

## Arbitration - Ecuador

### Tribunal dismisses \$56.1 million claim against Ecuador

Contributed by **Coronel & Pérez**

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#### Introduction

A United Nations Commission on International Trade Law (UNCITRAL) arbitration tribunal has rejected a \$56.1 million claim against the Republic of Ecuador under the US-Ecuador Bilateral Investment Treaty. The tribunal ordered the claimant to pay \$2 million in legal costs to the respondent. The underlying dispute arose within the framework of a licence for the generation of power which had been granted to the investor by a domestic regulatory agency. The tribunal found that the actions adopted by the agency during the performance of the agreement were not attributable to the state under international law because they lacked "governmental nature". The tribunal also rejected the investor's other claims, including expropriation and breach of fair and equitable treatment.

#### Background

Attracted by the new, rather liberal electricity framework and the business opportunities offered by the Ecuadorean power sector due to its recurrent shortages and lack of productivity, Ulysseas Inc, a US venture, imported and installed in Ecuador two power barges (PBI and PBII) in March/April 2003 and on April 16 2005, respectively. The installation of PBII was delayed by difficulties finding a viable mooring in Ecuador.

On August 15 2005 Ulysseas and the National Council for Electricity (Conelec), the Ecuadorean state agency empowered by law to regulate the sector, signed an agreement for the generation of electricity. A second agreement with the same purpose was signed on September 12 2006. The latter was amended on June 6 2007 to take into account the new location where Ulysseas had installed PBII. Under the PBII contract, Ulysseas had to generate electricity for 15 years from the date of signature.

Ulysseas never started power generation operations from PBII, even after an extension was granted on June 6 2007. Due to the high level of productivity of Ulysseas's installations, it was expected to do business primarily on the spot market. However, as this market began to work in a different fashion than was provided by the regulatory framework, the opportunities for a profitable operation faded. Ulysseas then turned to power purchase agreements (PPAs) in order to start its operations. During late 2007 and early 2008 Ulysseas entered into consultations and negotiations with the Ministry of Energy and CATEG (a distribution agency for the Guayaquil area which was fully owned by Conelec) for the signing of a PPA. These efforts proved fruitless, as the purchasers were willing to sign PPAs only in terms that Ulysseas found insufficient to recover all its expenses and to make a return on its investment.

In light of the negative business environment, Ulysseas did not start the generation of electricity as provided under the PBII contract. A notice of *force majeure* by Ulysseas was rejected by Conelec on the grounds that the agency was under no obligation to ensure Ulysseas a profitable operation. On April 23 2008 Ulysseas requested Conelec to agree to terminate the contract. The request was denied on September 12 2008, and Conelec imposed a fine on Ulysseas for failure to commence the production of electricity until that date.

Ulysseas took a series of actions to find a solution. It attempted to sell its assets to a state-owned power generator company and to negotiate once again a PPA with Conelec. On September 24 2009 Conelec informed Ulysseas that since it had not commenced electricity generation as provided by the contract, Conelec would assume operation of its assets temporarily through a delegate pursuant to Article 22 of the PBII contract. On October 8 2009 Conelec proceeded to take control of PBII by physically

Author

Hernán Pérez Loose



evicting the company's crew from the vessel.

PBII was handed back to Ulysseas on March 19 2010. Ulysseas claimed that serious damage had occurred to its vessel while it was operated by Conelec. After months of negotiations, Conelec terminated the PBII contract on March 17 2011, allowing Ulysseas to remove its vessel from Ecuador. By this time Ulysseas had already commenced international arbitration procedures under the US-Ecuador Bilateral Investment Treaty – the request for arbitration had been filed on May 8 2009. Ulysseas claimed, among other things, temporary expropriation of its investment and breach of the obligation to provide fair and equitable treatment, and demanded \$56.1 million in damages.

### **Tribunal award**

The arbitral tribunal found that the actions adopted by Conelec were not attributable to Ecuador under Article II(2)(b) of the treaty and Articles 4 and 5 of the International Law Commission (ILC) Articles of State Responsibility.<sup>(1)</sup> As a result, Ecuador was not liable to Ulysseas for the alleged damage that it had suffered during its business presence in Ecuador.

In the tribunal's opinion, the fact that Conelec was part of the Ecuadorian public sector and was subject to a system of state controls in light of the public interest in its activity did not make it an organ of the Ecuadorian state for the purpose of Article 4 of the ILC articles. Nonetheless, Conelec and other public entities may fall within the purview of Article 5 of the ILC articles and the treaty to the extent that governmental authority has been delegated to them, with the consequence that some of their acts can be attributed to the state provided they are "acting in that capacity in the particular instance".

The tribunal found that, with few exceptions, the conduct of Conelec and the other agencies involved in the energy sector lacked elements of governmental authority in their relation with Ulysseas. Relying on the ruling in *Jan de Nul v Egypt*,<sup>(2)</sup> which held that it is "not the public service element but the use of '*prérogatives de puissance publique*' or governmental authority" that matters for the purpose of attribution, the tribunal held that Conelec's actions within the PBII contract lacked that element. For the tribunal, the fact that the licence contract was an administrative rather than a private contract did not affect its conclusion. It underscored the facts that:

- the state was not party to the PBII contract; and
- Ulysseas's claims mostly related to contractual conduct in its dealing with Ulysseas, rather than acts done by Conelec outside the agreement under governmental authority.

To the extent that such acts were performed outside the scope of the licence contract, Conelec's conduct was attributable to the state according to Article 5 of the ILC articles and Article II(2)(b) of the treaty. The tribunal then examined the various acts adopted by Conelec and other agencies, and found that they were not attributable to the state inasmuch as they were executed as part of their regulatory powers.

The tribunal rejected Ulysseas's claim that the taking of its vessel by Conelec and the temporary administration by a delegate amounted to a temporary expropriation. According to the tribunal, Conelec exercised the power given to it under Ecuadorean law and the licence contract in the presence of a breach by Ulysseas of its contractual obligation to generate electricity for 15 years. The tribunal also dismissed Ulysseas's claim that the modifications introduced in the regulatory framework by Conelec since its vessels arrived in Ecuador and the PBII was signed frustrated its legitimate expectations, and therefore violated the fair and equitable clause of the treaty. While acknowledging that some tribunals have made the stability of the legal framework a key element of the investor's legitimate expectations, and thus of the fair and equitable standard, the tribunal took the narrower view and regarded changes in domestic laws and regulations as a legitimate exercise of state power.

In dismissing Ulysseas's claim the tribunal directed the parties to pay half of the cost of the arbitration proceeding each. As to the representation and assistance costs, it held that in view of the reasonableness of Ecuador's expenses (\$2 million), Ulysseas should pay that amount.

### **Comment**

The tribunal's finding that Conelec and the other agencies' actions involved in Ulysseas's investment were not attributable to the state was critical for the outcome. Its view that Conelec's conduct was purely of a contractual nature and therefore did not reach the level of governmental authority, despite the fact that the licence contract was an administrative contract, is somewhat puzzling. Under Ecuadorean administrative law, administrative contracts are distinguished from commercial contracts purely by the presence of such authority in favour of the contracting agency. Courts and commentators alike have widely endorsed such a rule. In addition, under Article 4(2) of the ILC articles, as well as the *Jan de Nul* ruling, domestic law must be considered in

order to determine whether an entity is a state organ for the purpose of attribution.

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

#### Endnotes

(1) *Ulysseas, Inc v Republic of Ecuador* (Prof Piero Bernardini (presiding arbitrator), Prof Michael Pryles and Prof Brigitte Stern), June 12 2012, Permanent Court of Arbitration.

(2) *Jan de Nul NV and Dredging International NV v Arab Republic of Egypt*, award, the International Centre for Settlement of Investment Disputes Case No ARB/04/13.

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