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PROPORTIONALITY: AN ADDITION TO THE INTERNATIONAL CENTRE FOR THE SETTLEMENT OF INVESTMENT DISPUTES' FAIR AND EQUITABLE TREATMENT STANDARD

ANNE MARIE MARTIN*

Abstract: The fair and equitable treatment standard, established in state law, customary law, and bilateral investment treaties, requires that states treat investors in a consistent and transparent manner. With its decision in *Occidental Petroleum Corp., Occidental Exploration and Production Company v. Republic of Ecuador*, the International Centre for the Settlement of Investment Disputes (ICSID) interpreted the ever-expanding fair and equitable treatment standard to include the principle of proportionality. After concluding that Ecuador's termination of the investor's contract was a disproportionate response to the investor's breach of that contract, the ICSID Tribunal awarded an incredible \$1.77 billion in damages. The potential for crushing liability for host countries and the overprotection of investors has resulted in the recent withdrawal of a number of host countries from the ICSID and from Bilateral Investment Treaties. This retreat will continue until the Tribunal recalibrates the fair and equitable treatment standard to provide balanced protection for both the investor and the host country.

INTRODUCTION

On October 5, 2012, the International Centre for the Settlement of Investment Disputes (ICSID) awarded damages of \$1.77 billion after finding that the Republic of Ecuador had breached Ecuadorian law, international law, and the Treaty between the United States of America and the Republic of Ecuador Concerning the Encouragement and Reciprocal Protection of Investment (the Bilateral Investment Treaty or BIT).¹ The ICSID Tribunal found that Ecuador had violated the fair and equitable treatment standard because Ecuador's termination of its Participation Contract with the Occidental Exploration and Production Company (OEPC) was not a proportional response

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¹ *Occidental Petroleum Corp., Occidental Exploration and Prod. Co. v. Republic of Ecuador*, ICSID Case No. ARB/06/11, Award ¶ 876 (Oct. 5, 2012).

to OEPC's breach of the contract.² At the time, OEPC was Ecuador's largest oil investor, extracting around 100,000 barrels of oil per day.³ Today, state-run Petroamazonas controls operations.⁴ Both the size of the award and the solidification of proportionality as a principle underlying the fair and equitable treatment standard have led some to describe the ruling as "the most important jurisprudential development of the year."⁵

This Comment considers proportionality in the context of the expanding definition of fair and equitable treatment and the appropriateness of the size of the award. Part I presents background information about the OEPC's investment in Block 15 in Ecuador and the *Caducidad* Decree, which terminated the contract between the parties. Part II explores the fair and equitable treatment standard in international investment law, particularly the principle of proportionality. Part II also discusses the Tribunal's findings and its calculation of damages. Part III argues that the Tribunal overly expanded the fair and equitable treatment standard to provide further protection to investors and calls for additional protections for host countries. Part III also argues that the size of the award is likely to deter developing countries from voluntarily submitting to the ICSID.

I. BACKGROUND

Block 15 is an area of 200,000 hectares located in the most oil-rich region of Ecuador, deep in the Ecuadorian Amazon rainforest.⁶ OEPC and Ecuador entered into the Participation Contract on May 21, 1999, which gave OEPC the obligation to develop and to exploit certain fields until 2012 and other fields until 2019 in exchange for a 70 percent share of the oil produced from Block 15.⁷ In 2000, OEPC and Alberta Energy Company (AEC) signed the Farmout Agreement, in which AEC agreed to contribute to OEPC's Block 15 investments in exchange for the right to 40 percent of OEPC's share of Block 15's production.⁸ Senior executives from OEPC and AEC met with the Ecuadorian Minister of Energy and Mines to inform him about the Farmout

² See *id.* ¶ 452.

³ Press Release, MidnightTrader Live Briefs, Energy Stocks Trimming Losses Late; Occidental Wins \$1.77-Billion Arbitration Award, (Oct. 8, 2012) available at http://go.galegroup.com.proxy.bc.edu/ps/i.do?id=GALE%7CA304701373&v=2.1&u=mclin_m_bostcoll&it=r&p=ITOF&w=w.

⁴ See *id.*

⁵ See *Global Dispute of the Year, Investment Arbitration: Occidental v. Ecuador, AMERICAN LAWYER* (Sept. 9, 2013), http://www.americanlawyer.com/PubArticleTAL.jsp?id=1202616473638&Global_Dispute_of_the_Year_Investment_Arbitration_Occidental_v_Ecuador (last visited Oct. 17, 2014).

⁶ Award, *Occidental Exploration and Prod. Co.*, ICSID Case No. ARB/06/11 ¶ 109.

⁷ *Id.* ¶¶ 115, 116, 117.

⁸ *Id.* ¶¶ 129, 130.

Agreement, but there is a dispute as to what occurred during that meeting, and the Ministry never granted official authorization.⁹

Years later, however, on August 24, 2004, the Attorney General of Ecuador wrote to the Minister of Energy and Mines requesting that he terminate the Participation Contract due to the transfer of interests and obligations to AEC, which OEPIC did without ministerial authorization.¹⁰ In September 2004, PetroEcuador, Ecuador's national oil company, initiated the termination procedure by notifying OEPIC of its alleged non-compliance with the Participation Contract; OEPIC denied the allegation.¹¹

In early 2005, anti-United States and anti-foreign investment demonstrators assembled in front of OEPIC offices in Quito to protest the government's failure to terminate OEPIC's contract.¹² During the spring of 2005, OEPIC had meetings with PetroEcuador to negotiate a solution.¹³ In April 2005, days of violent protests broke out in Quito, and the Ecuadorian Congress ousted President Lucio Gutiérrez.¹⁴ Additionally, the Minister of Energy and Mines and the Executive President of PetroEcuador resigned.¹⁵

In November 2005, Minister Iván Rodríguez, the new Minister of Energy and Mines, notified OEPIC of cause for termination of the Participation Contract.¹⁶ Protests continued, with a demonstration outside OEPIC's offices in May 2006 in which then-candidate for President, Dr. Rafael Correa, called for a symbolic "closure forever" of OEPIC.¹⁷ On May 15, 2006, Minister Rodríguez issued the *Caducidad* Decree, which immediately terminated the Participation Contract and required that OEPIC transfer all assets related to Block 15 to PetroEcuador.¹⁸ In May 2006, State officials seized all of OEPIC's oil fields in Block 15 as well as all property in its offices.¹⁹

Subsequently, OEPIC requested arbitration in front of an ICSID Tribunal.²⁰ An affiliate of the World Bank Group, the ICSID provides arbitral services for investment disputes to those states that have ratified the ICSID Convention.²¹ Investment arbitration has grown robustly over the past decade.²²

⁹ *Id.* ¶¶ 147, 149, 381.

¹⁰ *Id.* ¶¶ 177–178.

¹¹ *Id.* ¶ 180.

¹² *Id.* ¶ 181.

¹³ *Id.* ¶ 185.

¹⁴ *Id.* ¶ 186.

¹⁵ *Id.*

¹⁶ *Id.* ¶ 192.

¹⁷ *Id.* ¶¶ 196, 198.

¹⁸ *Id.* ¶ 199.

¹⁹ *Id.* ¶ 200.

²⁰ *See id.* ¶ 1.

²¹ *See* SHAYERAH ILIAS AKHTAR & MARTIN A. WEISS, CONG. RESEARCH SERV., R43052, U.S. INTERNATIONAL INVESTMENT AGREEMENTS: ISSUES FOR CONGRESS 7 (2013).

According to a report by the United Nations, in 2012, nine decisions awarded damages and parties filed a record sixty-two new cases.²³

In the arbitration, the ICSID Tribunal found that the assignment to AEC without Ministry authorization was in breach of the Participation Contract.²⁴ But the Tribunal also decided that the *Caducidad* Decree was not a proportionate response to OEPC's breach of contract, and therefore the government issued the Decree in breach of Ecuadorian law, customary international law, and Article II.3(a) of the BIC.²⁵ Consequently, the Tribunal awarded OEPC \$1,769,625,000 in damages.²⁶ The \$1.77 billion award to OEPC was the highest in the history of Investor-State Dispute Settlement.²⁷ One of the three members of the Tribunal, Brigitte Stern, dissented as to the calculation of damages.²⁸

Five days after the award, Ecuador filed an appeal of the \$1.77 billion judgment, arguing that the ICSID lacked jurisdiction over the case.²⁹ Ecuador has requested annulment of the award, claiming that this arbitration award and another lawsuit by Chevron could send Ecuador into bankruptcy.³⁰ The annulment request is still pending before the Tribunal.³¹

Additionally, while the proceedings were underway, Ecuador sent the World Bank notice of its denunciation of the ICSID Convention.³² The withdrawal took effect on January 7, 2010, after the commencement of the proceedings but before the final award.³³ Since 2008, Ecuador has also cancelled

²² See Gary Born, *A New Generation of International Adjudication*, 61 DUKE L. J. 775, 838–39 (2012).

²³ See Press Release, United Nations Conference on Trade and Development, International Investment Disputes Hit Record in 2012—U.N. Report, U.N. News Centre (Apr. 10, 2013).

²⁴ See Award, *Occidental Exploration and Prod. Co.*, ICSID Case No. ARB/06/11 ¶ 381.

²⁵ See *id.* ¶ 452.

²⁶ *Id.* ¶ 876.

²⁷ Press Release, UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT, *supra* note 23.

²⁸ Occidental Petroleum Corp., Occidental Exploration and Production Co. v. Republic of Ecuador, ICSID Case No. ARB/06/11, Dissenting Opinion ¶ 1 (Oct. 5, 2012).

²⁹ Alexandra Valencia, *Ecuador Files Appeal to \$1.77 Bln. Occidental Ruling*, REUTERS (Oct. 10, 2012), <http://www.reuters.com/article/2012/10/10/ecuador-occidental-idUSL1E8LAKEQ20121010> (last visited Oct. 17, 2014).

³⁰ Mercedes Alvaro, *Ecuador Plans to Audit Bilateral Investment Treaties*, EUROINVESTOR (Mar. 11, 2013), <http://www.euroinvestor.com/news/2013/03/11/ecuador-plans-to-audit-bilateral-investment-treaties/12243637> (last visited Oct. 17, 2014).

³¹ Occidental Petroleum Corp., Occidental Exploration and Production co. v. Republic of Ecuador, ICSID Case No. ARB/06/11, Proceeding, available at <https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=viewCase&reqFrom=Home&caseId=C80> (indicating that the annulment procedure is still pending).

³² News Release, *Ecuador Submits a Notice Under Article 17 of the ICSID Convention*, ICSID (July 9, 2009), available at <https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=OpenPage&PageType=AnnouncementsFrame&FromPage=NewsReleases&pageName=Announcement20>.

³³ *Id.*; see Award, *Occidental Exploration and Prod. Co.*, ICSID Case No. ARB/06/11.

nine bilateral investment treaties, and President Correa has said that he plans to challenge several others.³⁴ On March 11, 2013, President Correa presented a bill requesting that Ecuadorian lawmakers annul the Bilateral Investment Treaty.³⁵

II. DISCUSSION

A. *The Fair and Equitable Treatment Standard*

Judicial decisions on the fair and equitable treatment standard depend on the circumstances of the case.³⁶ Some examples of violations include a government's willful refusal to meet contractual obligations, abuse of government authority to evade agreements with investors, and bad faith during contract performance.³⁷ The standards of review in investment arbitration are less developed than in other areas of international law.³⁸ This is due to a number of reasons, including the recent dramatic increase in international investment arbitration and the varying backgrounds of arbitrators themselves.³⁹

Over the past decade, the ICSID has primarily discussed fair and equitable treatment as a measure for regulating a host country's duty to an investor.⁴⁰ Although the fair and equitable treatment standard is still evolving, it is well settled that the standard requires that the host country "act in a consistent manner, free from ambiguity and in total transparency, without arbitrariness and in accordance with the principle of good faith."⁴¹

The definition of the fair and equitable treatment standard evolves based on customary international law.⁴² International arbitral and judicial decisions have identified many themes that are applicable to fair and equitable treatment: "due process, arbitrary and/or discriminatory conduct, breach of legitimate expectations, acting beyond the scope of lawful authority and, to a lesser

³⁴ See Alvaro, *supra* note 30.

³⁵ Eduardo Garcia, *Ecuador Seeks to End Investment Protection Treaty with U.S.*, REUTERS (Mar. 12, 2013), <http://uk.reuters.com/article/2013/03/12/ecuador-us-treaty-idUKL1N0C401C20130312> (last visited Oct. 17, 2014).

³⁶ See Christoph Schreuer, *Fair and Equitable Treatment in Arbitral Practice*, 6 J. WORLD INV. & TRADE, 357, 380 (2005).

³⁷ See *id.*

³⁸ See Valentina Vadi & Lukasz Gruszczynski, *Standards of Review in International Investment Law and Arbitration: Multilevel Governance and the Commonwealth*, 16 J. INT'L ECON. L. 613, 615 (2013).

³⁹ See *id.* at 615, 616.

⁴⁰ See Peter Muchlinski, 'Caveat Investor'? *The Relevance of the Conduct of the Investor Under the Fair and Equitable Treatment Standard*, 55 INT'L & COMP. L.Q. 527, 527 (2006).

⁴¹ *Id.* at 530, (citing *Techmed v. Mexico*, ICSID Case No. ARB (AF)/00/2, Award, ¶¶ 154–155 (May 29, 2003)).

⁴² See Barnali Choudhury, *Evolution or Devolution? Defining Fair and Equitable Treatment in International Investment Law*, 6 J. WORLD INV. & TRADE 297, 319 (2005).

extent, the requirements of transparency and good faith.”⁴³ Proportionality is a recent addition to these principles that decisions have recognized as underlying the fair and equitable treatment standard.⁴⁴ In all cases, determination of whether a party has breached the standard depends on the specific circumstances of the case at issue.⁴⁵

B. The Parties’ Arguments and the Tribunal’s Findings

OEPC’s main contention in the arbitration was that the termination of the Participation Contract was made without legal grounds under both the Participation Contract itself and Ecuadorian Law.⁴⁶ OEPC first argued that Ecuador breached its obligations under the Bilateral Investment Treaty and international law by terminating the Participation Contract without legitimate cause.⁴⁷ Second, OEPC argued that, even assuming a termination event had happened, the *Caducidad* Decree would still be in breach of the BIT and Ecuadorian law because it was “unfair, arbitrary, discriminatory, and disproportionate.”⁴⁸

Ecuador, on the other hand, maintained that OEPC’s conduct constituted valid grounds for termination under Ecuadorian law because the terms of the contract identified transferal of rights without authorization from the Ministry as grounds for termination.⁴⁹ Ecuador further argued that the Ministry acted in an even-handed and rational manner throughout the two-year *Caducidad* investigation, fully complying with all obligations under the BIT, Ecuadorian law, and customary international law.⁵⁰ Ecuador also filed a counterclaim against OEPC based on malicious prosecution, breach of the Participation Contract clause regarding waiver of the right to use diplomatic or consular channels, destructive and unlawful conduct following the *Caducidad* Decree, and failure to pay the required assignment fee.⁵¹

The Tribunal found that the assignment of a 40 percent interest in Block 15 to AEC was a transfer of such rights and interests as prohibited in the Par-

⁴³ *See id.*

⁴⁴ *See* Occidental Petroleum Corp., Occidental Exploration and Prod. Co. v. Republic of Ecuador, ICSID Case No. ARB/06/11, Award, ¶ 404 (Oct. 5, 2012); Caroline Henckels, *Proportionality and the Standard of Review in Fair & Equitable Treatment Claims: Balancing Consistency & Stability with the Public Interest* 1, 2 (SOC’Y OF INT’L ECON. LAW, Working Paper No. 2012/27, 2012).

⁴⁵ Schreuer, *supra* note 36, at 364.

⁴⁶ Award, *Occidental Exploration and Prod. Co.*, ICSID Case No. ARB/06/11 ¶ 201.

⁴⁷ *Id.* ¶ 205.

⁴⁸ *Id.* ¶ 206.

⁴⁹ *Id.* ¶ 248.

⁵⁰ *Id.* ¶ 249.

⁵¹ *Id.* ¶ 283.

ticipation Contract in the absence of Ministry authorization.⁵² The Tribunal interpreted the language prohibiting the transfer or assignment of rights and obligations to include partial transfers or assignments, like OEPC's assignment to AEC, because the Participation Contract does not express the prohibition as being limited to total transfers or assignments.⁵³ In making this finding, the Tribunal noted that both the Participation Contract and Ecuador's Hydrocarbons Law require authorization by the Ministry for *all* forms of transfers or assignments.⁵⁴

The Tribunal also found that the OEPC failed to secure the required ministerial authorization and therefore breached the Participation Contract.⁵⁵ In making this finding, the Tribunal concluded that, with the assignment, OEPC prevented Ecuador "from exercising, in a formal way, its sovereign right to vet and approve AEC as the transferee of those rights and, even more importantly on the facts of the present case, to vet any other unknown investor to which AEC could eventually transfer its rights."⁵⁶ The Tribunal noted, however, that OEPC did not assign the rights to an unsuitable third party and Ecuador did not suffer any harm as a result of this transferal.⁵⁷ Because AEC was already active in Ecuador in 2000 and well-known to PetroEcuador, the Tribunal reasoned that, if OEPC had in fact sought ministerial consent, it most likely would have received it.⁵⁸ The Tribunal noted that OEPC's breach of the Participation Contract due to its failure to secure ministerial authorization, "while imprudent and ill advised, did not amount to bad faith."⁵⁹

The Tribunal then held that the *Caducidad* Decree was not a proportionate response to OEPC's breach of contract, finding it to be "a disproportionate sanction and a measure tantamount to expropriation of . . . [OEPC's] substantial investment in Ecuador."⁶⁰ The Tribunal found, therefore, that the Ecuadorian government issued the *Caducidad* Decree in breach of Ecuadorian law, customary international law, and Article II.3(a) of the BIT.⁶¹

The parties agreed that the constitutional principle of proportionality applies generally in Ecuadorian law.⁶² As evidence of customary international law, the Tribunal cited the growing body of jurisprudence on the principle of

⁵² *Id.* ¶ 307.

⁵³ *Id.* ¶ 305.

⁵⁴ *Id.* ¶ 306.

⁵⁵ *Id.* ¶ 381.

⁵⁶ *Id.* ¶ 679.

⁵⁷ *Id.* ¶ 447.

⁵⁸ *Id.* ¶¶ 682–83.

⁵⁹ *Id.* ¶ 384.

⁶⁰ *Id.* ¶ 681.

⁶¹ *Id.* ¶ 452.

⁶² *Id.* ¶ 397.

proportionality, most developed in Europe, requiring that administrative measures not be more drastic than necessary to achieve the required end.⁶³

Finally, the Tribunal found that a growing number of arbitrations, including ICSID cases, dealing with potential breaches of bilateral investment treaties have applied the principle of proportionality.⁶⁴ Article II.3(a) of the Bilateral Investment Treaty provides: “[i]nvestment 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 required by international law.”⁶⁵

Under the Participation Contract itself, the Minister was to exercise discretion in determining whether to issue the *Caducidad* Decree.⁶⁶ Thus, the Tribunal considered other alternatives available to the Minister, including insistence on payment of a transfer fee, improvements to the economic terms of the original settlement, or a negotiated settlement to address Ecuador’s concerns resulting from the breach.⁶⁷

This was also not the first arbitration between OEPC and Ecuador relating to the Participation Contract; in a previous arbitration, OEPC sued Ecuador for reversing its practice of reimbursing value-added tax (VAT) paid on purchases related to their investment activities.⁶⁸ In that proceeding, the Tribunal found that, in making changes to its tax law without providing clarity to its international investor, Ecuador had altered the legal and business environment in such a way as to consist of treatment that was not fair and equitable.⁶⁹

The Tribunal found, therefore, that Ecuador declared the *Caducidad* Decree as a result of numerous factors: OEPC’s failure to obtain the Minister’s consent in 2000 before the assignment to AEC, the publication of a prior VAT award in favor of OEPC, and social unrest directed against OEPC all contributed in a significant way.⁷⁰

⁶³ *Id.* ¶ 403.

⁶⁴ *Id.* ¶ 404 (citing *LG&E Energy Corp. and others v. The Argentine Republic*, ICSID Case No. ARB/02/1 (Oct. 3, 2006); *Azurix Corp. v. The Argentine Republic*, ICSID Case No. ARB/01/12 (July 14, 2006); *MTD Equity SDN.BHD. and other v. The Republic of Chile*, ICSID Case No. ARB/01/7 (May 25, 2004); *Tecmed S.A. v. The United Mexican States*, ICSID Case No. ARB (AF)/00/2 (May 29, 2003)).

⁶⁵ Treaty between the United States of America and the Republic of Ecuador concerning the Encouragement and Reciprocal Protection of Investment, U.S.-Ecuador, art. 2, Aug. 27, 1993, S. Treaty Doc. No. 103-15 (1997).

⁶⁶ Award, *Occidental Exploration and Prod. Co.*, ICSID Case No. ARB/06/11 ¶ 424.

⁶⁷ *Id.* ¶ 434.

⁶⁸ *Occidental Exploration and Production Co. v. Republic of Ecuador*, LCIA Case No. UN 3467, Award, ¶¶ 3–4, 26, 29 (July 1, 2004); Schreuer, *supra* note 36, at 378.

⁶⁹ Award, *Occidental Exploration and Prod. Co.*, LCIA Case No. UN 3467 ¶¶ 190–191; Schreuer, *supra* note 36, at 378.

⁷⁰ Award, *Occidental Exploration and Prod. Co.*, ICSID Case No. ARB/06/11 ¶¶ 683–685.

Considering other available remedies, the lack of harm suffered by Ecuador, and the intense political pressure that influenced the Minister's decision, the Tribunal concluded that the *Caducidad* Decree was not a proportionate response to OEPC's breach and was in violation the fair and equitable treatment standard.⁷¹

C. Calculation of Damages

After finding that Ecuador had violated this standard of fair and equitable treatment, the Tribunal awarded OEPC damages in the amount of \$1,769,625,000.⁷² In determining the damages, the Tribunal calculated the investment's fair market value, as mandated by Article III of the Bilateral Investment Treaty, and then reduced that number by a factor of 25 percent for OEPC's own breach of the Participation Contract.⁷³ Because the political backlash against OEPC after the announcement of the VAT award contributed to Ecuador's declaration of the *Caducidad* Decree, the Tribunal found that the breach by OEPC would reduce its award by only 25 percent, which represented the extent to which OEPC contributed to the damages it subsequently suffered under the *Caducidad* Decree.⁷⁴

Ecuador's Hydrocarbon Law governs investment under the Participation Contract and requires authorization by the Minister of Energy and Mines in the case of assignment.⁷⁵ The Tribunal found that no valid assignment occurred under Article 79 of Ecuador's Hydrocarbon Law, so, under the law, the "unauthorized transfer is null and void, that means that it does not exist . . . [and] does not produce legal effects."⁷⁶ OEPC therefore remained the 100 percent owner of all rights in the Participation Contract, and therefore could claim all of the damages awarded.⁷⁷

One Tribunal member, Professor Brigitte Stern, sharply dissented on the issue of damages, arguing that the 25 percent reduction of the award did not sufficiently account for OEPC's own bad act.⁷⁸ She noted that "with or without *caducidad*, with or without a declaration of nullity of the assignment of right by the majority, they were only entitled to receive 60 percent of the benefits of the Participation Contract."⁷⁹ The dissent also believed that the Tribu-

⁷¹ See *id.* ¶¶ 434, 445, 452, 684.

⁷² *Id.* ¶¶ 457, 825.

⁷³ *Id.* ¶¶ 707, 824–825.

⁷⁴ *Id.* ¶¶ 684, 687.

⁷⁵ *Id.* ¶ 618.

⁷⁶ *Id.* ¶ 636 (citing Hearing Transcript (Mar. 20, 2009) at 200, 201).

⁷⁷ *Id.* ¶ 634, 651.

⁷⁸ Occidental Petroleum Corp., Occidental Exploration and Production Co. v. Republic of Ecuador, ICSID Case No. ARB/06/11, Dissenting Opinion ¶ 7 (Oct. 5, 2012).

⁷⁹ *Id.* ¶ 161.

nal seriously underestimated the contribution by OEPC to the damage, given that OEPC's behavior deliberately risked *Caducidad*.⁸⁰

D. Scope of Proportionality and the Standard of Review

In the years before this case, the Tribunal had considered proportionality and the principles that define it.⁸¹ In 2003, the ICSID first applied the principle of proportionality in *Tecmed v. Mexico*.⁸² In *Tecmed*, the Tribunal considered the reasons that the host country did not renew an investor's contract to operate a landfill and whether the non-renewal was proportional given the harm suffered by the investor.⁸³ The Tribunal held that the host country had irrevocably destroyed all of the investor's operations by failing to renew its permit, and "means was disproportionate to end."⁸⁴ In applying proportionality, the ICSID Tribunal sought to separate good-faith regulatory measures focused on the public interest from retaliatory or fictitious measures.⁸⁵

The ICSID's application of the principle of proportionality, in *Tecmed* and in subsequent cases, reviews whether the regulatory investment measure is excessive and whether it constitutes expropriation of the opposing party's investment.⁸⁶ Tribunals primarily focus on the reasonableness of state conduct, determining whether the measure has a reasonable relationship to a rational policy.⁸⁷ Although most arbitral awards are silent as to how reasonableness has been interpreted, a few awards have suggested a balancing of the interests of the foreign investor and the host state.⁸⁸

III. ANALYSIS

The Tribunal's solidification of proportionality as a principle applicable to the fair and equitable treatment standard is a positive development insofar as it protects investors from arbitrary or discriminatory treatment.⁸⁹ Future Tribunals, however, must further develop the standard to provide host countries more protection because interpretation of the principle of proportionality

⁸⁰ *Id.* ¶ 7.

⁸¹ See Xiuli Han, *The Application of the Principle of Proportionality in Tecmed v. Mexico*, 6 CHINESE J. INT'L L. 635, 640 (2007).

⁸² *See id.*

⁸³ *See id.* at 641, 642.

⁸⁴ *See id.* at 642.

⁸⁵ *See id.*

⁸⁶ See Xiuli Han, *On the Application of the Principle of Proportionality in ICSID Arbitration and Proposals to Government of the People's Republic of China*, 13 JAMES COOK U. L. REV. 233, 243 (2006).

⁸⁷ See Roland Kläger, *Fair and Equitable Treatment: A Look at the Theoretical Underpinnings of Legitimacy and Fairness*, 11 J. WORLD INV. & TRADE 435, 442 (2010).

⁸⁸ *See id.*

⁸⁹ See Henckels, *supra* note 44, at 1; Han, *supra* note 81, at 642–43.

thus far has tipped the balance to provide investors much greater protection than host countries.⁹⁰ Additionally, in cases of breach of the proportionality principle, Tribunals will have difficulty awarding damages because they will need to consider how the investor's own bad act led to the disproportionate response and reduce the award by that amount.⁹¹ Finally, because the Tribunal's decision has shown a preference for investors over host countries, developing countries that depend on foreign investment will be wary of ICSID arbitration and bilateral investment treaties.⁹²

Fair and equitable treatment is a misunderstood term, primarily due to the lack of definition ascribed to the term in several trade treaties, most notably the North American Free Trade Agreement.⁹³ It has been argued that investors believe that fair and equitable treatment is a dynamic concept, with a definition that can develop and expand, while governments maintain that it is a fixed concept defined by its historical connotation.⁹⁴ Because the balance of protection has shifted to favor the investor with the expansion of the fair and equitable treatment standard to include the proportionality principle, governments should espouse the concept of an expanding fair and equitable treatment standard and push for heightened protection for states in the future.⁹⁵

This award illustrates the ICSID Tribunal's willingness to review administrative decisions of a sovereign under the principle of proportionality within the fair and equitable treatment standard.⁹⁶ As such, the Tribunal has demonstrated its commitment to using proportionality as the newest principle in the evolving definition of fair and equitable treatment.⁹⁷ Over the past decade, investment arbitration has faced considerable criticism, most notably the premise that investment arbitration does not in fact provide a level playing

⁹⁰ See Henckels, *supra* note 44, at 19; Choudhury, *supra* note 42, at 318.

⁹¹ See Occidental Petroleum Corp., Occidental Exploration and Production Co. v. Republic of Ecuador, ICSID Case No. ARB/06/11, Dissenting Opinion ¶ 1 (Oct. 5, 2012) (demonstrating the difficulty of awarding damages based on proportionality).

⁹² See Kate M. Supnik, *Making Amends: Amending the ICSID Convention to Reconcile Competing Interests in International Investment Law*, 59 DUKE L. J. 343, 355–57 (2009); Alvaro, *supra* note 30.

⁹³ See Choudhury, *supra* note 42, at 297.

⁹⁴ See *id.*

⁹⁵ See Han, *supra* note 81, at 649; Henckels, *supra* note 44, at 29. *But see* Choudhury, *supra* note 42, at 320.

⁹⁶ See Christian Leathley & Alejandro Garcia, *Record Award Against Ecuador Demonstrates Willingness of Tribunal to Review State Decisions on Ground of Proportionality*, HERBERT SMITH FREEHILLS DISPUTE RESOLUTION, ARBITRATION NOTES (Oct. 15, 2012), <http://hsf-arbitration.notes.com/2012/10/15/record-award-against-ecuador-demonstrates-willingness-of-tribunal-to-review-state-decisions-on-grounds-of-proportionality/> (last visited Oct. 17, 2014).

⁹⁷ See Occidental Petroleum Corp., Occidental Exploration and Production Co. v. Republic of Ecuador, ICSID Case No. ARB/06/11, Award, ¶ 404 (Oct. 5, 2012); Han, *supra* note 81, at 640; Leathley, *supra* note 96.

field, but is instead partial to protecting foreign investors.⁹⁸ Because proportionality analysis balances the investor's interests with competing public interests, the Tribunal should interpret the proportionality principle in the future to provide greater protection to host countries as well, which will result in a more level playing field.⁹⁹

The fair and equitable treatment standard requires an investor to deliver the reasonably anticipated benefits of the investment, and requires the host country to allow the investor a reasonable opportunity to profit on the investment.¹⁰⁰ The ICSID Tribunal must focus on the "bargain" between the investor and host country and decide whether both sides are keeping to this bargain.¹⁰¹ In order to better protect host countries, the Tribunal will need to determine whether the investor is working diligently enough to ensure the anticipated benefit.¹⁰²

On the issue of damages, this case highlights the complexity in determining damages when the award is based on proportionality.¹⁰³ As the dissenting arbitrator urged, there is difficulty in identifying contributory fault in practice and determining how much an investor contributed to the disproportionate response.¹⁰⁴ Some have argued that the subjective nature of the calculation, which "defies any mathematical precision," caused the great divergence in this case between the majority and the dissent.¹⁰⁵ Although a more detailed analysis of the reasoning behind the award might help, determination of allocation of fault is itself so subjective that it is hard to see what analysis the Tribunal could have offered to support the percentage of fault it allocated for each party.¹⁰⁶ The calculation of damages, especially on the issue of contributory fault by a breaching investor, will continue to be controversial, in this case and in the future.¹⁰⁷ Host countries will be reluctant to take action

⁹⁸ Born, *supra* note 22, at 842.

⁹⁹ See Henckels, *supra* note 44, at 29; Han, *supra* note 81, at 649; see also Supnik, *supra* note 92, at 366 (noting the ICSID's goal of creating a level playing field between investors and states).

¹⁰⁰ Muchlinski, *supra* note 40, at 556.

¹⁰¹ See *id.*

¹⁰² See *id.*

¹⁰³ See Dissenting Opinion, *Occidental Exploration and Prod. Co.*, ICSID Case No. ARB/06/11 ¶¶ 1, 7.

¹⁰⁴ See *id.* ¶¶ 1, 4; Borzu Sabahi & Kabir Duggal, Comment, *Occidental Petroleum v. Ecuador (2012): Observations on Proportionality, Assessment of Damages, and Contributory Fault*, 28 ICSID REV. 279, 289 (2013).

¹⁰⁵ See Sabahi & Duggal, *supra* note 104, at 289.

¹⁰⁶ See Award, *Occidental Exploration and Prod. Co.*, ICSID Case No. ARB/06/11 ¶¶ 686–687 (noting the difficulty in estimating percentages of contribution to the loss); Sabahi & Duggal, *supra* note 104, at 289.

¹⁰⁷ See Dissenting Opinion, *Occidental Exploration and Prod. Co.*, ICSID Case No. ARB/06/11 ¶ 1; Sabahi & Duggal, *supra* note 104, at 289, 290; Kenneth Stein, *Exxon-Venezuela Arbitration Dispute: Next Steps and Impact on Future Investor-State Disputes Under ICSID*, 4 J. WORLD ENERGY L. & BUS. 380, 389 (2011).

against breaching investors, given the potential for immense liability if the ICSID later rules the measure disproportionate to the breach.¹⁰⁸ In this way, the size of the award itself provides greater protection to investors.¹⁰⁹

Arbitrations between investors and host countries require balancing the private and public law concerns and “must avoid one-sided preferential treatment of investor rights.”¹¹⁰ There is a strong need for a proper balance between the protection of investors and the right of a state to regulate conduct within its borders.¹¹¹ It remains to be seen how the fair and equitable treatment standard will continue to develop in the future and what new element will be included in the standard.¹¹²

This expansion of the standard of fair and equitable treatment protects investors; however it must also continue to evolve to provide host countries adequate protections from investor conduct.¹¹³ Greater protection for host countries is absolutely necessary to maintain the legitimacy of the fair and equitable treatment standard and the voluntary submission of cases to the ICSID Tribunal.¹¹⁴ Otherwise, the preference for investors, coupled with the possibility of great liability under the ICSID arbitrations, may discourage states not only from enacting legitimate regulations, but also from engaging in bilateral investment treaties and ICSID arbitration.¹¹⁵

CONCLUSION

The goal of encouraging private investment in developing countries has led to an increasing number of bilateral investment treaties. The fair and equitable treatment standard is a basic premise of these bilateral investment treaties, and it has expanded over these years to encompass many principles, including most recently proportionality. Most of the principles under the standard heighten investor protection. This heightened investor protection, however, has led to increasing dissatisfaction among host countries. In addition, difficulty of determining the amount of damages in these cases will continue to

¹⁰⁸ See Tai-Heng Cheng & Lucas Bento, *ICSID's Largest Award in History: An Overview of Occidental Petroleum Corporation v The Republic of Ecuador*, KLUWER ARBITRATION BLOG (Dec. 19, 2012), <http://kluwerarbitrationblog.com/blog/2012/12/19/icsids-largest-award-in-history-an-overview-of-occidental-petroleum-corporation-v-the-republic-of-ecuador/> (last visited Oct. 17, 2014).

¹⁰⁹ See Muchlinski, *supra* note 40, at 527–28; Cheng & Bento, *supra* note 108.

¹¹⁰ See Ernst-Ulrich Petersmann, *International Rule of Law and Constitutional Justice in International Investment Law and Arbitration*, 16 IND. J. OF GLOBAL LEGAL STUD. 513, 532 (2009).

¹¹¹ See *id.* at 531 (citing *El Paso Energy Int'l v. Argentine Republic*, ICSID Case No. ARB/03/15 ¶ 70 (Apr. 27, 2006)).

¹¹² See Schreuer, *supra* note 36, at 386.

¹¹³ See Muchlinski, *supra* note 40, at 527–28, 530.

¹¹⁴ See Stein, *supra* note 107, at 389. *But see* Born, *supra* note 22, at 844.

¹¹⁵ See Supnik, *supra* note 92, at 373.

cause conflict. The Tribunal must provide more protections to host countries, which can be achieved through further interpretation of the principle of proportionality and through further scrutiny of the investor's economic benefit. If the Tribunal fails to provide more protection to host countries and to find a more systematic way of awarding damages, it will see increasing withdrawal of host countries from bilateral investment treaties and from the ICSID itself.