractor Participation". Clause 8.1 of the Contract set out a method of calculating the Contractor Participation in terms of the percentage to which it was entitled. The calculation included the calculation of a key component called "Factor X", which itself involved the use of an elaborate formula.

13. The arbitrators held that the negotiations between the parties proceeded on the common understanding that, although VAT would be payable by OEPC, it would subsequently be refunded to OEPC. They further held, which was not in dispute, that initially OEPC made regular applications to the SRI for the reimbursement of VAT which it had paid and that such reimbursement was made on a regular basis. However, in 2001 the Ecuadorian authorities changed their position. By Resolution 664 of 28 August 2001 the SRI denied OEPC's claims for refunds for the period October 2000 to May 2001 and stated the SRI view that reimbursement was already effected under the Contract on the basis that Factor X already took account of the fact the OEPC paid VAT and in effect compensated OEPC in respect of its liability for VAT. By Resolution 234 of 1 April 2002 the SRI annulled previous "Granting Resolutions" and ordered OEPC to return previous amounts reimbursed with interest. There followed other resolutions denying the right to refunds including Resolution 406 of 31 January 2003 and Resolution 026 of 6 March 2003.

14. The Head of the SRI, Ms de Mena, gave evidence to the arbitrators to the effect that "the State has the right to deal with tax questions via contractual modalities" and that it was the SRI's view that Ecuador had done so in the Contract by providing reimbursement through Factor X. The arbitrators rejected the submission that the Contract provided reimbursement of VAT through Factor X but held that OEPC was entitled to such reimbursement under the Contract. They held that OEPC was entitled to retain the refunds which had been made by SRI and that it was entitled to reimbursement of the VAT which the SRI had refused to refund.

15. Mr Cran stresses on behalf of Ecuador that OEPC did not make a claim against Petroecuador under the Contract and that its claim in the arbitration was brought entirely under the BIT. That is true but in our judgment of no real significance. The BIT creates rights and obligations as between OEPC and Ecuador. OEPC is entitled to enforce those rights, regardless of whether it could enforce similar rights against Petroecuador under the Contract. The significance of the Contract is that the position under it is directly relevant to answering the critical question, namely whether the judge was right to hold that the exception in respect of matters of taxation was excluded by Article X(2)(c) of the BIT. And the crucial parts of the arbitrators' conclusions on the facts are quoted at [34] of the judgment and at [18] below.

The judgment

16. The judge summarised at [27] to [33] the issues of jurisdiction which were before the arbitrators and how they resolved them. There were three such issues but this appeal is concerned only with what the judge called the second jurisdictional issue. He summarised Ecuador's case on this issue as follows at [27(2)]:

> "… 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."

17. The judge then described the arbitrators' conclusions on this issue thus at [28] to [32]:

> "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 mentioned in Article X.2(a), (b) and (c), as "*not persuasive*". 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*".
>
> 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*". 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*".
>
> 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)?

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*" 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".*"

18. The judge then summarised the arbitrators' conclusions on the merits at [34]:

> "… (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."

It was on the basis of those conclusions, especially those at (1) to (4), that the arbitrators concluded that the breaches of Articles II(1) and II(3)(a) of the BIT had caused OEPC damage, that it could retain the VAT refunds it had received and that it was entitled to the refunds which had been withheld.

19. It was not in dispute before the judge (or before us) that the Contract was an "investment agreement" within the meaning of Article VI(1)(a) and therefore Article X(2)(c). It was, as we understand it, accepted before the judge (and indeed initially before us) that the relevant "matters of taxation" were the issues underlying OEPC's claim or the nature of the real dispute between the parties. However, in the course of Mr Cran's concluding submissions before us on behalf of Ecuador, he submitted that the relevant matter of taxation was, as he put it in a written summary of Ecuador's concluding submissions, simply Ecuador's refusal to reimburse VAT paid on relevant inputs, without regard to Ecuador's defence at the arbitration to an enquiry into the question whether the reimbursement of VAT had been included in the contractual formula. However, in our opinion, the judge was correct to say at [107] that the dispute between Ecuador and OEPC was whether, in the circumstances, Ecuador's decision that OEPC was not entitled to a refund of VAT was a breach of Ecuador's obligations under Articles II and III of the BIT and that that dispute involved matters of taxation, ie the VAT payments. The judge was correct to hold that "the provisions of the Treaty, and in particular Article VI" did not apply unless those matters of taxation were "with respect to the observance of terms" of the Contract. As the judge observed at [46], the real issues before him were the extent of the exclusion and how the exclusion operated in the context of the dispute.

20. The judge spelled out the respective submissions of the parties in considerable detail. Having done so, he concluded at [79] that, given the structure of the BIT and the nature of OEPC's claim in the arbitration, it was inevitable that the court must examine not only the scope of the dispute resolution provisions in the BIT, but also the way in which the parties presented the dispute to the arbitrators. It followed that he would have 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. He concluded that the court had to consider first the nature of the dispute between the parties and then whether, on the true construction of the BIT, and Article X(2) in particular, the arbitrators had jurisdiction to determine the dispute. In our judgment, that was the correct approach.

21. At [80] to [87] the judge set out the parties' submissions and concluded at [88] that Mr Greenwood was correct in his submission on behalf of OEPC that, in order to determine whether Ecuador was in breach of its obligations under the BIT, the arbitrators had to consider the basis on which OEPC made its investment in Ecuador. They had to investigate and determine what OEPC's legitimate expectations were by the time the Contract was concluded in May 1999, including in particular what Ecuador and OEPC understood the position was on the repayment (if any) of VAT paid by OEPC. The judge held that, in order to consider those questions the arbitrators had to look into the factual background of the negotiations of the Contract and it also had to analyse the terms of the Contract itself. We agree with those conclusions.

22. We further agree with the judge at [91] that were it not for the fact that the current dispute concerned the question of VAT refunds, the dispute between the parties would fall within Article VI(1)(a) and (c) of the BIT. That is because the Contract is an "investment agreement" within the meaning of Article VI(1)(a) and the dispute arises out of or relates to the Contract and because the dispute arises out of or relates to an alleged breach by Ecuador of rights conferred or created by the BIT with respect to an investment within Article VI(1)(c) of the BIT. However, since the dispute involves "matters of taxation" within the meaning of Article 10(2), Article VI applies only with respect to one or more of the circumstances set out in paragraphs (a), (b) or (c) of Article X(2). Only paragraph (c) is now relied upon. As we see it, the reference in paragraph (c) to "terms of an investment agreement … as referred to in Article VI(1) (a) …" is simply a reference back to the terms of the relevant investment agreement and thus here to the Contract. It cannot be sensibly suggested that those terms were or are "subject to the dispute settlement provisions of a Convention for the avoidance of double taxation between the two Parties", or that they "have been raised under such settlement provisions and … not resolved within a reasonable period of time". It follows that the question is simply whether Article VI applies to matters of taxation in respect of "the observance and enforcement of terms of" the Contract.

23. We agree with the conclusions of the judge at [92] to [94] that the parties to the BIT intended that generally all matters of taxation should be outside the scope of the BIT and that unless a particular matter of taxation comes within the ambit of paragraph (a), (b) or (c), it is outside the scope of the BIT.

24. There were essentially two questions before the judge which are relevant to this appeal. The first is whether the claim falls within the ambit of Article X(2)(c) and the second is whether, if so, all the rules set out in the BIT, including those in Articles II and III, applied to such "matters of taxation" as are covered by Article X(2)(a), (b) and (c). The judge considered the second question first, at [96] and [97]. He then considered the first question at [98] to [109]. The judge resolved both issues in favour of OEPC. We will consider first the correct approach to construction of the BIT, then the first and second questions in turn.

Discussion

25. The correct approach to the construction of a provision of the BIT is not significantly in dispute. The BIT is governed by public international law and, as a treaty, its construction is governed by the rules on treaty interpretation which are set out in the Vienna Convention on the Law of Treaties 1969**.** It is agreed between the parties that these rules represent customary international law and that we must apply them.

26. The judge set out part of Article 31.1 of the Vienna Convention at [90] of his judgment. Mr Cran observes that he did not include Article 31.2. We therefore include it below, although we are not persuaded that the judge's failure to quote it is of any significance. Article 31 is part of Section III, which is entitled "Interpretation of Treaties". Article 31 is itself entitled "General rule of interpretation" and provides:

> "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.
>
> 2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:
>
> (a) any agreement relating to the treaty which was made between all the parties in connexion with the conclusion of the treaty;
>
> (b) any instrument which was made by one or more parties in connexion with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty
>
> 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 entitled "Supplementary means of interpretation". It provides:

> "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".

27. In the light of Articles 31 and 32 of the Vienna Convention there is little, if any, dispute between the parties as to the correct approach to construction of the BIT. It is, for example, common ground that the Submittal Letter is an aid to its construction.

28. We accept Mr Greenwood's submission that the object and purpose of a BIT (including this BIT) is to provide effective protection for investors of one state (here OEPC) in the territory of another state (here Ecuador) and that an important feature of that protection is the availability of recourse to international arbitration as a safeguard for the investor. In these circumstances it is permissible to resolve uncertainties in its interpretation in favour of the investor: see eg the views of the arbitrators in paragraph 116 of their award in *SGS v Philippines* (2004) 8 ICSID Reports 515.

29. It is common ground that the expression "observance and enforcement" should be construed disjunctively. Ecuador suggests that because of the reference in Article X(2)(c) to "the observation and enforcement of *terms*" of the Contract (our emphasis) the exclusion only applies where OEPC would have a claim for damages for breach of a term of the contract. However, in our judgment, that is to construe Article X(2)(c) too narrowly. Some assistance is to be gleaned in this regard from the Spanish text, which uses the term "observancia y el complimiento" for "observance and enforcement". As Mr Greenwood submits, "complimiento" would more naturally translate into English as "performance" or fulfilment". We accept Mr Greenwood's submission that the observance of the Contract was precisely what the SRI claimed to be upholding in its decision on VAT reimbursement. Its decisions were based on what it regarded or asserted to be the observance of the Contract.

30. We do not think that the reference to "terms" should be given too narrow a meaning. It does not mean express or implied terms in the sense those expressions are used in common law jurisdictions. We accept Mr Greenwood's submission that the question is whether OEPC's claim for reimbursement of VAT entails a departure from its bargain as set out in the Contract. This was what the judge essentially held at [100] and [101]. We agree with his conclusion at the end of [101], where he said:

> "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".

31. Earlier at [98] and [99] the judge had considered what was meant by "with respect to" in the expression "with respect to … the observance and enforcement of terms of an investment agreement". He held that it was an expression which was broad in effect and that it simply meant that there must be a link between the matters of taxation and the observance and enforcement of the terms of the Contract. Here there was such a link because Ecuador, through the SRI, claimed reimbursement or payment of the VAT on the basis that such reimbursement was contemplated by the contract because the contract price included VAT through Factor X. Unfortunately for Ecuador, the arbitrators held that Factor X did not include VAT but that the contract was made on the footing that any VAT paid would be refunded to OEPC.

32. The judge spelled that out in detail at [103] to [108]. We agree with the judge's conclusions in those paragraphs. It is sufficient for us to quote only [107] and [108] with which we agree:

> "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 [were] fundamental to how the Contract terms were to be observed and enforced."

33. Mr Cran submits that those conclusions are inconsistent with the terms of the Submittal Letter, which is an important aid to construction of the BIT. As already stated, we agree that the Submittal Letter is indeed an aid to construction and, no doubt, an important one. As Mr Cran observes, the judge set out the relevant part of the letter at [11] of his judgment. We in turn have set it out at [8] above. Mr Cran relies in particular upon the last sentence of the Submittal Letter as showing that the United States understood the exception in Article X(2)(c) as referring to "tax provisions contained in an investment agreement" and thus to the terms of the Contract properly so called.

34. However, Mr Greenwood submits in response that the Submittal Letter supports OEPC's approach to Article X(2) in four respects:

    i) it reinforces the conclusion drawn from the Preamble of the BIT that its object and purpose was to achieve a broad system of protection for the investor;

    ii) it reinforces the conclusion drawn from the text of Article X(2) that the object and purpose of Article X(2) was to avoid conflicts between the regime of double taxation conventions and that of BITs;

    iii) its statement that "the Treaty, and particularly the dispute resolution provisions, do apply in three areas" is incompatible with the notion advanced by Ecuador that Article X(2)(a) to (c) is essentially a provision for jurisdiction over particular types of claim, since the language used, namely the reference to applicability of the provisions of the BIT generally (and not individual provisions) supports the gateway analysis discussed below; and

    iv) it makes clear that one of the "areas" to which the BIT is applicable is "tax provisions contained in an investment agreement" and that this area is one not normally covered by double taxation conventions.

35. We accept those submissions. We further accept the submission that, although the Letter is an aid to construction of the BIT, the language of the Letter was not intended to have contractual effect but was an attempt to précis the position in lay terms for the benefit of a Senate Committee. In any event, it seems to us that the use of the term "tax provisions" in the Letter is broad enough to embrace the contractual bargain regarding tax payments and the participation factor which was part of the Contract.

36. In all the circumstances, like the judge, we conclude that OEPC's claim falls within the exception to "matters of taxation" in Article X(2)(c). We answer the first question accordingly and turn to the second question, which has been called the gateway question.

37. The question is whether, assuming that the judge was correct to hold that OEPC's claim falls within the exception to "matters of taxation" in Article X(2)(c), all the

rules set out in the BIT, including those in Articles II and III, applied to it. The judge held that it did. He accepted Mr Greenwood's submission that, once it was held that the claim did not involve an excluded matter of taxation, the gateway to the other relevant provisions of the BIT was opened. As we understand it, his reasons, which are to be found at [96] and [97] of his judgment can be summarised in this way:

i) The opening words of Article X(2) show that Articles VI and VII of the BIT apply to the matters of taxation which are not excluded because they provide that "the provisions of this Treaty, and in particular Articles VI and VII, shall apply to matters of taxation only with respect to" those matters which are included in paragraphs (a), (b) or (c).

ii) Article VI contains the dispute resolution provisions as between the investor (OEPC) and the state (Ecuador), which include arbitration in accordance with UNCITRAL Rules.

iii) Article X(2) does not limit the provisions of the BIT to disputes between the state and the investor which are expressly applied or (put another way) not expressly excluded by Article X. On the contrary, it simply provides that "the provisions of this Treaty" apply. As the judge expressed it at [96], "those words are clear and so must be given their ordinary meaning".

iv) This interpretation accords with the object and purpose of the BIT. The treaty sets out how the contracting parties will treat investors and their investments. The judge concluded:

> "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)."

v) In these circumstances the judge held at [97] that it was unnecessary to rewrite the opening words of Article X(2) and that, once a claim comes within (say) Article X(2)(c), that means that "the provisions of this Treaty, and in particle Articles VI and VII, shall apply". Those provisions include Articles II and III.

38. We agree with the judge for the reasons he gave. Mr Cran submits that not all the provisions of the BIT will be relevant in this context and there are good reasons why the parties would not have wished to include Articles II and III. We agree that there are some provisions which would not be capable of applying but that is not true of Articles II and III. The parties could have agreed to exclude Articles II and III from the scope of Article X. They did not do so. Indeed, they expressly included a reference to Article III in paragraph (a). They chose which matters of taxation were

CONCLUSIONS

39. It follows that, in our opinion, the judge answered both questions correctly and that he was right to dismiss Ecuador's challenge to the jurisdiction of the arbitrators under section 67 of the 1996 Act. In essence, we see no reason why the parties should not have agreed that Article II of the BIT was applicable to the facts of this case. The rights and obligations in Article II (and indeed III) of the BIT are expressed in different terms from the way in which the rights and obligations of the parties to the Contract are expressed in the Contract. They are nevertheless binding on Ecuador and OEPC under the BIT. The arbitrators were entitled, as they did in the passage quoted by the judge at [34] and set out at [17] above, to hold 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. …"

40. For the reasons we have given, which are essentially those given by the judge, we conclude that the arbitrators had jurisdiction to determine whether Ecuador was in breach of the terms of the BIT. We therefore dismiss the appeal.