

*This case summary was prepared in the course of research for  
[S Ripinsky with K Williams, Damages in International Investment Law \(BIICL, 2008\)](#)*

**Case summary**

Occidental Exploration and Production Company  
V  
The Republic of Ecuador

**Year of the award:** 2004

**Forum:** London Court of International Arbitration (UNCITRAL arbitration rules)

**Applicable investment treaty:** Ecuador – United States BIT (concluded 1993)

<b>Arbitrators</b> Prof. Francisco Orrego Vicuña, President Mr. Charles N. Brower Dr. Patrick Barrera Sweeney	<b>Timeline of the dispute</b> 11 November 2002 – notice of arbitration 1 July 2004 – arbitral award
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## **I. Executive Summary**

“Occidental”, a US company, was engaged in exploration and production of oil in Ecuador, under a 1999 contract with an Ecuadorian State-owned corporation. In 2000-2001 Occidental was regularly reimbursed amounts of VAT paid by it on purchases required for its activities. However, in mid-2001 the Ecuadorian tax authority issued resolutions denying all further applications for VAT refunds by Occidental and requiring the return of the amounts previously reimbursed – on the grounds that VAT reimbursement was already accounted for in the contract.

In 2002, Occidental instituted arbitral proceedings against Ecuador under the Ecuador – United States BIT claiming multiple violations of BIT provisions, including those on national treatment, fair and equitable treatment and full protection and security, prohibition of arbitrary or discriminatory measures and expropriation. Occidental requested to be reimbursed for all VAT amounts already paid on goods and services used for the production of oil for export, as well as for future VAT amounts (US\$ 201 million in total).

The Tribunal found that the contract did not include VAT refunds, and that the Claimant was entitled to such refunds under the Ecuadorian tax legislation and the law of the Andean Community. The Tribunal found further that the treatment accorded by Ecuador to the Claimant was less favourable than that accorded to certain national investors who continued to benefit from VAT refunds, which constituted a violation of the national treatment obligation. The Tribunal also found that Ecuador’s conduct violated the obligations to accord fair and equitable treatment and full protection and security. Other BIT claims were rejected.

In compensation, the Tribunal awarded the amounts of VAT paid by Occidental, whose refund was requested by it and denied by Ecuador, as well as the amounts of VAT paid by Occidental but not requested for refund. As a “conservative measure”, the Tribunal reduced the total amount by 1.5% to account for possible impropriety of invoices and other defects. The Tribunal refused to award future damages, i.e. the amounts of VAT to be paid and refunded in the future, as “contingent and indeterminate”. The Tribunal took measures to prevent Occidental from obtaining ‘double recovery’ given that domestic proceedings dealing with the same matter were still pending at the time of the arbitral award. Interest was awarded using, as a basis, Ecuadorian legislation applicable to delays of tax obligations but reduced the resultant amount by 50%.

## **II. Factual Background and Claims of the Investor**

In 1999, Occidental Exploration and Production Company (“Occidental”), a US company, entered into a participation contract (“the Contract”) with Petroecuador, a State-owned corporation of Ecuador, to undertake exploration for and production of oil in Ecuador.

Occidental applied regularly to the *Servicio de Rentas Internas* (SRI), an Ecuadorian tax authority, for reimbursement of Value-Added Tax (“VAT”) paid by Occidental on purchases required for its exploration and exploitation activities under the Contract; these refunds were granted on a regular basis.

In mid-2001, however, SRI issued resolutions denying all further applications for VAT refunds by Occidental and other companies in the oil sector and requiring the return of the amounts previously reimbursed. These SRI resolutions were based on the opinion that VAT reimbursement was already accounted for in the Contract’s participation formula.

Occidental filed four lawsuits in Ecuadorian tax courts objecting to the above mentioned resolutions as inconsistent with Ecuador’s legislation in force; these lawsuits were still pending at the time of arbitral award.

In 2002, Occidental instituted arbitral proceedings against Ecuador under the Ecuador – United States BIT (concluded in 1993, in force since 1997), claiming that the measures adopted by the SRI were in breach of the following BIT obligations:

- fair and equitable treatment;
- national treatment;
- not to impair by arbitrary or discriminatory measures the management, use and enjoyment of the investment; and
- not to expropriate directly or indirectly all or part of that investment. (para.36)

Occidental requested to be refunded all VAT already paid by it on goods and services used for the production of oil for export (approx. US\$ 80 million including interest), and claimed future VAT refunds (US\$ 121.3 million). (paras.21-22)

### **III. Findings on Merits<sup>1</sup>**

#### ***A. Applicable law***

The Tribunal discussed the (preliminary) issue of whether the Claimant was entitled to VAT refunds in light of the Contract, Ecuadorian tax legislation, decisions of the Andean Community and the law of the World Trade Organization. The essence of the dispute, however, related to violations of the BIT; to establish such violations and relevant remedies, the Tribunal applied provisions of the BIT and international law (para.93)

#### ***B. Entitlement to VAT Refunds***

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<sup>1</sup> In its award, the Tribunal also ruled on the issues of jurisdiction and admissibility (paras.37-92) which are not covered in this summary. Suffice is to note that, among other findings in that section, Occidental’s expropriation claim was dismissed by the Tribunal as inadmissible.

Before proceeding to the BIT claims, the Tribunal concluded that:

- the Contract's participation formula did not include VAT refunds (paras.110, 112, 115);
- the Ecuadorian tax legislation granted the right to VAT refunds to all exporters, including those in the oil sector (para.143); and
- under the law of the Andean Community, the Claimant also was entitled to VAT refunds (para.152).

The Tribunal thus concluded that the SRI resolutions in question were contrary to the Contract, to Ecuadorian law and to the law of the Andean Community.

### ***C. National Treatment***

The Claimant argued that Ecuador had breached its national treatment obligation given that various companies involved in the export of other goods (e.g., flowers, mining, seafood products), were still entitled to receive VAT refunds.

The Tribunal agreed with Occidental's argument that its treatment should be compared to that of actors in other (i.e. non-oil) economic sectors, and expressly rejected a WTO/GATT-style analysis of the national treatment obligation, which would restrict its comparison to "directly competitive or substitutable products". (paras.173-176)

Although the Tribunal was convinced that there had been no discriminatory intent in Ecuador's actions against foreign investor, "the result of the policy enacted and the interpretation followed by the SRI in fact has been a less favorable treatment" of Occidental. (para.177) Thus, the violation of the national treatment obligation was established.

### ***D. Fair and Equitable Treatment and Full Protection and Security***

The Tribunal interpreted the Fair and Equitable Treatment ("FET") standard to require the "stability of legal and business framework" (para.183) and emphasized that the relevant legal question under international law was not whether there was an obligation to refund VAT, but whether the legal and business framework met the requirements of stability and predictability. (para.191) The Tribunal also noted that the FET standard was objective and did not depend on whether the Respondent acted in good faith or not. (para.186)

On the facts of the case, the Tribunal concluded that the framework, under which the investment had been made and operated, was changed in an important manner by the actions adopted by the SRI: "[t]he tax law was changed without providing any clarity about its meaning and extent, and the practice and regulations were also inconsistent with such changes." (para.184) The Tribunal thus concluded that Ecuador breached its obligation to accord FET.

Having found that Ecuador was in breach of the FET standard, the Tribunal held that this had the effect of also constituting a breach of the related BIT guarantee of Full Protection and Security. (para.187)

### ***E. Impairment Claim - Rejected***

Article II (3) (b) of the BIT provided as follows:

Neither Party shall in any way impair by arbitrary or discriminatory measures the management, operation, maintenance, use, enjoyment, acquisition, expansion, or disposal of investments...

The Tribunal found that the management, operation, maintenance, use, enjoyment, acquisition, expansion or disposal of the investment had not been in any way *impaired* by the measures adopted. Therefore that claim was rejected.

## **IV. Findings on Damages**

### ***A. Law Applicable to the Determination of Damages***

In its award of damages, the Tribunal applied the BIT and international law.

### ***B. Compensation***

The Tribunal did not discuss the applicable standard of compensation.

First, the Tribunal held that the investor was not obliged to return the amounts of VAT refunded to him in 2000-2001, and that the resolutions of the SRI requiring him to do so were without legal effect. (para.202)

Secondly, the Tribunal awarded the following damages as causally linked to BIT breaches:

- 1) Amounts of VAT paid by Occidental, whose refund was requested and denied by SRI (US\$ 12.6 million);
- 2) Amounts of VAT paid by Occidental, whose refund was not requested (US\$ 60.5 million). Even though the Respondent objected, arguing with reference to *Feldman*, that amounts of VAT, which had not been claimed, could not be granted, the Tribunal accepted the Claimant's argument, that any application for refund would have been futile in view of the earlier refusals of refund.

These two heads of damages totaled US\$ 73.1 million. The Tribunal adjusted this figure on the following basis. The Respondent objected to the amount of US\$ 95,000 in connection with the VAT effectively submitted for reimbursement pointing to

impropriety of invoices and other aspects. This gave a correction factor of 0.0075, which, if applied to the total amount of US\$ 73.1 million, was equivalent to US\$ 550,000. As an additional “conservative measure”, which the Tribunal took to ensure that compensation “does not exceed the amount of VAT which [Occidental] in fact should have been refunded”, the Tribunal reduced compensation (US\$ 73.1 million) by a further 1.5 %, or approx. US\$ 1 million. Accordingly, the total amount of VAT awarded to Occidental was approx. US\$ 71.5 million. (para.207)

### **C. Date for Calculating Compensation**

The compensation of US\$ 71.5 million was determined by the amount of VAT which had had not been refunded by the Government of Ecuador by 31 December 2003. That date was apparently chosen by Tribunal as the one close to the date of the award.

The Tribunal refused to order a refund of VAT amounts that were not yet due to, or paid by, the Complainant, i.e. future damages (estimated by the Claimant at US\$ 121.3 million). The Tribunal relied on *Southern Pacific Properties, Chorzow Factory* and *Amoco* to support its view that those were “contingent and indeterminate damages” and therefore could not be awarded. (para.210)

### **D. Measures to Avoid Double Recovery**

At the time of the arbitration, Occidental had several claims for VAT refunds pending at local courts in Ecuador. To avoid double recovery, the Tribunal

- (1) held that Occidental shall not benefit from any additional recovery;
  - (2) directed the Claimant “to cease and desist from any local court actions, administrative proceedings or other actions seeking refund of any VAT paid through 31 December 2003”; and
  - (3) held that “any and all such actions and proceedings shall have no legal effect”.
- (para.209)

### **E. Interest**

To calculate interest for the awarded amount up to 31 December 2003, the Tribunal used the rate applied by the SRI for delay or late payment of tax obligations, in accordance with Ecuadorian tax laws, which resulted in the amount of approx. US\$ 7 million. However, noting that those provisions were not directly applicable (the BIT being the applicable law), the Tribunal adjusted the amount of interest downwards (without giving specific reasons) and awarded only half of it (US\$ 3.5 million). Interest was not compounded.

The Tribunal also ordered simple interest at the rate 2.75 % p.a. from 1 January 2004 to the date of the award. In case of non-compliance with the award within 30 days, the Tribunal ordered simple interest at the rate of 4%, from the date 30 days following the

Award until the date of effective payment. (paras. 9 and 13 of the concluding part of the award)

## V. Implications/ Initial Analysis

- This case, similarly to *Feldman*, poses a question of **relationship between restitution and compensation for damages**. If a State unlawfully deprives an investor of property and then returns this property, this is restitution. Here, the subject of deprivation was not real or movable property but money. The State was ordered to return to the investor the money that it had been unlawfully withholding; therefore this appears to be a case of monetary restitution.
- In this non-expropriatory case, the Tribunal did not discuss the **standard of compensation** – presumably because there was no need to value damages, as the latter consisted of an easily ascertainable monetary amount of VAT paid.
- **Conservative estimation**. The Tribunal adjusted the amount of damages by a “conservative measure” in order to ensure that compensation did not exceed the actual amount of VAT owed to Occidental. Generally, tribunals seem to prefer applying conservative analysis of damages, in order to avoid excessive compensation.
- **The amount of interest** was also adjusted downwards, in line with the Tribunal’s conservative approach (although without specific reasoning).
- Tribunal reverted to **domestic law** when awarding interest, although the award was made under the BIT.
- The rate used to calculate **post-award interest** was higher than that used for pre-award interest.
- The Tribunal dismissed the **future damages** claim on the basis that these damages were “contingent and indeterminate” (taxes still had to be paid and requested for refund). This approach seems to correspond to that taken in other cases of **continuous breach**, eg *LG&E v Argentina* (future dividends) and *Nykomb v Latvia* (future payments under a contract).
- The Tribunal thought it necessary to prevent the Complainant from obtaining ‘**double recovery**’, the possibility of which was present given the pending proceedings in domestic courts on the same subject-matter.