Arbitration - Ecuador

Principle of Equity Applied to *Inter-American Development Bank Case*

Contributed by **Coronel & Pérez**

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Background

In its first ruling dealing with international arbitration under the 2008 Constitution, the Constitutional Court has found that an *ex aequo et bono* arbitration (ie, an arbitration based on the principle of equity) agreed by the Ecuadorian government and the Inter-American Development Bank is permissible because it involves an agreement for foreign debt. According to the court, the requirement that arbitration agreements involving public entities must entrust the arbitrator with the power to rule on the dispute in accordance with the law does not apply when the state of Ecuador is acting in its international capacity. The court found that in such cases, the *ex aequo et bono* clause is warranted by the final paragraph of Article 422 of the Constitution.

As in the case of other Latin American countries, Ecuador's new constitution contains provisions dealing with the issue of arbitration. One such provision is Article 190 which provides that in public contracts "it is permissible to arbitrate in law, with the prior favourable opinion of the Attorney General's Office, in accordance to the conditions established in the law". Thus, the Constituent Assembly established a constitutional hierarchy similar to that established in the Arbitration and Mediation Act of 1996. In order for an arbitration to which a public entity is subject to be valid, the act stipulates that:

- the dispute must be contractual in nature;
- the Attorney General's Office must previously have issued a favourable opinion with regard to the arbitration agreement; and
- the arbitrators must be entrusted to solve the dispute according to the law, thus excluding the possibility of ruling on the dispute *ex aequo et bono*.

Facts

The government of Ecuador and the Inter-American Development Bank had negotiated a financial agreement which included an arbitration clause. The clause called for *ex aequo et bono* arbitration. As required by law, the minister of the economy asked the Attorney General's Office to give its legal opinion regarding the agreement. The attorney general objected to the arbitration clause based on Article 190 of the Constitution and asked the minister to negotiate a new clause in which the arbitrators were to rule in accordance with the law.

In light of this objection, the president of Ecuador's legal adviser requested the court to give its interpretation of the final paragraph of Article 422 of the Constitution, which states that:

"in the case of disputes on external debt, the State of Ecuador shall encourage arbitral solutions, taking into account the debt's origin and subject to the principles of transparency, equity and international justice".

In the request, the president's legal adviser reminded the court that the loan agreement with the Inter-American Development Bank:

"will be executed outside of Ecuador and that under Article 14 of the Civil Code persons that are outside of Ecuador will be subjected to Ecuadorian laws, when there will be acts the effects of which will be take place in Ecuador; and the rights and obligations that arise out of... family [relationships]... [I]t is clear therefore that [Article 14] is not applicable to the present case because the only two factual presuppositions considered

by the article... refer to the status of the persons' capacity and family relations."

The legal adviser underlined to the court that Article 422 allows for an exception "allowing arbitral solutions in equity" where the agreements involve external debt.

Constitutional Court Ruling

The court agreed with the president's legal adviser.(1) Although the court did not address the adviser's Civil Code argument, it held that contracts such as that between the Inter-American Development Bank and the government do not fall within the scope of Article 190 of the Constitution and therefore an arbitration clause *ex aequo et bono* is permissible. The court found that Article 190 applies only where Ecuador acts a public entity from an internal perspective. Where it acts as the subject of international rights and obligations, such as the ones arising out of contracts of foreign debt:

"*the applicable rules are those contained in Article 422 (final section), in concordance with the principles established in Articles 416(12), 289, 290 and 291 of the Constitution which embody the principles that public debt must follow."*

The court concluded from its reading of the final paragraph of Article 422 that Ecuador gives preference to arbitral solutions based on the principle of equity in foreign debt disputes. Such a reading allowed the court to overrule the opinion of the attorney general.

Comment

The ruling is highly questionable, not least because the court has not yet been established in accordance with the new Constitution. Its members were previously members of the old Constitutional Tribunal who appointed themselves as magistrates of the Constitutional Court in a highly controversial manner. In the absence of legislation that regulates their powers, these self-appointed magistrates issue what are known as 'transitional regulations'.

Furthermore, under the 2008 Constitution, the court lacks the authority to answer requests for opinions such as that submitted by the president's legal adviser in this case.

Finally, the court's reading of the final paragraph of Article 422 of the Constitution is misguided. The paragraph was drafted by the Constituent Assembly in order to facilitate the search for a global solution to the problem of debt in developing countries. That initiative was based, among other things, on an international arbitration settlement in response to claims by developing countries that their burden of external debt was unjustified on ethical and political grounds. Such matters are entirely unconnected to financing agreements involving institutions such as the Inter-American Development Bank and the agreement between the government and the bank should clearly have been deemed to fall within the scope of Article 190.

It is unclear whether this interpretation of Article 422 will change once the court begins to function in accordance with the 2008 Constitution, or will remain as a loophole created to meet the requirements of financial institutions such as the Inter-American Development Bank in moments in which they are short of cash. In any event, the ruling is surprising given the influence exerted by the Executive Branch over the courts and the critical attitude demonstrated by the president towards international arbitration and lending institutions in general over the last two years. It is also unclear why the government did not simply request the Inter-American Bank to change the arbitration clause. After all, an arbitration clause that entrusts the arbitrator to rule in law rather than in equity favours the creditor. Such a request may have removed the need for the court to issue a ruling which is incompatible with the Constitution.

For further information on this topic please contact Hernán Pérez Loose at Coronel & Pérez by telephone (+593 4 2519 900) or by fax (+593 4 2320 657) or by email (hperez@coronelyperez.com).

Endnotes

(1) Case 0005-09-IC.

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