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**Doing Business in Latin America**  
***IBA Latin American Regional Forum***  
**October 2018**

# Ecuador

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# VII. Ecuador

## A. Foreign investment

### i. Legal regime of foreign investment in Ecuador

The legal regime of foreign investment in Ecuador comprises the following norms, guarantees and protections:

#### A. THE CONSTITUTION

The Constitution of the Republic of Ecuador (the 'Constitution'), which is the supreme law of Ecuador, contains several provisions that deal with different aspects of investment, both domestic and foreign:

- Article 277 of the Constitution provides that investment, and the development of economic activities in general, must be consistent with the concept of *sumak kawsay* (best translated as 'the good life' or 'good living'), which is an ancient indigenous concept that integrates living in harmony with the community, culture and nature;
- Articles 321 and 322 of the Constitution recognise and guarantee the right to property in all forms, including intellectual property;
- Article 339 of the Constitution provides that the state has the duty to promote private, domestic, foreign and public investment. With respect to foreign investment in particular, the provision indicates that it must strictly comply with the country's legal framework and regulations, that it is complementary to domestic investment, and that domestic investment will enjoy priority over foreign investment. This priority is mainly evidenced in public procurement laws and regulations; and
- finally, the Constitution allows for disputes with domestic and foreign investors to be decided in arbitration.

#### B. INTERNATIONAL TREATIES AND CONVENTIONS SIGNED BY ECUADOR

The Constitution states that international treaties and conventions that Ecuador is party to prevail over domestic laws but enjoy lesser hierarchy than the Constitution, except those treaties and conventions regarding human rights if they provide for more favourable rights to individuals.

Ecuador is a member of the WTO, which provides a general trade regulation framework worldwide. The WTO Treaty includes guarantees, such as national treatment, most favoured nation and market access.

Similar provisions are contained in the Andean Community of Nations (Comunidad Andina ('CAN')) Treaty, to which Ecuador is a member, along with Peru, Bolivia and Colombia.

Until mid-2017, Ecuador was also party to several international investment agreements or BITs that provided specific guarantees to foreign investors doing business in Ecuador, including protection

against expropriation and dispute resolution mechanisms. Although all of these agreements have been denounced by the Ecuadorian Government, some contain sunset clauses that are still in force and protect investments made before the treaties were terminated. The Ecuadorian Government is currently planning to negotiate new BITs to replace those that have been terminated.

Finally, Ecuador is also party to several international agreements to avoid double taxation. These treaties include the following foreign jurisdictions: Germany, Belgium, Brazil, Canada, Chile, Spain, France, Italy, Mexico, Romania, Switzerland, Uruguay, Singapore, Korea, China, and the CAN.

#### C. ORGANIC CODE OF PRODUCTION, COMMERCE AND INVESTMENTS

The Organic Code of Production, Commerce and Investment (Código Orgánico de la Producción, Comercio e Inversiones (COPCI)) and its implementing regulation are the main pieces of legislation on the subject of investment in Ecuador. There are other laws and regulations that address certain specific aspects of investment in certain specially regulated areas such as energy, oil and gas, mining, telecommunications, finance and banking, securities and insurance, among others.

The COPCI sets forth both general and specific rules, incentives, guarantees and protections for domestic and foreign investment in Ecuador, as explained in more detail below.

#### D. REGULATION OF THE PPP REGIME

In December 2015, a new law was issued to promote and give incentives for PPPs for public projects. The law created a committee within the Executive Branch in charge of these PPPs that is now in charge of overseeing these partnerships.

The PPP law regulates the participation of private investors in the performance of public contracts, including construction, maintenance and other productive activities in areas of public interest. In exchange, not only will the Ecuadorian Government pay the developer, but it will also offer additional incentives, such as tax exemptions (including a ten-year exemption from income tax), simplified administrative procedures and regulatory security, which means that changes in key current regulatory norms will not apply to the developer.

Also, private investors can take the initiative regarding these projects, which means they need not wait for the Ecuadorian Government to launch a particular project.

#### *ii. General guarantees and protection for foreign investments*

In general terms, the COPCI sets forth the following guarantees and protection for all investments, regardless of their origin, amount and destination:

##### A. NON-DISCRIMINATION

The COPCI guarantees equal footing (non-discriminatory treatment) to both foreign and domestic investors, and their investments with respect to the management, operation, expansion and transfer of their investments.

The investor has the right to control, use, convert to any currency, and transfer or send abroad any funds derived from or related to its investment. The investor does not have the obligation to keep such funds in Ecuador or convert them into national currency. Investments are not subject to any restriction other than taxes and deductions applicable under Ecuadorian law.

From a tax perspective, both national and foreign investments are subject to the same applicable regime, except in the case that the investor has signed an investment agreement as provided in the COPCI, which provides for the additional and specific protection of tax stability.

#### B. OWNERSHIP RIGHTS

The property of investors is protected in the terms set forth in the Constitution, the COPCI and other relevant laws.

Both the Constitution and COPCI prohibit all forms of confiscation. Additionally, expropriation is subject to adequate and prompt compensation (ie, payment of the price). The investor may challenge in the courts the price proposed by the state if unreasonable.

#### C. OTHER RIGHTS OF INVESTORS

In addition to the protections and guarantees outlined above, the COPCI recognises the following rights of investors:

- freedom of production, commercialisation and pricing of legal goods and services.
- access to administrative and control actions that the state establishes to avoid any disloyal competition practices;
- freedom of import and export of goods and services, in accordance with the international agreements to which Ecuador is a party;
- free transfer abroad of the periodical earnings or profits that come from registered private investment once tax, profit sharing and other obligations are complied with;
- freedom to send resources abroad that are obtained through total or partial liquidation of the companies in which the registered foreign investment was made, or through the sale of shares, participations or acquired rights in investments;
- freedom to acquire or transfer shares, participations or rights of ownership to third parties, within Ecuador or abroad;
- freedom of access to the national financial system and to the stock market, to obtain financial resources; and
- freedom of access to the mechanisms for technical cooperation and technological assistance.

#### *iii. Specific guarantees and protections for investments*

The COPCI allows investors to sign investment agreements with the state in certain special circumstances. Such agreements give the investor the specific protection of tax stability for the

duration of the agreement, generally up to 15 years, and are renewable. These agreements are generally reserved for investments in certain areas deemed as strategic (eg, minerals, forest resources and oil). Tax stability may be lost if the investor fails to comply with the requirements, amounts, commitments and deadlines set forth in the investment agreement.

#### *iv. Incentives for investors*

The COPCI sets forth both general and specific incentives for investors. General incentives are available to any new investment carried out in any part of the national territory. They include:

- the progressive reduction of three percentage points of corporate income tax;
- those established for special growth zones, provided they comply with the criteria for their formation;
- additional deductions for calculating corporate income tax as mechanisms to encourage the improvement of productivity, innovation, and eco-efficient production;
- the benefits for companies opening their capital for the benefit of its workers;
- special payment arrangements for taxes on foreign trade operations;
- deduction from the corporate income tax of the additional compensation mandated by Ecuadorian law;
- exemption from the currency transfer tax for operations with external financing;
- exemption, for five years, of anticipated income tax payments for all new investments; and
- reforms on the calculation of the anticipated income tax payment.

The specific incentive of total exemption of corporate income tax for a period of five years is available to new investments that fulfil the following criteria laid out in the COPCI and applicable tax law:

- the new investment must contribute to the change of the energy matrix, strategic substitution of imports, fostering of exports, rural development in all of the country and urban development in certain designated areas; and
- the new investment must be made outside urban jurisdictions of Quito or Guayaquil, and must be made in any of the following economic sectors, considered as a priority for the country: production of fresh, frozen and industrialised foods; forestry and agroforestry and related processed products; metalworking; petrochemicals; pharmaceuticals; tourism; renewable energies including bioenergy or energy from biomass; foreign trade logistics services; biotechnology and applied software; and the strategic sectors of import substitution and export promotion, as determined by the President of the Republic.

If the investment is made in an area defined by the Ecuadorian Government as an ‘economically depressed zone’, it will enjoy an additional tax benefit for a period of five years, of twice (an additional 100 per cent) the deductibility of payroll cost for new employees.

Further, public projects executed under the PPP regime give access to income tax exemptions for ten years, in addition to certain exemptions on tax on remittances abroad, customs duties and others.

*v. Special Economic Development Zones*

Special Economic Development Zones (Zonas Especiales de Desarrollo ('ZEDEs')) are special areas within the national territory, designated and duly authorised as such by the state, which allows them to enjoy a special customs and legal regime.

ZEDEs are generally located near larger cities. In their selection and authorisation, investors and the state generally consider conditions such as environmental preservation, location, access to road infrastructure, and existence of other basic and required infrastructure, including access to utility services and connectivity, among others.

The special legal regime that ZEDEs enjoy consists essentially of the exemption from taxes and tariffs on foreign goods entering these areas for specific authorised purposes, which mainly refer to technological development and innovation, industrial diversification and the development of logistical infrastructure and capabilities.

*vi. Dispute resolution*

Based on the principle of party autonomy, all persons and legal entities, public or private, can establish a method agreed between them to resolve their disputes, other than recourse to ordinary courts. Alternative dispute resolution, such as negotiation, mediation and arbitration, are procedures recognised by the Constitution.

Thus, if at the time of execution of the arbitration agreement the parties are domiciled in different states, or the issue being litigated relates to an international trade operation susceptible to settlement and not affecting or impairing the national or collective interest (as in the case of foreign investment), the parties may establish in their agreement that the arbitration will be international. These types of arbitrations, according to Article 42 of the Arbitration and Mediation Law (AML), shall be regulated by the appropriate treaties, conventions, and instruments signed and ratified by Ecuador.

Article 11 of the Organic Law for the Office of the Attorney General and Article 4 of the AML set forth that public sector entities may submit their disputes to arbitration, provided there is a prior signed arbitration agreement. If a dispute has already arisen when the arbitral agreement is being considered, then the authorisation of the Attorney General is required. This authorisation is also necessary to submit disputes to international arbitration.

The Organic Code of Planning and Public Finance also requires the authorisation of the Attorney General for agreements of submission to an outside jurisdiction and to foreign legislation for the settlement of disputes relating to contracts concluded by the state.

Additionally, Article 27 of the COPCI establishes that conflicts that arise from an investment may be resolved through arbitration, but the arbitration clause must be included in an investment contract.

The mandatory applicable law will be Ecuadorian law, and there is a mandatory mediation phase that needs to be exhausted before arbitration commences.

Finally, and as mentioned above, many of the BITs that were signed by Ecuador in the past (and which still protect investments already made even if the treaties have been denounced) include dispute resolution mechanisms, such as investor-state arbitration.

### *vii. Future changes*

As of June 2018, Ecuador's National Assembly has been discussing a new economic incentives bill that, if it ultimately becomes law, will create tax cuts for new private investments, pardon tax interests and penalties, and reform several laws that will promote and facilitate private investment in the coming years.

## **B. Public services**

### *i. General framework*

The Constitution sets forth the general framework for the provision of public services in Ecuador, which is developed through laws and regulations. This framework has as one of its main principles that enjoying public services of optimum quality is a right of all persons, who shall have the ability to freely select them (Article 52), and that services should make effective the principles of *sumak kawsay* and solidarity (Article 85).

More specifically, the Constitution establishes that the state is responsible for the provision of drinking and irrigation water, sanitation, electricity, telecommunications, roadways, ports and airports, and all other public services determined by the law (Article 314). The Constitution contemplates the possibility that the state may delegate the provision of public services to mixed-economy enterprises where it is the majority shareholder, or exceptionally, to the private sector (Article 316).

This rule, of exceptionally delegating public services to the private sector, is referenced in Article 100 of the COPCI, enacted in 2010. The COPCI establishes various specific delegation regimes for the provision of public services by the private sector, such as concessions, strategic alliances and other contractual modalities that are specific to the required public service delegation. Concessions are regulated through sector-specific norms and a heavily amended law from the 1990s (the 'Modernisation Law'). Strategic alliances between the Ecuadorian state and private entities are the subject to the aforementioned law on PPPs.

### *ii. Rules and limitations for the delegation of the rendering of public services to private parties*

During the 1990s, the need arose in Ecuador to carry out a process of privatisation and concession of public services in order to support the state in its obligations to carry out a number of functions for which it had limited capacity, and to allow Ecuadorians to have greater and more effective access to a series of public services. For this reason, the so-called 'Modernisation Law' was enacted in 1993. This law sought to facilitate the intervention of the private sector in the rendering of public services.



The current Constitution, which came into force in 2008, and the COPCI, enacted in 2010, brought significant changes to this general framework. As mentioned above, they establish the state as the default and main provider of public services, and allowed the exceptional delegation to the private sector. The privatisation of water and social security services is expressly forbidden in this new framework, although the concessions for water services that pre-existed the Constitution (eg, that for Guayaquil, the most populous city in the country) have been allowed to remain.

The changes brought forth by the 2008 Constitution and COPCI have not fully eliminated the legal framework for the rendering of public services that was established in the Modernisation Law. However, they have modified it significantly and put limits on its implementation, making its application more relevant when exceptional circumstances are present.

Aiming to define these ‘exceptional circumstances’ with some more specificity, the COPCI establishes that in order for the state to delegate the provision of public services to the private sector, the following conditions must be met:

- the delegation of the public service must be of public interest;
- the state should not have the technological and/or economic capacity to provide the service; and
- the demand for the public service cannot be met by the participation of public enterprises and/or mixed companies.

If these conditions are met, the state may delegate the rendering of the public service of electricity, and provision and management of roads, ports and airport infrastructure, railways, and others. As mentioned above, the COPCI allows for various modalities of delegation, such as concessions and strategic alliances, among others. This is also regulated in the law on PPPs. The delegation must follow the appropriate tender processes, although, in the case of foreign governmental entities, the delegation can be made directly, that is, without the need to follow these processes.

In practice, delegation is possible and continues to occur in a number of areas, although the possibility for private parties to participate in the rendering of public services can vary notably depending on the sector. Thus, for example, in the area of electricity, power plants may be operated by private companies, provided their generated power does not exceed 50 MW. In the area of telecommunications, the participation of the private sector has been more significant, as the majority of users are served by two large foreign-owned private concessionaires.

## **C. Real estate**

### *i. Constitutional framework for real estate*

The Constitution guarantees to all people the right to property in all its forms, including real property. Foreigners who are in Ecuadorian territory have the same rights and duties as Ecuadorians, with the limitations established in the Constitution. One of those limitations is that foreign individuals or legal entities may not acquire any title to land or any concessions in national security areas or protected areas established by law.

Notwithstanding the protection of property rights as a general rule, the Constitution provides that state institutions may declare the expropriation of property for reasons of public utility or social and national interest, subject to fair valuation, compensation and payment.

#### *ii. Legal framework for real estate*

The basic legal framework for real estate is in the Civil Code, which contains rules that apply to both urban and rustic properties, unless there are express exceptions. The lease of urban real estate is governed specifically by the Tenancy Act (*Ley de Inquilinato*). The Organic Code of Territorial Organisation, Autonomy and Decentralisation (*Código Orgánico de Ordenamiento Territorial, Autonomía y Descentralización (COOTAD)*) establishes the powers of municipal governments with regard to the regulation of urban organisation and development, construction of buildings, cadastre and valuation of properties, and the establishment of taxes on real property. Municipal ordinances regulate the different aspects of competence of municipalities in real estate. Horizontal property is regulated by the Horizontal Property Act (*Ley de Propiedad Horizontal*) and its regulations.

#### *iii. Registration system*

Real estate is subject to a public registration system, made up essentially by the land registries that exist in each municipal district. Each property has a numbered registration file, which contains information on boundaries and dimensions; ownership history; liens and rights over the property; divisions and mergers to which it has been subject; judicially ordered restrictions; and lease contracts, the survival of which is desired in the event of a transfer of ownership of the property (see below). All of these acts and contracts must be registered with the appropriate land registry.

#### *iv. Real estate development*

The establishment of standards for urban development and construction of the responsibility of the municipalities, and is implemented through ordinances. These ordinances determine, in detail, the requirements and technical specifications that developments and buildings must meet, as well as the procedures for approval of the plans and technical reports that are necessary for the granting of construction permits. Such requirements include approvals from the fire department and from the entities in charge of the public services of electricity, telephone, water supply and sewerage. These ordinances also regulate the subsequent process for granting authorisations for sale and occupation.

#### *v. Horizontal property regime*

The horizontal property regime is made up generally by the Horizontal Property Act and its regulations. Additionally, there are municipal ordinances applicable in the relevant constituencies, determining requirements for properties subject to the horizontal property regime.

The municipal declaration of submission of a property to the horizontal property regime, as well as the general plans establishing common and exclusive spaces, must be registered with the Land Registry.

The right of every owner over the value of common spaces is proportional to the value of the floor, apartment or space that he/she owns, which is his/her share of co-ownership. Each owner must

contribute in that proportion to the expenses necessary for management, maintenance and repair of the common property and the payment of the insurance premiums.

Co-owners should approve, by a vote of at least two-thirds, a set of rules according the General Rules of the Condominium Act, in which their mutual rights and obligations are established. This set of rules must be notarised and registered at the Land Registry.

The regulations must contain rules on the management and conservation of the common spaces; the functions corresponding to the Assembly of Co-Owners; the rights, duties and form of election of the administrator; the distribution of management fees among the co-owners; and all that concerns the interests of the co-owners and the maintenance of the building.

Each co-owner has a right to vote on the General Assembly equivalent to his/her share of ownership. Decisions of the General Assembly are taken by a majority of votes representing more than half of the votes held by those attending the General Assembly. However the following qualified majorities are required by law:

- 75 per cent of the votes of co-owners to allow a co-owner to carry out works that involve modifications of the resistant structure, or vertical or horizontal building additions;
- 60 per cent of the votes of co-owners to allow modifications to the facade, provided that they do not involve changes or affect the structure; and,
- two-thirds of the votes of those attending the respective meeting for the imposition of extraordinary burdens, the building of improvements, or the making of any material alterations affecting the enjoyment of the common areas.

The legal, judicial and extrajudicial representation of the condominium is exercised either individually or jointly by the President or the administrator.

#### *vi. Transfer of title or encumbrance of real property*

Contracts for the sale or encumbrance of real property must be performed by public deed authorised by a notary, and must be registered at the Land Registry. In the case of a transfer of title, it is only with the registration in the Land Registry that the transfer of title is perfected.

The transfer of property generates a tax known as *alcabala*, referred to in the COOTAD, and certain additional taxes established by special laws. The COOTAD also sets a tax on property value gains and the profit on the transfer of urban properties, which is ten per cent of the difference between the purchase price and the sale value, minus a deduction of five per cent of such difference for each year elapsed since the purchase (which means that this tax cannot be collected after 20 years have passed from the acquisition year).

#### *vii. Real estate leasing*

The lease of rustic properties is regulated by the Civil Code. The lease of urban properties is specifically regulated by the Tenancy Act, the Civil Code rules being supplementary.

The lease can be executed by private instrument; the law does not require the formality of the public deed before a notary. However, the lease must be registered with the corresponding department of the municipality, which has to set the maximum monthly lease payment (which cannot exceed the sum of: (1) one-twelfth of the ten per cent of the commercial value that the property has recorded in the municipal cadastre; and (2) the value of the municipal taxes imposed on urban property).

Automatic increases in the monthly rental fees for residential properties during the minimum term of the lease are not allowed, but this prohibition only applies when the monthly rental fee is less than two minimum wages (US\$708 as of June 2015). The term of the lease is binding on both parties, and the lessee has the right to a minimum period of two years. Non-payment of the rental fee for two months is a cause for the termination of the lease.

The transfer of ownership of a leased property terminates a lease, provided the tenant is given notice within one month of the registration of the transfer in the Land Registry. This provision does not apply to the case of leases concluded by public deed and registered at the Land Registry, which must be respected by the new owner of the property.

The tenant needs authorisation from the lessor to sublease the property. Subletting without such authorisation is cause for termination of the lease.

The Tenancy Act applies to leases of rural property only with respect to the competence and procedure for resolving disputes, and to a few discrete aspects relating to the state of the property.

## **D. Development of ample/integrated capital markets and joint activities between Latin American countries**

### *i. Merger of stock exchanges: attempts versus realities*

Ecuador has two stock exchanges: one in Quito and one in Guayaquil. Both were created as corporations in the late 1960s, and changed their corporate form to non-profit entities in the 1990s, as required by the Securities Market Law.

In May 2014, the Securities Market Law was amended to require stock exchanges to once again adopt the form of corporations. Even though this amendment may be seen to have presented an opportunity for stock exchanges to merge (corporations can merge while non-profit entities cannot), it is not a foreseeable scenario in the near future. In fact, when a proposed amendment to the Securities Market Law included the obligation for stock exchanges to merge, this proposal was opposed by the stock exchanges.

It is worth noting that after the Stock Exchange National Council ordered stock exchanges to adopt a single trading system in 2011, there has been one interconnected system. This technological requirement has resulted in common trading processes and rules for both stock exchanges.

### *ii. MILA market: current results and expectations*

There is no current process of adhesion of Ecuador's stock exchanges to the MILA integrated market. Moreover, it is not legally possible for local stock markets to be interconnected to international stock

markets. A reform to the law would be necessary in the case in which Ecuador wants to become part of MILA.

*iii. Pacific Alliance: governmental action and proposed treatment and agreements*

Recently, Ecuador has changed its position regarding the country's participation in the Pacific Alliance. A meeting recently took place where it was decided that Ecuador will no longer be an official observer, but instead will participate as an invitee. Ecuador's Foreign Commerce Ministry has stated that the country is seeking to become a member of the Pacific Alliance, for which it is necessary to strengthen relationships with all member states. Furthermore, Ecuador will begin negotiations with the US in order to reactivate a Commercial and Investment Treaty.

*iv. IPOs of multilatina companies in Latin American capital markets*

There have not been any IPOs of multilatina companies in Ecuador. However, in the last few years, multilatinas, such as Arca Continental, and other large companies, such as Lafarge, have conducted buy-outs of Ecuadorian companies through local exchanges, as required by local laws.





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