



School of International Arbitration

IACL
International Arbitration Case Law

School of International Arbitration, Queen Mary, University of London

International Arbitration Case Law

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Award Name and Date: Burlington Resources, Inc. v. Republic of Ecuador (ICSID Case No. ARB/08/5) - Decision on Reconsideration and Award (February 7, 2017)

Case report by: Shehu Mustafa**, Editor Diego Luis Alonso Massa***

Summary:

Burlington Resources Inc. ('Burlington' or 'claimant') commenced ICSID arbitration against the Republic of Ecuador ('Ecuador' or 'respondent') over a claim of wrongful expropriation of Burlington's interests in certain oil blocks. On 7 February 2017, the ICSID Arbitral Tribunal issued its award, refusing to reconsider its decision on liability and rejecting Ecuador's contention that the computation of the damages to which Burlington is entitled should be made without regard to the contractual tax absorption provision which entitled Burlington to a compensation for the economic effects of certain tax statutes. Further, the Tribunal held that the investment that was expropriated by Ecuador was Burlington's contractual rights in the Production Sharing Contracts ('PSCs') which comprised the tax absorption provisions. As such, it did not matter that Burlington had relinquished its contractual claims against Ecuador.

Ecuador submitted that there were new facts which had come to its knowledge after the Tribunal's decision on liability, these new facts triggering the invocation of Article 51 of the ICSID Convention. In resolving this issue, the Tribunal held that although worded as a post-Award remedy, the language of Article 51 of the ICSID Convention could by analogy be applied to a decision. The Tribunal however ultimately rejected Ecuador's application for reconsideration of the decision on liability as the Tribunal rejected Ecuador's contention that the Tribunal had erred as a matter of law, and was misled on the facts.

On damages, the Tribunal held that the measure of compensation is full reparation. The Tribunal rejected Ecuador's contention that its expropriation of Burlington's investment was wrongful only because of its failure to pay compensation. The Tribunal held that the Discounted Cash Flow ("DCF") was the appropriate method for measuring the losses that Burlington suffered as a result of the expropriation by Ecuador.

Main issues: Finality of decisions vis-à-vis awards (*res judicata*); Expropriation; Reparation- the measure of compensation in international law; Fair Market Value versus Discounted Cash Flow; Relevant Time for Assessment of Value of Investment; Weighted Average Cost of Capital ("WACC").

Arbitral Tribunal: Prof. Gabrielle Kaufmann-Kohler, President; Prof. Brigitte Stern, Arbitrator; Mr. Stephen Drymer, Arbitrator

Secretary of the Tribunal: Mr. Marco Tulio Montañés-Rumayor

Assistant to the Tribunal: Dr. Magnus Jesko Langer

Counsel for the Claimant: Mr. Nigel Blackaby, Freshfields Bruckhaus Deringer US LLP; Mr. Elliot Friedman, Freshfields Bruckhaus Deringer US LLP; Mr. Carlos Ramos-Mrosovsky, Freshfields Bruckhaus Deringer US LLP; Mr. Leon Skornicki, Freshfields Bruckhaus Deringer US LLP; Ms. Lauren Friedman, Freshfields Bruckhaus Deringer US LLP; Ms. Bonnie Doyle, Freshfields Bruckhaus Deringer US LLP; Ms. Janet Tasigianis, Freshfields Bruckhaus Deringer US LLP; Ms. Cassia Cheung, Freshfields Bruckhaus Deringer US LLP; Mr. Alkesh Mcween, Freshfields Bruckhaus Deringer US LLP; Ms. Mandeep Dhaliwal, Freshfields Bruckhaus Deringer US LLP; Mr. Craig S. Miles, King & Spalding; Mr. Wade M. Coriell, King & Spalding; Ms. Elizabeth Silbert, King & Spalding; Ms. Jamie M. Miller, King & Spalding; Ms. Kate E. Hill, King & Spalding; Ms. Lisa Wong, King & Spalding; Mr. Jan Paulsson, Three Crowns LLP; Mr. Constantine Partasides, Three Crowns LLP; Mr. Javier Robalino Orellana, Ferrere.

Counsel for the Respondent: Prof. Pierre Mayer, Dechert (Paris) LLP; Mr. Eduardo Silva Romero, Dechert (Paris) LLP; Mr. Philip Dunham, Dechert (Paris) LLP; Mr. José Manuel García Represa, Dechert (Paris) LLP; Mrs. Erica Stein, Dechert (Paris) LLP; Ms. Audrey Caminades, Dechert (Paris) LLP; Ms. Véronique Moutot, Dechert (Paris) LLP; Ms. Marie Bouchard, Dechert (Paris) LLP; Ms. Gabriela González Giráldez, Dechert (Paris) LLP.

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Digest:

1. Facts of the Case

The claimant was a corporation created under the laws of the State of Delaware, United States of America (“USA”), in 1988 and active in the exploitation of natural resources. On 31 March 2006, Burlington was acquired by ConocoPhillips, a multinational energy company with headquarters in the State of Texas, USA (¶ 1). The respondent was Ecuador (¶ 3).

The claimant brought proceedings contending that certain actions of the respondent particularly the seizure of certain oilfields amounted to the expropriation of the claimant’s investment in the PSCs for Blocks 7 and 21 of the oilfields. (¶ 185). The arbitral tribunal constituted under the aegis of the International Centre for the Settlement of Investment Disputes (“ICSID”) rendered the award pursuant to the ICSID Convention and the “Treaty

between the United States and Ecuador concerning the Encouragement and Reciprocal Protection of Investments” of 11 May 1997 (“Ecuador-US BIT”) (P.6 and ¶ 473).

The claimants argued that the investments made in Ecuador were and are protected by the Ecuador-US BIT and that the actions of Ecuador were in violation of the BIT. The Tribunal had previously determined the question of its jurisdiction as well as that of Ecuador’s liability against Burlington. (¶ 5-6).

The main issues before the Tribunal were as follows: (i) whether the Tribunal should reconsider its decision on liability in the light of new facts which Ecuador asserted would have persuaded the Tribunal to resolve the question of liability in its favour had those facts been hitherto presented to the Tribunal (¶ 11, 17, 22 and 48); (ii) the measure of compensation for expropriation of Ecuador’s investment (¶ 160); (iii) the appropriate methodology for computation of the losses suffered by the claimant and the standard of compensation (¶ 368); (iv) whether the amount of compensation to which the claimant is entitled could be diminished as a result of the conduct of the claimant; (v) interest and costs.

While the respondent contended that the Tribunal was entitled to reconsider the decision on liability in view of certain documents, which the respondent could not rely upon at the liability phase, having been wrongly withheld by the respondent; as well as errors of law by the Tribunal’s invocation of the provisions of Article 74(4) of the Hydrocarbon Law of Ecuador which was not urged upon the Tribunal by either party (¶ 49), the claimant contended that it was entitled to the customary international law measure of compensation as set out in the *Chorzow Factory* case, which is full reversal of the economic effects it has suffered as a result of the respondent’s expropriation of its investment (¶ 139 and 147). The respondent on the converse, argued that its taking of the claimant’s investment was in accordance with the provisions of the Ecuador-US BIT save for the non-payment of compensation and as such, the measure of compensation is the fair market value of the investment valued on the date of expropriation plus interest from the date of the taking (¶ 149 and 150).

2. Procedural Background

On 2 June 2010, the Tribunal issued its Decision on Jurisdiction, indicating that it would take the necessary steps for the continuation of the proceedings towards the merits phase. In the course of the arbitration, on 17 January 2011, the respondent raised counterclaims seeking compensation for damage to the environment and infrastructure allegedly caused by the claimant. The Parties later entered into an agreement conferring jurisdiction over the counterclaims on the Tribunal.

On 14 December 2012, the Tribunal rendered its Decision on Liability and notified the Parties of the continuation of the proceedings (the quantum phase). On 28 January 2013, the respondent sought permission to submit (i) additional document requests and (ii) a motion for reconsideration of the Decision on Liability and requested the Tribunal to suspend the quantum proceedings or, in the alternative, organize parallel proceedings, for the motion for reconsideration. On 22 March 2013, the Tribunal permitted the respondent to submit a motion for reconsideration but refused to suspend the quantum proceedings or the holding of parallel proceedings.

On 2-6 March 2015, the Tribunal conducted the hearing on quantum and on the respondent's motion for reconsideration and on 7 February 2017 issued the Decision on Reconsideration and Award that incorporated the previous decisions on jurisdiction, liability and the respondent's counterclaim (¶ 43).

3. Analysis of Legal Issues by the Tribunal

The Tribunal addressed three major issues, discussed in detail below, regarding whether Ecuador's application for reconsideration of the decision on liability should be granted, what amount of compensation Burlington was entitled to, and who should bear the costs and in what proportion.

3.1 Ecuador's application for reconsideration of the decision on liability

The first issue centred on whether Ecuador's application for reconsideration of the decision on liability should be granted. Ecuador argued that the Tribunal had the power to reconsider the decision on liability (¶¶ 50-51). Ecuador further contended that the Tribunal should exercise that power in its favour because there were new facts which had come to its knowledge post the Tribunal's decision on liability and those new facts triggered the invocation of Article 51 of the ICSID Convention (¶¶ 54-58). Ecuador further contended that it could not get those facts because Burlington had wrongly asserted privilege and thereby deprived Ecuador of vital information.

Burlington countered that the ICSID Convention does not confer any power on the Tribunal to review a decision made in the course of the proceedings as the review can only be done after the final award is issued, and even in those circumstances, what is permitted is not a 'free-for-all reconsideration' (¶¶ 59-63). Burlington further contended that in the event the Tribunal found that it has the power to reconsider the decision on liability, that power should be exercised against Ecuador because the documents it withheld were rightly withheld, and in any case, the documents did not meet the standard of materiality as to have an impact on the decision of the Tribunal (¶¶ 64-68).

In resolving this issue, after considering the provisions of Articles 49-53 of the ICSID Convention, as well as Rules 25 and 38 of the ICSID Arbitration Rules (¶¶ 72-80), the Tribunal held that although worded as a post-Award remedy, the language of Article 51 of the ICSID Convention could by analogy be applied to a decision made in the course of the arbitration such as the decision on liability. The Tribunal therefore found that it had the power to reconsider the decision on liability (¶¶ 83-98). The Tribunal however ultimately rejected Ecuador's application for reconsideration of the decision on liability as it rejected Ecuador's contention that the Tribunal had erred as a matter of law, finding that to the extent that the complaint of error of law was based on a dissatisfaction with the Tribunal's interpretation of the Hydrocarbon Law of Ecuador and a decision on whether Burlington could rely on *exceptio non adimpleti contractus*, those complaints are not susceptible to reconsideration.

Furthermore, the Tribunal found that fundamental principles of allowing parties to be heard do not preclude the Tribunal from applying its own reasoning (¶¶ 110-115). As for Ecuador's contention that the Tribunal was misled on the facts, the Tribunal found that although Burlington did not release the documents to Ecuador timeously, Ecuador had obtained the documents at a much earlier time in parallel proceedings (¶¶ 117-118). Further,

the Tribunal found that there was no new information in the documents which materially affected the Tribunal's decision on liability (¶¶ 121-124).

3.2 Standard and Measure of Compensation

The second issue that the Tribunal had to deal with was that, once it had found that Ecuador was liable for expropriation in breach of its treaty obligations under the Ecuador-US BIT, a determination had to be made as to the standard of compensation as well as the appropriate mechanism for measuring the losses that Burlington had suffered.

Burlington contended that it was entitled to full reparation in view of the Tribunal's finding that the expropriation was unlawful, the appropriate standard of compensation being the customary international law standard of full reparation. Relying in particular on the *Chorzów Factory* case, as well as on the International Law Commission Articles on State Responsibility for Internationally Wrongful Acts, Burlington argued that full reparation requires that the amount that will be awarded to it by the Tribunal must be such an amount that fully eliminates the consequences of Ecuador's unlawful conduct, and re-establish the situation that would have existed in the absence of that unlawful conduct (¶ 139).

Burlington further contended that the appropriate method for measuring the compensation that will eliminate the effect of Ecuador's unlawful conduct was an assessment of the value of the assets lost as at the date of the award and using the discounted cash flow ('DCF') method. Burlington's claim can be broken down into two elements: (i) profits already lost, i.e., losses to the date of the award, with interest applied to actualize the cash flows to present value, and (ii) future lost profits, i.e., losses from the date of the award until the expiry of the PSCs, discounted to present value (¶¶ 225-229).

Burlington further contended that by Ecuador's taking of its investment, it lost the benefit of the tax absorption clause as well as the opportunity to get an extension of the PSCs and such a lost opportunity should be reflected in the measurement of the compensation due to it. Burlington contended that previous ICSID tribunals have recognized that the lost opportunity to earn future profits is a recoverable loss and that "the prospect for renewal of an authorization to do business is an asset with a value of its own" and thus an important element of a going concern (¶¶ 245-252).

On the converse, Ecuador argued that although it expropriated Burlington's assets, the expropriation was only wrongful by reason of non-payment of compensation and the standard of compensation in the context of a going concern should be to assess the investment's "earning capacity during the remainder of its life for assessing its 'market value'". As such, the compensation should be the value of the investment as at the date of the expropriation plus interest up to the date of the award.

Additionally, Ecuador submits that Burlington's valuation of these lost profits is grossly inflated, mainly because Burlington misapplies the relevant standards of compensation, uses the wrong valuation date, bases its calculation on incorrect assumptions (in particular, it fails to account for Law 42 taxes when projecting future profits), and applies an exaggerated interest rate. According to Ecuador's expert the fair market value of the PSCs ought to be valued on the date of the expropriation (¶ 231). Ecuador also contended that having relinquished its contractual claims, Burlington could not claim the benefit of the tax absorption provisions in the PSCs.

Ecuador further contended that any compensation that Burlington may be entitled to should be reduced by reason of Burlington's own actions which further aggravated the losses it may have suffered.

In resolving this issue, the Tribunal found that contrary to Ecuador's contention, the expropriation of Burlington's investment was unlawful and in breach of several other obligations aside from the obligation to pay compensation. As such, Burlington was entitled to full reparation because Ecuador in taking various measures which were aimed at exerting pressure on Burlington to renegotiate the PSCs at unfavourable terms, breached the requirements under Articles II (3) and III (1) of the Ecuador- US BIT. Indeed, pursuant to these provisions the State parties agreed that, to be lawful, an expropriation must be carried out (i) for a public purpose; (ii) in a non-discriminatory manner; (iii) upon payment of prompt, adequate and effective compensation, (iv) in accordance with due process of law; (v) in accordance with the principle of fair and equitable treatment, including in particular the requirement that the expropriation should not be arbitrary and that it be conducted according to the minimum standard of treatment; (vii) in accordance with the principle of full protection and security, and (viii) without breaching obligations it may have entered with regard to investments. The Tribunal found that Ecuador's conduct in expropriating Burlington's investment was discriminatory and in breach of the international minimum standard amongst other breaches. (¶¶ 163-175).

The Tribunal found that Burlington's investment which Ecuador expropriated included the contractual right to the tax absorption (¶¶ 191-193). The Tribunal also found that in view of the fact that Ecuador had full discretion to decide whether to grant or to refuse an extension of the PSCs, Burlington's claim for loss of future opportunity had failed (¶ 270). Further, the Tribunal found that full reparation necessitated that Burlington's compensation should be valued as at the date of the award (¶ 325). The Tribunal noted that having found that the standard of compensation was full reparation, the measure of compensation must be the full market value of the investment. The Tribunal however rejected the contention that it was bound to value the investment using a "willing buyer-willing seller" analogy especially in the face of the facts and the circumstances leading up to the expropriation. The Tribunal held that Burlington's losses were better measured using the DCF formula (¶¶ 366-368). The Tribunal rejected Ecuador's contention that Burlington's was responsible for some of its losses. In reaching this conclusion, the Tribunal assessed the parties' conduct in the light of Article 39 of the ILC Articles on State Responsibility which requires that account be taken of contribution to injury suffered by the wilful or negligent conduct of the injured party in the determination of compensation (¶¶ 572-585).

3.3 Costs

The third issue addressed by the Tribunal was the apportionment of costs. Both sides contended that they were entitled to an award of their full costs.

Burlington contended that as the standard of compensation was full reparation to wipe out the economic effects of the wrongful acts of Ecuador, the proceedings and attendant costs were one of such economic effects that ought to be wiped out (¶¶ 589-593). Burlington further contended that Ecuador's conduct in the course of the proceedings exacerbated the proceedings and such conduct included: violating procedural orders, a request to 'trifurcate' the proceedings, the motion for reconsideration, as well as submitting a bogus counterclaim which gave rise to over 1400 pages of briefs and 7 additional hearing days (¶ 594).

Burlington sought full indemnification in reliance on Rule 28 (2) of the ICSID Arbitration Rules (¶ 596).

Ecuador on its part asserted an entitlement to full costs recovery with respect to the proceedings on the principal claim because in its view, it ought to succeed on its motion for reconsideration and, in the event that it fails, all of Ecuador's claims would have failed save for the claim based on expropriation. Consequently, in that case, each party should bear its own costs (¶¶ 601-604). As for the proceedings on the counterclaim, Ecuador contended that it should recover its full costs because it is the prevailing party and even if it does not wholly succeed, Burlington's obstructionist behaviour during the proceedings by actions such as formalistic reading of applicable legislation, blatant denial of the infrastructure counterclaim despite clear evidence, false assertions which Ecuador had to conduct detailed and costly site assessments to debunk, all of that has needlessly exacerbated the proceedings (¶ 608).

The Tribunal in deciding the apportionment of costs, restated the relevant principles, starting by recognising its discretion with regard to costs as provided for in Article 61 (2) of the ICSID Convention. The Tribunal recognised that apportionment of costs requires an analysis of all of the circumstances of the case, including to what extent a party has contributed to the costs of the arbitration and whether that contribution was reasonable and justified. The starting point will be to look at the party that has prevailed and the extent of success, whether any unreasonable or frivolous claims were pressed, as well as conduct in the course of the proceedings (¶¶ 617-620). Where a finding of wrongdoing is made against a State, the motives and bona fides of the State will also be considered (¶ 621).

Upon applying the principles, the Tribunal found that although Burlington prevailed on most of its claims and Ecuador on its counterclaim, and that even if the latter has been found to act unlawfully, its request for trifurcation was not unreasonable and in the light of the unclear provisions in the ICSID Convention, the motion for reconsideration cannot be said to be illegitimate. Moreover, although the costs caused by Ecuador's counterclaim were significant in view of the limited amount awarded, it had to press those counterclaims for public interest goals (¶¶ 629-632).

In the circumstances, each party was to bear its counsel and expert witness' costs; while Ecuador was to bear 65% of the Tribunal's costs and fees, Burlington bore 35%. (¶¶ 633-634).

4. Decision

The Tribunal ultimately rejected Ecuador's application to reconsider the decision on liability, but found in favour of Ecuador on its counterclaim. The Tribunal also found in favour of Burlington regarding the standard of compensation as well as the method of valuation. On the costs, the Tribunal ordered that each party bears the costs of its counsel and expert fees. Ecuador was ordered to pay 65% of the Tribunal's fees and costs while Burlington had to bear the balance 35%.