Arbitration - Ecuador

Request for Annulment of ICSID Award Is Denied

Contributed by **Coronel & Pérez**

February 22 2007

Author

Hernán Pérez Loose

Background

On June 17 2004 Empresa Estatal Petróleos del Ecuador (PETROECUADOR), a corporation fully owned by the government of Ecuador, filed with the International Centre for Settlement of Investment Disputes (ICSID) Secretariat a request to annul an arbitral award dated February 20 2004 (ARB/01/10) rendered in arbitral proceedings to which PETROECUADOR and REPSOL YPF Ecuador SA were party.

The dispute between the parties arose when the government asked REPSOL to start negotiations to change the service contract under which it operated into a share-production agreement. However, in the process of liquidating the original contract, the parties disagreed over certain accounts. In the amended contract, the parties agreed to follow a procedure in order to resolve the pending dispute, which eventually involved the appointment of an expert. However, the disagreements continued and the matter was eventually brought to arbitration before the ICSID.

On February 20 2004 an ICSID tribunal, which included two Ecuadorian attorneys, ruled in favour of REPSOL. The tribunal ordered PETROECUADOR to pay over $13 million.

Nullity Proceedings

The main contention of PETROECUADOR before the *ad hoc* committee (Judd Kessler, Piero Bernardini and Gonzalo Biggs) was that the award was null and void because the tribunal had exceeded its powers under Article 52(b) of the International Convention for the Settlement of Investment Disputes between States and Nationals of Other States. According to PETROECUADOR, the tribunal exceeded its powers for the following reasons:

- The award was based on the fact that the dispute had arisen from the second contract; however, in PETROECUADOR's view, the dispute arose from the first contract;
- The tribunal had no competence to rule on the dispute since the controversy between the parties had already been settled by the National Hydrocarbons Board; according to PETROECUADOR, this ruling had the force of "administrative *res judicata*";
- Even if the dispute were to be settled under the second contract, the tribunal exceeded its powers when it ordered the payment of "an unliquidated debt", since certain parameters mentioned in the second contract for the liquidation of the debt were still undetermined;
- REPSOL did not have the proper authorization from the other member of the consortium to file the request for arbitration; and
- The tribunal did not apply the laws of Ecuador, in violation of Article 42(a) of the convention.

On the other hand, REPSOL urged the tribunal to dismiss the request for annulment on the following grounds:

- The original dispute concerned not which contract should apply, but rather PETROECUADOR's failure to pay despite its contractual commitment under the second contract;

- PETROECUADOR's allegation of lack of competence was already decided in the decision on jurisdiction of the original proceeding;

- The board's resolution was not subject to appeal because the dispute was contractual rather than administrative in nature - a characterization endorsed even by the attorney general;

- The amount due by PETROECUADOR was fixed in REPSOL's complaint and it would have been improper for the tribunal to review the liquidation of a debt that had been the subject of a prior and already settled dispute;

- REPSOL was fully authorized by the other member of the consortium to commence arbitration;

- The annulment of an award is a very restrictive proceeding which deals with the legitimacy of the award; therefore, the grounds for annulment must be interpreted narrowly. Moreover, nullity due to excess of powers must be self-evident (otherwise, the proceeding becomes an appeal); and

- Even if the tribunal had misapplied Ecuadorian law, this in itself did not constitute grounds for annulment under *Wena Hotels v Egypt*.(1)

Decision

In a decision handed down on January 8 2007, the *ad hoc* committee found unanimously for REPSOL. With regard to PETROECUADOR's contention that the tribunal had exceeded its powers, the committee held as follows:

- The exceeding of powers must be manifest in order to be valid grounds for annulment of an award. The exceeding of powers is generally considered to be manifest when it is evident from the reading of the award - that is, before examining the award's content in detail. On this issue, the committee relied on the *Wena* decision and the comments of Professor Schreuer.(2) The committee held that, from a first reading, the decision handed down by the tribunal in January 2003 was clear, convincing, well reasoned and free of contradictions. Moreover, the committee noted that the norms of the Ecuadorian legal system had been taken into consideration and applied by authoritative and experienced arbitrators, two of whom were of Ecuadorian nationality.

- Even assuming that the tribunal had wrongly applied the laws of Ecuador, under the ICSID system for the annulment of awards, mistakes in the application of the law - in contrast with a lack of application of the law - do not justify the annulment of an award under Article 42 of the convention. Previous decisions confirmed the relevance of this distinction in the context of annulment proceedings, keeping in mind that this type of proceeding must not be confused with an appeal, which is not available under Article 53 of the convention. The committee cited several decisions to support its conclusion.(3)

- Therefore, according to the committee, PETROECUADOR erred when stating that the tribunal had exceeded "its attributions because it had given an extensive interpretation to Ecuadorian norms, these legal rules which are part of [Ecuadorian] public law".

- Regardless of which contract (the first or the second) was at issue in the controversy, both parties had agreed to submit all controversies to ICSID arbitration. By virtue of this agreement, the jurisdiction of ICSID and the competence of the ICSID tribunal could not be challenged if - as in this case - all additional requirements under Article 25 of the convention have been met. Therefore, the jurisdiction of ICSID and the competence of the tribunal would not be discarded based on an objection that the matter of the dispute was related to an administrative act with the force of *res judicata*.

- The award resisted criticism under the concept of exceeding of powers. The tribunal did not rule on issues that were not brought to its attention, fail to rule on matters submitted by the parties or refuse to apply the law chosen by the parties.

The committee subsequently addressed PETROECUADOR's argument that the tribunal had exceeded its powers manifestly because it (i) ruled that the obligations of PETROECUADOR arose not from the first, but from the second contract, and (ii) did not

recognize the legal effects of a board decision which had not been challenged by REPSOL and which, according to PETROECUACOR, had the status of *res judicata*.

The committee found that the tribunal had not exceeded its powers on the grounds alleged by PETROECUADOR. The committee noted that there was ample evidence that the dispute arose after PETROECUADOR's refusal to comply with its obligation to pay the monies due after the liquidation of the first contract (an obligation that PETROECUADOR assumed expressly in the second contract). The committee acknowledged that the dispute between the parties arose during the execution of the first contract, but also stressed that the first contract was terminated on PETROECUADOR's own initiative and replaced by the second contract, which became the law of the parties. Even if this conclusion were erroneous, it would not constitute grounds for annulment of the award.

With regard to PETROECUADOR's contention that the decision of the board was *res judicata* and was thus immune from subsequent review, the committee held as follows:

- The decision of the board was adopted after the parties liquidated the first contract following agreed procedures.

- The powers of the board under the Hydrocarbons Law to review the liquidation of accounts after the expiration of oil contracts have certain limits imposed by the Constitution, other applicable laws and the circumstances of each case.

- The fact that PETROECUADOR and REPSOL had expressly agreed in the second contract to follow a particular procedure to liquidate the old accounts prevented the board - which was not a party to the contract - to modify the contractual arrangement unilaterally. The committee held that the sections of the award devoted to this issue revealed that the tribunal gave thorough consideration to the Hydrocarbons Law and related statutes. Moreover, according to the committee, a *prima facie* analysis of the award did not suggest that the tribunal had failed to apply Ecuadorian law to the dispute. The committee noted that it had no authority to annul an award on the basis of a "mere error in the application of the law, but only where the pertinent law had not been applied".

- PETROECUADOR raised no objection as to the validity of the procedure chosen by both parties to settle the disputed accounts - a procedure which included the binding opinion of an expert who was selected by both parties and who had received the approval of the attorney general. It was only at a later stage (when the expert rendered his opinion) that PETROECUADOR and the attorney general himself began to question the legality of the procedure and argue that the board (and not the expert) had the power to make such determination.

- The tribunal found that both parties eventually agreed to resolve the dispute through ICSID arbitration. This agreement to arbitrate rendered PETROECUADOR's argument (ie, that the tribunal was bound by the board's ruling and its alleged *res judicata* effect) futile.

The committee also dismissed PETROECUADOR's argument that the tribunal had exceeded its powers because REPSOL did not have the authority to represent the other companies of the consortium. The committee noted the lack of evidence to support this argument and the fact that the other companies of the consortium had ratified REPSOL's actions.

Moreover, the committee underlined that it is not an appeal tribunal and that the convention authorizes it to annul awards only where they contain manifest mistakes that may cast doubt on the legitimacy of the proceedings. It also observed that PETROECUADOR's arguments were in essence identical to those raised before the tribunal (which dealt with both jurisdiction and the merits of the case).

Finally, the committee reminded PETROECUADOR that the procedures to annul an award "should not be followed routinely or as mean to delay... the enforcement of an award". In light of PETROECUADOR's reluctance to pay the costs incurred during the proceedings, the committee ordered PETROECUADOR to pay the full amount of the costs, plus half of REPSOL's legal fees.

Comment

The ruling is a welcome development in the growing ICSID jurisprudence on the annulment of awards. As established by the convention, the annulment of an arbitral award must be an extraordinary decision made in exceptional circumstances. As stressed by the committee in this case, such proceedings are often confused with appeals. The ruling of the committee sends a strong message to losing parties that may consider the annulment procedure as another way to delay compliance with an adverse decision.

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) 41 ILM 933. 2002.

(2) "The ICSID Convention. A Commentary", 2001, page 933.

(3) *Klöckner v Cameroon*, ARB/81/2 ICSID Reports, Volume 2, 1994, page 95; *Amco v Indonesia*, ARB/81/1 ICSID Reports, Volume I, 1193, pages 515 and 516; *MINE v Republic of Guinea*, ARB/84/4.5 ICSID Review- FILJ 65 (1990).