

**INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT  
DISPUTES**

WASHINGTON, D.C.

In the annulment proceeding between

**OCCIDENTAL PETROLEUM CORPORATION  
OCCIDENTAL EXPLORATION AND PRODUCTION COMPANY**

**-and-**

**THE REPUBLIC OF ECUADOR**

(ICSID Case No. ARB/06/11)

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**DECISION ON ANNULMENT OF THE AWARD**

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Mr. Rodrigo Oreamuno B., Member of the Committee

*Secretary of the Committee*

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*Date of dispatch to the parties: November 2, 2015*

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**LIST OF DEFINED TERMS**

<b>AEC</b>	City Investing Company Limited, a Bermuda company, or its mother company Alberta Energy Corporation Ltd., a Canadian company.
<b>Andes</b>	Andes Petroleum Co.
<b>Application</b>	Application for annulment of the Award dated October 9, 2012.
<b>Arbitrability Objection</b>	Ecuador's jurisdictional objection as defined in para. 71 <i>infra</i> .
<b>Award</b>	<i>Occidental Petroleum Corporation and Occidental Exploration and Production Company v. The Republic of Ecuador</i> , ICSID Case No. ARB/06/11, Award, October 5, 2012.
<b>BIT/ US-Ecuador BIT/ Treaty</b>	Treaty between the United States of America and the Republic of Ecuador Concerning the Encouragement and Reciprocal Protection of Investments signed on August 27, 1993.
<b>C I</b>	Claimants' Counter-Memorial on Annulment, October 18, 2013.
<b>C II</b>	Claimants' Rejoinder on Annulment, February 28, 2014.
<b>Caducidad Decree</b>	Decree issued by the Ecuadorian Minister of Energy and Mines on May 15, 2006, which terminated the Participation Contract.
<b>CE</b>	Ecuadorian Constitution of 1998.
<b>Civil Code</b>	Ecuadorian Civil Code, Official Registry Supplement 46 dated June 24, 2005.
<b>Claimants</b>	OEPC and OPC.
<b>DCF</b>	Discounted cash flow.
<b>Decision on Jurisdiction</b>	<i>Occidental Petroleum Corporation and Occidental Exploration and Production Company v. The Republic of Ecuador</i> , ICSID Case No. ARB/06/11, Decision on Jurisdiction, September 9, 2008.
<b>Dissent</b>	<i>Occidental Petroleum Corporation and Occidental Exploration and Production Company v. The Republic of</i>

*Ecuador*, ICSID Case No. ARB/06/11, Dissenting Opinion by Prof. Brigitte Stern, October 5, 2012.

<b>DNH</b>	Ecuador's National Hydrocarbons Directorate.
<b>Ecuador / Republic/ Respondent</b>	The Republic of Ecuador.
<b>Farmout Agreement/ Farmout</b>	Agreement signed on October 19, 2000 between OEPC and AEC.
<b>Farmout Agreements</b>	The Farmout Agreement together with the Joint Operating Agreement.
<b>Farmout Property</b>	Wide concept as defined in Clause 1.01 of the Farmout Agreement, see para. 194 <i>infra</i> .
<b>February Email</b>	Email from the President of the Tribunal to the Parties, dated February 15, 2011.
<b>FET</b>	Fair and equitable treatment.
<b>FMV</b>	Fair market value.
<b>HCL</b>	Ecuadorian Hydrocarbons Law.
<b>HT</b>	English Transcript of the Hearing held in Paris on April 7-10, 2014.
<b>ICSID</b>	International Centre for Settlement of Investment Disputes.
<b>ICSID Convention</b>	Convention on the Settlement of Investment Disputes between States and Nationals of Other States.
<b>ICSID Arbitration Rules</b>	ICSID Rules of Procedure for Arbitration Proceedings of April 2006.
<b>Inadmissibility Objection</b>	Ecuador's jurisdictional objection as defined in para. 106 <i>infra</i> .
<b>Joint Operating Agreement</b>	Agreement signed by OEPC and AEC in order to implement the Farmout Agreement.
<b>Jurisdictional Objection</b>	Ecuador's jurisdictional objection as defined in para. 70 <i>infra</i> .
<b>Negotiation Objection</b>	Ecuador's jurisdictional objection as defined in para. 119 <i>infra</i> .

<b>Law 42</b>	Law modifying the HCL, enacted by the Ecuadorian Congress on April 19, 2006 and published in the Official Gazette on April 25, 2006.
<b>Letter Agreement</b>	Letter Agreement executed between Andes and OEPC on February 22, 2006.
<b>Minister</b>	Ecuadorian Minister of Energy and Mines.
<b>OEPC</b>	Occidental Exploration and Production Company.
<b>OPC</b>	Occidental Petroleum Corporation.
<b>Participating Agreements</b>	The Participation Contract together with the Unit Operating Agreements for the Eden-Yuturi Unitized Field and the Limoncocha Unitized Field.
<b>Participation Contract</b>	Contract dated May 21, 1999 between OEPC and PetroEcuador for the exploration and exploitation of hydrocarbons in Block 15 in the Ecuadorian Amazon.
<b>PCIJ</b>	Permanent Court of International Justice.
<b>PetroEcuador</b>	Ecuador's national oil company and successor to "Corporación Estatal Petrolera Ecuatoriana", today, "Empresa Pública de Hidrocarburos del Ecuador".
<b>R I</b>	Ecuador's Memorial on Annulment, August 12, 2013.
<b>R II</b>	Ecuador's Reply on Annulment, January 6, 2014.
<b>R III</b>	Ecuador's Opening Statement at the Hearing on Annulment, April 7, 2014.
<b>Reply on Jurisdiction</b>	Respondent's submission dated April 23, 2008.
<b>Request for Arbitration</b>	Request for arbitration filed by Claimants on May 17, 2006.
<b>Standing Objection</b>	Ecuador's jurisdictional objection as defined in para. 86 <i>et seq infra</i> .
<b>State Participation</b>	Income for the State related to the exploration and exploitation of crude deposits called the "participación del Estado en los excedentes de los precios de venta de petróleo" created by Law 42.
<b>VAT</b>	Value Added Tax.
<b>VAT Arbitration</b>	<i>Occidental Exploration and Production Company v. The Republic of Ecuador</i> , LCIA Case No. UN3467.

<b>VAT Award</b>	<i>Occidental Exploration and Production Company v. The Republic of Ecuador</i> , LCIA Case No. UN3467, Award, July 1, 2004.
<b>VAT Interpretative Law</b>	Interpretative Law relating to article 69-A (72) of the Internal Tax Regime Act (Law No. 2004-41) passed by the Ecuadorian Congress on August 2, 2004.
<b>VCLT</b>	Vienna Convention on Law of Treaties concluded on May 23, 1969.



**LIST OF CITED CASE LAW**

- AES*** *AES Summit Generation Limited and AES-Tisza Erömu Kft v. The Republic of Hungary*, ICSID Case No. ARB/07/22, Decision of the *ad hoc* Committee on the Application for Annulment, June 29, 2012.
- Amco II*** *Amco Asia Corporation and others v. Republic of Indonesia* ICSID Case No. ARB/81/1, Decision on Annulment, December 3, 1992.
- Alemanni*** *Giovanni Alemanni and others v. Argentine Republic*, ICSID Case No. ARB/07/8, Decision on Jurisdiction and Admissibility, 17 November 2014
- Azurix*** *Azurix Corp. v. The Argentine Republic*, ICSID Case No. ARB/01/12, Award, July 14, 2006.
- Azurix (Annulment)*** *Azurix Corp. v. The Argentine Republic*, ICSID Case No. ARB/01/12, Decision on the Application for Annulment of the Argentine Republic, September 1, 2009.
- Binder-Haas Claim*** *Binder-Haas Claim*, United States International Claims Commission (1951-1954), reprinted in I.L.R. 236-38 (1957).
- Caratube*** *Caratube International Oil Company LLP v. Republic of Kazakhstan*, ICISD Case No. ARB/08/12, Decision on the Annulment Application of Caratube International Oil Company LLP, February 21, 2014.
- Chorzów Factory*** *Case concerning the Factory at Chorzów (Claim for Indemnity) (Merits)*, P.C.I.J. Series A, No. 17 (Judgement of 13 September 1928).
- CMS*** *CMS Gas Transmission Company v. The Argentine Republic*, ICSID Case No. ARB/01/8, Decision on Annulment, September 25, 2007.
- Duke Energy*** *Duke Energy International Peru Investments No. 1, Limited v. Republic of Peru*, ICSID Case No. ARB/03/28, Decision of the Ad Hoc Committee, March 1, 2011.
- Enron*** *Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic*, ICSID Case No. ARB/01/3, Decision on the Application for Annulment of the Argentine Republic, July 30, 2010.

<b><i>Ethyl</i></b>	<i>Ethyl Corporation v. The Government of Canada</i> , Award on Jurisdiction, June 24, 1998.
<b><i>Fraport</i></b>	<i>Fraport AG Frankfurt Airport Services Worldwide v. The Republic of the Philippines</i> , ICSID Case No. ARB/03/25, Decision on the Application for Annulment of Fraport AG Frankfurt Airport Services Worldwide, December 23, 2010.
<b><i>Goetz</i></b>	<i>Goetz and others v. Burundi</i> , ICSID Case No. ARB/95/3, Award, February 10, 1999.
<b><i>Helnan</i></b>	<i>Helnan International Hotels A/S v. Egypt</i> , ICSID Case No. ARB/05/19, Decision of the ad hoc Committee, June 14, 2010.
<b><i>IBM (Jurisdiction Decision)</i></b>	<i>IBM World Trade Corp. v. Republic of Ecuador</i> , ICSID Case No. ARB/02/10, Decision on Jurisdiction and Competence, December 22, 2003.
<b><i>Impregilo v. Argentina</i></b>	<i>Impregilo S.p.A. v. Argentine Republic</i> , ICSID Case No. ARB/07/17, Decision of the ad hoc Committee on the Application for Annulment, January 24, 2014.
<b><i>Impregilo v. Pakistan</i></b>	<i>Impregilo S.p.A. v. Islamic Republic of Pakistan</i> , ICSID Case No. ARB/03/3, Decision on Jurisdiction, April 22, 2005.
<b><i>Indalsa</i></b>	<i>Industria Nacional de Alimentos S.A. and Indalsa Perú S.A. v. The Republic of Peru</i> , ICSID Case No. ARB/03/4, Decision on Annulment, September 5, 2007.
<b><i>Klöckner I</i></b>	<i>Klöckner Industrie-Anlagen GmbH and others v. United Republic of Cameroon and Société Camerounaise des Engrais</i> ICSID Case No. ARB/81/2, Decision on the Application for Annulment submitted by Klöckner against the Arbitral Award rendered on 21 October 1983, May 3, 1985.
<b><i>Lauder</i></b>	<i>Ronald S. Lauder v. The Czech Republic</i> , Final Award September 3, 2001.
<b><i>Lesi</i></b>	<i>Consorzio Groupement L.E.S.I. DIPENTA v. People's Democratic Republic of Algeria</i> , ICSID Case No. ARB/03708, Award, January 10, 2005.
<b><i>Lucchetti</i></b>	<i>Empresas Lucchetti, S.A. and Lucchetti Peru, S.A. v. The Republic of Peru</i> , ICSID Case No. ARB/03/4, Decision on Annulment, September 5, 2007.

<b>Malaysian Historical Salvors</b>	<i>Malaysian Historical Salvors Sdn, Bhd v. The Government of Malaysia</i> , ICSID Case No. ARB/05/10, Decision on the Application for Annulment, April 16, 2009.
<b>Malicorp</b>	<i>Malicorp Limited v. The Arab Republic of Egypt</i> , ICSID Case No. ARB/08/18, Decision on the Application for Annulment of Malicorp Limited, July 3, 2013.
<b>MCI</b>	<i>M.C.I. Power Group L.C. and New Turbine, Inc. v. Republic of Ecuador</i> , ICSID Case No. ARB/03/6, Decision on the Application for Annulment, October 19, 2009.
<b>Mihaly</b>	<i>Mihaly International Corporation v. Sri Lanka</i> , ICSID Case No. ARB/00/2, Award, March 15, 2002.
<b>MINE</b>	<i>Maritime International Nominees Establishment (MINE) v. Government of Guinea</i> , ICSID Case No. ARB/84/4, Decision on the Application by Guinea for Partial Annulment of the Arbitral Award dated January 6, 1988, December 14, 1989.
<b>MTD</b>	<i>MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile</i> , ICSID Case No. ARB/01/7, Award, May 25, 2004.
<b>Polish Nationals in Danzig</b>	<i>Treatment of Polish Nationals and Other Persons of Polish Origin or Speech in the Danzig Territory</i> , Advisory Opinion, (1932) PCIJ Series A/B no 44, ICGJ 291 (PCIJ 1932), February 4, 1932, Permanent Court of International Justice (historical) [PCIJ].
<b>PSEG</b>	<i>PSEG Global Inc. and Konya Ilgin v. Republic of Turkey</i> , ICSID Case No. ARB/02/5, Award, January 19, 2007.
<b>PSEG (Decision on Jurisdiction)</b>	<i>PSEG Global Inc. and Konya Ilgin v. Republic of Turkey</i> , ICSID Case No. ARB/02/5, Decision on Jurisdiction, June 4, 2004.
<b>RFCC</b>	<i>Consortium R.F.C.C v. Kingdom of Morocco</i> , ICSID Case No. ARB/00/6, Decision on Annulment, January 18, 2006.
<b>Rumeli</b>	<i>Rumeli Telekom A.S. and Telsim Mobil Telekomunikasyon Hizmetleri A.S. v. Republic of Kazakhstan</i> , ICSID Case No. ARB/05/16, Decision of the ad hoc Committee, March 25, 2010.
<b>Sempra</b>	<i>Sempra Energy International v. The Argentine Republic</i> , ICSID Case No. ARB/02/16, Decision on the Argentine Republic's Application for Annulment of the Award, June 29, 2010.

- SGS** *SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/01/13, Decision of the Tribunal on Objections to Jurisdiction, August 6, 2003.
- Soufraki** *Hussein Nuaman Soufraki v. The United Arab Emirates*, ICSID Case No. ARB/02/7, Decision of the ad hoc Committee on the Application for Annulment of Mr. Soufraki, June 5, 2007.
- Tecmed** *Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States*, ICSID Case No. ARB (AF)/00/2, Award, May 29, 2003.
- Teinver** *Teinver S.A., Transportes de Cercanías S.A. and Autobuses Urbanos del Sur S.A. v. Argentine Republic*, ICSID Case No. ARB/09/1, Decision on Jurisdiction, December 21, 2012
- Tza Yap Shum** *Tza Yap Shum v. The Republic of Peru*, ICSID Case No. ARB/07/6, Decision on Annulment, February 12, 2015.
- Víctor Pey Casado** *Víctor Pey Casado y Fundación “President Allende” v. República de Chile*, ICSID Case No. ARB/98/2, Decision on the Application for Annulment of the Republic of Chile, December 18, 2012.
- Vivendi I** *Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic*, ICSID Case No. ARB/97/3, Decision on Annulment, July 3, 2002.
- Vivendi II** *Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic*, ICSID Case No. ARB/97/3, Decision on the Argentine Republic’s Request for Annulment of the Award rendered on 20 August 2007, August 10, 2010.
- Wena** *Wena Hotels Limited v. Arab Republic of Egypt*, ICSID Case No. ARB/98/4, Decision of the *ad hoc* Committee on an application for the annulment of the Arbitral Award of 8 December 2000, February 5, 2002.

## I. THE ARBITRATION

### 1. SUMMARY OF THE DISPUTE

1. The Parties to the underlying arbitration were Occidental Petroleum Corporation (“**OPC**”) and Occidental Exploration and Production Company (“**OEPC**”) two U.S. companies, acting as Claimants (the “**Claimants**”), and the Republic of Ecuador (“**Ecuador**” or the “**Republic**”), as Respondent.
2. The dispute concerned the termination through the “**Caducidad Decree**”, issued by the Ecuadorian Minister of Energy and Mines (the “**Minister**”) on May 15, 2006, of a Participation Contract dated May 21, 1999 between OEPC and PetroEcuador for the exploration and exploitation of hydrocarbons in Block 15 in the Ecuadorian Amazon. Claimants alleged breaches by Ecuador of domestic and international law, especially of the 1993 Treaty between the United States of America and the Republic of Ecuador Concerning the Encouragement and Reciprocal Protection of Investments (the “**Treaty**”, the “**BIT**” or “**US – Ecuador BIT**”).
3. Respondent denied Claimants’ allegations of breach and formulated a counterclaim, asking the Tribunal to declare that it had fulfilled its obligations under the Participation Contract, Ecuadorian Law and the Treaty, and to dismiss all of Claimants’ claims.
4. Before summarizing the arbitration procedure and in order to ensure a proper context for its Decision, the Committee has prepared a brief summary of the facts that gave rise to the underlying dispute.

### 2. FACTUAL BACKGROUND

#### The Participation Contract

5. The Republic of Ecuador, through PetroEcuador, and OEPC entered into a Participation Contract for Block 15<sup>1</sup> in Ecuador on May 21, 1999 (the “**Participation Contract**”).
6. Under the Participation Contract, which was subject to Ecuadorian Law, OEPC received a share of the oil produced from Block 15, in return for undertaking the obligation to explore, develop and exploit Block 15, and assuming responsibility for all associated expenditures<sup>2</sup>:

“116. The Participation Contract, which expressly stated that it was to be “governed exclusively by Ecuadorian law,” transformed the conditions under which OEPC operated in Ecuador. Pursuant to Clause 4.2 of the Participation Contract, OEPC would no longer be reimbursed for its expenditures in exploring and producing Block 15. In return for accepting the obligation to explore, develop and exploit Block 15, and being responsible for all the associated expenditures, OEPC received a share of the oil produced from Block 15, referred to as OEPC’s “participation”. Clause 4.3 provided that

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<sup>1</sup> An area of approximately 200,000 hectares in Ecuador’s most prolific oil-producing region.

<sup>2</sup> Award at 116.

“Contractor shall invest capital and use the personnel, equipment, machinery and technology needed for the faithful performance of such activities in consideration of which Contractor shall receive, as participation, the percentage of Fiscalized Production provided for in Clause 8.1.” OEPC also had various other obligations under the Participation Contract, including payment of all Ecuadorian taxes and duties; periodic reporting of certain information to Ecuador; the establishment of good relations with the community; and the protection of the environment”.

7. Although, OEPC was free to dispose of its share of the Participation Contract, the transfer of such Contract and the assignment to third parties of rights arising thereunder required authorization from the Minister. The Participation Contract also provided that the transfer of rights or obligations without authorization of the Minister could result in termination of that Contract. The Tribunal explained these facts as follows<sup>3</sup>:

“119. The Tribunal notes, since this provision will be referred to later in the present Award, that OEPC was allowed to dispose freely of its share of the production from Block 15 as it wished. Under Clause 5.3.2, OEPC had the right to “[r]eceive and freely dispose of Contractor participation as established in Clause 8.1 of this Participation Contract”. While OEPC could freely dispose of its participation, its ability to transfer or assign its rights and obligations under the Participation Contract was subject to stringent conditions. Chapter 16 of the Participation Contract, entitled “Transfer and Assignment”, sets forth these conditions in provisions which are at the heart of the parties’ dispute in this arbitration”.

#### The Farmout Agreements

8. In 2000 OEPC and City Investing Company Limited (“AEC”), a Bermuda company, explored the possibility of a “farm-in” transaction over Block 15<sup>4</sup>:

“127. In order to finance the expansion of its operations in Ecuador, OEPC sought an arrangement that could provide the necessary funds, as well as diversify and reduce its exposure. At the same time, Alberta Energy Corporation Ltd. (“AEC”) [...] was looking to expand its investments in Ecuador. AEC had originally considered purchasing outright Block 15 from OEPC in 1999, together with two unrelated companies, City Investing and City Oriente, which operated blocks to the north of Block 15. However, while it did purchase the City companies that year, it did not approach OEPC about a purchase of Block 15 until 2000. On 15 May 2000, AEC made a formal proposal to OEPC to acquire OEPC’s entire interest in Block 15. OEPC rejected AEC’s proposal.

128. AEC then proposed to “farm-in” to Block 15. OEPC stated to the Tribunal that a farmout agreement with AEC was an attractive alternative because it allowed OEPC to continue to invest in Block 15 but with less of its own capital and to diversify its in-country risk. (...)”.

9. In October 2000, OEPC and AEC executed the Farmout Agreement (the “**Farmout Agreement**” or “**Farmout**”). The parties also signed a joint operating agreement

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<sup>3</sup> Award at 119.

<sup>4</sup> Award at 127-128.

in order to implement the Farmout (the “**Joint Operating Agreement**”, and together with the Farmout, the “**Farmout Agreements**”).

10. The Farmout Agreement, was subject to New York law and provided for two phases<sup>5</sup>:

“130. [...] In the first phase of the transaction AEC purchased a 40% so-called “economic interest” in Block 15. Essentially, through contributions to OEPC’s Block 15 investments, AEC purchased the right to 40% of OEPC’s share of Block 15’s production. This stage of the Farmout was described in Article II, titled “Farmout of Interest in Farmout Property”. [Emphasis added]

[...]

131. The second stage of the Farmout was described in Article IV of the Farmout Agreement, titled “Assignment of Legal Title”. Article 4.01 provided that this phase could not occur until and unless two conditions were met: AEC had made the required payments, and the Government had given its prior authorization [...]”. [Emphasis added]

11. AEC paid approximately US\$ 180 million to OEPC as consideration for the acquisition of its 40% economic interest in the production from Block 15, an amount equivalent to 40% of the expenditure so far. Thereafter, in compliance with the obligations assumed in the Farmout Agreements, AEC regularly paid to OEPC 40% of the expenditure incurred in the exploitation and development of Block 15 and received 40% of the oil produced<sup>6</sup>:

“132. In exchange for its economic interest in the production from Block 15, AEC agreed to pay 40% of all the capital and operating expenses in developing Block 15. Article 2.02 of the Farmout provided:

As between OEPC and [AEC], [AEC] upon Closing shall be obligated and agrees to perform all obligations and to bear and pay all costs, charges, expenses and liabilities attributable to the Farmout Interest in the Participating Agreements and Block 15 [...]”.

133. AEC also agreed to pay approximately \$180 million towards OEPC’s historical development costs. Under Article 3.02, approximately \$70 million was to be paid upon Closing. Pursuant to Article 3.03, AEC’s payment of the remaining amount was spread over four years according to the following schedule: \$50 million in 2001, \$25 million in 2002, \$20 million in 2003 and \$15 million in 2004”.

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<sup>5</sup> Award at 130-131.

<sup>6</sup> Award at 132-133.

The Farmout and Ecuador

12. A few days before the execution of the Farmout Agreement, OEPC representatives held a meeting with Ecuador's Minister of Mines to inform the Minister about the Farmout<sup>7</sup>:

“147. On 24 October 2000, senior executives of both OEPC and AEC flew to Quito from the United States and Canada in order to meet with the Minister of Energy and Mines, Pablo Terán, in the Minister's office. The purpose of the meeting was to inform the Minister about the Farmout and discuss the commitment to the OCP pipeline and new projects in Ecuador. Casey Olson, then Executive Vice President for Business Development of Occidental, and Paul MacInnes, then President and General Manager of OEPC, attended this meeting on behalf of OEPC. Steven Bell, then Vice President International of AEC, and Stephen Newton, then President and General Manager of AEC Ecuador, attended on behalf of AEC. Minister Terán was the only representative of Ecuador present at the meeting.

148. There were two distinct subject matters which were addressed during the meeting and the meeting itself had two distinct phases. The purpose of the first session, which lasted about 45 minutes, was to present the Farmout to Minister Terán and was attended by both the OEPC and AEC officials. In the second session, attended only by the OEPC officials and Minister Terán, the parties discussed new projects in Ecuador that OEPC was interested in pursuing”.

13. Although there is controversy regarding what was said at the meeting, both parties acknowledged that no copy of the Farmout Agreements was handed to the Minister<sup>8</sup>. OEPC at a later date sent a letter to the Minister requesting consent with respect to the transfer of economic interests in favor of AEC<sup>9</sup>:

“151. The next day, on 25 October 2000, Mr. MacInnes wrote to Minister Terán regarding the previous day's meeting. Mr. MacInnes wrote that the Farmout was an ‘imminent transaction pursuant to which [OEPC] intends to transfer to [AEC] 40% of its economic interest in the Participation Contract.’ Mr. MacInnes also wrote that, following that first stage of the transaction, ‘OEPC will continue being the only ‘Contractor’ entity under the Contract for Block 15;’ and that ‘once [AEC] has complied with its obligations contemplated in the transfer agreement, OEPC shall transfer to [AEC] the legal title corresponding to 40% of its interests [...] subject to the approvals that the Government of Ecuador may require at that time.’ The letter ended with a request to the Minister to ‘confirm [...] [the] consent with respect to the aforementioned transfer of economic interests in favor of [AEC]’”.

14. The issue of whether the Minister had or had not indicated whether approval for the transfer of economic interest was required became very relevant in the proceedings<sup>10</sup>:

“152. As explained later in this Award, one of the central issues in this proceeding is whether, during the meeting of 24 October 2000, Minister Terán

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<sup>7</sup> Award at 147-148.

<sup>8</sup> Award at 150.

<sup>9</sup> Award at 151.

<sup>10</sup> Award at 152.



in fact indicated that government approval was (or was not) required for the transfer of the economic interest to AEC under the Farmout. In this regard, the Tribunal notes that upon closing the Farmout on 31 October 2000, OEPC and AEC entered into a letter agreement mutually waiving satisfaction of any required government approvals for the first stage of the Farmout. That letter also expressly envisaged the requirement of government approval for the contemplated future transfer of legal title to AEC”.

15. In November 2000 the closing of the Farmout Agreement was made public through a press release issued by OEPC’s ultimate parent, OPC<sup>11</sup>. Between late October and late November 2000, there were meetings between OEPC’s and PetroEcuador’s executives in which the Farmout was mentioned<sup>12</sup>. In addition, government agencies – the Ministry of Energy and Mines and the National Hydrocarbons Directorate (“**DNH**”) – requested from OEPC information regarding AEC’s financial and technical capabilities and issued memoranda regarding the transaction<sup>13</sup>.

16. Finally, on January 2001, Ecuador’s Minister of Mines answered OEPC’s letter of October 25, 2000<sup>14</sup>:

“159. [...] noting the company’s “intention to transfer in the future 40% of the rights and obligations of block 15,” and indicating that such a future transfer would require prior government approval. Minister Terán also stated that OEPC ‘shall be the sole company that will continue participating in the current contract with the Ecuadorian State since it is the owner of 100% of the rights and obligations’”.

17. The issue of the transfer of rights by OEPC to AEC resurfaced in 2003 when an audit firm was retained by the DNH to conduct an audit of OEPC. The auditors issued a report in July 2004 recommending that OEPC seek government authorization for the assignment<sup>15</sup>:

“167. Moores Rowland issued its audit report on 14 July 2004, noting therein that the assignment of rights and obligations contemplated in the Farmout was made contingent on future events and that the assignment “might or might not happen” at the end of the four years during which the conditions were to be satisfied. The audit report recommended to the DNH that OEPC seek government authorization for the assignment during that year, assuming the assignment conditions were satisfied, and that the required ministerial approval be granted to OEPC in order to properly register the assignment”.

18. The day after the issuance of the audit report, OEPC wrote a letter to the new Minister of Energy and Mines requesting his approval for the transfer by OEPC to AEC of legal title to a 40% interest in Block 15. The approval was not granted<sup>16</sup>:

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<sup>11</sup> Award at 153.

<sup>12</sup> Award at 154.

<sup>13</sup> Award at 155, 158.

<sup>14</sup> Award at 159.

<sup>15</sup> Award at 167.

<sup>16</sup> Award at 169.

“169. The approval sought by OEPC was not granted. Rather, on 24 August 2004, as set forth in more detail later in this Award, the Attorney General of Ecuador ordered the Ministry of Mines and Energy to terminate the Participation Contract and the Unitized Fields Joint Operating Agreements through a declaration of *caducidad*”.

### The VAT Dispute

19. In August 2001, the SRI – Ecuador’s Tax Authority – changed its practice of refunding value added taxes (“**VAT**”) to oil companies and retrospectively claimed refunds of the taxes already paid. OEPC initiated an arbitration (the “**VAT Arbitration**”) seeking redress for the measure and obtained a US\$ 75 million award (the “**VAT Award**”) against Ecuador<sup>17</sup>:

“170. In August 2001, Ecuador’s tax authority, the SRI, contrary to its established practice of refunding value added taxes (“VAT”) to oil companies, refused to grant such refunds in the future and, retroactively, claimed refunds of the taxes already paid. OEPC interpreted this decision to be a violation of Ecuadorian tax laws and the Treaty and, in November 2002, filed an international arbitration claim against Ecuador to recover the VAT refunds.

171. On 1 July 2004, the VAT Tribunal issued a \$75 million VAT Award in OEPC’s favor, finding that Ecuador’s conduct had been unfair and discriminatory. The VAT Award was sent to the parties on 12 July 2004, and was immediately made public.

172. Ecuador challenged the award in the English courts. Its annulment application was rejected by the High Court on 2 March 2006 and that decision was confirmed by the Court of Appeal on 4 July 2007”.

20. On August 3, 2004, just a few weeks after the issuance of the VAT Award, Ecuador enacted the “**VAT Interpretative Law**” clarifying that the regime of VAT reimbursements was not applicable to petroleum operations<sup>18</sup>:

“548. The VAT Law, also referred to as the VAT Interpretative Law, was passed by the Ecuadorian Congress on 3 August 2004 very shortly after the VAT Award’s release on 2 August 2004. Its sole article provides as follows:

Article 69-A of the Internal Tax Regime Law [...] is hereby interpreted in the sense that reimbursement of Value Added Taxes, VAT, is not applicable to petroleum activities when referring to extraction, transportation and commercialization of oil, since petroleum is not produced, but is extracted from the respective reservoirs”.

### The Caducidad proceedings

21. In September 2004, upon request of the Attorney General, the Minister of Energy and Mines instructed PetroEcuador to initiate the termination procedure of the Participation Contract<sup>19</sup>:

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<sup>17</sup> Award at 170-171

<sup>18</sup> Award at 548.

<sup>19</sup> Award at 180.

“180. In a letter to the Executive President of PetroEcuador dated 8 September 2004, Minister López, acting upon the Attorney General’s request of 24 August 2004, instructed PetroEcuador to initiate the termination procedure. The Minister’s letter attached OEPC’s request of 15 July 2004 for the transfer to AEC of 40% of the legal title to Block 15, the Farmout Agreement and the Joint Operating Agreement, as well as a report from the DNH listing various technical infractions committed by OEPC. Acting on Minister López’s letter, on 15 September 2004, PetroEcuador notified OEPC of its alleged non-compliance with the Participation Contract. This notification gave OEPC ten business days to respond to the allegations. On 24 September 2004, OEPC sent a detailed 28-page letter to PetroEcuador denying the Attorney General’s allegations”.

22. The *Caducidad* proceedings against OEPC culminated on May 15, 2006 with the issuance of a *Caducidad* Decree<sup>20</sup>:

“199. On 15 May 2006, Minister Rodríguez issued the *Caducidad* Decree. The Decree terminated, with immediate effect, OEPC’s Participation Contract and ordered OEPC to turn over to PetroEcuador all its assets relating to Block 15. The thirty-three page Decree included: (i) a summary of the termination process; (ii) block quotes from the letters of the Attorney General, PetroEcuador and OEPC; (iii) additional description of these letters and the positions articulated therein, as well as descriptions of other documents in the record; (iv) a description of norms considered; and (v) approximately four pages of reasoning. The Decree cited as a legal basis for *caducidad* Articles 74.11, 74.12 and 74.13 of the HCL”.

#### Law 42

23. In April 2006, Ecuador enacted “**Law 42**”, which required all companies operating under participation contracts to contribute 50% of their windfall revenues to the State<sup>21</sup>:

“465. Law 42, also referred to as the HCL Amendment, was passed by the Ecuadorian Congress on 19 April 2006 and published in the Official Gazette on 25 April 2006. Law 42 added a provision to the HCL titled ‘State’s Participation in surplus from oil sales prices not agreed upon or not foreseen’. This provision, which became Article 55 of the HCL, states, in relevant part, as follows:

Contractor companies that hold participation contracts for the exploration and exploitation of hydrocarbons in effect with the Ecuadorian State in accordance with this Law, without prejudice to the volume of participation crude oil that corresponds to them, when the average actual monthly FOB sales price of Ecuadorian crude oil exceeds the average monthly sales price in effect on the date on which the contract was executed [...] shall recognize a participation in favor of the Ecuadorian State of at least 50% of the extraordinary revenues generated by the difference in prices. For purposes of this article, extraordinary revenues shall be understood to mean the difference in price described above, multiplied by the number of barrels produced.

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<sup>20</sup> Award at 199.

<sup>21</sup> Award at 465-466.

The price of crude oil as of the date of contract execution, used as reference to calculate of the difference, shall be adjusted based on the United States' Consumer Price Index published by the Central Bank of Ecuador.

466. On 13 July 2006, Ecuador issued Decree 1672 implementing Law 42 at the 50% rate". [Footnotes omitted]

### 3. **DECISION ON JURISDICTION AND AWARD**

24. On May 17, 2006, Claimants commenced an international investment arbitration against Ecuador under the Treaty, which eventually led to the Decision on Jurisdiction and the Award challenged in these proceedings.

#### Decision on Jurisdiction

25. Respondent submitted two jurisdictional objections:
- Under the first objection Respondent argued that the adjudication of the Parties' dispute was governed by the Participation Contract, which allegedly excluded *caducidad* from arbitration;
  - Under the second objection Respondent averred that Claimants had failed to respect the six-month waiting period, imposed by Article VI.3 of the Treaty, for submission of the dispute to arbitration.
26. The Tribunal issued a Decision on Jurisdiction dated September 9, 2008, (the "**Decision on Jurisdiction**") in which it dismissed the objections and decided as follows<sup>22</sup>:

"97. For the foregoing reasons, the Tribunal decides and declares as follows:

(i) the Respondent's first jurisdictional objection is denied;

(ii) the Respondent's second jurisdictional objection is denied;

(iii) the Respondent's alternative request for "an order that this arbitration be stayed until OEPC challenges the *Caducidad* Decree in the competent Ecuadorian administrative court and that court issues a final ruling on such challenge" is denied; and

(iv) the Tribunal has jurisdiction over both OEPC's and OPC's claims in this proceeding and the arbitral proceedings will continue to the merits phase in accordance with the calendar established in the Tribunal's Procedural Order N°. 1 as modified by Procedural Order N°. 2".

#### The Award

27. On October 5, 2012 the Tribunal issued its Award (the "**Award**"), which in its dispositive section ordered the following<sup>23</sup>:

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<sup>22</sup> Decision on Jurisdiction at 97.

<sup>23</sup> Award at 876-877.

“876. For all of the foregoing reasons, and rejecting all submissions and contentions to the contrary, the Tribunal DECLARES, AWARDS and ORDERS as follows in respect of the issues arising for determination in these proceedings:

(i) Ecuador acted in breach of Article II.3(a) of the Treaty by failing to accord fair and equitable treatment to the Claimants’ investment, and to accord the Claimants treatment no less [*favourable*] than that required by international law;

(ii) Ecuador acted in breach of Article III.1 of the Treaty by expropriating the Claimants’ investment in Block 15 through a measure “tantamount to expropriation”;

(iii) Ecuador issued the *Caducidad* Decree in breach of Ecuadorian law and customary international law;

(iv) OEPIC breached Clause 16.1 of the Participation Contract by failing to secure the required ministerial authorization for the transfer of rights under the Farmout Agreement; as a result of this breach, the damages awarded to the Claimants will be reduced by a factor of 25% (see subparagraph (v));

(v) Claimants are awarded the amount of US\$ 1,769,625,000 (US One billion, seven hundred sixty nine millions, six hundred twenty five thousand dollars), as calculated in paragraph 825 of this Award, for damages suffered as a result of the breaches set out above in subparagraphs (i), (ii) and (iii);

(vi) Ecuador is ordered to pay pre-award interest on the above amount at the rate of 4.188% per annum, compounded annually from 16 May 2006 until the date of this Award;

(vii) Ecuador is ordered to pay post-award interest from the date of this Award at the U.S. 6 month LIBOR rate, compounded on a monthly basis; and

(viii) Ecuador’s counterclaims, except that counterclaim specified in subparagraph (iv) above, are dismissed; and

(ix) Each Party is ordered to bear its own costs of the proceedings and the Claimants and the Respondent are ordered and mandated each to pay half of ICSID’s and the Tribunal’s costs of and incidental to the proceedings.

877. In accordance with Article 48(4) of the ICSID Convention, Arbitrator Stern dissents from the above majority and her statement of dissent is attached”.

### Dissenting Opinion

28. Arbitrator Stern dissented from the majority and attached a statement of dissent (the “**Dissent**”). Prof. Stern summarized her dissent as follows<sup>24</sup>:

“1. The present case is a very complex case to which the three members of the Tribunal have been extremely devoted during many years. Although I greatly respect and esteem my distinguished colleagues, I could not concur with them

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<sup>24</sup> Dissent at 1-5.

on several important legal findings. While I subscribe to the analysis of the facts and the law concluding that the Respondent acted in a disproportionate manner in its reaction to the serious violation of its laws by the Claimants, I am in complete disagreement with the way damages have been calculated, which I consider to be resting on grossly incorrect legal bases. To be accurate, I don't have a problem with figures, I have a problem with principles that were applied (or not) to reach these figures.

2. As a matter of fact, I disagree with all the answers given to what the Tribunal has called the "four 'core' threshold quantum issues" described in the following manner (§457 of the Award):

These issues concern the impact (if any) on the Tribunal's determination of quantum of:

- 1) The Ecuadorian Law 42;
- 2) The Ecuadorian VAT Interpretative Law;
- 3) The Farmout Agreement; and
- 4) The fault of the Claimants prior to the *Caducidad* Decree.

3. To give a general overview of my main points of disagreement, I can state that they are of two different types.

4. Firstly, there are – as is often encountered in a complex case as the one at stake – disagreements that would not, by themselves, have prompted me to write a dissent. On one hand, I consider that the consequence of the fault committed by the Claimants, when they violated the Ecuadorian law, is overly underestimated and insufficiently taking into account the importance that each and every State assigns to the respect of its legal order by foreign companies. On the other hand, I have a different analysis of the laws applicable in the determination of damages. These disagreements concern respectively the issues 4, 1 and 2 above.

5. Secondly, there is the fundamental impossibility for me to follow the different statements in the Award relating to the effect this Tribunal should give to the Farmout Agreement. The majority's position on the effect of the Farmout Agreement is, in my view, so egregious in legal terms and so full of contradictions, that I could not but express my dissent. In my view, there are two major questionable aspects in the majority's approach to the question of the effectiveness of the Farmout Agreement: the first is the analysis of the question of the effectiveness of a legal act under Ecuadorian law, which is based on a total lack of reasons, with the consequence that I was not able to follow the "reasoning" from point A to point B, as well as gross errors of law in the purported interpretation of the content of Ecuadorian law; the second, which in my view is even a more serious matter, is the manifest excess of power of the Award nullifying a contract concerning a company which not only was not a party to the arbitration, but moreover – even if it had been a party – could not be considered, being a Chinese company, as an investor over which the Tribunal had jurisdiction under the US/Ecuador BIT".

## II. THE ANNULMENT PROCEDURE

29. On October 9, 2012, the Republic of Ecuador filed with ICSID an application for annulment of the Award and a request to stay the enforcement of the Award (“**Application**”).
30. On October 11, 2012, pursuant to Rules 50(2)(a) and (b) of the ICSID Rules of Procedure for Arbitration Proceedings of April 2006 (“**ICSID Arbitration Rules**”), the Secretary-General of ICSID registered the Application and notified the Parties of the provisional stay of enforcement of the Award under ICSID Arbitration Rule 54(2).
31. On January 18, 2013, the Secretary-General, in accordance with Rule 6(1) of the ICSID Arbitration Rules, notified the Parties that the three members of the *ad hoc* Committee had accepted their appointments and that the *ad hoc* Committee was therefore deemed to have been constituted on that date. The *ad hoc* Committee was composed of Prof. Juan Fernández-Armesto, a national of the Kingdom of Spain, President of the Committee; Judge Florentino Feliciano, a national of the Philippines; and Mr. Rodrigo Oreamuno Blanco, a national of Costa Rica. Mr. Gonzalo Flores, Senior ICSID Legal Counsel, was designated to serve as Secretary of the *ad hoc* Committee.
32. On February 13, 2013, the Claimants filed a request to terminate the stay of enforcement of the Award.
33. On March 25, 2013, the *ad hoc* Committee held a first session with the parties by telephone conference. During the session the Parties agreed to a series of procedural matters, including, that this proceeding would be governed by the 2006 ICSID Arbitration Rules. The Parties confirmed that the Committee had been properly constituted in accordance with the ICSID Convention and the ICSID Arbitration Rules and that they had no objection to the appointment of any of its members. During the session a schedule for the written and oral pleadings was fixed.
34. On April 5, 2013, the Republic of Ecuador filed observations on the Claimants’ request to terminate the stay of enforcement of the Award.
35. On April 10, 2013, the *ad hoc* Committee issued Procedural Order No. 1.
36. On April 22, 2013 the Claimants filed a reply to Ecuador’s observations of April 5; and on May 6, 2013 Ecuador filed a rejoinder to the Claimants’ reply.
37. As directed in Procedural Order No. 1, a one-day hearing on the matter of the stay of enforcement of the Award was held on May 13, 2013, in Paris, France.
38. On August 12, 2013, Ecuador filed its Memorial on Annulment.
39. On September 30, 2013, the *ad hoc* Committee issued its *Decision on the Claimants’ Request to Terminate the Stay of enforcement of the Award*. In its decision, the Committee ordered that the stay of enforcement be maintained for the time being unconditionally.

40. On October 18, 2013, the Claimants submitted their Counter-Memorial on Annulment; on January 6, 2014, Ecuador submitted its Reply on Annulment and on February 28, 2014, the Claimants submitted their Rejoinder on Annulment.
41. A hearing on annulment was held at the World Bank's Offices in Paris, France from April 7 through April 10, 2014.
42. On August 1, 2014, the Claimants filed a request for modification of the Tribunal's decision of September 30, 2013 on the stay of enforcement. On August 28, 2014 Ecuador filed observations on the Claimants' request.
43. On September 23, 2014, the *ad hoc* Committee issued its Decision on the Claimants' request to modify its decision of September 30, 2013. The Committee decided to maintain the stay of enforcement of the Award.
44. On October 9, 2015, the Committee declared the proceedings closed, pursuant to Rule 38(1) of the ICSID Arbitration Rules.



### **III. GROUND S FOR ANNULMENT IN THE CONVENTION**

45. Respondent is invoking three grounds for annulment:
- that the Tribunal manifestly exceeded its powers in violation of Article 52(1)(b) of the Convention,
  - that the Tribunal seriously departed from a fundamental rule of procedure in violation of Article 52 (1)(d) of the Convention, and/or
  - that it failed to state the reasons on which the Award is based in violation of Article 52(1)(e) of the Convention.
46. The Committee will briefly review these standards in light of the arguments presented by both parties.
47. The starting point of such analysis is Article 53(1) of the Convention, which explicitly states that the award “shall not be subject to any appeal”. The award may only be subject to annulment if an *ad hoc* committee finds that one or more of the five grounds for annulment established in Article 52(1) apply. Awards can be annulled in their entirety “or any part thereof” [Article 52 (3)]. Committees, however, are not empowered to amend or replace such awards, nor to review the merits of the dispute. Factual findings and weighing of evidence made by tribunals are, as a general rule, outside the remit of *ad hoc* committees<sup>25</sup>. An exception could only be allowed if the applicant can prove that the errors of fact committed by the tribunal are egregious; in such case it is likely that the error causes the award to fall within one of the grounds for annulment listed in Article 52(1) of the Convention<sup>26</sup>.

#### **1. MANIFEST EXCESS OF POWERS**

48. Respondent invokes as a first ground for annulment that by rendering the Award “the Tribunal has manifestly exceeded its powers” [Article 52(1)(b) of the Convention]. Excess of powers is a polysemic concept:
- in its primary meaning it refers to situations where a tribunal adjudicates disputes not included in the powers granted by the parties;
  - but there is also a secondary sense: when a tribunal having jurisdiction adopts an erroneous decision that exceeds its powers.

#### **Manifest Jurisdictional Excess of Powers**

49. The power of any arbitral tribunal derives from the authority vested upon it through the consent of the parties; if arbitrators address disputes not included in the powers granted to them, or decide issues not subject to their jurisdiction or not capable of being solved by arbitration, their decision cannot stand and must be set aside.

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<sup>25</sup> *Malicorp*, at 119.

<sup>26</sup> *Vivendi I*, at 251.

50. Excess of powers can be committed both by overreach and by default. Awards can be annulled if tribunals:
- assume powers to which they are not entitled, be it by way of a decision which is *ultra petita* or by an excess of jurisdiction,
  - do not use the powers that have been vested upon them by the parties; somewhat paradoxically, a manifest shortfall in the exercise of jurisdiction may also constitute a manifest excess of power<sup>27</sup>.
51. Jurisdictional excess of powers requires a finding that the tribunal has misconstrued the applicable law (e.g. the law regulating ownership of a protected investment) or has wrongly established the relevant facts (e.g. whether an investor actually controls an investment)<sup>28</sup>. Article 52(1)(b) of the Convention requires that the excess of jurisdiction resulting from such misconstruction or from such wrongful determination be “manifest”<sup>29</sup>; if that requirement is fulfilled, the tribunal’s award deserves annulment.

Failure to apply the proper Law to the Merits

52. “Excess of powers” may exist not only in cases where tribunals wrongly assume jurisdiction, but also in the case of tribunals who, having jurisdiction, fail to choose the proper law with regard to the merits of the dispute.
53. Powers vested on arbitrators are not unlimited, but restricted. Arbitrators are authorized by the parties to make their adjudication of the merits only in accordance with applicable law, not on the basis of a law different from that agreed by the parties or *ex aequo et bono*. If arbitrators do otherwise, they exceed the authority received from the parties and their decision merits annulment.
54. Accepting this principle, *ad hoc* committees have concluded that arbitrators manifestly exceed their powers if they:
- totally disregard the applicable law, or
  - ground their award on a law other than the applicable law provided for in Article 42 of the Convention, i.e. the rules of law agreed by the parties, or, subsidiarily, the law of the Contracting State party to the dispute and such rules of international law as may be applicable<sup>30</sup>.
55. For an award to be annulled, the committee must find that the error made by the tribunal consisted in applying the wrong law to the merits, not of wrongly

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<sup>27</sup> *Vivendi I*, at 115; *Malaysian Historical Salvors*, at 80.

<sup>28</sup> Mayer, P., *To What Extent Can an Ad Hoc Committee Review the Factual Findings of an Arbitral Tribunal?*, in ANNULMENT OF ICSID AWARDS 245, (Emmanuel Galliard and Yas Banifatemi, eds.2004).

<sup>29</sup> CHRISTOPH SCHREUER, THE ICSID CONVENTION: A COMMENTARY 942-151 (2009) (2<sup>nd</sup> Ed): “These decisions [*Soufraki* and *Lucchetti*] confirm that an excess of power on a matter of jurisdiction must be “manifest” if it is to warrant annulment”; see also para. 56 *infra*.

<sup>30</sup> *Azurix (Annulment)* at 46 and 136; *CMS* at 49; *Lucchetti* at 98; *Soufraki* at 45; *Enron* at 67; *Helnan* at 55; *Sempra* at 205-207.

interpreting the correct law. To understand the contrary would imply transforming the well-settled standard of failure to apply the proper law into an error of law standard, changing the nature of the ICSID annulment procedure, and transforming it into an appeal mechanism with respect to the merits. Accepting this principle, *ad hoc* committees have made it clear that an error in the interpretation of the proper law does not constitute a manifest excess of powers<sup>31</sup>.

56. Misinterpretation or misapplication of the proper law to be applied to the merits, even if serious, does not justify annulment. In exceptional circumstances, however, a gross or egregious error of law could be construed to amount to a failure to apply the proper law, and could give rise to the possibility of annulment<sup>32</sup>. But the threshold for applying this exceptional rule must be set very high<sup>33</sup> – otherwise the annulment mechanism permitted by the Convention would expand into a prohibited appeal system on the merits<sup>34</sup>.

#### The Meaning of “Manifest”

57. Article 52(1)(b) of the Convention only permits annulment if a dual requirement is met: the existence of an excess of powers, and that such excess of powers is “manifest” – a term which the Parties agree means “perceived without difficulty”<sup>35</sup>.
58. The Parties also agree that this important additional limitation applies both to a jurisdictional excess of powers and to a failure to apply the proper law<sup>36</sup>. This conclusion, shared by this Committee, has been confirmed by previous committees<sup>37</sup>.
59. The above said, “manifest” does not prevent that in some cases an extensive argumentation and analysis may be required to prove that the misuse of powers has in fact occurred<sup>38</sup>.

## **2. SERIOUS DEPARTURE FROM A FUNDAMENTAL RULE OF PROCEDURE**

60. The second ground for annulment invoked by Respondent is that the Tribunal engaged in a serious departure from a fundamental rule of procedure. If a tribunal violates due process, and deprives a party of its right to be heard on equal terms and to contradict the arguments of the other party, annulment of the award is justified; justice cannot be achieved through a deeply flawed procedure.
61. Serious departure from a fundamental rule of procedure is frequently invoked by applicants, normally in conjunction with other grounds. But the hurdles for the

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<sup>31</sup> *Azurix* at 137, *MCI* at 42, *Soufraki* at 85, *Sempre* at 161.

<sup>32</sup> *Soufraki* at 86; *Sempre* at 164, this is accepted by the Parties: R II at 70; C II at 17.

<sup>33</sup> *AES* at 33.

<sup>34</sup> *Caratube* at 81.

<sup>35</sup> R II at 75, C I at 326, C II at 19.

<sup>36</sup> R II at 177, C I at 346 and C II at 27.

<sup>37</sup> *Duke Energy* at 98; *Soufraki* at 118, *Luchetti* at 100; *Azurix (Annulment)* at 68; *Enron* at 67; *Tza Yap Shum* at 79.

<sup>38</sup> *Víctor Pey Casado* at 70.

acceptance of this ground are high: in only a few cases has it led to the annulment of ICSID awards<sup>39</sup>.

62. The hurdles are reflected in the wording of Article 52(1)(d), which involves three requirements<sup>40</sup>:
- The procedural rule must be fundamental, and only those essential to the integrity and fairness of the arbitral process qualify as such;
  - The tribunal must have departed from it;
  - And the departure must be serious, i.e. the violation must have produced a material impact on the award; the applicant however is not required to prove that the violation of the rule of procedure was decisive for the outcome, or that the applicant would have won the case if the rule had been applied<sup>41</sup>.

### 3. FAILURE TO STATE REASONS

63. The third ground for annulment on which Respondent relies is that the Award failed to state the reasons on which it is based, as required by Article 52(1)(e) of the Convention.
64. The obligation to state reasons stems from Article 48(3) of the Convention, which requires tribunals to “deal with every question submitted to the Tribunal” and to “state the reasons upon which [the award] is based”. Unreasoned awards can be annulled, because parties should be able to ascertain to what extent a tribunal’s findings are based on a correct interpretation of the law and on a proper evaluation of the facts<sup>42</sup>. But as long as reasons have been stated, even if incorrect, unconvincing or non-exhaustive<sup>43</sup>, the award cannot be annulled on this ground. Article 52(1)(e) does not permit any inquiry into the quality or persuasiveness of reasons. As was stated in *MINE*<sup>44</sup>,

“the requirement to state reasons is satisfied as long as the award enables one to follow how the tribunal proceeded from Point A to Point B, and eventually to its conclusion, even if it made an error of fact or of law”<sup>45</sup>.

65. Nonetheless, *ad hoc* committees have held that contradictory or frivolous reasons are to be equated with a failure to state reasons and can result in annulment<sup>46</sup>:

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<sup>39</sup> *Amco II*; *Fraport*; *Víctor Pey Casado*.

<sup>40</sup> R II at 100, C II at 40.

<sup>41</sup> *Wena*, at 61; *Víctor Pey Casado*, at 78.

<sup>42</sup> *Lucchetti*, at 98.

<sup>43</sup> *Impregilo v. Argentina* at 181.

<sup>44</sup> And accepted by the Parties: R II at 112, 113; C I at 48, 51 and C II at 34.

<sup>45</sup> *MINE*, at 5.09.

<sup>46</sup> *Amco II*, at 1.18.

- Contradictory reasons cancel each other and will not enable the reader to understand the tribunal's motives<sup>47</sup>;
  - Frivolous reasons are those manifestly irrelevant and known to be so to the tribunal<sup>48</sup>.
66. But an examination of the reasons presented by a tribunal cannot be transformed into a re-examination of the correctness of the factual and legal premises on which the award is based. Committees do not have the power to review the adequacy of the reasons set forth by the tribunal in its award. Rather, the role of the committee is limited to analyzing whether a reader can understand how the tribunal arrived at its conclusion. Broadening the scope of Article 52(1)(e) to comprise decisions with inadequate reasons would transform the annulment proceeding into an appeal.
67. Similarly, the failure to address a particular argument raised by the Parties does not warrant annulment, unless it is decisive to the tribunal's decision (not *obiter dictum*)<sup>49</sup>. Contradictions, inconsistencies and unreasonable statements in the award can be cured applying the procedures set forth in Articles 49 and 50 of the Convention, which provide the parties with the opportunity to request that the tribunal address omissions, rectify material errors and clarify the interpretation of dubious points<sup>50</sup>.

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<sup>47</sup> *Klöckner I*, at 116.

<sup>48</sup> Broches: "Observations on the finality of ICSID awards" in *ICSID Review*, 321 (1991), at 366.

<sup>49</sup> R II at 114; C II at 36.

<sup>50</sup> *Impregilo v. Argentina* at 214.

#### IV. GENERAL OUTLINE OF THE GROUNDS FOR ANNULMENT

68. Respondent submits a total of 13 grounds for annulment<sup>51</sup>. The Committee will analyze these grounds in three different sections:
- In **Chapter V** the Committee will address Respondent's grounds which allegedly lead to the annulment of the Decision on Jurisdiction and consequently would entail annulment of the Award *in toto*, for lack of jurisdiction; the Committee will reject these grounds and confirm the Tribunal's jurisdiction;
  - In **Chapter VI** the Committee will analyze certain grounds for partial annulment invoked by Respondent, based on the argument that OEPC does not hold a 100% (but only a 60%) ownership interest in the expropriated investment<sup>52</sup>; the Committee will accept the first of these grounds, and order the partial annulment of the Award to the extent that the Tribunal assumed jurisdiction over an investment beneficially owned by the Chinese investor Andes, who is not protected under the Treaty;
  - **Chapter VII** will be devoted to additional grounds submitted by Ecuador, which if accepted would lead to annulment of the entire Award or of parts thereof<sup>53</sup>; the Committee will dismiss these grounds.

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<sup>51</sup> Some of the grounds are divided into separate sub-division – see R I p. 83 – 218; Respondent has also submitted a different structure of grounds in R III p. 315.

<sup>52</sup> See R III p. 317.

<sup>53</sup> See R III p. 316.

## V. THE DECISION ON JURISDICTION

69. Respondent avers that the Tribunal's Decision on Jurisdiction must be annulled for four separate reasons. Three of the reasons are related to the Tribunal's decision to assume jurisdiction over Claimants' claims relating to *caducidad*, whilst the fourth refers to the Tribunal's decision to disregard the mandatory negotiation requirements of the Treaty. In particular, Respondent requests the annulment of the Decision on Jurisdiction:

- Because the Tribunal rejected Ecuador's arbitrability objection, and it did so manifestly exceeding its powers and failing to state reasons (1.);
- Because the Tribunal dismissed Ecuador's objection that OPC had no standing without stating any reasons and manifestly exceeding its powers (2.);
- Because the Tribunal failed to state reasons for rejecting Ecuador's inadmissibility objection (3.); and
- Because the Tribunal also failed to give effect to the mandatory negotiation requirement in Article VI.3 of the Treaty, manifestly exceeding its powers (4.)

### 1. THE ARBITRABILITY OBJECTION

70. In the course of the jurisdictional phase of the arbitration, Ecuador made two independent and separate jurisdictional objections related to *caducidad*<sup>54</sup>:

- The "**Jurisdictional Objection**" based on the argument that certain clauses agreed upon in the Participation Contract excluded *caducidad* related matters from arbitration – an objection which (although rejected by the Tribunal) is not a subject matter of this annulment procedure<sup>55</sup>;
- A second objection, introduced into the proceedings for the first time in the hearing on jurisdiction<sup>56</sup>, based on Article 196 of the Ecuadorian Constitution ["**CE**"], the so called "**Arbitrability Objection**", which is the object of this annulment ground.

71. The Arbitrability Objection submitted by the Republic was based on the following arguments<sup>57</sup>:

- The CE is at the summit of the legal pyramid in Ecuador; as a matter of hierarchy of norms, the CE prevails over international treaties such as the BIT;

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<sup>54</sup> R II at 137.

<sup>55</sup> R II at 142.

<sup>56</sup> See Decision on Jurisdiction at 82- 83.

<sup>57</sup> R II at 133.

- Article 196 CE attributes exclusive jurisdiction to the administrative tribunals of Ecuador to adjudicate any dispute concerning *actos administrativos*;
- The *Caducidad* Decree is an *acto administrativo*;
- In accordance with Article 196 CE any dispute concerning the *Caducidad* Decree must be submitted to the Ecuadorian administrative tribunals, and cannot be submitted to ICSID arbitration.

72. Ecuador's Arbitrability Objection was rejected by the Tribunal at paras. 86, 87 and 88 of its Decision on Jurisdiction:

“86. More fundamentally, the Respondent cannot invoke its domestic law for the purpose of avoiding ICSID jurisdiction under the Treaty. As noted earlier, by virtue of the Treaty, the Respondent expressly consented to the submission of disputes for settlement by binding arbitration under the Washington Convention, thereby establishing the basis for this Tribunal's jurisdiction in the present circumstances. The Respondent's Constitution, at Article 163, recognizes that international treaties duly ratified by the Republic of Ecuador shall prevail over any laws in Ecuador. This was confirmed at the Hearing by the Respondent's own legal expert on Ecuadorian law when he answered questions posed to him by counsel for the Claimants:

«Q. You agree with me that pursuant to Article 163 of the constitution, in case of conflict between those duly-ratified international Treaties, on the one hand, and the arbitration law on the other hand, the provisions of the duly-ratified international Treaties shall prevail; correct?

A. Yes. That is so.

[...]

Q. Fair enough. A very simple assumption; if there was a duly-ratified Treaty that affirmatively granted jurisdiction to an Arbitral Tribunal, and the Ecuadorian arbitration law did not grant such jurisdiction because of a failure to meet certain requirements in that law, the Tribunal would still have jurisdiction pursuant to that Treaty; correct?

A. In such a situation, if Ecuadorian law, as you referred to, is a law or a lower level regulation, that would be the case».

87. [...] In its closing argument, counsel for the Respondent also argued that the “exclusive jurisdiction principle” according to which *caducidad* decrees may only be challenged before the Ecuadorian administrative courts is enshrined in the Ecuadorian Constitution, and that the Constitution prevails over the Treaty: [quote omitted]

88. The premise to this line of argument is based on a finding that the Participation Contract, be it Clause 22.2.1 or Clause 21.4, contains a clear and unequivocal waiver to ICSID jurisdiction. The Tribunal has found earlier in this Decision that no such waiver has been made under the Participation Contract. For all these reasons, the Respondent's first jurisdictional objection is accordingly denied”.



**A. Respondent's Position**

73. The Republic now argues that the Tribunal's decision to dismiss the Arbitrability Objection:
- Failed to state reasons and left the Arbitrability Objection unanswered; or at least was addressed by the Tribunal in a contradictory fashion equivalent to a failure to state reasons;
  - Amounts to a manifest excess of powers, because it simply ignored Ecuador's argument that the CE prevails over the Treaty within the pyramid of the Ecuadorian legal order<sup>58</sup>.
74. Respondent avers that the Decision should be annulled under Article 52(1)(b) and (e) of the Convention, for failure to state reasons and for manifest excess of powers, causing the subsequent nullity of the Award in its entirety<sup>59</sup>.

**B. Claimants' Position**

75. Claimants disagree. In their opinion the Tribunal did not fail to state its reasons in dismissing Ecuador's Arbitrability Objection, because it referred to
- the general principle that a State cannot rely on its domestic law to override its treaty obligations; and
  - Article 163 CE which provides that treaties prevail over any laws of Ecuador<sup>60</sup>.
76. Furthermore, the Tribunal correctly assumed jurisdiction and so did not exceed its powers at all, because Ecuador cannot invoke its domestic law (including the CE) to avoid ICSID jurisdiction and because Article 196 CE simply does not provide for the exclusive jurisdiction principle that Ecuador claims<sup>61</sup>.

**C. The Committee's Decision**

77. The Committee will first address the ground that the Tribunal failed to give reasons for its decision to dismiss the Arbitrability Objection, and then it will analyze whether the Tribunal manifestly exceeded its powers when it took such decision.
78. Articles 161, 163 and 196 CE<sup>62</sup> provide as follows:

Artículo 161: La aprobación de los tratados y convenios se hará en un solo debate y con el voto conforme de la mayoría de los miembros del Congreso. Previamente, se solicitará el dictamen del Tribunal Constitucional respecto a la conformidad del tratado o convenio con la Constitución. La aprobación de

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<sup>58</sup> R II at 182.

<sup>59</sup> R I at 282-283.

<sup>60</sup> C I at 68; C II at 69.

<sup>61</sup> C II at 71, 72.

<sup>62</sup> The Award refers to the 1998 Constitution.

un tratado o convenio que exija una reforma constitucional no podrá hacerse sin que antes se haya expedido dicha reforma.

Artículo 163: Las normas contenidas en los tratados y convenios internacionales, una vez promulgados en el Registro Oficial, formarán parte del ordenamiento jurídico de la República y prevalecerán sobre leyes y otras normas de menor jerarquía.

Artículo 196: Los actos administrativos generados por cualquier autoridad de las otras funciones e instituciones del Estado, podrán ser impugnados ante los correspondientes órganos de la Función Judicial en la forma que determina la ley.

### Failure to state Reasons

79. The Arbitrability Objection – the argument that the CE requires that disputes affecting *actos administrativos* be submitted to administrative courts – was dismissed by the Tribunal; the reasoning for such dismissal is to be found at para. 86, where the Tribunal states:
- That Ecuador has “expressly consented to the submission of disputes for settlement by binding arbitration under the Washington Convention, thereby establishing the basis for this Tribunal’s jurisdiction”;
  - That a State cannot “invoke its domestic law for the purpose of avoiding ICSID jurisdiction under the Treaty”;
  - That the CE recognizes in its Article 163 that “international treaties duly ratified by the Republic of Ecuador shall prevail over any laws in Ecuador”; and
  - That Ecuador’s own legal expert on Ecuadorian law confirmed this interpretation of Article 163 CE when examined at the hearing.
80. The Committee recalls that the requirement to state reasons is satisfied as long as the award enables one to follow how the tribunal proceeded from Point A to Point B, and eventually to its conclusion<sup>63</sup>.
81. In the present case, it is true that the reasons (contained in para. 86 of the Decision) precede the precise definition of the Arbitrability Objection (in para. 87). It is also true that in its reasoning, the Tribunal does not clearly differentiate between the Arbitrability Objection and the Jurisdictional Objection. But this lack of precision may be excused, because the Arbitrability Objection only became relevant in the course of the hearing, and in any case (as will be explained herein below) because it is without merit. Parties cannot expect that Tribunals devote extensive reasoning to arguments which, on their very face, cannot succeed.

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<sup>63</sup> *MINE*, at 5.09; see para 64 *supra*.

Manifest Excess of Powers

82. Respondent also argues that the Tribunal manifestly exceeded its powers when it dismissed the Arbitrability Objection, because:
- It ignored the argument that the CE prevails over the Treaty and, eventually,
  - It wrongfully assumed jurisdiction over claims related to *caducidad*.
83. The first argument is not true; the Tribunal did not ignore the argument put forward by Respondent that the CE prevails over the Treaty; the Tribunal rejected it, explaining that a State cannot rely on its own domestic law to avoid ICSID jurisdiction under the Treaty, and that Article 163 CE expressly provides that treaties prevail over domestic laws<sup>64</sup>.
84. The second argument must be dismissed for total lack of merit: the Tribunal was right in dismissing the Arbitrability Objection and thus assuming jurisdiction with respect to claims related to *caducidad* – there is no manifest excess of powers. The Committee concurs with the Tribunal that the Republic:
- Disregards the basic principle of international law that a State cannot invoke its domestic law, including its constitutional provisions, for the purpose of avoiding treaty obligations<sup>65</sup>;
  - Blatantly ignores the very CE, which in Article 163 pays tribute to this principle of international law, declaring that treaties form part of the Republic’s internal legal order and prevail over municipal laws, and in Article 161, which creates a general presumption that all international treaties in force are in conformity with the Constitution;
  - Misconstrues the impact of Article 196 CE with regard to Ecuador’s International Law obligations: Article 196 CE does not provide for the exclusive jurisdiction principle that Ecuador claims; the constitutional rule permits, but does not in any way mandate, recourse to administrative courts; to understand otherwise would lead to the conclusion that all *actos administrativos* are excluded from the scope of application of the BIT, and that the only acts which investment tribunals can review are *actos legislativos* and *actos judiciales*, adopted by the Ecuadorian legislative and

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<sup>64</sup> Decision on Jurisdiction at 86.

<sup>65</sup> See Articles 27 and 46 VCLT, ratified by Ecuador (without reservation to Article 27). It is clear from these international law principles, which codify existing customary international law on the subject, that Ecuador cannot invoke its domestic law for the purpose of avoiding ICSID jurisdiction under the US-Ecuador BIT. The same principle applies even where constitutional provisions are relied upon (see the judgement of the PCIJ *Polish Nationals in Danzig*, p. 24: “It should however be observed that [...] a State cannot adduce as against another State its own Constitution with a view to evading obligations incumbent upon it under international law or treaties in force”).

See also *IBM (Jurisdiction Decision)* at 72:

“International treaties establish norms of conduct between and for the States, the mandatory character of which cannot be avoided, the more since current International Law has the tendency to have its norms to prevail even over the provisions of the Political Constitutions themselves. It appears as such in doctrine and constitutional texts, but also in jurisprudence on human rights and community law”.

judicial authorities – a conclusion so untenable that it disavows Respondent’s argument.

85. In conclusion, Respondent’s first ground for annulment, that the Tribunal failed to state reasons and manifestly exceeded its powers when it decided to assume jurisdiction over Claimants’ claims relating to *caducidad*, is dismissed.

## 2. THE STANDING OBJECTION

86. In this arbitration OPC and OEPC are acting as Claimants – OPC being OEPC’s parent company. Respondent filed an objection against OPC’s participation (the “**Standing Objection**”).

87. The Standing Objection was submitted for the first time in Respondent’s Reply on Jurisdiction<sup>66</sup> (the “**Reply on Jurisdiction**”). Respondent argued that OPC’s claims should be dismissed for four independent reasons<sup>67</sup>. The first reason was that “OPC [had] failed to establish a basis for its standing as an investor”. This Standing Objection was developed in five paragraphs (90 – 94), in which the Republic raised two lines of reasoning:

88. First, Respondent stated that<sup>68</sup>:

“90. [...] OPC’s mere claim to be the ‘ultimate parent’ of a US company that has an investment in Ecuador [...] is not sufficient to establish that OPC is also an investor under the Treaty.

91. To prove its investor status, OPC would have to demonstrate how exactly it controls OEPC in order to establish that its connection to OEPC is close enough not to reach the ‘cut-off point beyond which claims would not be permissible as they would have only a remote connection to the affected company’. OPC failed to do so and thus failed to establish a basis for its standing as investor”. [Footnotes omitted].

89. Second, Respondent argued that since OPC’s claims are factually and legally identical to OEPC’s claims, they are not admissible in an arbitration where OEPC has appeared as a party and is asserting the same claims; investment tribunals have only granted standing to shareholders, where the shareholders were the true investors and the companies that were directly affected were mere local vehicles<sup>69</sup>.

90. The Tribunal dismissed Respondent’s arguments and confirmed its jurisdiction over OPC’s claims in para. 89 of the Decision on Jurisdiction:

“89. It follows that the Tribunal has jurisdiction over the Claimants’ claims under both the Participation Contract and the Treaty. For this reason, the Respondent’s submission that Claimant OPC, the ‘ultimate parent’ of OEPC, lacks standing to assert claims as an investor in the circumstances because it

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<sup>66</sup> Doc. EEA 168.

<sup>67</sup> Doc. EEA 168 at 88.

<sup>68</sup> Doc. EEA 168 at 90-91.

<sup>69</sup> Doc. EEA 168 at 93, quoting *Goetz* at 89.

is not a signatory to the Participation Contract is moot and need not be addressed as part of this Decision on Jurisdiction”.

**A. Respondent’s Position**

91. The Republic complains that the Tribunal summarized Ecuador’s position in a single paragraph and rejected the Standing Objection in two sentences, without addressing its arguments, giving rise to a failure to state reasons and to a manifest excess of powers<sup>70</sup>.

**B. Claimants’ Position**

92. Claimants disagree.
93. It is Claimants’ submission that it was in its Reply on Jurisdiction when the Republic for the first time raised the Standing Objection, and it only devoted six paragraphs to the argument and never disputed that OPC indirectly held a 100% stake in OEPC. The Tribunal dismissed Ecuador’s objection by stating that OPC was the “ultimate parent” of OEPC. This reflected the Tribunal’s understanding that OPC owned and controlled OEPC and had suffered an injury from the illegal expropriation of its Ecuadorian subsidiary<sup>71</sup>.
94. Claimants add that there can be no excess of powers, because the Treaty expressly provides that “investment” means:

“every kind of investment in the territory of one Party owned or controlled directly or indirectly by nationals or companies of the other Party”.

Since OPC is a company of the “other Party” and it indirectly owns and controls OEPC, the Tribunal had a tenable basis for finding that OEPC had standing<sup>72</sup>.

**C. The Committee’s Decision**

95. The Committee will first address the issue of failure to state reasons and then the manifest excess of powers argument.

Failure to state Reasons

96. Although the Standing Objection was addressed in the body of Respondent’s Reply submission, in its prayer for relief there was no specific request that the Tribunal dismiss the claims from OPC for lack of standing. The only prayer for relief was a request for a “declaration that the Tribunal has no jurisdiction over the Claimants’ claims for the reasons given in Ecuador’s objections to jurisdiction – but there was no subsidiary request that if the Tribunal admitted jurisdiction over OEPC’s claims, it should in any case dismiss those from OPC because of the Standing Objection<sup>73</sup>.”

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<sup>70</sup> R I at 286, 287; R II at 177.

<sup>71</sup> C I at 85; C II at 79.

<sup>72</sup> C I at 361; C II at 88.

<sup>73</sup> Doc. EEA 168 at 99; at 100 there is a different alternative request, which is not relevant for this discussion.

97. When Article 52(1)(e) provides that the award can be annulled when it “has failed to state the reasons on which it is based”, the rule is referring to the reasons used to support the award’s dispositive section in accordance with the parties’ relief. If there is no specific request for relief there is, thus, no need to give reasons.
98. But although there was no obligation to provide reasons, the Tribunal did address OPC’s alleged lack of legal standing in para. 89 of the Decision, stating the following reasons for rejecting the proposition:
- First, because the Tribunal had already found that it had jurisdiction under the Treaty, and consequently any argument that OPC lacked standing for failure to sign the Participation Contract was moot;
  - And second, because OPC was the “ultimate parent” of OEPC, a statement which reflected the Tribunal’s understanding that OPC owned and controlled OEPC and was thus an investor under the Treaty.
99. In this second leg of the argument the Tribunal addressed, albeit in a very succinct manner, the first issue raised in the Standing Objection: whether OPC’s control was too remote to warrant standing.
100. The Decision, however, does not seem to analyze Respondent’s second supporting argument: that OPC lacked legal standing because it was replicating part of OEPC’s treaty claims. Ecuador is now contending that this failure to address a second supporting argument amounts to a failure to state reasons, which should lead to annulment of the entire Award.
101. The Republic’s contention cannot succeed, because it is settled law that a tribunal has no obligation to address each and every argument put forth by the parties<sup>74</sup>.

#### Manifest Excess of Powers

102. Respondent’s subsidiary argument that by (implicitly) dismissing its Standing Objection and accepting jurisdiction over OPC’s claims, the Tribunal manifestly exceeded its powers must also be dismissed.
103. Article I.1.(a) of the Treaty provides that:

“investment” means every kind of investment in the territory of one Party owned or controlled directly or indirectly by nationals or companies of the other Party, such as equity, debt, and service and investment contracts”.

The Treaty thus extends its protections to any U.S. company which – either directly or indirectly – owns or controls an investment in the Republic of Ecuador.

104. It is a fact that OPC is the indirect owner of 100% of the shares in OEPC, and that both are U.S. corporations. There is a general presumption that a majority shareholder also controls the company, a presumption which can only be rebutted if there are special elements which create doubts about the owner’s control<sup>75</sup> – and

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<sup>74</sup> *Azurix (Annulment)* at 240; *Vivendi I* at 87.

<sup>75</sup> *Caratube*, at 271.

Ecuador has pled no such special elements. There thus can be no question that OPC, a U.S. corporation, controls OEPC, and as such has standing to act as Claimant in the present arbitration. This being so, the Tribunal cannot have exceeded its powers by confirming OPC's status as Claimant and accepting jurisdiction to hear its claims.

105. Summing up, Respondent's second ground for annulment, that the Tribunal manifestly exceeded its powers and failed to state reasons when it failed to reject OPC's Standing Objection, is dismissed.

### 3. **THE INADMISSIBILITY OBJECTION**

106. In its Reply on Jurisdiction, Respondent raised a subsidiary argument: even if the Tribunal had jurisdiction over OEPC's treaty claims, those claims would be premature, because Claimants had made no attempt to challenge the *Caducidad* Decree before the Ecuadorian administrative courts (the "**Inadmissibility Objection**").

107. This argument was allegedly supported by a number of investment tribunals that had held that a treaty claim is premature, unless there has been a reasonable attempt by the investor either to pursue redress in the forum specified in the contract or otherwise petition local authorities to reverse the act of which the investor complains<sup>76</sup>. As a consequence, the Republic requested that, pending Claimants' action before the Ecuadorian courts, the arbitration be suspended<sup>77</sup>.

#### A. **Respondent's Position**

108. According to Respondent, in its Decision on Jurisdiction the Tribunal rejected the Inadmissibility Objection in a single paragraph, which refers to "the reasons set forth in this decision", when in fact the Decision contains no reasons whatsoever in this regard<sup>78</sup>. This failure to state reasons is a ground for annulment.

#### B. **Claimants' Position**

109. Claimants disagree. In their opinion, the Tribunal's reasoning can be followed from A to B and does not warrant annulment. The Inadmissibility Objection was raised belatedly and briefly in Ecuador's Reply on Jurisdiction and addressed by Ecuador for only a few minutes in two days of jurisdictional hearings<sup>79</sup>.

110. The Tribunal rejected it with sufficient reasons, such reasons being that Ecuador could not use its domestic law to evade its international law obligations, that Ecuador expressly consented to submission of disputes for settlement by binding arbitration under the Convention, that the Participation Contract did not waive Claimants' rights to pursue ICSID arbitration and that it would have served no

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<sup>76</sup> Doc. EEA 168 at 80.

<sup>77</sup> R I at 289; R II at 164.

<sup>78</sup> R I at 291.

<sup>79</sup> C I at 93.

purpose to pursue local remedies given that attempts to reach a negotiated solution were indeed futile<sup>80</sup>.

**C. The Committee's Decision**

111. The Tribunal addressed Respondent's Inadmissibility Objection in the body and in the dispositive section of its Decision on Jurisdiction:

"96. Finally, it is recalled that the Respondent has requested, as part of its second jurisdictional objection, 'an order that this arbitration be stayed until OEPC challenges the *Caducidad* Decree in the competent Ecuadorian administrative court and that court issues a final ruling on such challenge'. This request is made on the basis of the allegation that the Claimants' claims are premature because the Claimants have made no attempt to challenge the *Caducidad* Decree before the Ecuadorian administrative courts. For the reasons set forth in this Decision on Jurisdiction, the Claimants were not required to do so, and this request is accordingly denied".

"97. For the foregoing reasons, the Tribunal decides and declares as follows: ... (iii) the Respondent's alternative request for 'an order that this arbitration be stayed until OEPC challenges the *Caducidad* Decree in the competent Ecuadorian administrative court and that court issues a final ruling on such challenge' is denied; ..."

112. It is clear from para. 96 that the Tribunal decided that Respondent's Inadmissibility Objection should be dismissed, because Claimants were not required to challenge the *Caducidad* Decree before the Ecuadorian Courts. The reasoning for this finding, however, is not specifically mentioned, and the Tribunal simply makes a general referral to "the reasons set forth in this Decision on Jurisdiction".

113. It is Respondent's contention that in the remaining parts of the Decision on Jurisdiction no explicit reasoning supporting the Tribunal's rejection of the Inadmissibility Objection can be found, and that this failure to state reasons should lead to an annulment of the Award.

114. In the Committee's opinion, the generic cross reference to the Decision *in toto* must be understood as a *renvoi* to para. 86 of the Decision, which conveys the implicit argument that if investment disputes have to be submitted to settlement by binding arbitration, such requirement precludes exhaustion of local remedies as a pre-condition.

115. The requirement that decisions be reasoned must be gauged in relation to the reasonableness and chance of success of the underlying proposition. In the present case, the Respondent's proposition that local remedies against the *Caducidad* Decree before the administrative courts of Ecuador must be exhausted, and that in the meantime the arbitration would have to be stayed, is unsupported either in the Treaty or in the Convention, does not lead to reasonable results and *ab initio* had a very low chance of success. As the *Helnan* Committee explained:

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<sup>80</sup> C II at 94.



“it would empty the development of investment arbitration of much of its force and effect, if, despite a clear intention of States parties not to require the pursuit of local remedies as a pre-condition to arbitration, such a requirement were to be read back in as part of the substantive cause of action”<sup>81</sup>.

116. In these circumstances, succinct and implied reasons – as those provided by the Tribunal – may be sufficient to defer annulment of the Award.
117. The Committee consequently comes to the conclusion that Respondent’s third ground for annulment, that the Tribunal failed to state reasons when it rejected the Respondent’s Inadmissibility Objection, should be dismissed.

#### 4. THE NEGOTIATION OBJECTION

118. The *caducidad* administrative procedure started in 2004. In the course of a two year long period, OEPC was granted and exercised its right to be heard and the Ecuadorian administrative authorities debated whether the imposition of the sanction of *caducidad* against OEPC was appropriate. It is a fact, acknowledged in the very *Caducidad* Decree, that in the course of this procedure OEPC presented a settlement proposal, which was rejected by PetroEcuador<sup>82</sup>. On May 15, 2006 the *Caducidad* Decree was issued by Ecuador’s Minister of Energy and Mines. Two days thereafter, on May 17, 2006, Claimants filed their request for arbitration (the “**Request for Arbitration**”).
119. During the jurisdictional phase of the arbitration, Respondent submitted a jurisdictional objection (the “**Negotiation Objection**”), arguing that Claimants had failed to respect the six-month waiting period for the submission of the dispute to arbitration, mandated by Article VI.3 of the Treaty, which reads as follows:

“3. (a) Provided that the national or company concerned has not submitted the dispute for resolution under paragraph 2 (a) or (b) and that six months have elapsed from the date on which the dispute arose, the national or company concerned may choose to consent in writing to the submission of the dispute for settlement by binding arbitration: [...]”. [Emphasis added].

120. According to Respondent, this cooling-off period represents one of the jurisdictional requirements in the Treaty, and an investor’s disregard of this rule deprives an arbitral tribunal of jurisdiction<sup>83</sup>.

#### The Tribunal’s Decision

121. The Tribunal dismissed the Negotiation Objection in its Decision on Jurisdiction. After summarizing the Parties’ respective position in paras. 90 – 92, the Tribunal explained its decision in paras. 93 – 95:

“93. In this regard, the Tribunal recalls that the *caducidad* procedure at issue in this arbitration was in fact initiated in 2004. As noted earlier, for some 18 months or so prior to the issuance of the actual *Caducidad* Decree on 15 May

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<sup>81</sup> *Helnan* at 47.

<sup>82</sup> *Caducidad* Decree at para. 15.

<sup>83</sup> R II at 192.

2006, OEPC made a number of submissions seeking to rebut the allegations on the basis of which the *caducidad* procedure was initiated, but to no avail.

94. Furthermore, the Tribunal accepts, albeit without prejudging the merits, that attempts at reaching a negotiated solution were indeed futile in the circumstances.

95. The Respondent's second jurisdictional objection is accordingly denied".  
[Footnotes omitted].

#### **A. Respondent's Position**

122. The Republic states that the Tribunal found that the Article VI.3 requirement had been met for two reasons:

- Because Claimants had indeed complied with the mandatory six month waiting period and
- Because in any case negotiations between the two Parties would have been futile.

123. It is Respondent's contention that both findings are grossly incorrect<sup>84</sup>:

- Claimants did not comply with the mandatory six month negotiation procedure, because the Tribunal calculated the time period from the beginning of the *caducidad* proceedings, when in fact it should have been calculated from the issuance of the *Caducidad* Decree – the date when the dispute actually arose; and Claimants filed the arbitration just two days thereafter, without any prior notice to the Republic<sup>85</sup>; previous tribunals have dismissed jurisdiction on this very ground<sup>86</sup>;
- As regards futility, Ecuador argues that settlement discussion would not have been futile<sup>87</sup> and that the Tribunal decided the contrary with almost no discussion and no acknowledgement of Claimants' burden to prove<sup>88</sup>.

124. In Ecuador's view, the Tribunal manifestly exceeded its powers by refusing to give effect to the mandatory negotiation requirements set out in Article VI.3 of the Treaty<sup>89</sup>.

#### **B. Claimants' Position**

125. Claimants disagree.

126. As regards the futility argument, Claimants submit that the Tribunal cited extensive arbitral precedent proving that where negotiations are bound to be futile, there is no

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<sup>84</sup> R I at 297.

<sup>85</sup> R I at 304, 305, 307; R II at 195.

<sup>86</sup> R II at 201.

<sup>87</sup> R I at 310.

<sup>88</sup> R I at 308, R II at 207.

<sup>89</sup> R I at 294.

need for the waiting period to have fully lapsed. Ecuador is constrained to accept this legal premise; it only disputes the Tribunal's factual determination that the negotiations would have been futile – a question which falls outside the scope of review of an annulment Committee<sup>90</sup>.

127. Claimants also submit that Ecuador's argument that a dispute only arose on the date of the *Caducidad* Decree, two days before Claimants filed this case at ICSID, is disingenuous. The dispute already existed in the course of the *caducidad* procedure<sup>91</sup>. In any case these factual findings are not within the purview of annulment committees<sup>92</sup>.

### C. The Committee's Decision

128. Respondent argues that the Tribunal manifestly exceeded its powers when it assumed jurisdiction, without respecting the mandatory six-month negotiation requirement established in Article VI.3. of the Treaty and requests that the Award be annulled for this reason.

129. The Tribunal's decision is based on two arguments:

- First, the Tribunal established that for some "18 months or so" prior to the *Caducidad* Decree OEPC had made a number of submissions seeking to rebut the allegations on the basis of which the *caducidad* procedure had been initiated; and
- Second, the Tribunal found that in the circumstances any attempt at reaching a negotiated solution was futile; and in a footnote, the Tribunal referred to a number of decisions from investment tribunals, which had held that where negotiations are bound to be futile, there is no need for the waiting period to have fully lapsed<sup>93</sup>.

130. The Committee will examine the futility reason first

131. The Tribunal cited extensive arbitral precedent establishing that where negotiations are bound to be futile, there is no need for the waiting period to lapse before claimant is authorized to file the Request for Arbitration. Respondent does not contest that the Tribunal's legal argument is right. Respondent's reasoning is different: it submits that

"with almost no discussion of the issue and no acknowledgement of Claimants' burden to prove, the Tribunal simply concluded that attempts to reaching a negotiated solution were indeed futile"<sup>94</sup>.

132. In the present case, the Tribunal, after reviewing and weighing the evidence, came to the conclusion that attempts at reaching a negotiated settlement were indeed

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<sup>90</sup> C I at 368.

<sup>91</sup> C I at 373.

<sup>92</sup> C II at 103.

<sup>93</sup> *Lauder* at 187-191; *Lesi* at 32(iv); *SGS* at 184; *Ethyl* at 84.

<sup>94</sup> R I at 308.

futile, that the six-month waiting period mandated by Article VI.3. of the Treaty could be dispensed with, and that Respondent's Negotiation Objection should be dismissed. The Tribunal's factual determination seems reasonable, and the Tribunal's legal argument is settled law<sup>95</sup>.

133. The Tribunal's dismissal of the Negotiation Objection, based on the argument that any further negotiation would be futile, must stand.

134. Given that the Tribunal correctly dismissed the Negotiation Objection on the basis of futility, the questions

- whether OEPC had made a number of allegations in the course of the *caducidad* procedure,
- whether these allegations were made before or after the dispute arose, and
- whether these allegations provide an additional reason which supports the Tribunal's decision to dismiss the Negotiation Objection

have become moot and need not be addressed.

135. Summing up, Respondent's fourth ground for annulment, that the Tribunal manifestly exceeded its powers when it rejected Respondent's Negotiation Objection, is dismissed.

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<sup>95</sup> *Teinver*, at 126, 129; *Alemanni*, at 310, 317.

**VI. PARTIAL ANNULMENT FOR WRONGFUL ASSUMPTION OF JURISDICTION OVER 40% OF CLAIMANTS' INVESTMENT**

136. Having dismissed Respondent's request that the Decision on Jurisdiction be annulled, the Committee must now turn to the grounds for partial annulment of the Award invoked by Ecuador. These grounds revolve around the argument that the Tribunal has wrongly assumed jurisdiction over a 40% share of Claimants' investment, because that share now belongs to Andes, a Chinese investor not protected by the Treaty.
137. *Pro memoria*: The execution of the Farmout Agreement between OEPC and AEC on October 1, 2000 (together with the Joint Operating Agreement) implied the transfer of a 40% ownership interest in the Block 15 investment from OEPC to AEC (who thereafter resold its interest to the Chinese company Andes). Since the parties failed to obtain the required authorization from the Ecuadorian Minister, the transfer eventually triggered Ecuador's declaration of *caducidad* of the Participation Contract.
138. The Tribunal found in the Award that Ecuador adopted this *caducidad* declaration in breach of Ecuadorian and customary international law, that the Caducidad Decree resulted in "a measure tantamount to expropriation" and that the Republic was required to pay damages to Claimants (albeit reduced by a factor of 25%, because OEPC had failed to secure the required ministerial authorization for the transfer of rights under the Farmout Agreement).
139. The grounds for partial annulment submitted by Respondent which will be analyzed in this Chapter address the following questions:
- Did the Tribunal wrongly assume jurisdiction over the 40% investment in Block 15 now beneficially owned by the Chinese investor Andes (and previously by the Bermudan company AEC)?
  - As a consequence thereof, does the Tribunal's decision to order Ecuador to compensate OEPC for that 40% interest fall outside its jurisdiction?

The Award

140. The Tribunal was perfectly aware of the significance of these questions. It requested additional submissions from the Parties and held a hearing on this very topic. Having heard the Parties, the Tribunal was unable to reach a unanimous decision: the majority took one route and arbitrator Stern dissented.
141. In the Award the majority of the Tribunal accepted the approach of awarding 100% of the value of the investment: it found that since the assignment of rights from the Participation Contract had not been authorized by the Ecuadorian Minister, such assignment was "null and void and has no validity whatsoever, and the Tribunal so finds". The assignment "must therefore be disregarded by the Tribunal for purposes of determining the compensation to which Claimants are entitled"<sup>96</sup>. With the result

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<sup>96</sup> Award at 650.

that in the Tribunal's opinion, OEPC continued to own, as of the date of the *Caducidad* Decree, 100% of the rights under the Participation Agreement and had to be compensated for 100% of the value of Block 15<sup>97</sup>.

142. Arbitrator Stern strongly dissented.
143. In her opinion at the time of the *Caducidad* Decree the rights under the Participation Contract were owned 60% by OEPC and 40% by AEC<sup>98</sup>, and OEPC had been fully paid for the assignment of its 40% interest<sup>99</sup>. Prof. Stern then found that both under New York and under Ecuadorian law the Farmout Agreement, not having been invalidated either by a New York Court or an Ecuadorian Court, should have been considered as still in force and binding<sup>100</sup> and that the ICSID Tribunal exceeded its powers in annulling AEC's rights thereunder<sup>101</sup>.
144. Arbitrator Stern added that title to AEC's 40% interest in Block 15 was split, the nominal legal title belonging to OEPC and the beneficial interest to AEC<sup>102</sup>. In accordance with international law, only the beneficial owner, AEC could claim compensation for expropriation<sup>103</sup>. Consequently, OEPC should only have received 60% of the total damages, in line with the *Chorzów Factory* principle of full recovery<sup>104</sup>.
145. Prof. Stern concluded with the remark that there is no unfairness in Ecuador acquiring a 100% interest in Block 15, and being only obliged to compensate 60% of its value – this being purely the result of the limited jurisdiction of ICSID tribunals<sup>105</sup>.

#### Ecuador's Request

146. In the present annulment procedure, Ecuador requests that the Award be partially annulled, to the extent that it compensates Claimants with any amount exceeding 60% of the value of Block 15<sup>106</sup>. The request is based on three separate grounds for annulment:
- That the Tribunal wrongly assumed jurisdiction over AEC's investment, thus manifestly exceeding its powers;
  - That when the Tribunal assessed damages it failed to apply international law principles, and that this failure amounts to a manifest excess of powers; and

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<sup>97</sup> Award at 651.

<sup>98</sup> Dissent at 28.

<sup>99</sup> Dissent at 33.

<sup>100</sup> Dissent at 116.

<sup>101</sup> Dissent at 132.

<sup>102</sup> Note introduced in the Spanish version of the Award to clarify the translation of "nominal legal title".

<sup>103</sup> Dissent at 151.

<sup>104</sup> Dissent at 158.

<sup>105</sup> Dissent at 166-167.

<sup>106</sup> R III p. 317.

- That the Tribunal manifestly exceeded its powers and failed to state reasons for declaring inexistent the assignment of rights between Claimants and AEC.

147. The Committee will approach this request by

- First summarizing the Tribunal's findings (1.),
- Then summarizing Respondent's and Claimants' positions (2. and 3.),
- And thereafter explaining its own decision (4.)

## 1. THE AWARD

148. The Tribunal devoted a whole section<sup>107</sup> of the Award to the issue of whether Claimants are entitled to 100% or only to 60% of the value of Block 15. The analysis starts with paras 613 and 614, which frame the question:

“613. The Tribunal will now deal with the central issue which, in its view, after the parties' arguments have been stripped of their complex legal ramifications, comes down to the following: does the execution by OEPC of the Farmout Agreement with AEC on 1 October 2000 (together with the Joint Operating Agreement) allow Ecuador, following *caducidad*, to compensate OEPC for 60% only of its interest in Block 15 or is it legally obliged to compensate OEPC for 100% of its interest in Block 15, being precisely what it has acquired upon the issuance of the *Caducidad* Decree?”

614. In other words, the key issue to be addressed in this section is whether any assignment to AEC of the 40% beneficial interest in Block 15 was actually effected by the Farmout Agreements (i.e., the Farmout Agreement and the Joint Operating Agreement) or whether any such purported assignment was void and therefore without legal effect. If the former, OEPC would be entitled to recover 100% of the established value of Block 15 under the relevant principles of international law; if the latter, it could recover 60% only”. [Footnote omitted].

149. Since the Farmout agreement is subject to New York law, the Tribunal then analysed whether a valid assignment of an equitable interest had taken place, both under Ecuadorian and New York law<sup>108</sup>.

### Ecuadorian Law

150. The Tribunal first recalled Clause 16.1 of the Participation Contract and Article 79 of the *Ley de Hidrocarburos* (“HCL”):

“16.1. La transferencia de este Contrato de Participación o la cesión a terceros de los derechos provenientes del mismo deberán ser autorizados por el Ministro del Ramo de conformidad con las leyes y reglamentos vigentes; de

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<sup>107</sup> Section E.4 in the chapter on quantum, paras. 612-658.

<sup>108</sup> Award at 616.

manera especial se cumplirán las disposiciones previstas en el artículo 79 de la Ley de Hidrocarburos y en los Decretos Ejecutivos Nos. 809, 2713 y 1179”.

“Art. 79: La transferencia de un contrato o la cesión a terceros de derechos provenientes de un contrato, serán nulas y no tendrán valor alguno si no procede autorización del Ministerio del Ramo, sin perjuicio de la declaración de caducidad según lo previsto en la presente ley”.

151. Applying Article 79 HCL the Tribunal came to the following conclusions:

- The purported assignment had no legal effect “and OEPC retained 100% of both the legal and beneficial ownership of all rights in the Participation Contract”<sup>109</sup>;
- The invalidity of any purported assignment did not affect the right of the State to declare *caducidad*<sup>110</sup>.

152. After having reached these conclusions, the Tribunal analysed and rejected Respondent’s counter-arguments:

The Requirement of Judicial Declaration of Nullity

153. The first counter-argument submitted by Respondent was that the assignment created an “absolute nullity” which required a judicial declaration<sup>111</sup>.

154. The Tribunal disagreed. In its opinion<sup>112</sup>

“622. Although not expressly stated in the Ecuadorian Civil Code, the Ecuadorian Supreme Court has confirmed on a number of occasions that Ecuadorian law recognizes automatic nullity or inexistence”.

155. The Tribunal then referred to four cases in which the Supreme Court of Ecuador had differentiated between the categories of inexistence, absolute nullity and relative nullity and concluded that the<sup>113</sup>

“626. [...] intended assignment that occurred under the Farmout Agreement and the Joint Operating Agreement undoubtedly meets the criteria [...] for inexistence”

The Tribunal continued<sup>114</sup>:

“626. [...] Where the law itself stipulates that an act has “no validity whatsoever” there is no need on its face for the assignment to be declared invalid by a judge, because it could never be valid in the first place – it lacked an essential element required for life”.

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<sup>109</sup> Award at 619.

<sup>110</sup> Award at 619 bis.

<sup>111</sup> Award at 620.

<sup>112</sup> Award at 622.

<sup>113</sup> Award at 626.

<sup>114</sup> Award at 626.



And then explained<sup>115</sup>:

“628. As noted above, Article 79 of the HCL is categorical in expressing, not only the illegal act, but also the consequence of the illegality. Significantly, a similar provision (Article 1745 of the [1970] Civil Code [Article 1718 of the 2005 Civil Code]) was being applied by the Supreme Court in the above case (and in others discussed below). Article 1745 [1718] provides that, where the law requires a public deed, contracts signed in another form “will be deemed as non-executed or signed”. Thus, the consequence of the illegality is specified. The result of the Court’s decision that such contracts are “inexistent” is that Article 1745 [1718] is given effect without the need for a judicial declaration. In other words, where the law itself clearly states that the contract is deemed to be unexecuted, and therefore has no life, there is no requirement for judicial confirmation. Similarly, under Article 79 [HCL], the law itself has deemed that an unauthorised assignment has no validity whatsoever, and therefore has no life. The logical consequence of this provision is that no further action is required to invalidate an unauthorised assignment”.

#### New York Law

156. The Tribunal then analysed the issue under New York law and concluded that New York law results in exactly the same conclusion as Ecuadorian law: where the governing law of the assignment is a foreign law, New York courts apply the governing law of the contract containing the non-assignment clause, when interpreting that clause. As clause 7.02 of the Farmout Agreement states that mandatory Ecuadorian laws governing the Participation Contract apply, New York courts would give effect to such laws, including the HCL<sup>116</sup>.

#### Findings

157. In para. 650 the Tribunal came to its main finding:

“650. It follows that, pursuant to New York and Ecuadorian law, the purported assignment by OEPC to AEC of rights under the Participation Contract pursuant to the Farmout Agreement and the Joint Operating Agreement is null and void and has no validity whatsoever and the Tribunal so finds. Under the doctrine of inexistence and under New York law, there is no requirement that the Court must first declare the assignment to be invalid”<sup>117</sup>.

The Tribunal then added:

“650. [...] As such, the purported assignment of rights under the Farmout Agreement and the Joint Operating Agreement was not valid and produced no legal effect. It must therefore be disregarded by the Tribunal for purposes of determining the compensation to which the Claimants are entitled. Consequently, the Tribunal finds that OEPC continued to own, as of the date

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<sup>115</sup> Award at 628.

<sup>116</sup> Award at 646, 647.

<sup>117</sup> Award at 650.

of the Caducidad Decree, 100% of the rights under the Participation Contract”<sup>118</sup>. [Footnote omitted].

With the following result:

“651. The Tribunal accordingly concludes that the Respondent is obliged to compensate the Claimants for 100% of their interest in Block 15 which it acquired upon the issuance of the *Caducidad* Decree”<sup>119</sup>.

#### The Severance Issue

158. Although the Tribunal found that the assignment of rights as between OEPC and AEC was inexistent, at the same time it concluded that “the Farmout Agreement itself remains a valid contract between OEPC and AEC”, because Article 79 HCL is concerned with the legal effect of the assignment itself and does not invalidate the Farmout Agreement or the Joint Operating Agreement<sup>120</sup>. This idea, that it is possible to sever the assignment of rights, which is null, and the Farmout Agreement, which remains valid, is further developed in para. 635:

“635. [...] For the avoidance of doubt, as noted above, the Tribunal reiterates that in the present case it is the validity of the assignment that is under scrutiny, and not the validity of the Farmout Agreement or the Joint Operating Agreement. The Tribunal’s findings on the validity of the assignment do not affect other obligations that might arise between the parties to the Farmout Agreement and the Joint Operating Agreement (such parties being different to [*sic*] those in the present arbitration), nor does it affect the ability of AEC to seek damages from OEPC for a failure to comply with the terms of those Agreements, such as obtaining necessary government consent for the assignment”. [Footnote omitted].

159. The idea that the transaction effected between OEPC and AEC can be severed in two parts,

- the assignment of rights, which is automatically null and inexistent,
- and the rest of the Farmout and Joint Operating Agreements, which remains valid,

is one of the most disputed and obscure conclusions of the Award. The issue was the subject of extensive debate in the course of the annulment hearing, with the Parties holding opposite interpretations<sup>121</sup>.

#### Three additional Arguments of Respondent

160. In the final part of its analysis, the Tribunal dismissed three additional arguments submitted by Respondent:

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<sup>118</sup> Award at 650.

<sup>119</sup> Award at 651.

<sup>120</sup> Award at 619; 619 *bis*.

<sup>121</sup> HT p. 894 – 931.

161. (i) The first argument was unjust enrichment. The Tribunal stated as follows<sup>122</sup>:

“654. [...] the Tribunal notes that the invalidity of the assignment under New York and Ecuadorian law does not mean that AEC (or Andes) may not have recourse against OEPC under the Farmout Agreement. As mentioned earlier, the unauthorised assignment does not invalidate the Farmout Agreement as between the assignor, OEPC and the assignee, AEC nor is the legal position affected by the fact that the assignor and the assignee actually implemented *inter se* parts of the legally invalid and unauthorised assignment. OEPC promised to deliver certain rights to AEC under the Farmout Agreement, but due to its failure to secure authorisation from the Ministry it was in breach of that promise. This breach of contract may form the basis of a claim by AEC (or Andes) against OEPC. These factors weigh heavily against any unjust enrichment arguments raised in respect to OEPC’s entitlement to receive compensation for 100% of the interests in the Participation Contract”.

162. (ii) The second argument related to the *Chorzów Factory* dictum, which reads as follows<sup>123</sup>:

“This principle ... has the effect, on the one hand, of excluding from the damage to be estimated, injury resulting for third parties from the unlawful act and, on the other hand, of not excluding from the damage the amount of debts and other obligations for which the injured party is responsible. The damage suffered by the Oberschlesische in respect of the Chorzow undertaking is therefore equivalent to the total value—but to that total only—of the property, rights and interests of this Company in that undertaking, without deducting liabilities”. [Emphasis added].

163. The Tribunal found<sup>124</sup>:

“656. As a matter of international law, any liability that OEPC might have to AEC or Andes under various other agreements (including the Farmout Agreement) does not affect the Claimants’ right to receive compensation from Ecuador. Ecuador cannot discount OEPC’s claim by reference to liabilities that may be owed to third parties such as AEC. This principle is clearly recognised in the *Chorzów Factory* dictum ...”.

164. (iii) The third argument is twofold:

- that the Claimants allegedly lacked standing to claim damages beyond their “remaining” 60% interest in Block 15; and
- that no willing buyer would pay a price based on 100% of the value of Block 15, since OEPC only owns a 60% interest.

165. The Tribunal dismissed this argument with the following reasoning<sup>125</sup>:

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<sup>122</sup> Award at 654.

<sup>123</sup> *Chorzów Factory*, p. 31.

<sup>124</sup> Award at 656.

<sup>125</sup> Award at 658.

“658. [...] In view of the Tribunal’s conclusion in relation to the invalidity of the assignment as set out above, this objection of the Respondent has become moot”.

## **2. RESPONDENT’S POSITION**

166. Respondent avers that the Tribunal should have granted Claimants damages equivalent to 60% of the value of Block 15, and that its decision to calculate the damages as 100% of such value should be annulled, leading to a partial annulment of the Award. Respondent invokes three separate grounds for annulment<sup>126</sup>:

- First, that the Tribunal exercised *ratione personae* jurisdiction over a Chinese company, Andes, without any entitlement arising out of the Treaty or the Participation Contract, thus manifestly exceeding its powers (**A.**);
- Second, that the Tribunal failed to apply the applicable rules of international law on damages, incurring in a manifest excess of powers (**B.**); and
- Third, that the Tribunal acted with manifest excess of powers and failed to state reasons in reaching the conclusion that the assignment of the Farmout Agreement would be inexistent under Ecuadorian law (**C.**)

### **A. The Exercise of *ratione personae* Jurisdiction over Andes**

167. Respondent argues that there is an excess of powers if a tribunal exercises jurisdiction over a company which is not a party to the arbitration agreement and is not an investor protected by the applicable BIT<sup>127</sup>.

168. It is undisputed that the Treaty does not protect Chinese nationals. The ICSID arbitration clause contained in the Participation Contract only benefits the parties to such Contract – and Andes does not qualify as such<sup>128</sup>.

169. The Tribunal, by deciding that Claimants are entitled to damages amounting to 100% of the value of Block 15, took three decisions which affected Andes without having jurisdiction over it<sup>129</sup>:

- First, it nullified the Farmout Agreement without Andes being a party to this arbitration;
- Second, by granting Claimants damages equivalent to 100% of the value of Block 15, it effectively granted Andes 40% of that sum (if Claimants comply with the 2006 Letter Agreement and transfer to Andes 40% of whatever proceeds they obtain);

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<sup>126</sup> R I sections 13-14; R II sections 11-12.

<sup>127</sup> R I at 532.

<sup>128</sup> R I at 535.

<sup>129</sup> R I at 536-539.

- Third, the Tribunal expropriated Andes of its investment of 40% of Block 15 if, contrary to the preceding scenario, Claimants decide not to transfer to Andes 40% of the proceeds of the underlying arbitration.

**B. Failure to apply the proper Rules of International Law on Damages**

170. Respondent submits that the Tribunal also manifestly exceeded its powers when it failed to apply the proper principles of international law relating to the assessment of damages<sup>130</sup>. The Tribunal specifically failed to apply the following rules and principles:

- The willing buyer/willing seller international law standard<sup>131</sup>;
- The *Chorzów Factory* dictum<sup>132</sup>;
- The international law rule prohibiting unjust enrichment<sup>133</sup>.

**C. The Inexistence of the Assignment of the Farmout Agreement**

171. Respondent finally argues that if one assumes – as the Tribunal has concluded – that Ecuador had committed an unlawful expropriation, Claimants would only be entitled to claim the value of their investment, i.e. their 60% ownership stake in Block 15 (minus their contributory fault). By finding the assignment to be inexistent, however, the Tribunal allowed Claimants to recover the value of their investment and the value of AEC’s 40% stake in Block 15. This finding should be annulled for manifest excess of powers and for resting the decision on insufficient, frivolous and contradictory reasons<sup>134</sup>:

172. (i) The excess of powers derives from the fact that the Tribunal actually invented a set of rules for awarding Claimants damages far greater than the loss they sustained<sup>135</sup> and cherry picked one provision of the HCL, disregarding all the other provisions of the law<sup>136</sup>.

173. There is a second reason why the Tribunal committed an excess of powers: it is a general principle of law that the nullity or inexistence of a contract may be declared if, and only if, all the parties to the contract are parties to the judicial process. Given that AEC was not a party to the underlying arbitration, the majority lacked the authority to declare the Farmout Agreements without validity<sup>137</sup>. Even admitting (*quod non*) that the assignment could be severable from the Farmout Agreements, Ecuador is at a loss to understand how a claim for the nullity of the assignment

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<sup>130</sup> R I at 547.

<sup>131</sup> R I at 549-557; R II at 442-457.

<sup>132</sup> R I at 558-570; R II at 458-476.

<sup>133</sup> R I at 571-578; R II at 477-493.

<sup>134</sup> R I at 584.

<sup>135</sup> R I at 591-646; R II at 510-560.

<sup>136</sup> R I at 647-655; R II at 561-566.

<sup>137</sup> R I at 661.

could be admissible when the parties to the assignment are not the parties to the judicial proceedings<sup>138</sup>.

174. (ii) The failure to state reasons should also lead to annulment, because the majority's determination rests on a combination of frivolous, scarce and contradictory reasons<sup>139</sup>.

### **3. CLAIMANTS' POSITION**

175. Claimants disagree with Respondent's arguments. In their opinion, Respondent distorts the Award. The Tribunal only found that the Claimants purported to effect a transfer of rights under the Participation Contract, and then declared the transfer to be inexistent, while expressly affirming the validity of the Farmout Agreement<sup>140</sup>.

#### **A. The Exercise of *ratione personae* Jurisdiction over Andes**

176. Claimants aver that the Tribunal did not manifestly exceed its powers by improperly exercising jurisdiction *ratione materiae* over the Chinese company Andes, because the Tribunal did not award Andes any damages. The majority simply awarded Claimants the value of their investment, which was 100% of the rights under the Participation Contract. As a matter of international law, the Tribunal had to award Claimants damages reflecting 100% of their investment; it was not entitled to deduct Claimants' liabilities – as reflected in the *Chorzów Factory* dictum<sup>141</sup>.
177. Respondent's argument that the Tribunal had expropriated Andes' rights is wrong, because those rights are unaffected by the Award; the Tribunal expressly affirmed the validity of the Farmout Agreement<sup>142</sup>.

#### **B. Failure to apply the proper Rules of International Law on Damages**

178. Claimants argue that the Tribunal did not manifestly exceed its powers by failing to apply the proper law in determining the value of Claimants' investments<sup>143</sup>, because
- It applied the willing buyer/willing seller standard<sup>144</sup>;
  - It applied the *Chorzów Factory* dictum<sup>145</sup>, and
  - The international law rule prohibiting unjust enrichment<sup>146</sup>

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<sup>138</sup> R II at 576.

<sup>139</sup> R I at 677-709, R II at 583-640.

<sup>140</sup> C I at 444.

<sup>141</sup> C I at 480; C II at 281.

<sup>142</sup> C I at 482.

<sup>143</sup> C I at 445-448.

<sup>144</sup> C I at 449-454; C II at 267-270.

<sup>145</sup> C I at 455-462; C II at 271-275.

<sup>146</sup> C I at 463-474; C II at 276-280.

**C. The Inexistence of the Assignment of the Farmout Agreement**

179. (i) Claimants aver that the Tribunal did not manifestly exceed its powers by failing to apply the proper law when it found that the purported assignment by OEPC to AEC was inexistent and thus had no legal effects. The Tribunal found that
- Ecuadorian law recognizes the concept of inexistence;
  - Following the clear wording of Article 79 of the HCL the assignment was inexistent rather than an absolute nullity<sup>147</sup>;
  - An inexistent act does not need to be invalidated; and
  - Even if it were an absolute nullity, pending the judicial declaration the assignment still had no legal effect<sup>148</sup>.
180. Claimants aver that even if Ecuador's arguments were correct (*quod non*), they would only amount to a mere error.
181. Finally, Claimants submit that Ecuador is understandably at pains to retreat from its previous admissions. The Tribunal noted<sup>149</sup> that its conclusions regarding inexistence of the assignment had previously been fully endorsed by Ecuador and its legal experts<sup>150</sup>. In Claimants' opinion, the fact that Ecuador originally held the contrary position proves that the Tribunal's position at least is reasonable – thus making annulment for gross error of law unavailable<sup>151</sup>.
182. Claimants also recall that the Tribunal did not declare that the Farmout Agreement or Joint Operating Agreement was invalid – only the transfer of certain rights<sup>152</sup>.
183. (ii) The Tribunal's reasoning can be followed from point A to point B and so does not warrant annulment<sup>153</sup>:
- Article 79 HCL states that any unauthorized transfer of rights under the Participation Contract shall “be null and void and shall have no validity whatsoever”; consequently the purported assignment of rights was invalid;
  - The Ecuadorian Supreme Court has confirmed on a number of occasions that Ecuadorian law recognizes automatic nullity or inexistence;
  - No further action is required to invalidate an unauthorized assignment.

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<sup>147</sup> C I at 497-505.

<sup>148</sup> C I at 226.

<sup>149</sup> Award at 636-644.

<sup>150</sup> C I at 223.

<sup>151</sup> C II at 254.

<sup>152</sup> C I at 512.

<sup>153</sup> C II at 227.

184. Ecuador's efforts to manufacture a contradiction between the Tribunal's findings is unavailing, as is Ecuador's claim that the Tribunal's decision rests on frivolous and contradictory reasons<sup>154</sup>.

#### **4. THE COMMITTEE'S DECISION**

185. The Committee must decide whether the majority of the Tribunal fell into any of the grounds for annulment advanced by Ecuador, when, against the vocal dissent of one of its members, it assumed jurisdiction with regard to 100% of Block 15, without taking into consideration that the Claimant, OEPC, had transferred 40% of its interest to a third party, initially the Bermudan company AEC, which thereafter sold it to the Chinese company Andes. And, if it comes to the conclusion that the Tribunal indeed wrongly assumed jurisdiction, the Committee must then decide whether this excess of powers merits annulment under the strict requirements imposed by Article 52 of the Convention.

186. The extent and scope of Claimants' investments is more than a purely legal issue, relevant only for the calculation of damages in this case. It has wider repercussions, touching on the natural tension between general principles of equality and equity vis-à-vis the jurisdictional scope of ICSID arbitration. This tension is inbuilt in a legal system which only protects investments held by investors of a certain nationality, covered by a specific BIT, but denies protection to other investors, including domestic investors<sup>155</sup>.

187. Through the expropriation of the Participation Contract, Ecuador acquired a 100% interest in Block 15; fairness would seem to require that it indemnify 100% of the value of such asset. And the Tribunal, when it decided to calculate damages on 100% of the investment, was undoubtedly guided by a purpose of delivering a fair and equitable solution<sup>156</sup>.

188. But viewed from the angle of OEPC, its damage seems to be limited to 60% of the value of the Block, because ownership over the remaining 40% had been transferred to a third party (AEC, a company which is not a party to the arbitration, and which is not protected by the US – Ecuador BIT), which duly paid to OEPC the agreed consideration and which finally resold the participation to Andes.

189. To comply with its duty of adjudicating Respondent's request for annulment, the Committee will:

- As a first step, review in some detail the underlying facts and the applicable law (A.);
- As a second step, it will analyse Respondent's ground for annulment that the Tribunal exceeded its powers, and will come to the conclusion that by assuming jurisdiction over the investment now beneficially owned by the

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<sup>154</sup> C II at 231,239.

<sup>155</sup> As Arbitrator Stern noted in the concluding remark of her dissent there is an underlying tension between fairness and equity and the scope of jurisdiction of investment tribunals; Dissent at 166, 167

<sup>156</sup> This idea can be fathomed from the last line of para. 613, quoted at para. 148 *supra*.



Chinese investor Andes the Tribunal indeed committed a manifest excess of jurisdiction (**B.**).

**A. Underlying Facts and Applicable Law**

**a. The Participation Contract**

190. In 1999 PetroEcuador and OEPC signed the Participation Contract, which expressly stated that it was to be governed by Ecuadorian law<sup>157</sup>. The parties agreed that OEPC, in return for accepting the obligation to explore, develop and exploit Block 15, and being responsible for all associated expenditures, was to receive a share of the oil produced, the balance corresponding to Ecuador.

191. The transfer of the Participation Contract and the assignment to third parties of rights arising thereunder was regulated in clause 16.1.:

“La transferencia de este Contrato de Participación o la cesión a terceros de derechos provenientes del mismo deberán ser autorizados por el Ministro del Ramo, de conformidad con las leyes y reglamentos vigentes: de manera especial se cumplirán las disposiciones previstas en el artículo 79 de la Ley de Hidrocarburos y en los Decretos Ejecutivos Nos. 809, 2713 y 1179”.

192. Clause 16.1. clearly established that both the transfer of the Contract (i.e. the transfer of the bundle of rights and obligations corresponding to OEPC) and the assignment of any right (without obligations) required authorization from the Minister.

193. The Participation Contract also provided that the transfer of rights or obligations without authorization of the Minister could result in its termination:

“21.1. Terminación: Este Contrato de Participación terminará:  
[...]  
21.1.2. Por transferir derechos y obligaciones del Contrato de Participación, sin autorización del Ministerio del Ramo”.

**b. The Farmout Agreements**

194. In October 2000 OEPC and City Investing Company Limited (“**AEC**”), a Bermuda company, executed the Farmout Agreements (consisting of the Farmout Agreement and the Joint Operating Agreements), which were subject to New York law. The purpose of the Farmout Agreements was to transfer from OEPC to AEC the ownership of a 40% interest in the rights and obligations deriving from the so called “**Farmout Property**” (a wide concept which included the “**Participating Agreements**”, one of which was the Participation Contract). This transfer of ownership was to be executed in two phases:

- In the first phase OEPC would hold legal title to AEC’s 40% interest in the Farmout Property “as a ‘nominee’”, acting “on behalf of AEC”, OEPC being obligated, “at the sole risk, cost and expense” of AEC to act with

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<sup>157</sup> Participation Contract Clause 22.1.

respect to the 40% Farmout Interest of AEC as AEC shall direct, “as if AEC were a party” to the Participation Contract “owning legal title to a 40% interest” in such Contract and in Block 15<sup>158</sup>;

- In the second phase –which never came into force – OEPC would transfer to AEC the legal title for AEC’s 40% participation in the Farmout Property.

195. Having signed the Farmout Agreements, AEC paid approximately US\$ 180 million to OEPC as consideration for the acquisition of its 40% Farmout Property, the amount being equivalent to 40% of the expenditure so far. In compliance with the obligations assumed in the Farmout Agreements, thereafter AEC regularly paid to OEPC 40% of the expenditures incurred in the exploitation and development of Block 15, and received 40% of the oil produced.

196. What were the legal consequences of the Farmout Agreement?

197. In accordance with the agreed terms, the execution of the Farmout Agreements resulted in OEPC transferring to AEC ownership of a 40% interest in the Farmout Property. And clause 1.01 of the Farmout Agreement defined Farmout Property to include (*inter alia*) the following:

“(a) the Participating Agreements [which include the Participation Contract] and the rights and obligations therein granted to OEPC in and with respect to Block 15 and the related obligations of OEPC [...] accruing after the Effective Date hereunder;

(b) All wells, equipment, ancillary pipelines, facilities and personal property situated in Block 15 at the Effective Time and owned or granted to and held by OEPC [...]”[Emphasis added].

198. The definition of Farmout Property leaves no room for doubt that, as regards the Participation Contract, what OEPC was transferring to AEC was the ownership of a 40% interest in the complete bundle of “rights and obligations” which formed OEPC’s legal position under that Contract – and not simply certain rights deriving therefrom.

199. A second element is important: the purpose of the Farmout Agreements was the transfer of “ownership” over the Farmout Property, including OEPC’s legal position under the Participation Contract. This conclusion is supported by clause 3.3.1 of the Joint Operating Agreement, which reads as follows:

“Unless otherwise provided in this Agreement, all the rights and interests in and under the Participating Agreements, all Joint Property and any Petroleum produced from the Agreement Area shall, subject to the terms of the Participating Agreement, be owned by the Parties in accordance with their respective Participating Interests” [emphasis added].

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<sup>158</sup> Farmout Agreement Clause 2.01.

200. It is important to note that the conclusion that the Farmout Agreements caused the transfer of ownership of a 40% interest in OEPC's rights and obligations under the Participation Contract is shared by the Tribunal – at least in its initial analysis<sup>159</sup>:

“303. [...] Again, this language explicitly evidences that the Joint Operating Agreement served to operate a transfer of rights and obligations held under the Participation Contract, resulting in AEC's purported 'ownership' over these rights to the extent of its Participating Interest”.

201. Summing up: upon the execution of the Farmout Agreements in 2000, OEPC retained a 60% interest in the Farmout Property (which included OEPC's legal position under the Participation Contract), and for good consideration transferred to AEC ownership over a 40% interest in the Farmout Property. The transfer was never authorized by the Ecuadorian Minister of Mines, as required by Article 79 HCL. However, OEPC and AEC duly complied with the terms and conditions agreed upon in the Farmout Agreements.

**c. Split Title: Beneficial Ownership and Nominee**

202. Although the Farmout Agreements foresaw a transfer of ownership, the transfer was timed to occur in two phases, and it was agreed that AEC was only to acquire formal title over its 40% share in the Farmout Property in a second phase. During the first phase (which is the only one relevant, because it was during that phase when the *Caducidad* Decree was issued) the parties agreed in clause 2.01 of the Farmout Agreement that title to the 40% interest in the Farmout Property was to be split:

- AEC, who had paid the consideration for acquiring ownership, would be the "beneficial owner" of its portion of the Farmout Property;
- While OEPC would be acting as a "nominee" for AEC, appearing as formal owner *vis-à-vis* third parties (including *vis-à-vis* the Ecuadorian public administration).

203. Ownership title was thus divided between a nominee (OEPC, who held legal title on behalf of the beneficial owner) and a beneficial owner (AEC who bore the costs, profits, risks and rewards of ownership, whose instructions the nominee agreed to follow and who thus controlled its share of the investment).

204. Prof. Stern has drawn attention to the legal relevance of this split ownership structure created by the Farmout Agreements<sup>160</sup>.

205. The Committee agrees with Prof. Stern's analysis. The Farmout Agreements have indeed provided that, at the time when the *Caducidad* Decree was issued, the Claimants only retained full title over 60% of their investment in Block 15. For the remaining 40%, OEPC was simply a "nominee", who held apparent ownership, but

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<sup>159</sup> Award at 303.

<sup>160</sup> Dissent at 148.

in substance was acting on behalf and for the benefit of the true beneficiary, AEC. It was AEC who actually controlled a 40% share in the Farmout Property.

The Tribunal's Disagreement

206. The majority of the Tribunal, however, disagrees with this analysis. In its Award it reaches the opposite conclusion<sup>161</sup>:

“658. [...] Also moot is Respondent's contention that there is a risk of double jeopardy as AEC has no standing to sue Ecuador directly for compensation given that it holds no rights – beneficial or otherwise – in the Participation Contract” [emphasis added].

207. In the Committee's opinion, the Tribunal's finding is inconsistent with the clear language of clause 2.01 of the Farmout Agreement, which provides that during phase I of the transaction OEPC

“shall hold legal title to the interest in the Farmout Property represented by the [40%] Farmout Interest of AEC in the Participating Agreements [which include the Participation Contract] as a 'nominee', with the obligation to convey title to such interest to AEC [in phase II]” [emphasis added].

208. If in the Farmout Agreements the parties agreed that OEPC would act as AEC's nominee, the inescapable consequence is that AEC became the beneficial owner of the interest in the Farmout Property. This conclusion is confirmed by the last sentence of clause 2.01 of the Farmout Agreement:

“OEPC shall be obligated, at the sole risk, cost and expense of AEC to act with respect to the Farmout Interest of AEC as AEC shall direct from time to time as if AEC were a party to the Participating Agreements [which include the Participation Contract] owning legal title to a 40% interest in the Participating Agreements and the interests therein granted in Block 15”.

209. The same principle is repeated in clause 3.2.1 of the Joint Operating Agreement:

“3.2.1 Pursuant to the provisions of the Farmout Agreement, AECI has on the Effective Date a forty percent (40%) interest in the Participating Agreements that until the Transfer Date shall be equivalent economically to, but shall not include, nominal legal title and, thereafter, shall include legal title”.

210. In view of the clear language of the Farmout Agreements, and the undisputed fact that OEPC and AEC duly complied with its terms and conditions, and paid the consideration established therein, the Tribunal's conclusion that AEC did not acquire any interest – beneficial or otherwise – in the Participation Contract is untenable.

211. Furthermore, the Tribunal's conclusion is inconsistent with its own finding that the Farmout Agreements

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<sup>161</sup> Award at 658.

“303. [...] operate[d] a transfer of rights and obligations held under the Participation Contract, resulting in AEC’s purported ‘ownership’ over these rights to the extent of its Participating Interest”<sup>162</sup>.

**d. AEC is not a Creditor**

212. A corollary of the fact that AEC is a beneficial owner and controller of a 40% interest in the Farmout Property is that AEC cannot be considered as a creditor, holding a contractual right to claim from OEPC a share of the Block 15 oil production.
213. OEPC and AEC could have structured their relationship as a “cash against future oil transaction”, as a simple sales agreement, where AEC agrees to pay an uncertain price (equivalent to a percentage of the expenditure in Block 15) and receives an uncertain quantity of oil in the future (the agreed percentage of whatever oil the Block produces).
214. The parties chose not to do so.
215. Instead, they agreed on the Farmout Agreements, which formalized a totally different transaction: a transaction where OEPC transferred to AEC beneficial ownership and control to a 40% interest in the Farmout Property, and AEC paid the agreed consideration for the ownership of such asset. As owner of an interest in the Farmout Property, AEC had the rights and obligations concomitant with its co-ownership status: AEC participated in the management of the Property, it was under an obligation to contribute to the expenditure of exploiting and developing Block 15 and it was entitled to collect its portion of the oil revenue generated.

**e. Transfer to Andes and Letter Agreement**

216. In 2005 – five years after the execution of the Farmout Agreements – EnCana, AEC’s parent company, executed a Share Sale Agreement with Andes Petroleum Co. (“**Andes**”), a Chinese company, whereby EnCana sold AEC to Andes<sup>163</sup>. The parties also signed a supplemental indemnity agreement, in which the seller assumed certain obligations and indemnities related to possible actions by the Ecuadorian authorities related to Block 15 and the Participation Contract.

Letter Agreement

217. In February 2006 – i.e. during the *Caducidad* procedure but before the issuance of the *Caducidad* Decree – OEPC and Andes executed a Letter Agreement (the “**Letter Agreement**”)<sup>164</sup> in which
- Andes released OEPC of any liability arising out of the *Caducidad* proceedings and acknowledged that OEPC had no obligation to compensate Andes in case of *caducidad* [clause 2 (a)];

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<sup>162</sup> Award at 303.

<sup>163</sup> R I at 199.

<sup>164</sup> Doc. EEA 152.

- OEPC and Andes agreed to share all cost on a 60/40 basis [clause 2 (f)]
- OEPC agreed to share with Andes 40% of whatever monetary award OEPC received as result of the *caducidad* proceedings or any monetary award received from Ecuador, net of any costs, in effect creating a joint venture [clause 2 (g)].

218. The Letter Agreement is consistent with and the natural consequence of the Farmout Agreements.

219. Under the Farmout Agreements, ownership of the Farmout Property, including OEPC's bundle of rights and obligations resulting from the Participation Contract, was shared 60/40 between OEPC and AEC. When the Republic declared *caducidad* of the Participation Contract and took the Farmout Property, AEC was deprived of its asset and its ownership rights transformed into the right to collect a compensation, if any, from Ecuador. The Letter Agreement simply acknowledges and formalizes this fact.

**f. The *Caducidad* Decree**

220. A few months thereafter, in May 2006, the Ecuadorian Minister of Energy issued the *Caducidad* Decree, a ministerial decision adopted after a lengthy preliminary administrative procedure. In the decision the Minister, applying the HCL, declared the *caducidad* of the Participation Contract, as a sanction for the unauthorized transfer of rights between OEPC and AEC/Andes. The powers of the Minister to order *caducidad* derive from Article 74 HCL, the first article in the chapter of the law devoted to "*Caducidad, Sanciones y Transferencias*":

"Art. 74: El Ministerio del Ramo podrá declarar la caducidad de los contratos si el contratista:

[...]

11. Traspasare derechos o celebrare contrato o acuerdo privado para la cesión de uno o más de sus derechos, sin la autorización del Ministerio;

12. Integrare consorcios o asociaciones para las operaciones de exploración o explotación, o se retirare de ellos, sin autorización del Ministerio; y

13. Reincidiere en infracciones a la Ley y sus reglamentos".

221. The Minister found that OEPC's conduct had resulted in the grounds for *caducidad* set forth in sections 11, 12 and 13 of Article 74 HCL<sup>165</sup>. His decision led to the automatic termination of the Participation Contract<sup>166</sup>. Besides, OEPC was forced to turn over to the State and to PetroEcuador the concession and all assets used in connection with Block 15, without any compensation<sup>167</sup>.

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<sup>165</sup> *Caducidad* Decree at OC 09284.

<sup>166</sup> Participation Contract clause 21.1.

<sup>167</sup> Article 75 HCL.

222. But the most important consequence of the declaration of *caducidad* was that Article 79 HCL, a rule establishing that transfers of contract or assignment of rights, executed without prior administrative authorization, shall be null and void and without validity, became relevant.

**g. The Nullity under Article 79 HCL**

223. Article 79 HCL provides as follows:

“La transferencia de un contrato o la cesión a terceros de derechos provenientes de un contrato, serán nulas y no tendrán valor alguno si no precede autorización del Ministerio del Ramo, sin perjuicio de la declaración de caducidad según lo previsto en la presente Ley.

El Estado recibirá una prima por el traspaso y la empresa beneficiaria deberá celebrar un nuevo contrato en condiciones económicas más favorables para el Estado y para PETROECUADOR, que las contenidas en el contrato primitivo” [Emphasis added].

224. The rule applies in two situations:

- The first is if the holder of an oil contract executes a “transferencia de un contrato”, i.e. if the holder transfers to a third party (the totality or a portion of) its legal position in the contract (i.e. of the bundle of rights and obligations arising therefrom); and
- The second is if the holder of an oil contract carries out a “cesión a terceros de derechos provenientes de un contrato”, i.e. the holder assigns rights (but not obligations) deriving from such an oil contract.

The legal provision then orders that, except if the authorization of the Minister has been obtained, the transfer or the assignment shall be null and void and shall have no validity whatsoever.

225. The proper interpretation of Article 79 HCL has been an intensely disputed question. Two issues have merited special attention:

- whether the nullity predicated by this rule is automatic, not requiring judicial declaration (**h**) and
- whether it is possible to sever the transaction between OEPC and AEC into an assignment of rights on one side, and the remaining content of the Farmout Agreements on the other, with the assignment being null and void, and the Farmout Agreements surviving as a valid transaction (**i**).

**h. Does Article 79 HCL result in Automatic Nullity/ Inexistence?**

226. The majority of the Tribunal accepted that, although not expressly stated in the Ecuadorian Civil Code, the Ecuadorian Supreme Court had confirmed on a number of occasions that Ecuadorian law recognizes automatic nullity or inexistence<sup>168</sup>.

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<sup>168</sup> Award at 622.

And the Tribunal concluded that Article 79 HCL is one of those instances of automatic nullity, there being no requirement that the unauthorized transfer or assignment be declared invalid by a judge, because the law itself stipulates that the act “has no validity whatsoever”<sup>169</sup>. The same result would – in the opinion of the majority of the Tribunal – flow from the application of New York law.

227. Arbitrator Stern dissented.
228. In her opinion under New York law (which was the contractually relevant law), the Farmout Agreements, not having been invalidated by a New York court, should be considered as still in force and binding<sup>170</sup>.
229. Under Ecuadorian law she came to the same conclusion. Analyzing the very case law used by the majority of the Tribunal, she concluded that the cases stand for the principle that inexistence only results from the absence of the solemnity of a legal deed, when such form is required by law. Absence of other formalities, like the absence of an administrative authorization, entails an absolute nullity<sup>171</sup>. And absolute nullity has to be declared by a judge, as is stated without any possible ambiguity in section 1699 of the Civil Code.
230. Prof. Stern concluded that if the applicable law was Ecuadorian law, the Farmout Agreements, not having been invalidated by a court, should also have been considered as still in force.

#### The Committee’s Analysis

231. The Farmout Agreement provides that it is to be governed by New York law “except to the extent that the laws of Ecuador require application of the laws of Ecuador to the Participating Agreements”<sup>172</sup>. This implies – as the Award acknowledges – that New York courts would give effect to mandatory Ecuadorian laws governing the Farmout Agreement, including the HCL, when considering the validity of the assignment<sup>173</sup>, and that the materially relevant law is that of Ecuador.
232. The Ecuadorian Civil Code contains the following regulation with regard to the nullity of contracts:

”Art. 1698.- La nulidad producida por un objeto o causa ilícita, y la nulidad producida por la omisión de algún requisito o formalidad que las leyes prescriben para el valor de ciertos actos o contratos [...] son nulidades absolutas.

Art. 1699.- La nulidad absoluta puede y debe ser declarada por el juez, aún sin petición de parte, cuando aparece de manifiesto en el acto o contrato; [...]”.[Emphasis added].

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<sup>169</sup> Award at 626.

<sup>170</sup> Dissent at 55.

<sup>171</sup> Dissent at 105.

<sup>172</sup> Clause 7.02.

<sup>173</sup> Award at 646.



233. Ecuadorian law creates the category of “*nulidad absoluta*” of a contract, applicable when there is a failure to comply with a formality or requirement established by law. Such “*nulidad absoluta*” must be declared by a judge (i.e. it is not automatic) in order to produce the voidance of a validly executed contract.
234. The Committee agrees with Prof. Stern: the nullity deriving from Article 79 HCL was caused by the failure to comply with a “*requisito que las leyes prescriben para el valor de ciertos contratos*”, namely the authorization of the Minister, and thus it constitutes a “*nulidad absoluta*” as defined in Article 1698 of the Civil Code, with the consequence that the nullity had to be declared by a judge.
235. The majority of the Tribunal based its decision to declare the assignment of rights inexistent, and thus not requiring a judicial declaration, “[o]n [the] face” of Article 79 HCL<sup>174</sup>. Based on this interpretation, the Tribunal concluded that the transfer of ownership in favour of AEC/Andes, which had occurred in the year 2000, when the Farmout Agreements had been executed, was inexistent<sup>175</sup>.
236. The majority of the Tribunal’s interpretation is incorrect: Article 79 does not mention the concepts of “inexistence” or “automatic nullity”, it simply states that the transfer or assignment “*serán nulas y no tendrán valor alguno si no procede la autorización del Ministerio*”, and this nullity clearly fits into the definition of a “*nulidad absoluta*” under Article 1698 of the Civil Code. The words “*y no tendrán valor alguno*” are a simple reiteration of the main effect produced by nullity.
237. To support its position the Tribunal also invoked Article 1718 of the Civil Code<sup>176</sup>. Article 1718 provides as follows:
- “Art. 1718.- La falta de instrumento público no puede suplirse por otra prueba en los actos y contratos en que la Ley requiere esa solemnidad; y se mirarán como no ejecutados o celebrados, aun cuando en ellos se prometa reducirlos a instrumento público dentro de cierto plazo, bajo una cláusula penal. Esta cláusula no tendrá efecto alguno”. [Emphasis added]
238. This provision is irrelevant for the issue under discussion.
239. Article 1718 refers to the proper formalization of obligations and contracts, and provides that, if the law requires that a contract be formalized in an “*instrumento público*”, the absence of such requirement renders the contract inexistent. Article 1716 defines “*instrumento público*” as a deed authenticated by a notary or other authorized civil servant. Since it is undisputed that Ecuadorian law does not require that the Farmout Agreements be formalized in an “*instrumento público*”, the rule provided for in Article 1718 is irrelevant in this case.

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<sup>174</sup> Award at 619.

<sup>175</sup> Award at 619.

<sup>176</sup> Award at 628. Although the Tribunal refers to Article 1745, such numbering corresponds to the repealed 1970 Ecuadorian Civil Code. The 2005 Civil Code has an identical provision in Article 1718.

240. The Tribunal also tried to find support for its conclusion in Ecuadorian case law, which allegedly acknowledges the concept of “inexistence” and “automatic nullity”<sup>177</sup>.
241. The Committee has analysed the case law referred to by the Tribunal and has found no support for the majority’s conclusion: all cases deal with the inexistence of promises to buy/sell which had not been properly formalized in an “*instrumento público*” (i.e. in a notarial deed). The case law is clear that “inexistence” only arises in exceptional cases, when the law requires that the contractual consent be formalized with “*solemnidad*” (i.e. in an “*instrumento público*”, as required in certain contracts involving real estate). There is no discussion that the consent to enter into the Farmout Agreements was properly formalized and did not require “*solemnidad*”. What is being discussed is whether the properly formalized Farmout Agreement became inexistent by operation of Article 79 HCL. The parties have not referred to any Ecuadorian case law holding that an otherwise valid contract was rendered inexistent as a consequence of the failure to obtain an administrative authorization.

**i. Can the Farmout Agreements be severed for Nullity purposes?**

242. The majority of the Tribunal did not only decree that the assignment of rights formalized in the Farmout Agreement was inexistent and that no judicial declaration was required, it also specifically declared that such invalidity did not affect the Farmout Agreements<sup>178</sup>.
243. In the course of the arbitration Claimants had argued that under New York law any portion of the Farmout Agreements which did not require authorization from the Minister could be severed and would survive, even if the assignment of certain rights was null and void under Article 79 HCL.
244. This idea was taken up by the majority of the Tribunal, who agreed that the assignment of rights could be severed from the underlying Farmout Agreements, and while the former was automatically null and void and inexistent, by application of Article 79 HCL, the latter remained valid. The Tribunal expressed its reasoning with the following words<sup>179</sup>:

“... the Tribunal reiterates that in the present case it is the validity of the assignment that is under scrutiny, and not the validity of the Farmout Agreement or the Joint Operating Agreement. The Tribunal’s findings on the validity of the assignment do not affect other obligations that might arise between the parties to the Farmout Agreement and the Joint Operating Agreement (such parties being different to [*sic*] those in the present arbitration), nor does it affect the ability of AEC to seek damages from OEPC for a failure to comply with the terms of those Agreements, such as obtaining necessary government consent for the assignment”.

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<sup>177</sup> Award at 622.

<sup>178</sup> Award at 635.

<sup>179</sup> Award at 635.

245. Prof. Stern dissented<sup>180</sup>:

“126. If I understand correctly what the majority wants to convey here, it seems that it is saying that it cannot judge the validity of the Farmout Agreement, because it is between parties that are different than the ones before the ICSID Tribunal, but that it can rule on the validity of the assignment. This line of reasoning is quite difficult to follow, as it seems to me first that the parties to the assignment are exactly the same as the parties to the Farmout Agreement and second that the assignment and the Farmout Agreement are one and the same thing intrinsically linked together”.

The Committee’s Analysis

246. The Committee agrees with Prof. Stern that the opinion of the majority of the Tribunal is difficult to follow, because very little reasoning has been provided. According to the majority, the nullity would have been generated by Article 79 HCL, but the Tribunal has failed to provide any explanation on why this rule supports its conclusion.

247. In fact, the literal wording of Article 79 HCL contradicts the Tribunal’s conclusions.

248. Article 79 HCL distinguishes between two types of transactions:

- “*transferencia de un contrato*” and
- “*cesión a terceros de derechos provenientes de un contrato*”.

The Farmout Agreements qualify as a “*transferencia de un contrato*”, and not as a mere “*cesión de derechos*”. OEPC is not simply assigning certain rights to AEC. The object of the Farmout Agreements is the transfer to AEC of a bundle of rights and obligations which constitute 40% OEPC’s position in the Participation Contract<sup>181</sup>.

249. If what has triggered the application of Article 79 HCL is the unauthorized “*transferencia de un contrato*” executed by means of the Farmout Agreements, the rule itself mandates that the “*transferencia de contrato*” shall be null and void and shall have no validity. There is no room to argue that the Farmout Agreements, the instrument which formalized the “*transferencia de contrato*”, can survive, while the “*transferencia de contrato*” is (automatically or not, that is irrelevant for this discussion) null and void. Farmout Agreements and “*transferencia de contrato*” are one and the same thing, and both are identically affected by the nullity brought about by the lack of authorization<sup>182</sup>.

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<sup>180</sup> Dissent at 126.

<sup>181</sup> See clause 1.01 and 2.01 Farmout Agreement and para 198 *supra*.

<sup>182</sup> The conclusion would be the same if the Farmout Agreements are considered as a simple “*cesión de derechos*”, for the reasons noted by Prof. Stern in her dissent.

**j. Claims filed by the affected Parties**

250. Immediately after the issuance by the Minister of Energy of the *Caducidad* Decree, Claimants filed this arbitration, requesting compensation for 100% of the assets taken by the Ecuadorian government.
251. The Tribunal eventually reached the decision that the Republic had expropriated Claimants' investment in Block 15 in breach of Article II.1 of the Treaty, and that the *Caducidad* Decree had been issued in breach of Ecuadorian law and customary international law<sup>183</sup>.
252. Claimants have been affected by Ecuador's acts in contravention of the Treaty. But so were AEC/Andes, being the beneficial owner of a 40% in the Farmout Property, which included the rights and obligations deriving from the Participation Contract and all the assets used in Block 15<sup>184</sup>. This beneficial ownership was taken by the Republic of Ecuador, together with the 60% share property of OEPC.
253. Notwithstanding the damage suffered, there is no indication in the file that Andes has filed a separate claim against the Republic, either before the Courts of Ecuador or before any international tribunal<sup>185</sup>. The only claim submitted has been the present action, in which OEPC is requesting 100% of the value of Block 15. This is consistent with the Letter Agreement in which OEPC and Andes agreed that any reward arising from this procedure will be shared 60/40 – the ownership structure over the Farmout Property provided for in the Farmout Agreements.
254. There is also no evidence in the file that any judge or arbitrator, either in Ecuador or in New York, has declared the nullity of the Farmout Agreements, as a consequence of the violation of Article 79 HCL (or otherwise). And, in accordance with basic principles of procedural fairness, the Award rendered in this arbitration proceeding, in which AEC/Andes was not represented, could in no case result in the voidance of the Farmout Agreements, to which AEC/Andes were a party.

**B. Excess of Powers in assuming Jurisdiction over the Investment held by Andes**

255. In the previous section the Committee concluded that:
- upon execution of the Farmout Agreements in 2000, OEPC retained a 60% interest in the Farmout Property (which included OEPC's legal position under the Participation Contract), and for good consideration transferred to AEC/Andes beneficial ownership over a 40% interest in such Farmout Property; such transfer was never authorized by the Ecuadorian Minister of Mines;
  - in 2006 the Ecuadorian Government issued the *Caducidad* Decree, which led to the automatic termination of the Participation Contract<sup>186</sup>,

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<sup>183</sup> Award at 876.

<sup>184</sup> See para. 198 *supra*.

<sup>185</sup> At least there is no information in the file showing otherwise.

<sup>186</sup> Participation Contract clause 21.1.

established that an administrative authorization should have been obtained at the time when the Farmout Agreements were executed, and triggered the application of Article 79 HCL<sup>187</sup>;

- Article 79 HCL provides for the “*nulidad absoluta*” of any unauthorized assignment of rights or transfer of agreement, and that such “*nulidad absoluta*” requires declaration by a judge (i.e. it is not automatic), and that there is no evidence in the file that any judge has declared the nullity of the Farmout Agreement;
- AEC/Andes was not a party to the underlying arbitration proceedings, and in accordance with general principles of law, the Award could under no circumstances declare the invalidity of the Farmout Agreement, to which AEC had been a party;
- the assignment of rights and the Farmout Agreement cannot be severed: it is impossible to argue (as the Tribunal did) that the assignment of rights is invalid, affected by a an automatic nullity or inexistence provoked by the application of Article 79 HCL, and simultaneously to hold that the Farmout Agreement is still valid and binding. The Farmout Agreement embodies a “*transferencia de contrato*” and both would be identically affected if the supervening nullity were declared by a judge.

256. Having established these conclusions, the Committee will now turn to Respondent’s argument that the Tribunal exceeded its powers by assuming jurisdiction over the investment now beneficially owned by AEC/Andes – and come to the conclusion that a manifest excess of powers has indeed occurred (a.). It will then dismiss Claimants’ counterargument (b.) and will establish the consequences of the partial annulment of the Award (c.).

**a. The Tribunal’s Assumption of Jurisdiction over the Investment held by Andes**

257. Respondent argues that an ICSID tribunal commits a manifest excess of powers if it exercises jurisdiction over the investment held by AEC/Andes

- which is not a party to the arbitration agreement contained in the Participation Contract and
- which is not a protected investor under the BIT (in this case the Ecuador-US BIT) from which the Tribunal derives its authority<sup>188</sup>.

258. In the present case the protected investment consists in the so called Farmout Property, comprising the Participation Contract and the assets used for the exploitation and development of Block 15, and in accordance with the Farmout Agreements its ownership is split between OEPC and AEC/Andes

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<sup>187</sup> Article 75 HCL.

<sup>188</sup> R I at 532.

- OEPC being full owner of a 60% interest in the Property, and
- AEC/Andes being the beneficial owner and controller of the remaining 40% interest, which OEPC held as AEC/Andes' nominee<sup>189</sup>.

#### Split Title in International Law

259. In cases where legal title is split between a nominee and a beneficial owner international law is uncontroversial: as Arbitrator Stern has stated in her Dissent<sup>190</sup> the dominant position in international law grants standing and relief to the owner of the beneficial interest – not to the nominee.

260. The *status quaestionis* was summarized thus by David Bederman<sup>191</sup>:

“International law authorities have agreed that the real and equitable owner of an international claim is the proper party before an international adjudication, and not the nominal or record owner. This principle was espoused as early as 1876, and was a consistent element in early claims practice. Moreover, claims tribunals following the First World War explicitly enquired into the beneficial ownership of property at issue before them. The fact that the nominal owner did not have a real interest in the subject property, or that the beneficial owner was not of a proper nationality, was occasionally the decisive ground for dismissing a claim. Claims settlement commissions after the Second World War likewise continued this practice, and it has been observed recently in the jurisprudence of the Iran-United States Claims Tribunal. The notion that the beneficial (and not the nominal) owner of property is the real party-in-interest before an international court may be justly considered a general principle of international law”. [Footnotes omitted; emphasis added].

261. Other authors have confirmed the conclusion<sup>192</sup>.

262. The position as regards beneficial ownership is a reflection of a more general principle of international investment law: claimants are only permitted to submit their own claims, held for their own benefit, not those held (be it as nominees, agents or otherwise) on behalf of third parties not protected by the relevant treaty. And tribunals exceed their jurisdiction if they grant compensation to third parties whose investments are not entitled to protection under the relevant instrument.

263. This subjective limitation of ICSID jurisdiction is a natural consequence of international investment law. Arbitral tribunals are not courts of justice holding unfettered jurisdiction. The role of arbitral tribunals is not to redress torts

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<sup>189</sup> See para. 208 *supra*.

<sup>190</sup> Dissent at 148-151.

<sup>191</sup> David J. Bederman: “*Beneficial Ownership of international Claims*” in *International and Comparative Law Quarterly*, Vol. 38, 1989, p. 936.

<sup>192</sup> Francisco Orrego Vicuña: “*Changing approaches to the nationality of claims in the context of diplomatic protection*”, *ICSID Review*, Vol. 15, 2000 p. 352: “In claims to property beneficially owned by one person, the nominal title to which is vested in another person of different nationality, it was usually the nationality of the former that prevailed for the purposes of the claims”; Marjorie M. Whiteman, *Digest of International Law*, Vol. 8, pp. 1261-1261; Richard B. Lillich & Daniel B. Magraw, *The Iran-United States Claims Tribunal: Its contribution to the Law of State Responsibility*, 1998, p. 105: “The Tribunal’s precedents have made clear that beneficial owners of property are to be preferred as legitimate claimants over nominal owners. This was the express conclusion of the 1993 *Saghi* decision”.

worldwide. Arbitral tribunals are instruments created by and subject to the consent of States, as formalized in the relevant instrument, and are only empowered to adjudicate disputes between protected investors and consenting States. Other disputes are outside their remit. Investors cannot expand the jurisdiction *ratione personae* of arbitral tribunals by executing private contracts with third parties.

264. Specifically, protected investors cannot transfer beneficial ownership and control in a protected investment to an unprotected third party, and expect that the arbitral tribunal retains jurisdiction to adjudicate the dispute between the third party and the host State. To hold the contrary would open the floodgates to an uncontrolled expansion of jurisdiction *ratione personae*, beyond the limits agreed by the States when executing the treaty.

The Tribunal committed an Excess of Powers

265. The Committee has already verified that with regard to the 40% interest in the Farmout Property title is split, beneficial ownership and control being held by AEC/Andes, with OEPC acting as nominee on behalf of the beneficial owner. It has also concluded that in situations like this international law provides that only the beneficial owner, AEC/Andes, can claim for interference with its interest, while the nominee, OEPC, lacks standing to claim in the name of the beneficial owner<sup>193</sup>.
266. In the present case, the Tribunal has decided to compensate OEPC for 100% of the investment in Block 15. But 40% of that investment does not belong to OEPC, the U.S. corporation protected by the BIT and which is also party to the Participation Contract, but to Andes, a Chinese company, unprotected by the BIT and which does not participate in such Contract. By compensating a protected investor for an investment which is beneficially owned by a non-protected investor, the Tribunal has illicitly expanded the scope of its jurisdiction and has acted with an excess of powers.

The Excess of Powers is manifest

267. Article 52(1)(b) requires that the excess of powers be manifest. The Committee has already concluded that this additional limitation applies in situations where it is argued that the tribunal committed a jurisdictional excess of powers<sup>194</sup>. That said, “manifest” does not prevent that in some cases an extensive argumentation and analysis may be required to prove that the misuse of powers has in fact occurred<sup>195</sup>.
268. In the present case, the excess of powers is manifest: the Tribunal decided to assume jurisdiction over an investment which, at the relevant time, no longer belonged to OEPC [for the purposes of Article I(a) of the Treaty], and to compensate Claimants for 100% of the value of Block 15, without taking into consideration that:

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<sup>193</sup> The same conclusion is reached by Arbitrator Stern in her Dissent at 151.

<sup>194</sup> See para. 58 *supra* with case law. Note that with regards to errors of law affecting the merits, the standard is even higher: only gross and egregious errors of law can lead to annulment (see para 56 *supra*).

<sup>195</sup> *Victor Pey Casado*, at 70.

- in accordance with the Farmout Agreement, Claimants for good consideration had transferred beneficial ownership of a 40% share in the Farmout Property to AEC/Andes, OEPC remaining simply as a “nominee”, who holds apparent ownership, but in substance acts on behalf and for the benefit of the beneficial owner, AEC/Andes<sup>196</sup>;
- OEPC and AEC/Andes have at all times acted in full compliance with the terms and conditions agreed upon in the Farmout Agreements, there being no evidence in the file of any judicial declaration of voidance either by application of Article 79 HCL or otherwise;
- AEC/Andes not being a party to these arbitration proceedings, the Award could under no circumstances declare the invalidity of such Agreements;
- The assignment of rights and the Farmout Agreement are one and the same thing, and that both would be equally affected by a hypothetical nullity declared in accordance to Article 79 HCL;
- The existence of an uncontroversial principle of international law for situations when legal title is split between a nominee and a beneficial owner: as Arbitrator Stern stated in her Dissent<sup>197</sup> and the Committee has confirmed, international law only grants standing and relief to the owner of the beneficial interest – not to the nominee.

#### The Committee’s Decision

269. The Committee thus finds that the Tribunal committed a manifest excess of powers for the purposes of Article 52(1)(b) of the Convention.
270. Article 52(3) of the Convention grants committees “the authority to annul an award or any part thereof on any grounds set forth in paragraph (1)” of such article. Exercising its authority under said Article, the Committee partially annuls the Award, to the extent that the Tribunal has assumed jurisdiction with regard to the investment now beneficially owned by the Chinese investor Andes (and previously by the Bermudan company AEC), i.e. AEC/Andes’ 40% interest in the Farmout Property, and has awarded damages to OEPC based on such decision.
271. The rest of the Award remains unaffected.
272. A final *caveat*: neither the international law principles nor the Committee’s decision imply that investors holding beneficial ownership are left unprotected from interferences by host States. Such investors will enjoy the protection granted under the treaties which benefit their nationality. In the present case, AEC/Andes are entitled to the protection which investors from Bermuda/China enjoy, when investing in Ecuador, under applicable bilateral investment treaties or under general principles of international law. What they are not entitled to – because they are not

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<sup>196</sup> See para 208 *supra*.

<sup>197</sup> Dissent at 148-151.



U.S. nationals or companies – is to the protection offered to U.S. investors investing in Ecuador under the U.S.-Ecuador BIT.

Case Law

273. Investment arbitration case law has acknowledged the principle that under international law legal standing pertains to beneficial owners and not necessarily to nominees, and that unprotected parties cannot receive compensation, even if claimed on their behalf by protected investors.
274. A case which shows striking similarities with this arbitration is *Impregilo v. Pakistan*.

In *Impregilo v. Pakistan* an Italian company had created a joint venture without legal personality under the laws of Switzerland called GBC, in which it held a majority participation, together with a German, a French and two Pakistani companies, in order to participate in a tender to construct hydroelectric power facilities in Pakistan. Impregilo then acted as the only signatory of the contract on behalf of the joint-venture. It was also the only claimant in the arbitration. In the procedure it argued that it was under a contractual obligation to distribute any monetary award with its partners. Thus, the only way for Impregilo to obtain its stake was for the Tribunal to permit Impregilo to proceed on behalf of all partners. The claimant reasoned that it could not be made whole for its own personal damage from the treaty breaches, unless it collected 100% of the damage suffered by the joint venture, because it had to distribute any amount awarded with its partners.

275. The Tribunal rejected Impregilo's attempt to claim amounts that would be turned over to unprotected third parties stating:

“144. Analysis: In the Tribunal's view, Impregilo cannot advance claims in these proceedings on behalf of the other participants in GBC.

[...]

146. The question is raised whether a party who does fall within the ambit of a BIT and the Convention may act in arbitration proceedings in a representative capacity, in order to advance claims on behalf of other entities who do not so qualify. In the Tribunal's view, the issue turns upon the precise scope of the parties' respective consent to the jurisdiction of ICSID. It is now well-accepted that “consent of the parties is the cornerstone of the jurisdiction of the Centre”.

147. In this case, Pakistan's consent is delineated by the BIT. In concluding the Treaty with Italy, Pakistan has conferred certain rights on Italian nationals in connection with the protection of investments in Pakistan. It has not conferred any rights on nationals of any other state, nor on nationals of Pakistan itself.

148. It must follow that the scope of Pakistan's consent to ICSID is correspondingly limited. On a proper construction, Pakistan has consented to the resolution by ICSID of its disputes arising out of investments made by Italian nationals in Pakistan. There is nothing in the BIT to extend this to claims of nationals of any other state, even if advanced on their behalf by

Italian nationals. Any other interpretation would obviously expose Pakistan to claims by nationals of any state worldwide.

149. To this end, investors of German nationality [...] and Pakistani nationality [...] cannot benefit from the protection conferred upon Italian investors by the 1997 BIT.

[...]

151. The fact that Impregilo may be empowered to advance claims on behalf of its partners is an internal contractual matter between the participants of the Joint Venture. It cannot, of itself, impact upon the scope of Pakistan's consent as expressed in the BIT. Equally, the fact that Impregilo may be obliged to account to its partners in respect of any damages obtained in these proceedings is also an internal GBC matter, which has no bearing on Pakistan's agreed exposure under the BIT. If this were not so, any party would be at liberty to conclude a variety of private contracts with third parties, and thereby unilaterally expand the ambit of a BIT". [Emphasis added, footnotes omitted]<sup>198</sup>.

276. The *Impregilo* tribunal concluded that

“[i]t follows that this Tribunal has no jurisdiction in respect of claims on behalf of, or losses incurred by, either GBC itself or any of Impregilo's joint venture partners”<sup>199</sup>.

277. The decision rendered in the *Binder-Haas Claim* is particularly interesting<sup>200</sup>: in 1945 the Government of Yugoslavia had taken 7,500 shares of the company Dugaresa which were initially owned by Etexco, a Swiss corporation owned by four individuals. Some years before the expropriation, these individuals had transferred their holdings in Etexco to Edwin Binder – an American citizen – to hold as “constructive trustee”. A claim was brought by Mr. Binder together with the four individuals (one of which lacked American citizenship). The Commission decided that Mr. Binder was not entitled to make a claim on his own behalf and that claims must be filed by the four other persons, who were the real or beneficial owners. Since one of them was not an American citizen, her claim had to fail. That of the other claimants succeeded.

278. In *PSEG v. Turkey*, an ICSID tribunal held that it would be improper “if compensation is awarded in respect of investments or expenses incurred by entities over which there is no jurisdiction”<sup>201</sup>.

PSEG, a US company, was granted an authorization to conduct a feasibility study for the construction of a coal mine and a coal-fired plant in Turkey. Thereafter, PSEG signed an implementation contract and a concession contract. The North American Coal Company (NACC) assisted PSEG with the mining aspects of the project. Guris, a Turkish company, participated in

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<sup>198</sup> *Impregilo v. Pakistan*, at 146-151.

<sup>199</sup> *Ibid.* at 153.

<sup>200</sup> *Binder-Haas Claim*, United States International Claims Commission (1951-1954), reprinted in I.L.R. 236-38 (1957), Doc. EEA 136.

<sup>201</sup> *PSEG* at 325.

the project as a sponsor. The claimants initiated ICSID proceedings under the Turkey-US BIT and the Tribunal found that Turkey was in violation of the fair and equitable treatment obligation.

279. In determining the compensation payable, the tribunal denied recovery to PSEG for contributions made to the project by the other companies. The Tribunal stated that<sup>202</sup>

“As the Tribunal noted in the Decision on Jurisdiction of 4 June 2004, these entities might have a claim against PSEG in the light of intra-corporate arrangements, but this is not something for which Turkey is liable, directly or indirectly”.

280. In *Mihaly v. Sri Lanka*, a case better known for its analysis of pre-investment expenditures, the ICSID Tribunal also examined the *locus standi* of the company.

Mihaly International Corp., a US company, wanted to build a power plant in Sri Lanka. Eventually, Mihaly instituted proceedings invoking the US-Sri Lanka BIT, looking for reimbursement of its expenditures on the project in its own name and on behalf of its partner, Mihaly (Canada). Sri Lanka denied any awareness of it ever dealing with Mihaly (USA) during negotiations and alleged that Mihaly (USA) had no standing before the tribunal, neither by reason of its partnership with Mihaly (Canada) nor in its capacity as an undisclosed assignee.

281. The Tribunal held that Mihaly (USA) was only entitled to file a claim in its own name against Sri Lanka. However, with regards to the claim of rights on behalf of its Canadian partner, the Tribunal did not uphold jurisdiction<sup>203</sup>:

“To allow such an assignment to operate in favour of Mihaly (Canada) would defeat the object and purpose of the ICSID Convention and the sanctity of the privity of international agreements not intended to create rights and obligations for non-Parties. Accordingly, a Canadian claim which was not recoverable, nor compensable or indeed capable of being invoked before ICSID could not have been admissible or able to be entertained under the guise of its assignment to the US Claimant. A claim under the ICSID Convention with its carefully structured system is not a readily assignable chose in action as shares in the stock-exchange market or other types of negotiable instruments, such as promissory notes or letters of credit. The rights of shareholders or entitlements of negotiable instruments holders are given different types of protection which are not an issue in this case before the Tribunal. This finding is without prejudice to the right of Mihaly (Canada) to pursue its claims, if any, before another otherwise competent forum”.

#### **b. Claimants’ Counter-Argument**

282. Claimants disagree with the proposal that the Tribunal exceeded its powers by improperly exercising jurisdiction *ratione personae* over the Chinese company Andes.

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<sup>202</sup> *Ibid.* at 325; see also *PSEG (Decision on Jurisdiction)*.

<sup>203</sup> *Mihaly* at 24.

283. Claimants' main argument is that there can be no excess of jurisdiction because the Tribunal did not award Andes any damages. The Tribunal simply awarded Claimants the value of their investment, which was 100% of the rights under the Participation Contract. As a matter of international law, the Tribunal had to award Claimants damages reflecting 100% of their investment; it was not entitled to deduct Claimants' liabilities – as reflected in the *Chorzów Factory* dictum<sup>204</sup>.
284. The Committee is not convinced.
285. (i) First, the Committee has already concluded that Claimants' investment only amounts to 60% of the Farmout Property; for the remaining share of 40% OEPC is holding title as a nominee, acting on behalf of the beneficial owner, AEC/Andes. When the Tribunal awarded Claimants a compensation calculated on the basis of 100% of the value of Block 15, it was assuming jurisdiction over Claimants' alleged ownership rights over a 40% interest in the Farmout Property, disregarding that in accordance with the Farmout Agreements Claimants had transferred those rights to AEC/Andes.
286. (ii) There is a second argument.
287. Contrary to the Claimants' allegations, the dictum in the *Chorzów Factory* decision supports the Committee's position – not that of Claimants'.
288. The dictum was first invoked by the Tribunal in its Award<sup>205</sup>:

“This principle ... has the effect, on the one hand, of excluding from the damage to be estimated, injury resulting for third parties from the unlawful act and, on the other hand, of not excluding from the damage the amount of debts and other obligations for which the injured party is responsible. The damage suffered by the Oberschlesische in respect of the Chorzow undertaking is therefore equivalent to the total value - but to that total only - of the property, rights and interests of this Company in that undertaking, without deducting liabilities”. [Emphasis added, footnote omitted].

289. It stands for the common sense proposition that in the calculation of damages for the taking of assets
- debts and other obligations for which the injured party is responsible should not be excluded, while
  - injury resulting to third parties should indeed be excluded.

To give an example: if a State expropriates a piece of real estate, the mortgage loan which served to finance the acquisition should not be deducted from the fair market value; but if the investor before the expropriation had transferred a 50% share of the property to a third party, the third party's share in the value of the investment must be deducted from the claim for compensation.

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<sup>204</sup> C I at 480; C II at 281.

<sup>205</sup> Award at 656.

290. In the present case, the transaction entered into between OEPC and AEC, and formalized in the Farmout Agreements, consisted in the transfer of a 40% interest in the Farmout Property. AEC/Andes became (and has not ceased to be) the beneficial owner of that portion of the Farmout Property (including the Participation Contract), and as beneficial owner AEC/Andes could exercise its ownership rights over the Farmout Property through its nominee. AEC/Andes became a co-owner of the Farmout Property, not a creditor of OEPC.
291. The dictum in *Chorzów Factory* confirms the Committee's conclusion: as a matter of international law, the Tribunal was precluded from awarding Claimants damages reflecting 100% of the investment, because it was required to exclude from the compensation the injury caused to a third party, who was the beneficial owner of a 40% interest in the expropriated investment.

**c. Effects of the partial Annulment of the Award**

292. The Committee has decided to partially annul the Award to the extent that the Tribunal has assumed jurisdiction with regard to the investment beneficially owned by the Chinese investor Andes. What remains to be clarified is the precise effect of this finding<sup>206</sup>.
293. In Sub-paragraph (v) of the dispositive section of the Award, the Tribunal made the following decision<sup>207</sup>:

“876 [...] (v) Claimants are awarded the amount of US\$ 1,769,625,000 (US One billion, seven hundred sixty nine millions, six hundred twenty five thousand dollars), as calculated in paragraph 825 of this Award, for damages suffered as a result of the breaches set out above in subparagraphs (i), (ii) and (iii)”.

294. Paragraph 825 of the Award reads as follows:

“825. Having determined earlier that the Claimants' damages should be reduced by a factor of 25% because of their own wrongful act which contributed in a material way to the damages which they subsequently suffered when the *Caducidad* Decree was issued on 15 May 2006, the Claimants' damages for the expropriation by Ecuador of their interest in the Participation Contract amount to US\$ 1,769,625,000 (US One billion, seven hundred sixty nine millions, six hundred twenty five thousand dollars) which the Tribunal orders the Respondent to pay” [Footnote omitted].

295. Respondent avers that a partial annulment of the Award for excess of powers must lead to an annulment of Sub-Paragraph (v) of the dispositive section of the Award<sup>208</sup>. The Tribunal concurs. The calculation of damages which underlies the Tribunal's decision is based on the assumption that OEPC is the owner of a 100% interest in the expropriated property. This clearly derives from para. 824 of the Award:

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<sup>206</sup> A question which was intensely debated during the annulment hearing: HT p. 716 *et seq.* (Prof. Mayer), HT p. 980 *et seq.* (Mr. Rivkin).

<sup>207</sup> Award at 876.

<sup>208</sup> HT p. 717-718.

“824. Using the economic model agreed by Professor Kalt and Mr. Johnston, the Tribunal, informed by all the findings that it has made in the present Section of its Award and assisted by Professor Kalt and Mr. Johnston’s agreed calculations, determines that the Net Present Value of the discounted cash flows generated by the Block 15 OPEC production as of 16 May 2006 is US\$ 2,359,500,000 (US Two billion, three hundred fifty nine millions and five hundred thousand dollars)”. [Footnote omitted].

296. Consequently, the Committee’s decision to partially annul the Award must lead to the annulment of the quantification of damages (US\$ 1,769,625,000) contained in Sub-paragraph (v) of the dispositive section of the Award to the extent that it compensates the Claimants for 100% (and not for 60%) of the value of Block 15– but not of the rest of such Sub-paragraph.
297. The next question to be addressed is whether the Committee is authorized to substitute the annulled figure of damages with the correct number, or whether this task must be entrusted to a new investment tribunal. The parties have discussed this issue, and while Respondent favours the constitution of a new tribunal<sup>209</sup>, Claimants have accepted that in the proper circumstances annulment committees are authorized to insert correct data in partially annulled decisions<sup>210</sup>.
298. The Committee concurs with Claimants.
299. It is true that annulment committees are not empowered to amend or replace awards. But this is not the task at hand. What is required in this case, in which the Committee is partially annulling the Award, is for the Annulment Committee to substitute the Tribunal’s figure of damages with the correct one. If this task can be performed without further submissions from the Parties and without additional marshalling of evidence, committees should be entitled to do so. Basic reasons of procedural economy speak in favour of this solution. There is no need for the parties to incur the additional cost and delay of going through a second investment arbitration, when the correct number can be inserted by the annulment committee, after performing a very simple arithmetic calculation and without further input from the parties.
300. This is the case in the present arbitration.
301. The Tribunal has established the value of 100% Block 15, i.e. of the Farmout Property, at US\$ 2,359,500,000. Consequently, the value of a 60% interest would amount to US\$ 1,415,700,000. Applying to this amount the 25% reduction factor explained in para. 825 of the Award, the resulting amount is US\$ 1,061,775,000. This is the proper amount that should have been inserted in Sub-paragraph (v) of the dispositive section of the Award, reading as follows<sup>211</sup>:

“876 [...] (v) Claimants are awarded the amount of US\$ 1,061,775,000 (US One billion, sixty one millions, seven hundred and seventy five thousand

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<sup>209</sup> HT p. 719-721.

<sup>210</sup> HT p. 980.

<sup>211</sup> The same conclusion could be reached by simply calculating 60% of US\$ 1,769,625,000

dollars), as calculated in paragraph 825 of this Award, for damages suffered as a result of the breaches set out above in subparagraphs (i), (ii) and (iii)".

\* \* \*

302. Respondent has alleged a number of additional grounds for partial annulment of the Tribunal's decision to award damages to OEPC based on a 100% (and not a 60%) interest in the Farmout Property or which pertain to the 60/40 issue. Since these grounds, if accepted, would lead to the same result as the partial annulment already decided by the Committee, they have become moot and need not be further addressed<sup>212</sup>.

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<sup>212</sup> These grounds include *inter alia* the following:

- i) The Tribunal manifestly exceeded its powers by, and failed to state the reasons for, declaring inexistent the illegal, unauthorized assignment between Claimants and AEC/Andes (RI, ground 14, para.580; RII, ground 12, para. 582)
- (ii) The Tribunal manifestly exceeded its powers by, after the submission phase of the arbitration had concluded, raising a new argument for Claimants and awarding Claimants US\$ 943 million on that argument (RI, ground 12, para. 502; RII, ground 10, para. 392).

## VII. OTHER GROUNDS FOR ANNULLMENT

303. Respondent avers that there are eight additional grounds<sup>213</sup> for annulment, three of which should result in the annulment of the entire Award, and four in the annulment of certain parts; there is also an allegation of a serious departure from a fundamental rule of procedure.

304. The three grounds for total annulment are:

- The decision to apply the principle of proportionality (1.);
- The decision that Claimants' violation of the HCL and the Participation Contract was mere negligence (2.);
- The decision that Claimants' treaty claims were not defective because this issue was *res iudicata* (3.);

305. The four grounds for partial annulment of certain parts of the Award are:

- The exclusive use of a DCF model in determining the value of the investment (4.);
- The decision to disregard Law 42 when assessing Claimants' damages (5.);
- The decision to disregard the VAT Interpretative Law (6.);
- The decision to disregard alternatives to *caducidad* when awarding damages (7.);

306. The alleged serious departure from a fundamental rule of procedure affects the Tribunal's email dated February 15, 2011 (8.)<sup>214</sup>.

### Manifest Excess of Powers

307. Most of the grounds for annulment invoked by Respondent are based on the argument that the Tribunal committed a manifest excess of powers by failing to choose the proper law to be applied to the merits.

308. It should be remembered that the test for this ground to succeed is very high.

309. Investment arbitration case law is unanimous in the conclusion that annulment for failure to choose the proper law applicable to the merits is only permitted if the tribunal totally disregarded applicable law or grounded its award on a law other than the applicable law. The error committed by the tribunal must consist in applying the wrong law, not in wrongly interpreting the correct law.

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<sup>213</sup> See R III p. 316.

<sup>214</sup> Respondent alleges that the decision to disregard alternatives to *Caducidad* also implied a serious departure from a fundamental rule of procedure – R III p. 315.



Misinterpretation or misapplication of the proper law to the merits, even if serious, does not justify annulment. Only exceptionally gross or egregious errors of law, acknowledged as such by any reasonable person, could be construed to amount to a failure to apply the proper law, and could give rise to the possibility of annulment<sup>215</sup>.

#### Failure to state Reasons

310. The same high standard applies to the failure to state reasons, the other ground frequently invoked by Respondent: as long as reasons have been stated, even if incorrect, unconvincing or non-exhaustive, the award cannot be annulled. Only total absence of reasoning or contradictory or frivolous reasons can lead to annulment<sup>216</sup>.

#### **1. THE PRINCIPLE OF PROPORTIONALITY**

311. The principle of proportionality is one of the cornerstones of the Award. The Tribunal devoted a full section and 35 pages of its analysis to “The Proportionality of the Sanction for the Unauthorized Transfer of Rights under the Participation Contract<sup>217</sup>. The Tribunal drew its (in this point unanimous) decision in para 452<sup>218</sup>:

”452. It follows that even if OEPC, as the Tribunal found earlier, breached Clause 16.1. of the Participation Agreement and was guilty of an actionable violation of Article 74.11 (or Articles 74.12 or 74.13), the *Caducidad* Decree was not a proportionate response in the particular circumstances, and the Tribunal so finds”.

#### **A. Respondent’s Position**

312. Respondent argues that in an inherently contradictory decision the Tribunal held that *caducidad* was a disproportionate sanction and therefore contrary to Ecuadorian law, customary international law and the Treaty, despite having found
- That in the Participation Agreement the Parties freely agreed that *caducidad* was the applicable sanction if OEPC transferred rights to third parties without approval and
  - That OEPC had transferred rights without such approval<sup>219</sup>.
313. The Award should be annulled because its central holding is that although Ecuador imposed the exact sanction to which Claimants agreed in the Participation Contract, that sanction was disproportionate. Such a holding creates an inescapable conflict

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<sup>215</sup> See para 56 *supra*.

<sup>216</sup> See para 65 *supra*.

<sup>217</sup> Award at 384-452.

<sup>218</sup> Award at 452.

<sup>219</sup> R I at 386.

with the principle of *pacta sunt servanda* and represents a textbook example of a tribunal acting as *amiable compositeur*<sup>220</sup>.

314. In Respondent's opinion, the Tribunal avoided the application of the Participation Contract, a contract executed after extensive arms-length negotiations between sophisticated parties, and in doing so failed to apply Ecuadorian law and the international law principle of *pacta sunt servanda*<sup>221</sup>. In fact, what the Tribunal did was to rewrite the Participation Contract<sup>222</sup>. Where the will of the Parties is clear – as it is with respect to the terms of the Participation Contract – the principle of proportionality has no place<sup>223</sup>.
315. By purporting to apply a principle of proportionality that is not encompassed in the Participation Contract, Ecuadorian law, the Treaty or customary international law, the Tribunal has manifestly exceeded its powers because:
- The proportionality principle is not referred to in the Participation Contract<sup>224</sup>;
  - There is no proportionality principle which overrides the *pacta sunt servanda* principle neither under Ecuadorian law<sup>225</sup> nor under international law<sup>226</sup>;
  - The fair and equitable treatment (“FET”) principle in the Treaty cannot be relied upon to avoid application of the Participation Contract.
316. The Tribunal also failed to state the reasons on which it decided to hold Ecuador liable for a breach of the proportionality principle<sup>227</sup>, and its decision is based on incomprehensible or, at best, frivolous reasons<sup>228</sup>.

## **B. Claimants' Position**

317. Claimants disagree and recall that on this issue the Tribunal's findings were unanimous<sup>229</sup>.
318. In Claimants' submission the Tribunal clearly stated its reasons and explained that the proportionality principle exists under applicable Ecuadorian and international law<sup>230</sup>, that it must be applied to a decision to declare *caducidad*<sup>231</sup> and that Ecuador

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<sup>220</sup> R II at 286.

<sup>221</sup> R I at 392; R II at 294.

<sup>222</sup> R I at 401-406; R II 310.

<sup>223</sup> R I at 419.

<sup>224</sup> R I at 427.

<sup>225</sup> R I at 431; R II at 331.

<sup>226</sup> R I at 452; R II at 319.

<sup>227</sup> R I at 458, R II at 343.

<sup>228</sup> R I at 466; RII at 350.

<sup>229</sup> C I at 171.

<sup>230</sup> C I at 152.

<sup>231</sup> C I at 160.

violated that principle when it did so<sup>232</sup>. The Tribunal's reasoning can be followed from point A to point B and to its conclusion and so does not warrant annulment<sup>233</sup>.

319. Claimants aver that the Award provides no basis for annulment: the Award clearly stated the Tribunal's reasons for its decision that the principle is incorporated into the Treaty and into customary international law<sup>234</sup> and that the proportionality principle and the *pacta sunt servanda* principle are not in conflict<sup>235</sup>. Claimants also reject that the reasoning was contradictory, incomprehensible or frivolous<sup>236</sup>.
320. As regards excess of powers – which Claimants analyse separately – the Tribunal applied the proper law when it concluded that the *Caducidad* Decree was a disproportionate sanction in breach of the Treaty, customary international law, Ecuadorian law and the Participation Contract<sup>237</sup>. Claimants underline that the Tribunal declared *caducidad* on the basis of HCL and not of the Participation Agreements<sup>238</sup> and did not rewrite or avoid the application of the Participation Contract or avoid the application of the *pacta sunt servanda* principle<sup>239</sup>. Neither did the Tribunal decide *ex aequo et bono* when it found that a principle of proportionality exists under international law<sup>240</sup>.

### **C. The Committee's Decision**

321. The Committee will analyze Ecuador's argument that the Award should be annulled by first explaining the Tribunal's (unanimous) decision regarding proportionality (a.) and then reviewing and ultimately rejecting the Republic's arguments (b.).

#### **a. The Tribunal's Decision regarding Proportionality**

322. The Tribunal started its analysis of proportionality stating that under Ecuadorian law proportionality is a general principle of administrative law. Relying on the testimony of both Parties' Ecuadorian law experts and on several Ecuadorian law authorities (including the CE, Ecuadorian administrative law and Ecuadorian Supreme Court jurisprudence) the Tribunal found that<sup>241</sup>

“398. [...] the Government must weigh the content and purpose of any sanctioning measure with the conduct which has been impugned, and with the loss of rights which the individual will suffer by reason of the intended sanction” [Footnote omitted].

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<sup>232</sup> C I at 162.

<sup>233</sup> C II at 154.

<sup>234</sup> C I at 175.

<sup>235</sup> C I at 179.

<sup>236</sup> C I at 185; C II at 164.

<sup>237</sup> C I at 397; C II at 169.

<sup>238</sup> C I at 407.

<sup>239</sup> C I at 413.

<sup>240</sup> C I at 418, C II at 171.

<sup>241</sup> Award at 398.

323. The Tribunal's explanation makes clear that proportionality is a principle to be applied by the Ecuadorian authorities when adopting *actos administrativos* or imposing administrative sanctions. It is not a principle of contract law.
324. The Tribunal then added that the principle of proportionality is also commonly applied "in a variety of international settings", including the WTO Panel decisions concerning the GATT, decisions of the European Court of Justice, of the European Court of Human Rights and tribunals in international investment disputes<sup>242</sup>. The proportionality principle is also "applicable to potential breaches of bilateral investment treaty obligations", including the FET standard<sup>243</sup>. Here the Tribunal analyzed and relied on a number of ICSID decisions<sup>244</sup>.
325. The Tribunal then delved into the precise meaning of proportionality when applied to the imposition by the public administration of a severe penalty like *caducidad*. The Tribunal declared<sup>245</sup>:
- "416. [...] In cases where the administration wishes to impose a severe penalty, then it appears to the Tribunal that the State must be able to demonstrate (i) that sufficiently serious harm was caused by the offender; and/or (ii) that there had been a flagrant or persistent breach of the relevant contract/law, sufficient to warrant the sanction imposed; and/or (iii) that for reasons of deterrence and good governance it is appropriate that a significant penalty be imposed, even though the harm suffered in the particular instance may not have been serious".
326. The Tribunal found that it was ultimately common ground between the parties that the principle of proportionality applied to the present dispute, because a declaration of *caducidad* pursuant to Article 74 HCL is a discretionary administrative sanction and the parties agreed that<sup>246</sup>
- "where the Minister has a discretion, the principle of proportionality is relevant".
327. On the evidence presented to it, the Tribunal unanimously concluded that Ecuador had violated the proportionality principle when it declared *caducidad*, because the Minister had other, less traumatic, legal options<sup>247</sup>, but notwithstanding these alternatives, chose the radical sanction of *caducidad*, which implied the loss of Claimants' total investment, amounting to many hundred millions of US\$.
328. This decision was influenced by the fact that OEPC had successfully litigated against the Republic in another investment arbitration, and had secured the so-called VAT Award, which required Ecuador to indemnify OEPC in an amount of more than US\$ 70 M.

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<sup>242</sup> Award at 402-404.

<sup>243</sup> Award at 404.

<sup>244</sup> *MTD, Tecmed, Azurix*; Award at 405-409.

<sup>245</sup> Award at 416.

<sup>246</sup> Award at 425.

<sup>247</sup> Award at 434.

329. The Tribunal noted that farmout agreements are very common in the oil industry, that Ecuador suffered no harm<sup>248</sup>, that AEC was already an approved operator in Ecuador<sup>249</sup>, that some punishment for OEPC's failure to secure the authorization may well have been justified<sup>250</sup>, but

“450. [...] the overriding principle of proportionality requires that any such administrative goal must be balanced against the Claimants' own interests and against the true nature and effect of the conduct being censured. The Tribunal finds that the price paid by the Claimants – total loss of an investment worth many hundreds of millions of dollars – was out of proportion to the wrongdoing alleged against OEPC, and similarly out of proportion to the importance and effectiveness of the “deterrence message” which the Respondent might have wished to send to the wider oil and gas community”.

330. The Tribunal concluded<sup>251</sup>:

“452. It follows that even if OEPC, as the Tribunal found earlier, breached Clause 16.1 of the Participation Contract and was guilty of an actionable violation of Article 74.11 (or Articles 74.12 or 74.13), the *Caducidad* Decree was not a proportionate response in the particular circumstances, and the Tribunal so finds. The *Caducidad* Decree was accordingly issued in breach of Ecuadorian law, in breach of customary international law, and in violation of the Treaty. As to the latter, the Tribunal expressly finds that the *Caducidad* Decree constituted a failure by the Respondent to honour its Article II.3(a) obligation to accord fair and equitable treatment to the Claimants' investment, and to accord them treatment no less [favourable] than that required by international law”.

#### **b. Review of Respondent's Arguments**

331. Article 74 HCL reads as follows:

“El Ministerio del Ramo podrá declarar la caducidad de los contratos, si el contratista:

[...]

11. Traspasare derechos o celebrare contrato o acuerdo privado para la cesión de uno o más de sus derechos, sin la autorización del Ministerio;

12. Integrare consorcios o asociaciones para las operaciones de exploración o explotación, o se retirare de ellos, sin autorización del Ministerio; y

13. Reincidiere en infracciones a la Ley y sus reglamentos”.

332. Article 75 HCL provides:

“La declaración de caducidad de un contrato implica la inmediata devolución al Estado de las áreas contratadas, y la entrega de todos los equipos, maquinarias y otros elementos de exploración o de producción, instalaciones industriales o de transporte, sin costo alguno para PETROECUADOR y, además, la pérdida automática de las cauciones y garantías rendidas según la Ley y el contrato, las cuales quedarán en favor del Estado”.

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<sup>248</sup> Award at 444.

<sup>249</sup> Award at 445.

<sup>250</sup> Award at 450.

<sup>251</sup> Award at 452.

333. And clause 21.1. of the Participation Contract states as follows:

“21.1. Terminación: Este Contrato de Participación terminará:

[...]

21.1.1. Por declaratoria de caducidad emitida por el Ministerio del Ramo por las causales y bajo el procedimiento establecido en los artículos setenta y cuatro (74), setenta y cinco (75) y setenta y seis (78) de la Ley de Hidrocarburos, en lo que sean aplicables;

21.1.2. Por transferir derechos y obligaciones del Contrato de Participación, sin autorización del Ministerio del Ramo”.

#### The Alternatives in Case of unauthorized Transfer

334. In accordance with the HCL and with clause 21.1 of the Participation Contract an unauthorized transfer of the Participation Contract can lead to two different results:

335. (i) The first alternative is an administrative declaration of *caducidad* by the Ecuadorian administrative authorities.

336. Article 74 HCL authorizes the Minister, after having observed the appropriate *procedimiento administrativo*<sup>252</sup>, to adopt an *acto administrativo*, the declaration of *caducidad*, premised on one or more of the grounds set forth in the HCL (not in the Contract) having been met. And one of such grounds is the unauthorized transfer of rights and obligations deriving from the Participation Contract. As a matter of Ecuadorian domestic law, if the holder of the concession contract disagrees with the Minister’s *acto administrativo*, it can be appealed before the appropriate *Tribunal contencioso-administrativo*<sup>253</sup>.

337. *Caducidad* is not a contractual decision; it is an administrative act regulated in the HCL. Clause 21.1.1. of the Participation Contract simply draws the contractual consequences of a *declaración de caducidad* adopted by the Minister: in that case the Participation Contract – a contract signed between Petroecuador (not the Republic) and OEPC – is terminated.

338. But *caducidad* not only provokes the contractual termination of the Participation Contract, it also implies a severe administrative sanction under Article 75 HCL: OEPC is required to turn over to the Government all assets and equipment used for the exploration and production of Block 15, without any compensation, and to forfeit any bonds or guarantees<sup>254</sup>.

339. (ii) Unauthorized transfer of the Participation Contract can also lead to a different result: PetroEcuador can choose to exercise its contractual right to terminate the Participation Contract under clause 21.1.2., which provides that if OEPC transfers

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<sup>252</sup> See the reference to the *procedimiento administrativo* in clause 21.1.1. of the Participation Contract.

<sup>253</sup> Article 173 CE.

<sup>254</sup> Clause 21.2.4 includes a cross-reference to the sanction. But Ecuador’s right to take OEPC’s Block 15 assets without compensation derives from Art. 75 HCL, not from Clause 21.2.4.

its rights and obligations without ministerial authorization, the Participation Contract can be terminated by a decision adopted by PetroEcuador (not by the Republic). This decision is contractual in nature, does not constitute an *acto administrativo*, and any dispute with regard thereto must be adjudicated in accordance with the arbitration clause contained in such Contract.

340. Contractual termination by PetroEcuador leads to ordinary restitution under civil law – it does not result in OEPC’s obligation to turn over all Block 15 assets to the State without compensation<sup>255</sup>.

#### Ecuador’s Decision

341. In the present case the Republic opted for the first alternative: after having followed the appropriate administrative procedure, which included OEPC’s right to be heard, the Minister adopted an *acto administrativo* declaring *caducidad*, the *Caducidad* Decree. The issuance of the Decree produced the sanction provided for in Article 75 HCL: OEPC was forced to turn over to the public administration all Block 15 assets, which represented investments amounting to many hundred millions of US\$, without any compensation.

342. Against this factual and legal backdrop Ecuador is arguing

- That the application of the proportionality principle is in contradiction with the *pacta sunt servanda* principle, and that the Tribunal rewrote the Participation Contract to insert the proportionality principle;
- That in the Participation Contract the parties had agreed that the declaration of *caducidad* by the Minister would automatically lead to termination, and where the will of the parties is clear, there is no place for proportionality.

#### The Committee’s Decision

343. Ecuador’s arguments fail, being based on a wrong understanding of what the Tribunal decided and what the Parties agreed upon.

344. In its Award the Tribunal decided that both Ecuadorian and international law require that when administrative authorities adopt decisions to sanction citizens, they must apply the principle of proportionality, weighing the severity of the sanction against various factors (which include the harm caused and the nature of the violation), in order to avoid that the irregular behaviour of the citizen be sanctioned with a disproportionate penalty.

345. After

- noting a close connection between the VAT Award (which required the Republic to pay a significant indemnity to OEPC) and the declaration of *caducidad* and the existence of “ill-feeling against OEPC” in Ecuador,

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<sup>255</sup> See clause 21.2.4 in relation to clause 21.4.

- establishing that Ecuador had suffered no harm as a consequence of the violation,
- taking into account that Ecuador could have imposed a less drastic sanction and indeed had done so in past similar violations,

the Tribunal, weighing the available evidence, found that the *caducidad* decision “was not a proportionate response in the particular circumstances”<sup>256</sup>.

346. The Tribunal has convincingly reasoned and explained its decision. But even if the reasoning had been less convincing, the weighing of evidence and the eminently factual evaluation of whether an administrative decision is or not proportional, form part of the Tribunal’s prerogatives, which under Article 52 of the Convention, as a general rule, fall outside the remit of an *ad hoc* committee.
347. There is a further argument: the Tribunal’s finding is also perfectly consistent with the Parties’ agreement (under clause 21.1.1 of the Participation Contract) that a declaration of *caducidad* would result in termination of the Contract. That clause can only refer to a properly adopted declaration of *caducidad*, not to one which was taken in contravention of Ecuadorian law. The clause does not imply – as Ecuador seems to say – that OEPIC consented that any declaration of *caducidad*, however adopted, could result in termination and loss of all assets without compensation.
348. A simple *reductio ad absurdum* proves the point: assume that the Minister’s declaration had been adopted with *desviación de poder* or with corruption. Clause 21.1.1. cannot be construed as OEPIC’s *ex ante* acceptance that a declaration of *caducidad*, even if adopted under such irregularities, would legitimize the termination of the Contract and seizure of assets without compensation.

#### Inexistence of the Principle of Proportionality in applicable Law

349. Ecuador also argues that the Tribunal has manifestly exceeded its powers because the principle of proportionality is allegedly not encompassed in the Participation Contract, Ecuadorian law, or in customary international law.
350. The argument cannot succeed, because the standard for annulment in allegations of misapplication or misinterpretation of law applicable to the merits is especially high: only exceptionally gross or egregious errors of law could be construed to amount to a failure to apply the proper law to the merits, and could give rise to the possibility of annulment<sup>257</sup>. The Tribunal has not committed any gross or egregious error of law. To the contrary: the Tribunal has convincingly explained that the principle of proportionality between intensity and scope of the illicit activity, and severity of the sanction is a general principle of punitive and tort law, both under Ecuadorian and under international law.

#### Failure to state Reasons

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<sup>256</sup> Award at 442-452.

<sup>257</sup> See para 56 *supra*.



351. The Committee has summarized the Tribunal’s reasoning on this issue in the preceding sub-section<sup>258</sup>. The reasoning can be followed from point A to point B and to the Tribunal’s decision. Respondent’s argument that the Tribunal failed to state the reasons on which it decided to hold Ecuador liable for a breach of the proportionality principle, or that its decision is based on incomprehensible or, frivolous reasons, fails.

## 2. THE FINDING OF NEGLIGENCE

### A. Respondent’s Position

352. Respondent argues that the Tribunal failed to state the reasons on which it based its decision and manifestly exceeded its powers when it held that Claimants were merely negligent in failing to disclose the true nature of the Farmout Agreement to Ecuador and to obtain ministerial authorization in 2000. This finding allegedly had a case-determinative effect on the Tribunal’s holding in relation to two key issues, the proportionality of the *Caducidad* Decree and Claimants’ appropriate percentage of fault<sup>259</sup>.

353. Respondent adds that the Tribunal’s analysis is self-contradictory. The Tribunal labeled Claimants’ conduct as negligent, but described it precisely in intentional, not negligent terms<sup>260</sup>. The Tribunal created a new kind of violation of the HCL (a merely negligent one) and then concluded that Ecuador had acted disproportionately in declaring *caducidad*<sup>261</sup>. In so doing, the Tribunal ignored uncontroverted evidence<sup>262</sup>, misapplied Ecuadorian law<sup>263</sup>, provided no reasons<sup>264</sup> and contradicted many of its own findings in other parts of the Award<sup>265</sup>. The Tribunal also failed to state reasons, the finding of negligence remaining unexplained<sup>266</sup> and self-contradictory<sup>267</sup>.

354. Ecuadorian law distinguishes between conduct that is “*dolosa*” and conduct that is “*culposa*” (with three different levels of “*culpa*”) – but the Tribunal never mentioned, much less applied, the standard of care that governed Claimants’ conduct under Ecuadorian law<sup>268</sup>. The Tribunal simply averred that OEPC was negligent because it lacked bad faith – without any analysis, consideration, reference or mention of the legal standard under Ecuadorian law<sup>269</sup>. And the Tribunal’s determination of negligence affected both the finding of lack of proportionality and the issue of quantum<sup>270</sup>.

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<sup>258</sup> See para 342 *et seq. supra*.

<sup>259</sup> R I at 333.

<sup>260</sup> R I at 343.

<sup>261</sup> R I at 348.

<sup>262</sup> R I at 349.

<sup>263</sup> R I at 350.

<sup>264</sup> R I at 351.

<sup>265</sup> R I at 354.

<sup>266</sup> R II at 267.

<sup>267</sup> R II at 271.

<sup>268</sup> R II 235, 236.

<sup>269</sup> R II at 237.

<sup>270</sup> R II 240-244; 245-253

355. The Tribunal's determination that OEPC negligently breached the Participation Contract and violated the HCL ignores settled Ecuadorian law, which does not take into account the actor's intent when evaluating or determining a violation of the HCL. Thus the Tribunal manifestly failed to apply Ecuadorian law and international law, and acted *ex aequo et bono*<sup>271</sup>.

**B. Claimants' Position**

356. Claimants first line of defense is that the Committee should not consider this ground for annulment for two reasons:

- Factual findings are not reviewable in an annulment; and the Tribunal's negligence finding was a factual finding<sup>272</sup>;
- Furthermore the finding only affected two issues on which Ecuador prevailed: the dismissal of Claimants' legitimate expectations claim and the determination of contributory fault by OEPC, which resulted in a reduction of the amount of damages by 25%<sup>273</sup>.

357. In addition, Claimants submit that the foundation of Ecuador's argument is wrong. The Tribunal did not artificially create a new kind of violation of the HCL – a merely negligent one<sup>274</sup>. Nor did the Tribunal identify negligence as a factor in its proportionality analysis, let alone a determinative one<sup>275</sup>. Instead, the Tribunal based its argument that the *Caducidad* Decree lacked proportionality on three findings:

- That Ecuador suffered no harm;
- There existed in Ecuador ill feeling against OEPC; and
- Ecuador could have imposed less drastic sanctions<sup>276</sup>.

358. Furthermore, the Tribunal clearly stated the reasons for its finding that Claimants did not act in bad faith but were merely negligent<sup>277</sup>, and in its conclusion that the *Caducidad* Decree was a disproportionate sanction in breach of the Treaty, customary international law and the Participation Contract<sup>278</sup>. The Tribunal's reasoning can be followed from point A to point B and so does not warrant annulment<sup>279</sup>.

**C. The Committee's Decision**

359. The Committee will analyze Ecuador's argument that the Award should be annulled by first explaining the Tribunal's (unanimous) decision regarding the finding of

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<sup>271</sup> R II at 254.

<sup>272</sup> C II at 129.

<sup>273</sup> C II at 132.

<sup>274</sup> C I at 115-116; C II at 134.

<sup>275</sup> C I at 117.

<sup>276</sup> C I at 118.

<sup>277</sup> C I at 123-147.

<sup>278</sup> C I at 148-169.

<sup>279</sup> C II at 141-142.

negligence (a.) and then reviewing and ultimately rejecting the Republic's arguments (b.).

**a. The Tribunal's Decision regarding Negligence**

360. In essence, Ecuador's ground for annulment is based on one single word, used by the Tribunal in one single paragraph of the Award – paragraph 380.

361. Paragraph 380 reads as follows:

“380. The Tribunal reiterates its conclusion. As the Tribunal's analysis of the Farmout Agreements earlier in this Award has demonstrated, the Claimants' interpretation of the Farmout Agreement was wrong. However, the Tribunal does not consider, as the Respondent has argued, that it was made in bad faith. The Claimants' failure to seek ministerial authorization was a mistake, a serious mistake, but it was not done in bad faith. Should Paul MacInnes and his colleagues, during their visit with Minister Terán on 24 October 2000, have given him a copy of the Farmout Agreement and the Joint Operating Agreement so that his advisors could have formed their own opinion about the true nature of the transaction? As stated earlier, the Tribunal has no hesitation in answering its own question in the affirmative. OEPC and AEC were negligent in not doing so. But again, the Tribunal does not find that failure to do so amounted to bad faith. They may have been negligent but there was no intention on their part to mislead. They were simply convinced that they were right and acted accordingly without seeking to mislead the Ecuadorian government. In a number of instances, in the fall of 2000, they revealed publicly in Ecuador that they had entered into a farmout transaction with AEC”. [Emphasis added].

362. This paragraph concludes a very long section (Section 2) entitled “OEPC's Duty to obtain Authorization for the Transfer of Rights under the Participation Contract”, devoted to a detailed analysis of Claimants' failure to request authorization for the execution of the Farmout Agreements from the Ecuadorian government. In paragraph 380 the Tribunal “reiterates the conclusions” to be drawn from the preceding section; these conclusions are eminently factual and consist of the following three findings:

- That Claimants' failure to seek ministerial authorization was a serious mistake;
- That Claimants were “negligent” when they failed to deliver a copy of the Farmout Agreements at the visit to the Ecuadorian Minister;
- That there was however no bad faith and no intention to mislead.

Legal consequences

363. The Tribunal's factual findings gives rise to two legal consequences:

364. (i) The first consequence is drawn by the Tribunal in paragraph 383, which provides as follows<sup>280</sup>:

“[...] Having concluded above that OEPC’s failure to secure the required authorization on the part of the Ecuadorian authorities in October 2000, while not amounting to bad faith, was negligent, the Tribunal considers that the Claimants cannot be found to have had a legitimate expectation that the Minister would not exercise his discretion and impose *caducidad*”.

365. In the Tribunal’s opinion, Claimants’ negligence leads to the forfeiture of any legitimate expectation that the Minister would not exercise his sanctioning powers and decree *caducidad*.

366. (ii) The second consequence is drawn in the following section (Section 3) entitled “The Proportionality of the Sanction for the unauthorized Transfer of Rights under the Participation Contract”. The section starts at paragraph 384, in which the Tribunal once again reiterates its factual findings:

“384. The Tribunal has found that the Farmout Agreement and the Joint Operating Agreement operated to effect a transfer of rights under the Participation Contract from OEPC to AEC. The Tribunal has also found that this transfer required authorization on the part of the Ecuadorian authorities, that this authorization was not sought, but that OEPC’s failure to secure such authorization in October 2000, while imprudent and ill advised, did not amount to bad faith”[Emphasis added].

367. It is worth noting that in this summary of facts, the Tribunal drops the expression “negligent”, and substitutes it with “imprudent”. The use of this synonym shows that the Tribunal never gave a precise legal meaning to the concepts “negligent” or “imprudent” – they were used as convenient adjectives to describe Claimants’ conduct. Contrary to Respondent’s allegation, the Tribunal never had the intention of creating a new kind of violation of the HCL – a merely negligent one.

368. After this summary of its previous findings, contained in paragraph 384, the Tribunal devotes a 35 page long discussion<sup>281</sup> to the legal issue of proportionality, reaching the conclusion that the sanction of *caducidad* imposed by the Government was a disproportionate punishment for Claimants’ wrongdoing, for three reasons:

- because Ecuador suffered no harm,
- because there was ill feeling against OEPC arising from its success in securing the VAT Award, and
- because the Republic had the alternative of imposing less drastic sanctions<sup>282</sup>.

369. The Tribunal’s finding that OEPC’s conduct had been “imprudent”, “negligent” and “ill advised”, but did not amount to “bad faith”, is not mentioned *expressis*

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<sup>280</sup> Award at 383.

<sup>281</sup> Award at 385-452.

<sup>282</sup> Award at 442-452.

*verbis* among the reasons canvassed by the Tribunal to justify its disproportionality conclusion. The Tribunal however refers to Claimants' negligent or imprudent conduct in paragraph 384, the first of the proportionality section, as a "preliminary Observation"; thus, it is very likely that this factual finding weighed in the Tribunal's mind when it decided that the *caducidad* was a disproportionate sanction.

**b. Review of Respondent's Arguments**

370. The Republic argues that the Tribunal manifestly exceeded its powers when it held that Claimants were merely negligent in failing to disclose the true nature of the Farmout Agreement to Ecuador and to obtain ministerial authorization and failed to state the reasons on which it based its decision. Claimants disagree: in their submission, the Tribunal's findings were purely factual, only related to issues on which Ecuador prevailed, and were properly reasoned.
371. The Committee has already noted that as a general rule factual findings and weighing of evidence made by tribunals are outside the scope of review of *ad hoc* committees – an exception could only be allowed if the applicant can prove that the errors of fact committed by the Tribunal are so egregious as to give rise to one of the grounds for annulment listed in Article 52(1) of the Convention<sup>283</sup>.
372. In paragraphs 380, 383 and 384 of the Award the Tribunal finds that the Claimants, although they failed to request the necessary authorization, did not act in "bad faith", that they "may have been negligent, but there was no intention on their part to mislead", and that their failure to secure the authorization "while imprudent and ill advised, did not amount to bad faith".
373. These are all factual findings, which the Tribunal adopted after having reviewed the extensive evidentiary record, heard the witnesses and weighed the available evidence. The Tribunal is best placed to perform this task, and its conclusions should not be second-guessed by an *ad hoc* committee – save in exceptional circumstances, when the errors of fact committed by the tribunal are so egregious as to give rise to one of the grounds for annulment established in Article 52(1) of the Convention.

No exceptional Circumstances

374. This exception is clearly not applicable in the present case.
375. The reasoning used by the Tribunal in reaching its conclusion that Claimants acted negligently, but not in bad faith, is straightforward and easy to follow:
- There was a "debate within the ranks of OEPC as to whether or not ministerial authorization was necessary"<sup>284</sup> and "the two camps within OEPC had sound and valid reasons"<sup>285</sup>;

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<sup>283</sup> See para 47 *supra*.

<sup>284</sup> Award at 343.

<sup>285</sup> Award at 345.

- “[T]he mutual waiver executed by OEPC and AEC on 31 October 2000 [...] confirms the prevailing OEPC and AEC view that no governmental approval was required for the transfer of the 40% economic interest. This waiver is consistent with Version A [of the draft letter], the script of the first three paragraphs of the 25 October letter but not with the fourth paragraph of that letter”<sup>286</sup>. “That paragraph is misleading. The Tribunal does not believe that OEPC intended to mislead Minister Terán but that nevertheless was the result of the imprecise wording”<sup>287</sup>;
- “[O]n 1 November 2000, OPC issued a press release. That news release is wholly inconsistent with the theory of the Respondent that the Claimants wanted to conceal the transaction”<sup>288</sup>;
- Claimants were “simply convinced that they were right and acted accordingly without seeking to mislead the Ecuadorian government”<sup>289</sup>;
- “In a number of instances in the fall of 2000 [Claimants] had revealed publicly in Ecuador that they had entered into a Farmout transaction with AEC. When they realized that their behaviour, and in particular the last paragraph of their 25 October letter, created confusion within the Ministry, they tried to dissipate that confusion”<sup>290</sup>;
- “Claimants’ interpretation of the Farmout Agreement was wrong. However, the Tribunal does not consider, as the respondent has argued, that it was made in bad faith”<sup>291</sup>;

All these arguments lead the Tribunal to the following conclusion<sup>292</sup>:

“OEPC’s failure to secure the required authorization on the part of the Ecuadorian authorities in October 2000, while not amounting to bad faith, was negligent”.

376. Against this background, Respondent’s annulment request cannot succeed.

377. Contrary to Ecuador’s submission, the Tribunal did not fail to give reasons, its analysis is not self-contradictory, and the Tribunal most certainly did not create a new kind of violation of the HCL. The Tribunal simply made a judgmental analysis of Claimants’ conduct, and for the reasons clearly explained in the Award, concluded that OEPC had not acted with bad faith, but simply imprudently or negligently. The Committee understands this conclusion to mean that OEPC had not acted with gross negligence which is commonly regarded as amounting to or equivalent to bad faith, but had acted only with simple imprudence or negligence. It then applied this factual finding to justify the dismissal of OEPC’s legitimate

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<sup>286</sup> Award at 363.

<sup>287</sup> Award at 360.

<sup>288</sup> Award at 364.

<sup>289</sup> Award at 380.

<sup>290</sup> Award at 380.

<sup>291</sup> Award at 380.

<sup>292</sup> Award at 383.

expectations claim, and it was also taken into consideration (among other reasons) when it analyzed the proportionality test.

378. There is no basis for an annulment. Ecuador's ground for annulment is dismissed.

**3. RES IUDICATA**

379. Clause 22.2.1. of the Participation Contract reads as follows:

“En el caso de controversias que pudieren surgir a causa de la aplicación de este Contrato de Participación, la Contratista, de acuerdo con la legislación del Ecuador, renuncia de manera expresa a utilizar la vía diplomática o consular, o a recurrir a cualquier órgano jurisdiccional nacional o extranjero no previsto en este Contrato de Participación, o a un arbitraje no reconocido por la ley ecuatoriana o no previsto en este Contrato de Participación. El incumplimiento de esta disposición será motivo de caducidad de este Contrato de Participación”.

380. In the jurisdictional phase of the procedure, Respondent made and the Tribunal dismissed a jurisdictional challenge, arguing that clause 22.2.1. of the Participation Contract implied an agreement that *caducidad* related disputes be exclusively solved by the Ecuadorian administrative courts. In paragraph 70 of the Decision on Jurisdiction, the Tribunal stated its decision:

“70. The Tribunal agrees with the Claimants regarding the interpretation of Clause 22.2.1 of the Participation Contract. The Tribunal does not accept that, by virtue of this provision, the parties agreed that *caducidad*-related disputes under the Participation Contract would solely be resolved by submission to the Ecuadorian administrative courts, *i.e.* the TCA. This is simply not what the clause says”.

381. The defense that claims must be first submitted to the Ecuadorian administrative courts was again brought up by Ecuador in the merits phase of the arbitration. In the Award, the Tribunal dismissed the argument with the following reasoning<sup>293</sup>:

“291. [...] The Claimants were legally obliged, says the Respondent, to pursue a local challenge to the *Caducidad* Decree before the courts in Ecuador.

292. In brief, the Claimants answer that this is a “recycled” version of the jurisdictional argument advanced by the Respondent in its jurisdictional challenge which has been dismissed by the Tribunal in its Decision on Jurisdiction and which is now being “reincarnated” as a merits defense.

293. The Tribunal agrees with the Claimants. The matter is *res judicata*”.

382. The Award then made a cross-reference to paragraph 70 of the jurisdictional Decision (quoted above), and summarily came to the following conclusion<sup>294</sup>:

“296. This disposes of the Respondent's preliminary objection which is dismissed”.

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<sup>293</sup> Award at 291-293.

<sup>294</sup> Award at 296.

**A. Respondent's Position**

383. Ecuador avers that Claimants did not seek a reasonable resolution of the *caducidad* claims in the Ecuadorian administrative courts before submitting their Request for Arbitration; instead they filed such Request almost immediately<sup>295</sup>. This fact has given rise to two successive defenses, in the jurisdictional phase first and then in the merits phase.
384. In its merits argument Ecuador submits, as a substantive matter, that Claimants' treaty claims must be dismissed, because the Minister's *Caducidad* Decree does not rise to the level of an international treaty breach, Claimants having failed to first challenge the declaration in the Ecuador administrative courts<sup>296</sup>. Respondent argues that when the Tribunal dismissed this argument in its Award, it manifestly exceeded its powers and failed to state reasons.
385. Respondent adds that the defense that a treaty claim is defective on the merits is distinct from a jurisdictional objection that the claim is not admissible for failure to exhaust administrative remedies.
386. The Tribunal rejected Ecuador's argument on the mistaken basis that it was the same argument that Ecuador had raised during the jurisdictional phase. Without any reasoning or analysis, the Tribunal stated, in conclusory fashion, that the matter is *res iudicata*. In holding so, the Tribunal failed to discuss the applicable law governing *res iudicata* and the case law presented by Respondent<sup>297</sup>, and also whether Ecuador's defense was indeed barred by that doctrine<sup>298</sup>. The Tribunal's interpretation of the principle of *res iudicata* was egregiously incorrect, and the error was so grave as to be tantamount to a manifest excess of powers<sup>299</sup>. The absence of any rationale or, at best, the merely perfunctory nature of the reasons on this point makes it impossible for the reader to follow the Tribunal's reasoning<sup>300</sup>.

**B. Claimants' Position**

387. Claimants aver that the arguments presented by Ecuador in the jurisdictional and merits phase were indistinct. They relied on exactly the same premise, that the State should be afforded the opportunity to review the egregious conduct, made the same arguments and used the same authorities<sup>301</sup>. In the Award, the Tribunal again dismissed the recycled objection, referring to *res iudicata*, with the meaning that it had already considered and decided this issue<sup>302</sup>. The Tribunal did state its reasons

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<sup>295</sup> R I at 323.

<sup>296</sup> R I at 315.

<sup>297</sup> R I at 326.

<sup>298</sup> R I at 329.

<sup>299</sup> R II at 218.

<sup>300</sup> R II at 229.

<sup>301</sup> C I at 103-104.

<sup>302</sup> C I at 107.



for dismissing Ecuador's recycled jurisdictional objection; it had been argued previously and dismissed and consequently it was *res iudicata*<sup>303</sup>.

388. In any case, the Tribunal's invocation of *res iudicata* was proper, because there was sufficient identity of grounds, Ecuador's submissions in both the jurisdictional and merits phase being founded on the same holdings from the same, inapplicable, case law. If the Tribunal had not unanimously rejected Ecuador's arguments as *res iudicata*, and had once again dealt fully in the Award with Ecuador's repetitive argument, there is no reason to believe that the Tribunal would have come to a different conclusion than it did in the Decision on Jurisdiction<sup>304</sup>.

### C. The Committee's Decision

389. This annulment ground revolves around the issue whether Claimants, as a precondition to filing their *caducidad* related claims in the investment arbitration, were forced to submit such claims to adjudication by the Ecuadorian administrative courts.

390. The issue was brought up by Respondent in the jurisdictional phase of the arbitration. It gave rise to the so-called first Jurisdictional Objection. The Tribunal rejected it, arguing that Ecuador could not rely on its domestic law to evade ICSID arbitration<sup>305</sup>, and that the parties had not agreed that *caducidad* related claims would solely be resolved by submission to the Ecuadorian administrative courts<sup>306</sup>.

391. In the merits phase Ecuador brought up the same argument again. It argued that<sup>307</sup>:

“291. [...] Claimants' Treaty claims are 'substantially defective' even if the Tribunal has jurisdiction over these claims because 'the act of the Minister in issuing the *Caducidad* Decree cannot attach responsibility to the State as a substantive matter when there was a mechanism available for review of that act, which the investor simply failed to invoke'”.

392. The Tribunal dismissed Ecuador's objection with little difficulty, holding that:

- Ecuador's attempt to require Claimants to pursue their claims in Ecuador's local courts was a “recycled” version of its jurisdictional objections that had been “reincarnated as a merits defense”<sup>308</sup>;
- The Tribunal had already “stated very clearly” that it rejected Ecuador's argument that Claimants were required to bring their claims to local Ecuadorian courts prior to bringing their claims before ICSID<sup>309</sup>;

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<sup>303</sup> C II at 111.

<sup>304</sup> C I at 385.

<sup>305</sup> Decision on Jurisdiction at 86-88.

<sup>306</sup> Decision on Jurisdiction at 70.

<sup>307</sup> Award at 291.

<sup>308</sup> Award at 292-293.

<sup>309</sup> Award at 294.

- Thus the Tribunal had already “dispose[d] of the Respondent’s preliminary objection”<sup>310</sup>;
- Therefore the Tribunal agreed with Claimants that Ecuador’s attempt to re-litigate its claims was barred by “*res iudicata*”.

393. The reasoning can be followed from point A to point B and to its conclusions, to use the MINE test<sup>311</sup>, and therefore does not justify annulment, because the reader “can understand how the tribunal arrived at its conclusion”<sup>312</sup>.

394. Respondent avers that the Tribunal’s decision to refer to the principle of *res iudicata* was egregiously incorrect, and the error was so grave as to be tantamount to a manifest excess of powers. This is not so. The principle of *res iudicata* is a characteristic feature of most domestic legal systems, but it is also an important principle of international law<sup>313</sup>. In its Decision on Jurisdiction the Tribunal had already dismissed Ecuador’s argument that the proper forum to adjudicate any *caducidad* dispute was the Ecuadorian administrative courts. In the merits phase of the procedure Ecuador chose to bring up the same argument again – thinly disguised as a merits defence. The Tribunal was perfectly entitled to summarily reject it, reasoning that the same defence had already been conclusively rejected in the Decision on Jurisdiction.

395. The ground for annulment is dismissed.

#### **4. DCF MODEL AS EXCLUSIVE VALUATION METHODOLOGY**

396. The Tribunal, having established that Ecuador had breached the Treaty, turned to the quantification of the losses suffered by OEPC. As a first step, the Tribunal determined that a DCF valuation was the proper methodology to establish the value of Block 15<sup>314</sup>:

“708. The Tribunal is of the view that, in this case, the standard economic approach to measuring the fair market value today of a stream of net revenues (*i.e.*, gross revenues minus attendant costs) that can be earned from the operation of a multi-year project such as OEPC’s development of Block 15 is the calculation of the present value, as of 16 May 2006, of the net benefits, or “discounted cash flows”.

397. The Tribunal then described how it would approach the task of valuing OEPC’s assets<sup>315</sup>:

“709. Using a DCF model as the starting point for measuring FMV, the Tribunal further observes that the analytical framework for determining FMV in the present circumstances requires several steps. These steps are clearly summarized by the Respondent. The Claimants agree. They are:

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<sup>310</sup> Award at 296.

<sup>311</sup> See para 48 *supra*.

<sup>312</sup> *Caratube*, at 102.

<sup>313</sup> *Indalsa* at 86.

<sup>314</sup> Award at 708.

<sup>315</sup> Award at 709.

- (a) Determination of the size of the reservoir [...];
- (b) Creation of a production profile [...];
- (c) Assignment of risk adjustment factors [...];
- (d) Application of a price forecast [...]; and
- (e) Application of a discount rate [...].

398. In subsequent sections the Tribunal analyzed the different steps, determined the proper inputs into the DCF model and asked both parties' experts to run the DCF model using those inputs. Having done that, the Tribunal reached the conclusion that the fair market value of Claimants' expropriated assets amounted to US\$ 2,359 M<sup>316</sup> – a figure which was then reduced by 25% due to Claimants' contributory fault.

399. The Tribunal also analyzed the possibility of using other valuation techniques:

400. First it referred to the comparable sales methodology, noting that “[t]he Respondent submits that the examination of comparable sales is also critical ‘because it allows the evaluator to test the reasonableness of the DCF assumptions against market conditions’”, while “Claimants maintain that it is inappropriate”<sup>317</sup>. The Tribunal found in favour of Claimants<sup>318</sup>:

“787. Having considered the parties' arguments and the evidence of their respective witnesses and experts, the Tribunal agrees with the Claimants that “each oil and gas property presents a unique set of value parameters”. Therefore, the Tribunal concludes that it can derive no assistance from an analysis of the seven transactions which the Respondent has submitted as comparable sales”.

401. Second, the Tribunal also addressed the EnCana sale of 2005 as a separate comparable transaction<sup>319</sup>, coming to the conclusion that it was “an inapt choice for a comparable analysis”, because it was contaminated by the *caducidad* decision<sup>320</sup>, because oil prices had moved and because it included non-Block 15 assets<sup>321</sup>.

#### **A. Respondent's Position**

402. Respondent argues that the Award should be annulled, because the Tribunal failed to state the reasons for basing itself exclusively on a DCF model to determine the fair market value of OEPC's investment<sup>322</sup>, notwithstanding Ecuador (and its

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<sup>316</sup> Award at 824.

<sup>317</sup> Award at 780-781.

<sup>318</sup> Award at 787.

<sup>319</sup> Award at 784.

<sup>320</sup> Award at 785-786.

<sup>321</sup> Award at 788.

<sup>322</sup> R I at 491.

expert) repeatedly insisted that any such analysis should be both vetted and corroborated with three other valuation methods<sup>323</sup>:

- Comparable sales analysis,
- Actual sales data and
- Pay-out consideration<sup>324</sup>.

403. Ecuador does not dispute that the Tribunal examined and rejected the “comparable sales data” methodology presented by Ecuador’s expert. However, according to Respondent, the two other alternative valuation methods advanced by it were not similarly addressed, and were dismissed without a single reason<sup>325</sup>. Given that Ecuador had urged the Tribunal to corroborate any DCF analysis with other methods of valuation, such *lacuna* in the Tribunal’s reasoning requires that its decision on damages be annulled<sup>326</sup>.

404. This is Ecuador’s first argument.

405. The Republic advances a second argument why the Award should be annulled: the Tribunal contradicted itself, initially stating that it would use the DCF model “as a starting point for measuring FMV”<sup>327</sup>, but then valuing Claimants’ investments exclusively on the basis of a DCF model<sup>328</sup>.

## **B. Claimants’ Position**

406. Claimants disagree. In their opinion the Tribunal did not fail to state reasons for its decision to exclusively use a DCF analysis in determining the value of OEPC’s investment<sup>329</sup>. The Tribunal’s reasoning can be followed from point A to point B and to its conclusions, and so does not warrant annulment<sup>330</sup>.

407. Claimants then address Respondent’s specific reasons for requesting annulment.

408. The first reason alleged by Ecuador is that the Tribunal did not expressly reject every argument presented by the Republic: the Award did not address, and dismissed without a single reason, two alternative valuation methods proposed by Ecuador, actual sales data and pay-out consideration.

409. Claimants disagree: according to their submission the Tribunal did consider and expressly rejected the actual sales data methodology, i.e. the data deriving from the EnCana sale. Thus, the only alternative valuation method that the Tribunal did not expressly reject was pay-out consideration, which the Republic had mentioned only

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<sup>323</sup> R II at 377.

<sup>324</sup> R II at 380.

<sup>325</sup> R II at 387.

<sup>326</sup> R II at 389.

<sup>327</sup> Award at 709.

<sup>328</sup> R II at 390.

<sup>329</sup> C I at 190.

<sup>330</sup> C II at 195.

in a mere paragraph in each of its pre-hearing written pleadings and not at all in its post-hearing brief on quantum<sup>331</sup>. This is – in Claimants’ submission – not a ground for annulment.

410. Second, Claimants advance that the Tribunal did not contradict itself, because it never stated that the DCF model was “a starting point” to be followed by consideration of alternative valuation methods. It is impossible to identify any genuine contradiction in the Tribunal’s reasoning on damages that could warrant annulment<sup>332</sup>.

### **C. The Committee’s Decision**

411. This ground for annulment is based exclusively on an alleged failure to state reasons.
412. In this case, the failure to state reasons alleged by Ecuador refers to the Tribunal’s quantum determination. Annulment of quantum decisions face an additional hurdle: *ad hoc* committees have consistently held that tribunals have a wide margin of discretion with respect to the calculation of damages<sup>333</sup>.

#### Ecuador’s specific Request

413. The starting point of Respondent’s ground for annulment is the methodology chosen by the Tribunal to establish quantum – a DCF model:
- The Tribunal justified its choice arguing that “the standard economic approach to measuring the fair market value today [...] of Block 15 is the calculation of the present value, as of 16 May 2006, of the net benefits or ‘discounted cash flows’”<sup>334</sup>;
  - It then added that DCF methodology was “the economically appropriate and reliable measure of the cumulative economic harm suffered by the Claimants as a consequence of the contract termination”<sup>335</sup>;
  - That “the discounted cash flow method is the most widely used and generally accepted method in the oil and gas industry for valuing sales or acquisitions”<sup>336</sup>;
  - And came to the conclusion that supplementing the DCF model with comparable sales analysis would be inappropriate and unreliable, because “each oil and gas property presents a unique set of value parameters”<sup>337</sup>; Respondent’s expert had acknowledged “the difficulty in finding truly

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<sup>331</sup> C II at 202-203.

<sup>332</sup> C II at 206-207.

<sup>333</sup> *Duke Energy* at 256; *Rumeli* at 146, *Vivendi II* at 255; *Wena* at 91.

<sup>334</sup> Award at 708.

<sup>335</sup> Award at 708.

<sup>336</sup> Award at 779.

<sup>337</sup> Award at 787.

comparable situations”<sup>338</sup>; and “the comparable sales approach of the Respondent’s expert [...] is unreliable in this case”<sup>339</sup>;

- Finally the Tribunal added the EnCana sale was not a useful comparable because of contamination due to the possible issuance of the *Caducidad* Decree<sup>340</sup>, differences in the price of oil and the inclusion of non-Block 15 assets<sup>341</sup>.

414. Ecuador does not dispute that the Tribunal’s findings are properly reasoned. Its line of argument for seeking annulment is more nuanced:

415. First, the Republic argues that the Tribunal failed to examine two alternative valuation methods advanced by Ecuador (actual sales data and pay-out consideration), which were dismissed without a single reason<sup>342</sup>. This failure to address particular arguments advanced by the Respondent should lead to the annulment of the damages calculation and of the Award *in toto*<sup>343</sup>.

416. Respondent’s argument is factually wrong. As the Claimants have correctly averred, the Tribunal did address and ultimately reject the application of the actual sales data deriving from the EnCana sale<sup>344</sup>. Thus the only alternative valuation method that the Tribunal did not expressly reject was pay-out consideration, an obscure methodology which Respondent had briefly mentioned in its pre-hearing written pleadings and had failed to include in its post-hearing brief on quantum<sup>345</sup>.

417. Tribunals do not have the duty to address every single argument advanced by each party. Only case-decisive arguments must be answered. Respondent has failed to prove that the application of pay-out consideration, as an alternative methodology to complement the valuation resulting from DCF methodology, was a case-decisive argument, that would lead to a significant modification of the compensation to be awarded. The fact that Respondent failed to refer to pay-out consideration in its final and conclusive quantum brief seems to indicate the contrary: that Ecuador itself was of the opinion that it lacked materiality for the Tribunal’s compensation decision.

418. There is a second argument which is being advanced by the Respondent: it submits that there is a contradiction in the Award, because in paragraph 709 the Tribunal states that it will be “using a DCF model as a starting point for measuring FMV”, while in fact the Award established the value of the investment exclusively on the basis of a DCF model.

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<sup>338</sup> Award at 782.

<sup>339</sup> Award at 783.

<sup>340</sup> Award at 786.

<sup>341</sup> Award at 788.

<sup>342</sup> R II at 387.

<sup>343</sup> R II at 389.

<sup>344</sup> Award at 786, 788.

<sup>345</sup> Doc. EEA 180; C II at 203.

419. The argument is without merit. The Tribunal never stated that the DCF model was “a starting point” to be followed by consideration of alternative valuation methods. The Award speaks for itself.

420. The ground for annulment is dismissed.

**5. THE DECISION TO DISREGARD LAW 42 WHEN ASSESSING CLAIMANTS’ DAMAGES**

421. In March 2006 the President of the Republic submitted to the Ecuadorian Congress a bill proposing an amendment to the HCL. On 19 April 2006 the bill was passed and became Law 42. This new law added the following provision to the HCL:

“Las compañías contratistas que mantienen contratos de participación para la exploración y explotación de hidrocarburos vigentes con el Estado ecuatoriano de acuerdo con esta Ley, sin perjuicio del volumen de petróleo crudo de participación que les corresponde, cuando el precio promedio mensual efectivo de venta FOB de petróleo crudo ecuatoriano supere el precio promedio mensual de venta vigente a la fecha de suscripción del contrato y expresado a valores constantes del mes de la liquidación, reconocerán a favor del Estado ecuatoriano una participación de al menos el 50% de los ingresos extraordinarios que se generen por la diferencia de precios. Para los propósitos del presente artículo, se entenderá como ingresos extraordinarios la diferencia de precio descrita multiplicada por el número de barriles producidos.

El precio del crudo a la fecha del contrato usado como referencia para el cálculo de la diferencia, se ajustará considerando el Índice de Precios al Consumidor de los Estados Unidos de América, publicado por el Banco Central del Ecuador”.

422. Law 42 thus obliged concessionary companies to pay to the Ecuadorian state 50% of their “*ingresos extraordinarios*”, such term being defined as the number of barrels produced multiplied by the increase in the price of crude, at the time when the concession was granted and when the oil was produced.

423. In quantifying the value of Claimants’ losses that resulted from Ecuador’s breaches, the Tribunal needed to consider whether Law 42 should be factored into the calculations. The Tribunal devoted a 26-page long section to this issue<sup>346</sup> and came to the following conclusion<sup>347</sup>:

“547. For all the foregoing reasons, the Tribunal will disregard Law 42 for the purpose of its valuation of the quantum of the Claimants’ damages”

424. Arbitrator Prof. Stern dissented<sup>348</sup> and reached the opposite conclusion<sup>349</sup>:

“13. As a result of the foregoing, I consider that Law 42 should have been taken into account in the calculation of damages”. [Emphasis in the original]

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<sup>346</sup> Award at 465-547.

<sup>347</sup> Award at 547.

<sup>348</sup> Dissent at 9-13.

<sup>349</sup> Dissent at 13.

425. The impact of Law 42 in the valuation of OEPC's assets is very substantial; the non-application reduces the value of the assets by at least US\$ 816 M<sup>350</sup>, although the actual impact could be higher<sup>351</sup>.

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<sup>350</sup> Mr. García Represa for Respondent, HT p. 236:5.

<sup>351</sup> R I at 719.



**A. Respondent's Position**

426. Respondent argues that the Tribunal manifestly exceeded its powers (a) and failed to state reasons (b) on which it based its decision to assume jurisdiction over Law 42 matters and to disregard the Law 42 levy when assessing Claimants' damages. In total Respondent lists 11 different reasons which in its opinion should lead to annulment.

**a. Excess of Powers**

427. Respondent lists five reasons why the Tribunal manifestly exceeded its powers:

428. First, the Tribunal refused to consider whether under international law, Law 42 was a "matter of taxation", and as such excluded from the Tribunal's jurisdiction pursuant to Article X.2 of the Treaty. Instead, the Tribunal decided to apply Ecuadorian law to conclude that Law 42 was not "a matter of taxation" and hence was not excluded from jurisdiction<sup>352</sup>. This, in and of itself, is sufficient to warrant annulment of the Award, as shown in several prior annulment decisions<sup>353</sup>.

429. Ecuador then criticizes the Tribunal's additional argument that "even if Law 42 were a tax", it "would be captured by the 'exception to the exception' of Article X.2(c)" because "the Participation Contract [...] in the opinion of the tribunal is an investment agreement"<sup>354</sup>. The Respondent disagrees with the Tribunal and submits that the Participation Contract cannot be characterized as an investment agreement, and that the Tribunal failed to state reasons and committed a manifest excess of powers, for failure to undertake the mandate entrusted to it<sup>355</sup> and for failure to consider and apply the applicable law, ruling instead as an *amiable compositeur*<sup>356</sup>.

430. Second, the Tribunal expressly refused to apply international law when it disregarded the international law principle according to which "States are not liable to pay compensation to a foreign investor when, in the normal exercise of their regulatory powers, they adopt in a nondiscriminatory manner *bona fide* regulations that are aimed at the general welfare"<sup>357</sup>, merely on the basis of a re-written Participation Contract<sup>358</sup>.

431. Third, the Tribunal also manifestly exceeded its powers by failing to apply the international law principle according to which, absent an express and specific stabilization undertaking by the State, the fair and equitable treatment standard does not include a legitimate expectation that the State will not amend its laws and regulations<sup>359</sup>. The Tribunal's unreasoned refusal to follow the well-known international law principle on the sole basis that the Participation Contract (which

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<sup>352</sup> R I at 723.

<sup>353</sup> R II at 669.

<sup>354</sup> R I at 744-749, citing Award at 497-499.

<sup>355</sup> R I at 728.

<sup>356</sup> R II 677.

<sup>357</sup> Award fn 65.

<sup>358</sup> R I at 729.

<sup>359</sup> R I at 731.

does not include any stabilization clause and moreover expressly provides for the application of new fiscal measures in Clauses 8.6 and 11.11) would somehow “fetter the State’s exercise of its regulatory powers”, constitutes a manifest excess of powers<sup>360</sup>.

432. Fourth, the Tribunal also manifestly exceeded its powers when it effectively disregarded the plain text of Law 42 (in particular Article 2), distinguishing between “participation in volumes” of crude oil (guaranteed by clause 8.1. of the Participation Contract and unaffected by Law 42) and “participation in revenues” obtained by the concessionary (impacted and reduced by Law 42, but not guaranteed by the Participation Contract) to conclude that Ecuador had breached the Participation Contract<sup>361</sup>. Several *ad hoc* committees have found an annulable error where a tribunal, like in the present circumstances, failed to abide by the ordinary meaning of the term of the legal instrument it purports to interpret and apply<sup>362</sup>.
433. Fifth, the Tribunal failed to apply the international law standard for determining the FMV of Block 15 (the willing buyer/willing seller standard) and thereby manifestly exceeded its powers<sup>363</sup>.

**b. Failure to state reasons**

434. Respondent says that the Tribunal failed to state reasons or provided directly contradictory reasons (equivalent to no reasons) in order to avoid applying Law 42 to its calculation of the compensation:
435. Sixth, the Tribunal defined Law 42 as a “unilateral decision of the Ecuadorian Congress to allocate to the Ecuadorian State a defined percentage of revenues earned by contractor companies such as OEPC that hold participation contract”<sup>364</sup>, while only one paragraph earlier it contradicted itself when it held that Law 42 “is neither a royalty, a tax, a levy or other measure of taxation under the Participation Contract”<sup>365</sup>. The contradiction could not be more glaring, as the definition provided by the Tribunal of Law 42 is exactly that of a tax measure<sup>366</sup>.
436. Seventh, in seeking to retain jurisdiction over Law 42 faced with Article X.2 of the Treaty, the majority failed to give any reasons whatsoever for holding that “even if Law 42 were a tax” it “would be captured by the ‘exception to the exception’ of Article X.2(c)”. The Tribunal’s entire reasoning is found in a single sentence<sup>367</sup>: “the Participation Contract [...] in the opinion of the tribunal is an investment agreement”. This conclusion is simply asserted or postulated instead of being reasoned. It fails to even mention Ecuador’s contrary arguments and prevents the

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<sup>360</sup> R II at 682.

<sup>361</sup> R I at 735.

<sup>362</sup> R II at 694.

<sup>363</sup> R I at 739.

<sup>364</sup> Award at 510.

<sup>365</sup> Award at 509.

<sup>366</sup> R I at 742.

<sup>367</sup> Award 497-499; R I at 749.

reader from following the Tribunal's reasoning from point A to point B and eventually to its conclusion<sup>368</sup>.

437. Eighth, the Tribunal acknowledged that the Participation Contract guaranteed OEPC a participation in the production of crude, but also found that "by taking 50% of OEPC's revenues [Law 42] modified radically the participation percentages agreed in Clause 8.1"<sup>369</sup>. If Clause 8.1, as the Tribunal held, allocates only crude production and not revenues, it is simply impossible to follow the Tribunal's rationale for concluding that Law 42's taking of a percentage of revenues constitutes a breach of clause 8.1<sup>370</sup>.
438. It was not disputed in the underlying arbitration that Clause 8.1's participation formula allocates only crude production to OEPC (not revenues) and that OEPC continued to receive, even after the enactment of Law 42, all of the crude production resulting from the application of Clause 8.1. Accordingly, how can a law taxing revenues breach a contractual clause allocating crude volumes<sup>371</sup>?
439. Ninth, the Award fails to state reasons for why, after Claimants abandoned their argument that Law 42 somehow breached Clause 5.3.2. of the Participation Contract (contractor's right to freely dispose of its participation in barrels), the Tribunal found that such breach had occurred<sup>372</sup>. Respondent acknowledges that the Tribunal gave reasons for one breach of the Contract – the breach relating to Clause 8.1. But a single reasoning cannot cure the Tribunal's failure to state reasons for all other breaches<sup>373</sup>.
440. Tenth, the Tribunal failed to state reasons for why the introduction of Law 42, aside from the contractual framework, implied a unilateral and substantial modification of the "legal framework that existed at the time the Claimants negotiated and agreed the Participation Contract [...]"<sup>374</sup>. The Award is notably silent as to what the legal framework supposedly modified was, since not a single provision of Ecuadorian law is cited in support of the majority's finding<sup>375</sup>.
441. Furthermore, the Tribunal did not address the implications of the Constitutional Court's upholding of Law 42's legality, which included a response to arguments of breach of contract<sup>376</sup>.
442. Eleventh, the Award failed to state the reasons for its holding that Law 42 flouts Claimants' legitimate expectations, in addition to a breach of the Participation

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<sup>368</sup> R II at 717.

<sup>369</sup> Award at 523.

<sup>370</sup> R I at 751.

<sup>371</sup> R I at 753.

<sup>372</sup> R I at 757.

<sup>373</sup> R II at 735.

<sup>374</sup> Award at 525, R I at 758.

<sup>375</sup> R II at 737.

<sup>376</sup> R II at 741.

Contract, considering that the FET standard does not equate to the stabilization of the legal framework<sup>377</sup>.

**B. Claimants' Position**

443. Claimants submit that Ecuador's submission on Law 42 belie its true complaint: that the Tribunal decided against Ecuador, not that the Tribunal committed annullable errors. Ecuador grossly distorts the true factual and procedural background and none of its complaints have any merit, let alone constitute annullable errors<sup>378</sup>.

**a. Excess of powers**

444. In Claimants' opinion the Tribunal did not manifestly exceed its powers by failing to apply the proper law, when it decided to disregard Law 42 for the purposes of valuing Claimants' investment:

445. First, Ecuador claims that the Tribunal manifestly exceeded its powers by refusing to consider whether under international law, Law 42 was a matter of taxation for purposes of the Treaty. The Claimant avers that the Tribunal did not refuse to do so, because it analyzed whether Law 42

“ is [...] a tax, a royalty, a levy or, more generally, a ‘matter of taxation’ under the Treaty [...]”<sup>379</sup>

and came to the conclusion that it is not<sup>380</sup>.

446. Besides, Ecuador feigns ignorance of its own prior confirmation in the VAT Agreement of the Tribunal's jurisdiction regarding Law 42. Ecuador cannot, on the one hand, agree in a contract that the Tribunal has jurisdiction over Law 42 and now contend that the Tribunal's confirmation of that jurisdiction is a manifest error<sup>381</sup>.

447. Finally, Ecuador also ignores the Tribunal's unequivocal conclusion that Law 42, even if it was a matter of taxation, would be captured by the exception to the exception of Article X.2.(c) of the Treaty. Ecuador had consistently asserted, over the course of the VAT Arbitration and the appeal of the VAT Award, that the Participation Contract constituted an investment agreement within the meaning of the Treaty. The evidence contained in the VAT Award showing that Ecuador has consistently treated the Participation Contract as an investment agreement is “implicit in the considerations and conclusions contained in the Award” – to use the phrase coined by the *Wena* committee<sup>382</sup>.

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<sup>377</sup> R II at 742.

<sup>378</sup> C I at 270-271.

<sup>379</sup> Award at 487, emphasis added.

<sup>380</sup> C II at 310.

<sup>381</sup> C II at 309.

<sup>382</sup> *Wena* at 81, C II at 293.

448. Second, Ecuador says that the majority refused to apply international law when it disregarded the international law principle that States are not liable to pay compensation when adopting in the normal exercise of regulatory powers non discriminatory *bona fide* regulations aimed at the general welfare. In fact what happened was that the Tribunal decided that, on the facts of the case, the principle offered Ecuador no defense. Ecuador improperly challenges the merit of that conclusion<sup>383</sup>.
449. Third, Ecuador complains that the Tribunal exceeded its powers by failing to apply the principle according to which, absent a stabilization undertaking, the FET standard does not include a legitimate expectation that the State will not amend its laws and regulations. Again, this complaint has nothing to do with a manifest excess of powers; it exclusively pertains to the merits of the Tribunal's decision. The Tribunal held that because Claimants relied upon Ecuador's specific representations, Claimants' legitimate expectations were protected by the Treaty. Ecuador may disagree with this finding of fact, but it cannot take its annulment case any further<sup>384</sup>.
450. Fourth, Ecuador complains that the Tribunal disregarded the plain text of Law 42, which distinguishes between participation in volumes of crude oil and participation in revenues obtained by the concessionary.
451. In Claimants' opinion this merits contention has no place in an annulment procedure. In any event, on the substance of the argument, Ecuador is clearly wrong. The Tribunal understood that Law 42 nominally mandated Ecuador to take cash rather than crude, but it had the effect of radically diminishing Claimants' participation in crude by taking 50% of its gross revenues from the sale of that participation in the crude oil. Clause 8.2. of the Participation Contract defines Claimants' gross revenue simply as the market value of Claimants' participation in crude. It cannot be controversial that a measure taking away half of the market value of crude will effectively take away the crude that yields that market value. The Tribunal rejected Ecuador's nonsensical proposition that Law 42 did not affect Claimants' rights under the Participation Contract, because Law 42 seized the cash representing the crude's market value rather than the physical crude itself.<sup>385</sup>
452. Fifth, the Republic says that the Tribunal failed to apply the international law standard for determining FMV – the willing buyer/willing seller standard. This again is a rank appeal of the Tribunal's merits findings and offers no conceivable ground for annulment<sup>386</sup>. The Tribunal accepted Claimants' reasoning that a State cannot reduce its liability on the basis of a wrongful act, such as Law 42. It explained that "a valuation tool like the willing buyer analogy cannot override that principle"<sup>387</sup>.

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<sup>383</sup> C I at 531.

<sup>384</sup> C I at 534.

<sup>385</sup> C I at 542-543.

<sup>386</sup> C I at 535.

<sup>387</sup> Award at 541.

**b. Failure to state Reasons**

453. Sixth, there is nothing contradictory in the Tribunal's finding that Law 42 is a "unilateral decision of the Ecuadorian Congress to allocate to the Ecuadorian State a defined percentage of revenues earned by contractor companies such as OEPC that hold participation contract"<sup>388</sup> and its finding, on the other hand, that Law 42 is "neither a royalty, a tax, a levy or any other measure of taxation under the Participation Contract"<sup>389</sup>.
454. In the course of the procedure, Ecuador itself submitted categorically that Law 42 is not a tax, because it had not been enacted in accordance with the special legislative procedures reserved for taxes under Ecuadorian Law. Its present position is a stunning about-face<sup>390</sup>.
455. Ecuador's complaint is in essence that the Award erred in the application of international law – which is beyond the review of this Committee. When the Award analyzed whether Law 42 "is a tax, a royalty, a levy or, more generally, "a matter of taxation" under the Treaty"<sup>391</sup>, it applied international law<sup>392</sup>.
456. Seventh, even if Law 42 were a tax, the Tribunal clearly stated that it would be captured by the exception to the exception set forth in Article X.2.(c) of the Treaty, because the Participation Contract is an investment agreement.
457. Ecuador's criticism of the Tribunal's decision in this regard is not just baseless it is also astoundingly misleading. Ecuador asserted for the first time in its Post-Hearing Brief on Law 42 that the Participation Contract was not an investment agreement. Previously and consistently Ecuador had taken the position over a decade of arbitration and appellate proceedings that Claimants' Participation Contract did constitute an investment agreement within the meaning of Article VI of the Treaty. The argument was specifically made in the course of the VAT Arbitration and Award, which form parts of the factual matrix considered by the Tribunal.
458. Eighth, the Tribunal stated its reasons for concluding that Law 42, by taking 50% of gross revenues above the reference price, constituted a breach of Clause 8.1, modified the contractual and legal framework and frustrated Claimants' expectations. There is no inconsistency between the Tribunal's reference to Claimants' contractual rights to receive a participation in the production of crude oil and its statement that Law 42 takes 50% of OEPC's revenues. What Ecuador calls an inconsistency is in fact the Tribunal's considered rejection of Ecuador's unsustainable argument that the Participation Contract allowed Ecuador to deprive Claimants of an economic benefit of their contractually agreed participation in crude (*i.e.* its revenue) as long as it did not physically seize that participation in crude (*i.e.* the volume of crude)<sup>393</sup>.

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<sup>388</sup> Award at 510.

<sup>389</sup> Award at 509.

<sup>390</sup> C I at 275.

<sup>391</sup> Award at 487.

<sup>392</sup> C II at 310.

<sup>393</sup> C I at 290-291.

459. Ninth, Ecuador complains that Claimants withdrew their Clause 5.3.2. claim and that the Award does not include the reasons relied upon by the Tribunal to address a claim previously abandoned. Claimants did not do so, nor did the Award find that the Claimants withdrew this claim. The Award cannot be required to provide reasons for considering a withdrawn claim when no claim was withdrawn<sup>394</sup>.
460. Tenth, Ecuador's argument that the Award did not provide reasons for finding that Law 42 modified the legal framework at the time when the Participation Contract was executed is equally invalid. It is obvious that the introduction of a law that did not exist at the time the Participation Contract was entered into and which unilaterally modified the parties' bargain is a change of the legal framework<sup>395</sup>.
461. Ecuador now further states that the Tribunal failed to assess the implications of the Constitutional Courts decision, which referred to the breach of contract argument. However, Ecuador had specifically argued in the arbitration that the Tribunal did not need to consider the lawfulness of Law 42<sup>396</sup>. Besides, Ecuador has not established that the constitutionality of Law 42 is pivotal or outcome determinative<sup>397</sup>.
462. Eleventh, Ecuador alleges that the Award failed to state reasons for finding that, in addition to a breach of the Participation Contract, Law 42 flouted the Claimants' legitimate expectations. The Award stated its reasons: "the investor, OEPC, was justified in expecting that this contractual framework would be respected and certainly not modified unilaterally by the Respondent"<sup>398</sup>.

### **C. The Committee's Decision**

463. The Committee will analyze this ground for annulment by summarizing the Tribunal's decision regarding Law 42 (**a.**), the Republic's arguments for requesting the annulment (**b.**) and then adjudicating the jurisdictional objection (**c.**) and the application of Law 42 in the DCF model (**d.**).

#### **a. The Tribunal's decision regarding Law 42**

464. In April 2006, a month before the expropriation of Claimants' investment in Block 15, the Republic adopted Law 42, which modified the HCL in two aspects:

- First it created a new category of income for the State related to the exploration and exploitation of crude deposits called the "*participación del Estado en los excedentes de los precios de venta de petróleo*"<sup>399</sup> ("**State Participation**");
- Then it defined the obligation of concessionary companies to acknowledge in favour of the Ecuadorian State ("*reconocerán a favor del Estado*");

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<sup>394</sup> C II at 297.

<sup>395</sup> C II at 298.

<sup>396</sup> C I at 298; Doc. EEA -184 Ecuador's Post-Hearing Brief on Law 42, para 37 *et seq.*

<sup>397</sup> C II at 300.

<sup>398</sup> Award at 526, C II at 301.

<sup>399</sup> Article 44 HCL, as amended by Law 42.

*Ecuatoriano*”) a State Participation equal to 50% of the “*ingresos extraordinarios que se generen por la diferencia de precios*”. And such “*diferencia*” is calculated by multiplying the number of barrels produced by the difference between crude oil prices at the time of execution of the contract and present market prices<sup>400</sup>.

465. What is the legal nature of the State Participation created by Law 42?
466. Law 42 does not clarify the issue. The Ecuadorian legislator adopted a policy of calculated ambiguity, expressed in the choice of the term “*participación*”, a novel concept which had not been used either in the HCL nor in the Participation Contract, and which does not seem to have a specific legal meaning under Ecuadorian law. The ambiguity continued during the arbitration and was reflected by the Tribunal in the Award<sup>401</sup>:

“The Tribunal recalls that the Respondent, throughout the Hearing on Quantum, was loath to characterize Law 42”.

467. The legal nature of the State Participation is especially relevant in order to establish the Tribunal’s jurisdiction, because Article X (2) of the Treaty limits the jurisdiction of investment tribunals in “matters of taxation”. Article X (2) reads as follows:

“2. Nevertheless, the provisions of this Treaty, and in particular Article VI and VII, shall apply to matters of taxation only with respect to the following:

- (a) expropriation, pursuant to Article III;
- (b) transfers, pursuant to Article IV; or
- (c) the observance and enforcement of terms of an investment agreement [...]. [Emphasis added].

468. Article X (2) thus excludes from the jurisdiction of an investment tribunal any “matter of taxation”, except if the “exception to the exception” applies: that the investment consists in an investment agreement and the dispute relates to its observance and enforcement.

469. When confronted with the Law 42 argument, the Tribunal faced two distinct issues:

- The first was whether it had jurisdiction at all to address any Law 42 matter (i), and
- The second, whether it should deduct the amounts accruing under the Law 42 levy in favour of the Republic, from the DCF model (thus reducing the compensation by more than US\$ 800 M) (ii).

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<sup>400</sup> Article 55 HCL, as amended by Law 42.

<sup>401</sup> Award at 489.



(i) The jurisdictional Challenge

470. The argument that the Tribunal’s jurisdiction could be affected by Law 42 only became relevant at a very late stage of the arbitration; it was at the Hearing on Quantum when the Respondent<sup>402</sup>

“488. [...] for the first time in these proceedings, claimed that “the question of Law 42 is excluded from the Arbitral Tribunal’s jurisdiction in accordance with Article 10 of [the] Treaty”. In effect, as will be seen, the Respondent was now adopting the position that Law 42 was a “matter of taxation” [Footnote omitted].

471. Recalling that at the Hearing on Quantum the Respondent had categorically submitted that Law 42 “is not a tax”, because it did not follow the special procedures required in the Constitution<sup>403</sup>, the Tribunal came to the conclusion that the State Participation was not a tax<sup>404</sup>:

“509. For purposes of characterizing Law 42, it is sufficient for the Tribunal to conclude, as it now does, that the participation of Ecuador under Law 42 “in surplus from oil sales prices not agreed upon or not foreseen,” is neither a royalty, a tax, a levy or any other measure of taxation under the Participation Contract”.

472. But then *ad cautelam* the Tribunal added a second argument<sup>405</sup>:

“497. [...] even if Law 42 were a tax, it would not, in the opinion of the Tribunal, create a jurisdictional barrier to the Claimants’ Law 42 claim under the Treaty for the following reasons”.

473. The Tribunal then explained its reasoning<sup>406</sup>:

“499. The Tribunal is of the view that Law 42, even if it was characterized as a “matter of taxation”, would be captured by the “exception to the exception” of Article X.2(c) of the Treaty. The dispute between the parties, in the present arbitration, relates directly to the observance and enforcement of the terms of the Participation Contract which, in the opinion of the Tribunal, is an investment agreement under Article VI(1)(a) of the Treaty”.

474. With this “belt and braces” double reasoning, the Tribunal dismissed Respondent’s jurisdictional objection.

(ii) The Impact of Law 42 on the Compensation

475. The Tribunal then analysed the impact – if any – of Law 42 on the calculation of compensation owed to OEPC and came to the following conclusions:

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<sup>402</sup> Award at 488.

<sup>403</sup> Award at 490.

<sup>404</sup> Award at 509.

<sup>405</sup> Award at 497.

<sup>406</sup> Award at 499.

476. The Tribunal first examined the contractual bargain negotiated by the parties when they executed the Participation Contract, and concluded thus:

“522. It is clear to the Tribunal that, in the Participation Contract, the Claimants knowingly accepted the risk of losses on its investment in case of a low price scenario and the Respondent knowingly forewent the opportunity to increase its participation in case of a high price scenario. This was the bargain which was struck by the parties and which was reflected in the Participation Contract”.

477. Then it analysed the impact of Law 42 on this contractual bargain, and found that the State Participation “struck at the very heart of OEPC’s acquired rights under the Participation Contract”<sup>407</sup>, because<sup>408</sup>

“525. [...] with the introduction of Law 42, the Respondent modified unilaterally and in a substantial way the contractual and legal framework that existed at the time the Claimants negotiated and agreed the Participation Contract and thereby violated Clauses 5.3.2 and 8.1 of the Participation Contract”.

478. The Tribunal made the following legal inferences<sup>409</sup>:

“527. In conclusion, Law 42 is in breach of the Participation Contract and flouts the Claimants’ legitimate expectations. It is, as a result, in breach of the Respondent’s Article II.3(a) Treaty obligation to accord fair and equitable treatment to the Claimants’ investment and the Tribunal so finds”.

479. The Tribunal also addressed Respondent’s argument, that any willing buyer wishing to value the FMV of the Participation Contract, would have used the existence of Law 42 as a factor to obtain a reduction of the price to be paid. The Tribunal rejected the argument, accepting Claimants’ reasoning that<sup>410</sup>

“541. [...] a State cannot reduce its liability for wrongful act [here, expropriation/disproportionate sanction via *caducidad*] on the basis of another wrongful act [applying Law 42 to OEPC in breach of the Participation Contract][...] *A valuation tool like the willing buyer analogy cannot override that principle*”. [Emphasis in the original].

## **b. Summary of Respondent’s Arguments**

480. Ecuador submits 11 grounds for the (partial) annulment of the Award, based on alleged abuse of powers in five cases, and on failure to state reasons in the remaining six, arguing that the Tribunal lacked jurisdiction to address disputes relating to Law 42 and that it erred when it decided to deduct the State Participation mandated by Law 42 from the DCF model.

481. The Committee will analyze first the grounds for annulment based on a jurisdictional objection (c. *infra*) and then the remaining grounds affecting the use

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<sup>407</sup> Award at 523.

<sup>408</sup> Award at 525.

<sup>409</sup> Award at 527.

<sup>410</sup> Award at 541.

of Law 42 in the DCF valuation (**d. infra**). This distinction is relevant, because the powers of *ad hoc* committees are quite different in one scenario and in the other:

- The primary concept of excess of powers refers to situations where a tribunal adjudicates disputes not included in the powers granted by the parties; if a Tribunal exceeds its jurisdiction and such excess is manifest, its decision cannot stand.
- The situation is quite different if a tribunal having jurisdiction adopts an erroneous decision that is said to exceed its powers; in this secondary concept of abuse of powers, annulment requires that the error committed by the tribunal consisted in applying the wrong law (not of wrongly interpreting the correct law) or that the error amounts to a gross or egregious error of law – a much more onerous test than in a case of primary excess of powers<sup>411</sup>.

### **c. The Jurisdictional Objection**

482. Article X (2) and of Article VI (1) of the Treaty read as follows:

“Article X.2.

Nevertheless, the provisions of this Treaty, and in particular Article VI and VII, shall apply to matters of taxation only with respect to the following:

- (a) expropriation, pursuant to Article III;
- (b) transfers, pursuant to Article IV; or
- (c) the observance and enforcement of terms of an investment agreement [...]”.

“Article VI.1.

For purposes of this Article, an investment dispute is a dispute between a Party and a national or company of the other Party arising out of or relating to (a) an investment agreement between that Party and such national or company; (b) an investment authorization granted by that Party’s foreign investment authority to such national or company; or (c) an alleged breach of any right conferred or created by this Treaty with respect to an investment”. [Emphasis added].

### The Tribunal’s Award

483. In the past Ecuador consistently argued that the Participation Contract was an investment agreement for the purposes of Article VI of the Treaty. The argument was employed in the VAT arbitration to support Ecuador’s claim that the Treaty’s fork in the road provision should apply to OEPC’s VAT claim. For this reason Ecuador argued in the VAT Arbitration and before the English High Court and the English Court of Appeal that the Participation Contract was an investment agreement. As the High Court confirmed<sup>412</sup>,

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<sup>411</sup> See paras 55-56 *supra*.

<sup>412</sup> CAA 73 at 111, C I at 288.

“Ecuador argued that the claims of OEPC before the Quito courts related to an investment agreement between Ecuador (via PetroEcuador) and OEPC, and so fell within the terms of Article VI(1)(a) of the BIT”.

484. The VAT Arbitration is relevant to this arbitration: the Tribunal expressly listed the VAT Arbitration and Respondent’s appeal of the VAT Award in its description of the factual matrix considered by the Tribunal in its Award<sup>413</sup>.

485. In the Hearing on Quantum Ecuador changed its position and for the first time claimed that the Tribunal lacked jurisdiction to address any Law 42 dispute, because the State Participation created by such Law was a “matter of taxation” excluded by Article X (2) of the Treaty from the jurisdiction of investment arbitration tribunals, and because the “exception to the exception” did not apply.

486. In the Award, the Tribunal dismissed Respondent’s jurisdictional challenge, concluding that the State Participation created by Law 42 was not a “matter of taxation”<sup>414</sup>. But the Tribunal did not stop there, and added the following alternative reason:

“499. The Tribunal is of the view that Law 42, even if it was characterized as a “matter of taxation”, would be captured by the “exception to the exception” of Article X.2(c) of the Treaty. The dispute between the parties, in the present arbitration, relates directly to the observance and enforcement of the terms of the Participation Contract which, in the opinion of the Tribunal, is an investment agreement under Article VI(1)(a) of the Treaty”.

487. Summing up, the Tribunal rejected the jurisdictional challenge based on a main and on an alternative reason:

- The main reason being that in the Tribunal’s opinion Law 42 was not a matter of taxation,
- And the alternative reason that the dispute affected the observance and enforcement of an investment agreement and consequently fitted within the “exception to the exception”,

both reasons being independent from each other, and the validity of one reason sufficing to establish jurisdiction<sup>415</sup>.

#### Respondent’s Claims for Annulment

488. Respondent claims that the Tribunal erred when it dismissed the jurisdictional challenge, and that the error affected both the main and the alternative reasons.

489. As regards the alternative reason, the so called “exception to the exception”, Ecuador asserts that in the present case neither of the two conditions required by Article X of the Treaty was met:

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<sup>413</sup> Award at 108, 170-172.

<sup>414</sup> Award at 509.

<sup>415</sup> Award at 499.

- the Participation Contract was not an investment agreement for the purposes of Article VI of the Treaty, because its clause 22.1.4 did not specifically refer to Article 30 of the 1997 Investment and Protection Act – allegedly a requirement of Ecuadorian law for a contract to be considered as an investment agreement;
- furthermore, the dispute did not relate to the observance and enforcement of the terms of an investment agreement<sup>416</sup>.

490. Respondent's claim for annulment is supported by three grounds:

- First, the decision implies a manifest excess of powers, because it amounts to a failure on the part of the Tribunal to undertake the mandate entrusted to it<sup>417</sup>;
- Second, there is also a manifest excess of powers because the Tribunal failed to apply the proper law and ruled instead as an *amiable compositeur*<sup>418</sup>;
- Third, the Tribunal failed to give reasons for its finding<sup>419</sup>.

#### The Committee's Decision

491. For convenience the Committee will start its analysis with the alternative reason, *i.e.* with the Tribunal's decision in para. 499 of the Award, establishing that the "exception to the exception" applied, thus creating jurisdiction to adjudicate Law 42 matters.

492. The "exception to the exception" revolves around the issue whether the Participation Contract could be considered an "investment agreement" for the purposes of Article X (2) of the Treaty. This provision includes a cross reference to Article VI (1) (a), which describes an investment agreement as an agreement between a State and a national or company of the other State. The Treaty thus establishes three requirements for the existence of an "investment agreement":

- That there is an "agreement",
- That it relates to an "investment", and
- That it is executed between a State and a national of the other contracting State.

493. The Tribunal reasonably found that the "exception to the exception" provided for in Article X (2) was applicable:

- It first found that the Participation Contract indeed is an investment agreement under Article VI(1)(a) of the Treaty, *i.e.* that it meets the three

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<sup>416</sup> Doc. EEA 184 at 154; R I at 748.

<sup>417</sup> R I at 728.

<sup>418</sup> R II at 677.

<sup>419</sup> R II at 717.

requirements set forth in that Article: (i) that it is an agreement, (ii) that it formalizes an investment and (iii) that it binds Ecuador (through PetroEcuador) with a U.S. investor;

- It then found that the dispute relates directly to the observance and enforcement of the terms of the Participation Contract; and this is indeed so, because the Tribunal's main conclusion as regards the merits was that

“Law 42 is in breach of the Participation Contract and flouts the Claimants’ legitimate expectations”<sup>420</sup>.

494. The Tribunal thus justified and reasoned that the two requirements set forth in Article X (2) of the Treaty for the “exception to the exception” to apply, namely

- the execution of an investment contract, and
- the existence of a dispute which refers to the observance and enforcement of the terms of the investment contract,

had been duly met. In so doing, the Tribunal did not fail to undertake the mandate entrusted to it, it certainly did not act as an *amiabile compositeur* and it did not fail to reason its decision.

495. The Tribunal failed to address Respondent's argument that the Participation Contract did not constitute an investment agreement, because it lacked an allegedly required reference to a specific Ecuadorian law. But this failure can never lead to annulment. Tribunals have a duty to justify their decision – not to address every single subordinate argument submitted by the parties, especially if the argument on its very face is meritless.

496. Having found that the Tribunal in any case had jurisdiction to address the Law 42 dispute under the “exception to the exception” rule of Article X (2) of the Treaty, the question whether Law 42 is a “matter of taxation” has become moot and does not need to be addressed.

#### **d. Application of Law 42 in the DCF Valuation**

497. Turning now to Respondent's substantive ground for annulment: in the Award the Tribunal decided that Law 42 should not be taken into consideration in determining the value of the investment, *i.e.* that in the DCF model the stream of income of Block 15 should not be reduced by the amount of the State Participation mandated by Law 42.

498. The Tribunal's decision can be summarized as follows:

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<sup>420</sup> Award at 527.

- The introduction of Law 42 implied a unilateral and substantial violation of the contractual framework agreed among the Parties in the Participation Contract<sup>421</sup>;
- Claimants had a legitimate expectation that the Participation Contract would be complied with<sup>422</sup>;
- Law 42 is in breach of the Participation Contract (and also of Article II (3) (a) Treaty, which creates an obligation to accord fair and equitable treatment to the Claimants' investment)<sup>423</sup>;
- A State cannot reduce its liability on the basis of its own wrongful acts; Law 42 is wrongful, because it constitutes a breach of the Participation Contract<sup>424</sup>;
- For all these reasons, the Tribunal decided to disregard Law 42 in its quantum valuation<sup>425</sup>.

499. Ecuador challenges these findings arguing that the Tribunal manifestly exceeded its powers and failed to state reasons, and that the Award should be annulled.

500. The Committee will briefly analyze each of the nine merits grounds for annulment invoked by Respondent and come to the conclusion that all of them should be dismissed. The numbering is the same one followed in the section "Respondent's Position" (some numbers are omitted, because jurisdictional grounds have already been analyzed in the preceding section)<sup>426</sup>:

### Second

501. Respondent submits that the Tribunal expressly refused to apply international law when it disregarded the international law principle according to which

"States are not liable to pay compensation to a foreign investor when, in the normal exercise of their regulatory powers, they adopt in a nondiscriminatory manner *bona fide* regulation that are aimed at the general welfare"<sup>427</sup>,

merely on the basis of a re-written Participation Contract<sup>428</sup>.

502. In fact, what happened was that the Tribunal affirmed the existence of such principle of international law<sup>429</sup>, but that, on the facts of the case, and because of

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<sup>421</sup> Award at 525.

<sup>422</sup> Award at 527.

<sup>423</sup> Award at 527.

<sup>424</sup> Award at 541.

<sup>425</sup> Award at 547.

<sup>426</sup> Paras 491-496 *supra*.

<sup>427</sup> Award fn. 65.

<sup>428</sup> R I at 729.

<sup>429</sup> Award at 528-529.

Ecuador's failure to honour its contractual and Treaty obligations, offered Respondent no defense. There is no excess of powers.

### Third

503. Respondent also argues that the Tribunal manifestly exceeded its powers by failing to apply the international law principle that the FET standard does not include a legitimate expectation that the State will not amend its laws and regulations, absent an express and specific stabilization undertaking by the State<sup>430</sup>.
504. Respondent's complaint cannot succeed for analogous reasons. The Tribunal never contradicted the international law principle quoted by Respondent. The Tribunal correctly held that Claimants were entitled to assume that Ecuador would respect the contractual framework agreed between the Republic and the investor<sup>431</sup>.

### Fourth

505. Respondent says that the Tribunal also manifestly exceeded its powers when it effectively disregarded the plain text of Law 42, which distinguishes between "participation in volumes" of crude oil (guaranteed by clause 8.1. of the Participation Contract and unaffected by Law 42) and "participation in revenues" obtained by the concessionary (impacted and reduced by Law 42, but not guaranteed by the Participation Contract), to conclude that Ecuador had breached the Participation Contract<sup>432</sup>.
506. Respondent's annulment claim cannot succeed. Ecuador's challenge is not an annulment ground – it is a merit contention, already submitted to the Tribunal and dismissed by the Tribunal in the Award, with proper reasoning.
507. In para. 521 of the Award the Tribunal dealt with the very argument which the Respondent is now re-submitting as a ground for annulment. The Tribunal dismissed it with the reasoning set forth in paras. 523 and 524: under the Participation Contract, OEPC had the right to receive a participation in the crude oil produced, and to freely dispose of such participation at market prices<sup>433</sup>. The Tribunal correctly concluded that Law 42 affected this right and that by enacting Law 42 Respondent unilaterally modified the contractual framework agreed upon in the Participation Contract<sup>434</sup>.

### Fifth

508. Ecuador submits that the Tribunal failed to apply the international law standard for determining the FMV of Block 15 (the willing buyer/willing seller standard) and thereby manifestly exceeded its powers<sup>435</sup>.

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<sup>430</sup> R I at 731.

<sup>431</sup> Award at 526.

<sup>432</sup> R I at 735.

<sup>433</sup> Clauses 8.1, 8.2 and 5.3.2. of the Participation Contract; Award at 523-524.

<sup>434</sup> Award at 525.

<sup>435</sup> R I at 739.



509. The ground of annulment is without merit. The willing buyer/willing seller standard is simply a valuation tool used for calculating compensation in certain circumstances. Tribunals have a wide discretion in selecting and applying valuation tools. Selection of one valuation tool in preference to another, or failure to apply a valuation tool does not give rise to a manifest excess of powers.

Sixth

510. Respondent says that the Tribunal committed a glaring contradiction: in para. 510 of the Award when it defined Law 42 as a

“510. [...] unilateral decision of the Ecuadorian Congress to allocate to the Ecuadorian State a defined percentage of revenues earned by contractor companies such as OEPC that hold participation contract”,

while only one paragraph earlier it held that Law 42

“509. [...] is neither a royalty, a tax, a levy or other measure of taxation under the Participation Contract”<sup>436</sup>.

511. The claim is dismissed.

512. There is absolutely no contradiction between the Tribunal’s statements in paras. 509 and 510.

513. In para. 509 the Tribunal simply states that the State Participation “is neither a royalty, a tax, a levy or any other measure of taxation under the Participation Contract”, *i.e.* in accordance with Ecuadorian law. This is an undisputed conclusion, since Ecuador itself categorically averred that Law 42 is not a tax under Ecuadorian law, because it had not been enacted in accordance with the special legislative procedures required for the enactment of tax laws in Ecuador.

514. Para. 510 then draws the only possible conclusion from the preceding analysis: since under Ecuadorian law the State Participation is not a tax, it must be a *sui generis* decision adopted by Congress to allocate to the State a defined percentage of revenues earned by concessionary companies.

Eighth

515. Respondent argues that the Tribunal failed to state reasons, when it acknowledged that the Participation Contract guaranteed OEPC a participation in the production of crude, but then found that “by taking 50% of OEPC’s revenues [Law 42] modified radically the participation percentages agreed in Clause 8.1”<sup>437</sup>. If Clause 8.1, as the Tribunal held, allocates only crude production and not revenues, it is simply impossible to follow the Tribunal’s rationale for concluding that Law 42’s taking of a percentage of revenues constitutes a breach of clause 8.1<sup>438</sup>.

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<sup>436</sup> Award at 509.

<sup>437</sup> Award at 523.

<sup>438</sup> R I at 751.

516. This ground for annulment is in fact a restatement of the fourth, this time under the guise of lack of reasons. It has no merit. The Tribunal's reasoning in paras. 521-525 is coherent and permits a reader to follow the trail of analysis.

#### Ninth

517. The Republic submits that the Award fails to state reasons for the conclusion that Law 42 breached clause 5.3.2 of the Participation Contract<sup>439</sup>.

518. Clause 5.3.2 of the Participation Contract grants OEPC the right to

“recibir y disponer libremente de la Participación de la Contratista establecida en la cláusula 8.1”.

519. Both clauses are linked: clause 8.1. defines OEPC's participation, while clause 5.3.2. OEPC's right to receive it and freely dispose of it. The Tribunal found that the right to freely dispose<sup>440</sup>

“524. [...] becomes meaningless unless it includes the right “freely” to enjoy the revenues from such disposal. Law 42 extinguished that right with respect to half of all revenues accruing from sales by OEPC at a price in excess of the reference price”.

520. The Tribunal's reasoning permits any reader to get from point A to point B and establish the appropriate conclusion without difficulty. There is no failure to state reasons – although Respondent may not agree with the reasoning. The request is dismissed.

#### Tenth

521. The Republic avers that the Tribunal failed to state reasons for why the introduction of Law 42, aside from the contractual framework, implied a unilateral and substantial modification of the “legal framework that existed at the time the Claimants negotiated and agreed the Participation Contract [...]”<sup>441</sup>. Besides, the Tribunal did not address the implications of the Constitutional Court's upholding of Law 42's legality, which included a response to arguments of breach of contract<sup>442</sup>.

522. Respondent's argument is misplaced: the contractual framework was modified through the enactment of a Law, and consequently the applicable legal framework was also affected. Finally, whatever arguments the Ecuadorian Constitutional Court might have used is irrelevant for this arbitration: what is relevant are the arguments actually submitted by the Parties to the Tribunal in the course of the procedure. The request for annulment is dismissed.

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<sup>439</sup> R I at 757; the Parties have discussed whether Claimant had or not abandoned this claim; it would seem that, at least explicitly, Claimants never abandoned the claim; the discussion in any case is irrelevant for annulment purposes.

<sup>440</sup> Award at 524.

<sup>441</sup> Award at 525, R I at 758.

<sup>442</sup> R II at 741.

Eleventh

523. Finally, the Respondent argues that the Award failed to state the reasons for its holding that Law 42, in addition to a breach of the Participation Contract, flouts Claimants' legitimate expectations, considering that the FET standard does not equate to the stabilization of the legal framework<sup>443</sup>.
524. Ecuador's argument must be dismissed.
525. In para. 527 of the Award, the Tribunal found that "Law 42 is in breach of the Participation Contract and flouts the Claimants' legitimate expectations". The Tribunal had explained its decision in the preceding paragraph<sup>444</sup>:

"526. [...] The investor, OEPC, was justified in expecting that this contractual framework would be respected and certainly not modified unilaterally by the Respondent".

An investor's legitimate expectations are those which have been embodied in the terms of the contract. Every investor who executes a contract with a State has an expectation that the State will comply with its obligations and not modify unilaterally the agreement reached.

\* \* \*

526. Summing up, the Committee concludes that the Tribunal's findings that it held jurisdiction to adjudicate the Law 42 dispute and that the State Participation mandated by Law 42 should not be deducted from the stream of income included in the DCF model do not give rise to any grounds for annulment.

**6. THE DECISION TO DISREGARD THE VAT INTERPRETATIVE LAW**

527. In 2001 the Ecuadorian tax authority altered its policy of refunding VAT to oil companies. The tax authority refused to grant such refunds in the future, and retrospectively sought to claim reimbursement of refunds already paid. Claimants claimed that this measure was a violation of the Treaty and Ecuadorian law and commenced the first investment arbitration against Ecuador, the so called VAT Arbitration<sup>445</sup>.
528. In 2004 the tribunal issued the VAT Award, which found that Ecuador was obliged to reimburse OEPC for VAT, that OEPC had a legitimate expectation that the tax would be reimbursed and that Ecuador had breached its Treaty obligations<sup>446</sup>. It ordered Ecuador to reimburse outstanding amounts – in excess of US\$ 75 M.
529. Just a few weeks after the VAT Award had been issued, the Ecuadorian Congress adopted the VAT Interpretative Law, a one article text that provided:

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<sup>443</sup> R II at 742.

<sup>444</sup> Award at 526.

<sup>445</sup> Award at 170.

<sup>446</sup> Award at 554.

“Art. 1.- Interpretase el artículo 69-A (72) de la Ley de Régimen Tributario Interno introducido por la Ley 99-24, publicada en el Suplemento del Registro Oficial No. 181 del 30 de abril de 1999, en el sentido de que el reintegro del Impuesto al Valor Agregado, IVA, no es aplicable a la actividad petrolera en lo referente a la extracción, transporte y comercialización de petróleo crudo, puesto que el petróleo no se fabrica, sino que se lo extrae de los respectivos yacimientos”.

530. The Tribunal found that it was “obvious” that the VAT Interpretative Law “was a direct response to the VAT Award”<sup>447</sup>.

531. Enactment of the VAT Interpretative Law gave rise to a doubt: whether it should be taken into consideration for quantifying Claimants’ damages – a question very similar to that posed by Law 42 with regard to the State Participation.

532. The Tribunal analyzed the issue and decided not to reduce Claimants’ damages on account of the VAT Interpretative Law. It found that the VAT Interpretative Law was designed to achieve the same objective as the administrative measures that the VAT Tribunal had already found to be in breach of Claimants’ Treaty rights<sup>448</sup>:

“558. While the VAT Interpretative Law was presented as an attempt to clarify the confusion identified by the VAT Tribunal, the fact of the matter is that the VAT Interpretative Law accomplishes the very same effect as the SRI Decrees which the VAT Tribunal had found to be in breach of certain provisions of the Treaty”.

533. The Tribunal then stated<sup>449</sup>:

“560. In the view of the Tribunal, the VAT Interpretative Law, unfairly and arbitrarily, frustrated the legitimate expectations of the Claimants in precisely the same way as the SRI’s Decrees and is thus also in breach of the Treaty. As such, as between the Claimants and the Respondent, the VAT Interpretative Law is without legal effect and should not be taken into account as a factor which impacts the fair market value of the Claimants’ investment”.

534. And concluded<sup>450</sup>:

“564. As the Tribunal emphasized earlier, *nullus commodum capere de sua injuria propria*: a State cannot be allowed to take advantage of its own wrongful act. The result of the implementation of that well-known principle of international law is that “the effects of actions taken by the nationalizing State in relation to the enterprise which actions may have depressed its value” must be disregarded in the determination of that value. The Tribunal, applying that principle to the facts of the present case, concludes that it must disregard the VAT Interpretative Law in determining the fair market value of the Claimants’ investment” [Footnotes omitted].

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<sup>447</sup> Award at 557.

<sup>448</sup> Award at 558.

<sup>449</sup> Award at 560.

<sup>450</sup> Award at 564, footnotes omitted.

535. The Tribunal could have stopped here. But it didn't. It added an *alternative* argument – that the VAT Interpretative Law should also be disregarded because it triggered Clause 8.6 (e) of the Participation Contract, entitling the hypothetical willing buyer to apply a correction factor to offset the economic burden<sup>451</sup>.

536. Clause 8.6 (e) of the Participation Contract reads as follows:

“8.6. Estabilidad económica: En caso de que por acción del Estado Ecuatoriano o PETROECUADOR, ocurriere cualquiera de los eventos que se describen a continuación, que tenga consecuencias en la economía de este Contrato de Participación:

[...]

e. Cobro del Impuesto al valor Agregado IVA conforme consta en el Oficio No. 01044 de 5 de octubre de 1998, que consta como Anexo No. XVI, mediante el cual la Dirección de Servicio de Rentas Internas manifiesta que las Importaciones que realice la Contratista para la[s] operaciones del Bloque 15 bajo el esquema del Contrato de Participación, están gravadas con dicho tributo.

En los casos señalados en los literales [...] e) se incluirá un factor de corrección en los porcentajes de participación, que absorba el incremento o disminución de la carga económica, conforme al Anex[o] No. XIV” [Emphasis added].

537. The Tribunal's alternative reasoning is contained in paras. 567, 568 and 569 of the Award:

“567. It is clear that, for the correction factor to be triggered automatically into effect, the VAT Interpretative Law must be found to have an impact on the economy of the Participation Contract. The Tribunal notes that the parties to the Participation Contract did not in any way specify how that impact was to be measured. It is thus left to the Tribunal, in the exercise of its discretion, to do so.

568. The Tribunal recalls that the VAT Award held that OEPC has “a right to reimbursement (of the VAT) under the law” and that “this reimbursement was not included in OEPC's contract”. The right of the Claimants to be reimbursed the Value Added Tax has now been legislated out of existence. There is no doubt, in the view of the Tribunal, that the VAT Interpretative Law has thereby increased the economic burden of the Claimants and thus impacted the economy of the Participation Contract.

569. Consequently, any hypothetical willing buyer of OEPC's rights under the Participation Contract, relying on the findings and conclusions of the VAT Tribunal, would be entitled to apply for a correction factor in the participation percentages to absorb the increase in its economic burden in accordance with Clause 8.6 and Annex No. XIV of the Participation Contract” [Footnotes omitted].

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<sup>451</sup> Award at 763-769.

538. Ecuador now avers that the Tribunal failed to provide satisfactory reasoning for its alternative finding and that the failure to state reasons merits annulment of the Award.

**A. The Parties' Positions**

539. Respondent takes issue with the Tribunal's reasoning. The Award simply equated the terms "economy of the contract" (clause 8.6 (e) first paragraph) and "economic burden" (clause 8.6 (e) last paragraph), implying that every collection of VAT had *ipso facto* an impact on the economy of the Participation Contract. Considering the Parties' diverging positions in this respect, this finding warranted some kind of explanation, as arbitrator Stern noted in her dissent<sup>452</sup>.

540. According to Respondent, the reasoning of the Award fits into one summary sentence, which fails to provide any reason whatsoever as to why the concepts of "economic burden" and "economy of the contract" should be understood as being equivalent<sup>453</sup>:

"568. [...] There is no doubt, in the view of the Tribunal, that the VAT Interpretative Law has thereby increased the economic burden of the Claimants and thus impacted the economy of the Participation Contract"<sup>454</sup>.

541. Claimants disagree.

542. Ecuador's challenge to the Award's *obiter* reasoning regarding Claimants' alternative argument cannot undermine the Tribunal's conclusion that the VAT Interpretative Law should be disregarded<sup>455</sup>. As Ecuador itself notes, "the Parties agree that the failure to address a particular argument they raised does not warrant annulment unless it was 'decisive', *i.e.*, material to the tribunal's decision (not *obiter dictum*)"<sup>456</sup>. Since the clause 8.6 (e) argument was not material to the majority's decision, the Committee need not consider Ecuador's arguments about it<sup>457</sup>.

543. Claimants add that the Tribunal in any case provided substantial reasons for the argument<sup>458</sup> and that Ecuador's complaint boils down to the proposition that the Tribunal should have addressed a question that was not before the Tribunal – whether "economy of the contract" and "economic burden" were equivalent to one another. The Tribunal was asked to decide "whether or not clause 8.6 (e) of the Contract is triggered into effect in the circumstances of the present case"<sup>459</sup> and this is exactly what the Tribunal did<sup>460</sup>.

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<sup>452</sup> Dissent at 14.

<sup>453</sup> R II at 758.

<sup>454</sup> Award at 568, R I at 767.

<sup>455</sup> C II at 327.

<sup>456</sup> R II at 114.

<sup>457</sup> C II at 330.

<sup>458</sup> C II at 326.

<sup>459</sup> Award at 565.

<sup>460</sup> C II at 332.

**B. The Committee's Decision**

544. The Tribunal's conclusion with regard to the VAT Interpretative Law is that it should not be taken into consideration in the DCF model used for valuing Claimants' investment (thus increasing the compensation in an amount which Respondent estimates in the US\$ 30 M range<sup>461</sup>). The main reason for this finding is analogous to that used to exclude Law 42: the enactment of the VAT Interpretative Law was in breach of Claimants' rights under the Treaty and thus could not be used to reduce Respondent's liability<sup>462</sup>.
545. Ecuador is not asking the Committee to annul this finding. Neither does Ecuador challenge the reasoning invoked by the Tribunal to support it. Ecuador only challenges an additional argument adduced by the Tribunal, and it does so for alleged failure to state reasons.
546. After having reached its conclusion with regard to the VAT Interpretative Law, the Tribunal could have stopped its reasoning. It did not. Instead the Tribunal took up an additional argument to confirm the conclusion it had already reached: even if the VAT Interpretative Law were to be applied (*quod non*), clause 8.6 (e) of the Participation Contract required that a correction factor be introduced, neutralizing the effect of the VAT Interpretative Law<sup>463</sup>.
547. Ecuador is asking the Committee to annul this additional argument for lack of reasons.
548. Ecuador's request cannot succeed. Committees are empowered to annul decisions, if the Tribunal fails to state the reasons on which such decisions are based (not the reasoning itself). In this case it is undisputed that the decision not to apply the VAT Interpretative Law is properly reasoned. The existence or inexistence or the quality of any additional reasoning can never lead to annulment of the decision.
549. In any case, the reasoning underlying the additional argument brought up by the Tribunal can be properly followed from point A to point B through to its conclusions, as Claimants have convincingly explained in their Second Submission<sup>464</sup>.

**7. THE DECISION TO DISREGARD ALTERNATIVES TO CADUCIDAD**

550. Ecuador argued in the course of the arbitration that the HCL only authorized the Republic two actions in response to Claimants' unauthorized transfer of rights: it could either declare *caducidad* or do nothing<sup>465</sup>. The Tribunal rejected the contention and identified various alternatives<sup>466</sup>:

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<sup>461</sup> R I at 765.

<sup>462</sup> Award at 564.

<sup>463</sup> Award at 570.

<sup>464</sup> C II at 326.

<sup>465</sup> R I at 711.

<sup>466</sup> Award at 434.

“434. In summary, the Tribunal considers that the foregoing options existed as an alternative to *caducidad*, namely:

- i) insistence on payment of a transfer fee in the order of USD 11.8 million; and/or
- ii) improvements to the economic terms of the original contract; and/or
- iii) a negotiated settlement which could of course have covered any areas that the parties so desired, including payment of the transfer fee which had been avoided, renegotiation of the contract and additional compensation” [Footnote omitted].

**A. The Parties’ Positions**

551. Respondent first argues that the Tribunal’s finding that Ecuador did have alternatives to declaring *caducidad* was a manifest excess of powers, “since a simple review of the Participation Contract and the HCL shows no such alternative”<sup>467</sup>.
552. Ecuador then submits a second argument: the consequence of having lawful alternatives is that such alternatives should have been considered in assessing damages owed to Claimants. Otherwise any damages award would overcompensate and unjustly enrich the Claimants<sup>468</sup>. Damages should have consisted in the difference between the FMV of Block 15 and the amount of any of those alternative sanctions. In awarding damages that failed to consider these alternatives the Tribunal failed to apply, or alternatively grossly misapplied, international law on damages and thus manifestly exceeded its powers<sup>469</sup>. The Tribunal also failed to state reasons for its decision<sup>470</sup>.
553. Claimants disagree.
554. As regards the first ground for annulment invoked by Ecuador, Claimants aver that Respondent has failed to elaborate and to cite any excess of powers<sup>471</sup>.
555. Addressing the second ground, Claimants allege that Ecuador could have argued that the damages should be reduced on account of the costs of alternatives to *caducidad*. It chose not to do so.
556. Ecuador had in fact submitted a counterclaim for the Claimants’ failure to pay the required assignment fee and negotiate a new Participation Contract – which correspond to some of the alternatives to *caducidad*<sup>472</sup>. But then Ecuador withdrew the counterclaim<sup>473</sup>.

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<sup>467</sup> R I at 712.

<sup>468</sup> R I at 714-716.

<sup>469</sup> R II at 646.

<sup>470</sup> R II at 648.

<sup>471</sup> C I at 516.

<sup>472</sup> Award at 854.

<sup>473</sup> Award at 869.



557. Ecuador cannot now fault the Tribunal for failing to quantify these alternatives, because other than the cost of the transfer fee, Ecuador never presented evidence on the economic impact of these alternatives<sup>474</sup>. A Tribunal is not required to address every single argument presented by the parties, especially an argument that was introduced as a counterclaim that was dropped and that became redundant given the very large penalty imposed by the Tribunal to reflect Claimants' contributory negligence<sup>475</sup>.

**B. The Committee's Decision**

558. Respondent submits two separate grounds for annulment.

559. The first is based on the argument that a simple review of the Participation Contract and the HCL shows that there is no alternative to *caducidad* and that the Tribunal committed a manifest excess of powers when it held otherwise. The ground was not further elaborated, and received no further attention in Respondent's Reply<sup>476</sup>. In any case it is without merit. The Tribunal came to the conclusion that alternatives to *caducidad* existed, and the Respondent has not been able to prove that this constitutes an error of law (and even less so that it is an egregious error of law which merits annulment).

560. The second ground is that the Tribunal should have considered in its quantum calculation the impact of an alternative to *caducidad*. The difficulty in this argument is that it was never pleaded by Respondent in the arbitration, and that the Tribunal already factored into the compensation calculation a 25% reduction as a sanction for Claimants' behaviour. It can never lead to annulment of the Award.

561. The ground for annulment is dismissed.

**8. THE TRIBUNAL'S EMAIL DATED FEBRUARY 15, 2011**

562. During the month of November of 2009 a hearing on quantum was held in Paris. A few months thereafter, on 12 February 2010 Claimants, acting on behalf of both Parties, made the following procedural proposal to the Tribunal<sup>477</sup>:

“557. Moreover, the Tribunal's request followed the parties' own procedural proposal that Claimants had articulated a year earlier in their letter of February 12, 2010:

“Both parties have stated to the Tribunal that they are willing to return their models with inputs requested by the Tribunal if the Tribunal were to find that helpful in preparing a final award”. CEA-80, Claimants' Letter of February 12, 2010”. [Emphasis added].

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<sup>474</sup> C I at 250-251.

<sup>475</sup> C I at 255.

<sup>476</sup> See R II at 642-652.

<sup>477</sup> C I at 557.

563. A year later the Tribunal took up this offer. On 15 February 2011 the President sent the following email (the “**February Email**”) to the Parties<sup>478</sup>:

“The Tribunal has reached the point in its deliberations where it requires the assistance of both parties’ experts, Mr. Joseph Kalt and Mr. Daniel Johnston, in order to help the Tribunal assess the proper calculation of damages.”

Therefore, in accordance with Rule 34 (2) of the ICSID Arbitration Rules, the Tribunal calls upon the parties to produce Messrs. Kalt and Johnston for consultation with the Tribunal at the ICSID’s headquarters in Washington at 10.30 a.m. on Wednesday, 27 April 2011. If the parties agree, the Tribunal would wish to consult with the parties’ experts alone without the presence of counsel”. [Emphasis added].

564. The experts’ cooperation eventually led to a Joint Expert Report that presented an agreed DCF valuation, on which the Tribunal relied in its damages calculation<sup>479</sup>.

**A. The Parties’ Positions**

565. Respondent argues that the Tribunal committed a serious departure from a fundamental rule of procedure by issuing the February Email: it was a “determination of liability” which failed to state reasons, and thus violated Article 48(3) of the Convention and Arbitration Rule 47, which require that the award state the reasons upon which it is based<sup>480</sup>.

566. Ecuador does not deny that the Tribunal had the authority to call upon the Parties to produce evidence pertinent to the issues in dispute. Ecuador’s challenge is that, in so doing, the Tribunal communicated to the Parties its ultimate decision on liability, without any reasoning or explanation whatsoever<sup>481</sup>. Ecuador avers that ICSID tribunals should only issue a decision on liability by way of an award. Yet the Tribunal did not follow that orthodox approach. It communicated its ultimate decision on liability through the February Email<sup>482</sup>.

567. Claimants disagree.

568. In Claimants’ submission, Ecuador’s claim fails on the very first hurdle: it cannot properly identify the relevant rule of procedure that could have plausibly been violated<sup>483</sup>. The Tribunal was acting perfectly within its powers as articulated in Article 43 of the Convention and Arbitration Rule 34 (2), which empower tribunals to call upon the parties to produce documents, witnesses and experts<sup>484</sup>. Articles 48 and 49 of the Convention (and Arbitration Rules 47 and 48) only apply to final awards, and not to other, less formal communications. The February Email was not a decision on liability – and certainly not an ultimate one. The Tribunal did not

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<sup>478</sup> Doc. EEA 175.

<sup>479</sup> Award at 692, 708-778.

<sup>480</sup> R I at 483-484.

<sup>481</sup> R II at 363.

<sup>482</sup> R II at 366.

<sup>483</sup> C I at 554.

<sup>484</sup> C I at 554-555.

purport to have reached a conclusive decision, and the arbitrators were free to present any award they saw fit, after the February Email<sup>485</sup>.

**B. The Committee's Decision**

569. This claim for annulment is submitted under Article 52 (1) (d) of the Convention: that the Tribunal has committed a serious departure from a fundamental rule of procedure – a ground with a high standard for its acceptance<sup>486</sup>.
570. Respondent argues that the February Email sent by the Tribunal meets these requirements, because, although it is not an award, it formalizes the Tribunal's final and binding decision accepting the Respondent's liability, without providing any reasoning, and thus flouts Article 48(3) of the Convention.
571. The argument is totally without merit.
572. A *quantum* hearing had been held in November 2009. Thereafter both Parties had offered the participation of their experts to re-run the DCF model with input from the Tribunal. In the February Email the Tribunal simply accepted this offer – a decision which was well within its powers under Article 43 of the Convention and under Arbitration Rule 34 (2).
573. The February Email is not a final and binding decision on quantum. It is simply a procedural request for the Parties' experts to come forward and help the Tribunal in the assessment of damages. It did not create *res iudicata*. Every arbitrator remained free to decide on the merits one way or another. The February Email did not formalize a merits decision. Since it did not, the Tribunal was not required to provide reasons.
574. The ground for annulment is dismissed.

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<sup>485</sup> C II at 180-181.

<sup>486</sup> See para 62 *supra*.

### VIII. COSTS AND EXPENSES

575. The Parties submitted their statements on costs simultaneously on June 8, 2015. Ecuador informed the Committee that its total costs incurred in connection with this annulment proceeding were US\$ 4,098,034.26 in legal fees, plus US\$ 547,102.11 in administrative costs and US\$ 973,440.50 in ICSID costs (registration fee and Ad Hoc Committee's fees)<sup>487</sup>.
576. Claimants declared that their legal fees and expenses in connection with this annulment proceeding were US\$ 3,932,575.79 in legal fees, plus US\$ 508,209.06 in administrative costs<sup>488</sup>.
577. Ecuador has requested that its legal and arbitration costs be borne by Claimants<sup>489</sup>.
578. Article 61(2) of the ICSID Convention provides as follows:
- “... the Tribunal shall, except as the parties otherwise agree, assess the expenses incurred by the parties in connection with the proceedings, and shall decide how and by whom those expenses, the fees and expenses of the members of the Tribunal and the charges for the use of the facilities of the Centre shall be paid. Such decision shall form part of the award”.
579. Article 52(4) extends the application of this provision to annulment proceedings.
580. Neither Ecuador nor Claimants have completely prevailed in the present annulment proceedings. The Republic was requesting a decision annulling the Award in its entirety – the Committee has dismissed this request. Alternatively, Ecuador submitted a petition for partial annulment, which the Committee has accepted. Claimants were defending the full validity of the Decision and the Award.
581. The Committee has thus not ruled completely in favour of any of the parties. Ecuador's claims were *prima facie* serious. Furthermore, each side presented valid and reasonable arguments in support of its respective case, and both acted fairly and professionally.
582. In view of these circumstances, the Tribunal decides that Claimants shall bear one half, and Respondent the other half of the costs incurred by ICSID in relation to the proceedings, and that each side shall bear its own litigation costs and other expenses. Since Respondent has advanced US\$ 1,000,000 towards the costs incurred by ICSID, Claimants shall reimburse Respondent half of that amount, by offset against the compensation due under the Award.

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<sup>487</sup> Respondent's Statement on Costs, p 1.

<sup>488</sup> Claimants' Statement on Costs, p 1.

<sup>489</sup> R I at 771 iii); R II at 770 iii).

## IX. SUMMARY

583. Respondent requested in its Reply on Annulment that the Committee:

- “ i. Annul the Award in its entirety; or
- ii. alternatively, partially annul the Award as described in this Reply on Annulment at paragraphs 230, 285, 358, 391, 404, 494, 641, 652, 745, and 769; and
- iii. in any event order Claimants to bear the entire costs of this annulment proceeding, including the ICSID costs and Ecuador’s legal costs and other expenses”.

584. As regards its first petition, Ecuador alleged four grounds which would result in annulment of the Decision on Jurisdiction and, consequently of the entire Award. The Committee rejected all of these grounds. Ecuador also submitted a number of additional grounds for the total annulment of the Award, which the Tribunal also rejected. Thus Ecuador’s first petition is entirely dismissed.

585. As regards Ecuador’s alternative petition for partial annulment, such petition has succeeded. The Committee has found that the Tribunal manifestly exceeded its powers by wrongly assuming jurisdiction with regard to the investment now beneficially owned by the Chinese investor Andes, with the result that the compensation owed to Claimants should be reduced from 100% to 60% of the value of Block 15.

586. The Tribunal has established the value of 100% of Block 15, i.e. of the Farmout Property, at US\$ 2,359,500,000. Consequently, the value of a 60% interest would amount to US\$ 1,415,700,000. Applying to this amount the 25% reduction factor explained in para. 825 of the Award, the resulting amount is US\$ 1,061,775,000. This is the proper amount that should have been inserted in Sub-paragraph (v) of the dispositive section of the Award<sup>490</sup>, reading as follows:

“876. [...] (v) Claimants are awarded the amount of US\$ 1,061,775,000 (US One billion, sixty one millions, seven hundred seventy five thousand dollars), as calculated in paragraph 825 of this Award, for damages suffered as a result of the breaches set out above in subparagraphs (i), (ii) and (iii)”.

587. The rest of the Award remains unaffected.

588. Respondent alleged a number of additional grounds for partial annulment of the Tribunals’ decision to award damages to Claimants based on a 100% (and not a 60%) interest in the Farmout Property or which pertain to the 60/40 issue. These grounds have become moot.

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<sup>490</sup> The same conclusion could be reached by simply calculating 60% of US\$ 1,769,625,000

589. Finally, with regard to costs, the Committee has decided that Claimants shall bear one half, and Respondent the other half of the ICSID costs in relation to these proceedings, and that each side shall bear its own litigation costs and other expenses.

**X. DECISION**

590. For the reasons set forth above, the Committee unanimously renders the following decision:

1. The Committee partially annuls the Award, on the ground of manifest excess of powers [ICSID Convention Article 52(1)(b)], to the extent that the Tribunal assumed jurisdiction with regard to the investment now beneficially owned by the Chinese investor Andes (and previously by the Bermudan company AEC), with the result that the proper compensation owed by Respondent to Claimants should be the amount calculated in para. 586 of this Decision.
2. The rest of the Award remains unaffected.
3. All other grounds of Respondent's application for annulment are rejected.
4. Each Party shall bear one half of the ICSID costs, and its own litigation costs and expenses incurred with respect to this annulment proceeding.
5. The stay of enforcement of the Award is declared automatically terminated in accordance with Rule 54(3) of the ICSID Arbitration Rules.

[signed]

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Judge Florentino P. Feliciano  
Member of the *ad hoc* Committee  
October 12, 2015

[signed]

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Mr. Rodrigo Oreamuno B.  
Member of the *ad hoc* Committee  
October 19, 2015

[signed]

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Prof. Juan Fernández-Armesto  
President of the *ad hoc* Committee  
October 29, 2015