



School of International Arbitration

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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: Murphy Exploration & Production Company International v. Ecuador, Case No. AA434 (2012-16), PCA – Final Award - 10 February 2017

Case report by: Annelise Sander** Editor, Arran Dowling-Hussey***

Summary: This is a decision on damages rendered by an investment arbitration tribunal concerning a dispute between Murphy Exploration and the State of Ecuador. The dispute arose from the enactment of Law 42, which continually imposed a windfall levy on foreign oil revenues from 50% to 99%.

The Tribunal issued an award on Jurisdiction in November 2013, and a Partial Final Award in May 2016. This summary refers only to the Final Award issued in February 2017, which discusses damages and incidental damages issues.

Main issues: Damages; offsets and credits; post-award interest on costs; inclusion of an extension contract (license — including future performance) on the calculation of Fair Market Value (“FMV”); sale price of the investor company and mitigation damages;

Arbitration Panel: Professor Bernard Hanotiau, Presiding Arbitrator, Professor Kaj Hobér, appointed by Claimant, and Me Yves Derains, appointed by Respondent, replacing Georges Abi-Saab, who withdrew from the Tribunal due to health reasons on December 2013. The parties originally appointed Professor Brigitte Sterns and Professor Guido Santiago Tawil as arbitrators, but on February 2012 both arbitrators withdrew due to personal reasons.

Claimant’s Counsels: Craig S. Miles, Roberto J. Aguirre Luzi, Esteban Leccese, Santiago Maqueda, and Tim Kistner, and Anita Alvarez and Carol Tamez, all of them from King & Spalding LLP in Houston, US; Kenneth Fleuriet and Sarah Z. Vasani, from King & Spalding International LLP in London, UK; and Francisco Roldán from Pérez Bustamante & Ponce in Quito, Ecuador.

Respondent’s Counsels: Diego García Carrión, Blanca Gómez de la Torre, and Giannina Osejo from the Ecuadorian State’s Attorney General office; Mark A. Clodfelter, Alberto Wray, Constantinos Salonidis, Diego Cadena, Diana Tsutieva, Alexandra Kerr Meise, Anna D. Avilés-Alfaro, Kathryn Kalinowski, and Kathern Schmidt, all of them from Foley Hoag LLP in Washington D.C., US; Bruno Leurent, Thomas Bevilacqua, Ivan Urzhumov, Angelynn Meya and Hana Doumal, from Foley Hoag LLP in Paris, France.

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Digest:

1. Facts of the Case

Claimant, Murphy Exploration, is a corporation incorporated in Delaware, United States, who own shares of a local Ecuadorian corporation and Respondent is the State of Ecuador. (¶ 1-2). The present dispute arose out of a series of Ecuadorian legislative measures taken by the State of Ecuador relating to the hydrocarbons industry in the 2000s. (¶ 3).

Claimant, through its local subsidiary, Murphy Ecuador Oil Limited (predecessor of the State-owned Petroecuador) entered into a participation contract in 1996, in which, according to the Claimant, they would receive a share of the oil production calculated on the basis of the volume of production and without regard to the oil prices. (¶ 3).

When Ecuador enacted Law 42, this legislation entitled the State of Ecuador to receive 50% of the profits of the oil production where the market value exceeded certain prices (“Law 42 at 50%”). And, then, at a later time, the State participation in the profits went up to 99% (“Law 42 at 99%”). (¶ 3).

Claimant alleged that this was a violation of the US-Ecuador Bilateral Investment Treaty – (“BIT”), signed on 23 August 1993. (¶ 3).

On 6 May 2016, the Tribunal issued a Partial Final Award that recognized a violation of the BIT by the implementation of the Law 42 at 99%. (¶ 4).

The Tribunal noted in the aforementioned Partial Final Award that it was unable to calculate damages with the information before it, and thus, directed the parties to attempt to agree on: (1) the Adjustment Sum that should be made to the fair market value of Murphy Ecuador; (2) the interest calculation. The Tribunal also provided that Claimant was entitled to any difference between the Adjustment Sum and the purchase price of USD 78.9 million. (“Entitlement”). In paragraphs 503 and 504 of the Partial Final Award the Tribunal held that:

503. The Tribunal has found that Law 42 at 50% was lawful, but that Law 42 at 99% was unlawful. Accordingly, the Tribunal determines that Claimant should be compensated for the fair market value of Murphy Ecuador assuming that the wrongful act—i.e., Law 42 at 99%—did not occur, meaning that Law 42 at 50% would still have been in place at the valuation date of March 2009. For Claimant to be restored to a ‘but-for’ scenario, the fair market value figure of USD 87.8 million must be adjusted

to account for the fact that Murphy Ecuador would have continued paying participation under Law 42 at 50% if Law 42 at 99% had never been introduced.

504. *The Tribunal is not able to calculate that sum on the basis of the information submitted by the Parties. The Tribunal directs the Parties to attempt to agree within three months from the date of this Award on the adjustment that should be made to the fair market value of Murphy Ecuador of USD 87.8 million to account for an ongoing obligation on the part of Claimant to make Law 42 payments at 50% (“Adjusted Sum”). The Tribunal finds that Claimant is entitled to any difference between the Adjusted Sum and the purchase price of USD 78.9 million for Murphy Ecuador (“Entitlement”). The Tribunal also directs the Parties to attempt to agree on the pre- and post- award interest calculations that flow from the Tribunal’s rulings here and in the following section. If the Parties fail to agree on any sum within that time period, the Tribunal will invite each Party to submit, simultaneously and within a further month, a submission setting out that Party’s calculation of the Adjusted Sum, the Entitlement, and pre- and post-award interest. The Tribunal will then make the necessary findings.*

2. Procedural Background of this final award

On 6 May 2016, a Partial Final Award was issued (¶ 6). Later, on 6 June 2016, Claimant requested the tribunal to make an “additional award deciding Claimant’s claim for post-award interest and cost of arbitration” pursuant to Article 37 the United Nations Commission on International Trade Law Rules of 1976 (“UNCITRAL Rules”), and in the alternative Claimant’s requested a correction of the award pursuant to Article 36 of the UNCITRAL Rules (¶ 7). Respondent was notified and objected to Claimant’s request. (¶ 8-10).

However, by emails dated 29 June 2016, both parties reflected their disagreement about the “calculation of the sums referred to in paragraphs 503-504 of the Partial Award”. (¶ 11).

Thus, on 1 July 2016, the Tribunal accepted the post-final award submissions. (¶ 12). On the same date, the Tribunal issued Procedural Order n. 4 (“PO.4.”), which denied Claimant’s request under articles 36 and 37 of the UNCITRAL Rules, and also requested a supplementary deposit for costs. (¶ 12).

Both parties filed written submissions for the Tribunal deliberations. (¶ 13). And both agreed that further briefing on paragraphs 503 and 504 of the Partial Final Award was unnecessary. (¶ 14-15).

3. Summaries of the Arguments and the Analyses of the Tribunal

The Tribunal addressed four issues regarding (1) whether the Tribunal should reconsider its position about the non-FET claims relating to the Law 42 at 50%; (2) whether the Adjustment Sum and the Entitlement difference includes the Extension Contract; (3) whether the Sale of Murphy Ecuador has a positive or negative effect; and (4) whether the Tribunal should reconsider its decision on Procedural Order n. 4 (PO.4.) about cost.

3.1. Whether the Tribunal should reconsider its position about the non-FET claim relating to the Law 42 at 50%

The Tribunal decided on the Partial Final Award, paragraph 294, that Ecuador had breached the fair and equitable treatment (“FET”) clause of the US-Ecuador BIT, and thus, it was not necessary to determine Murphy’s claims that Ecuador had other provisions, such as the umbrella clause, the full protection and security, the non-impairment through arbitrary measures, and the expropriation claims (“non-FET claims”). (¶ 22).

Claimant requested that the Tribunal reconsider its position and determine the non-FET claims in relation to the Law 42 at 50%, especially the argument that the umbrella clause claim also violated the BIT. Accordingly, the Claimant submitted that the Tribunal should declare that Ecuador violated the BIT by enacting and enforcing Law 42 at 50% and 99%. (¶ 22, 23-25).

Respondent opposed, because Claimant’s request included analysis of factors outside paragraphs 503-504 that were the only issued before the Tribunal. (¶ 22). The Tribunal had already clearly decided the issue in relation Law 42 at 50% on the Partial Final Award on paragraph 294. (¶ 27).

Respondent also contended that if Claimant seriously believed that the Tribunal failed to decide any of its claims, Claimant should have pursued a request for an additional award under the UNCITRAL Rules. (¶ 28).

The Tribunal rejected Claimant’s request, because such request asked the Tribunal to reconsider what it had already decided on the Partial Final Award, based on the FET claim. (¶ 32). Contrary to Claimant’s position that the Tribunal chose not to decide the issue, the Tribunal responded that as the Tribunal had stated on the Partial Final Award on paragraph 294, “since the Claimant had relied on the violation of several Treaty’s provision as *alternative grounds* for its claim for compensation, once the Tribunal [had] found that one of the alternative grounds is well-founded, *deciding on the other grounds is no longer part of the Tribunal’s mission.*”. (¶ 31). In the Tribunal’s view, it would be unnecessary and a duplicative re-examination of the merits. (¶ 32).

3.2. Whether the Adjustment Sum and the Entitlement difference includes the Extension Contract

On paragraphs 501 and 502 of the Partial Final Award, the Tribunal adopted “future free cash flows of Murphy Ecuador between March 2009 and January 2012” for the purposes of calculating the Fair Market Value of Murphy on 12 March 2009, and then discounting the effect of Law 42. (¶ 33).

Claimant alleged that the cash flow should also include the Extension Contract —new contractual framework negotiated with Repsol YPF Ecuador as part of Claimant’s sale of Murphy Ecuador, extending the term from 2012 (the end of the term of original Participation Contract) to 2018 (the end of the term of the Extension Contract). (¶ 33-35). Because the Extension Contract was a “valuable extension rights” that was undoubtedly factored into the sale price of Murphy Ecuador to Repsol. (¶ 34). Not to consider the Extension Contract, limiting recover to the cash flow just until 2012, rather than 2018, would be “unfair under compensation” for Claimant. (¶ 35).

Respondent rejected Claimant's assertions for three reasons. (¶ 36). Firstly, because it exceeded the parameters expressed on paragraphs 503 and 504 of the Partial Final Award. Secondly, it lacked economic justification. And thirdly, it was contradictory with the Claimant's consistent position in favor of discounting the full amount of the Sale Price of Murphy to Repsol from the overall damages. (¶ 36-40.)

The Tribunal agreed with Respondent that the arguments raised by Claimant exceeded what was determined as an adjustment on paragraphs 504 and 505 of the Partial Final Award. (¶ 42-43).

3.3. Whether the Sale of Murphy Ecuador has a positive or negative effect

The parties also disagreed as to how to account for the difference between the Adjustment Sum and the Repsol Sale Price on 12 March 2009 (i.e. the price Repsol had paid to acquire Murphy Ecuador). (¶ 44).

Respondent alleged that the difference was negative, and such negative difference should be "offset" of Claimant's total damages, to avoid overcompensation. (¶ 44, 45).

Because the difference between the Adjustment Sum (USD 57.6 million) and the Price Sale (USD 78.9 million) has a negative value of USD 21.3 million, Respondent submitted that Claimant was paid USD 21.3 million more than the Murphy's FMV. (¶ 47), and that such value should be "offset" (¶ 53-54) regardless of whether or not the Tribunal anticipated the mitigating value of the Murphy-Repsol Sale. (¶ 49).

Also, as a result of the full mitigation no pre- or post-award interest should be granted. (¶ 50).

On the other hand, Claimant answered that Respondent's allegations had no merit, and maintain that the Tribunal should contemplate the Entitlement as an additional sum to Murphy Exploration, instead of a credit to Ecuador. (¶ 44).

Claimant provided the Tribunal with four different mathematical scenarios for the calculation of the Adjustment Sum, the Entitlement, and the pre- and post-award interest. (¶ 60).

Claimant also provided that Respondent's "offset" argument was invalid and untimely. (¶ 61). Claimant described it as a Respondent's attempt to transform the Entitlement into a "credit". (¶ 61). The Tribunal's Partial Final Award decision "meant exactly what it said", that the Entitlement could "only lead to further damages" for the investor, and not a credit for the host State. (¶ 61 and 65).

In addition, Claimant alleged that there was no link between Law 42 payments and the entitlement that would justify an "offset", that the Repsol Sale Price acted as mitigation post-sale forward-looking damages and not a pre-sale related with the historical Law 42 payments. (¶ 62-63).

Claimant also noted that Respondent had never alleged such "offset" theory in later stages of the proceedings, and Respondent was now precluded from bringing such claim. (¶ 61).

The Tribunal agreed with Respondent that the difference between the Adjustment Sum (USD 57.1 million) and the Sale Price (78.9 million) was indeed negative. (¶ 68). However, the

Tribunal ultimately agreed with Claimant that such negative effect could not be offset in favor of the Respondent, and that the Entitlement was, therefore, zero. (¶ 69-70).

3.4. Whether the Tribunal should reconsider its decision on PO.4. about cost.

The parties also disputed whether the Tribunal should grant post-award interest cost. (¶ 71). Claimant maintained that PO.4. decision should be reconsidered, and that the Tribunal should grant the post-award interest costs. (¶ 71).

Respondent answered that Claimant's request was improper, "extraneous", "unrelated", and "merely another effort to create an artificial situation to counter- balance the implications of paragraphs 503-504." (¶ 71 and 75).

The Tribunal agreed with Respondent and found that granting Claimant's request would be equal to reconsider what had already been decided on the Partial Final Award and the PO.4. (¶ 76). The Tribunal also noted, and reiterated PO.4., Section IV: "[t]he reasons why the Tribunal has not granted post-award interest on costs is that no specific claim in this respect was before the tribunal at the time of rendering the award." (¶ 76).

4. Decision

The Tribunal dismissed three of Claimant's requests. (¶ 84). The Tribunal dismissed Claimant's request for further reasoning about the non-FET claims; the request that the Adjustment Sum and Entitlement should account for the Extension Contract as well as the request that the Tribunal should revisit the PO.4. decision about post-award interest on cost. (¶ 84).

The Tribunal also dismissed Respondent's request that the negative difference between the Adjustment Sum and the Repsol Sale price should be "offset". (¶ 84).

Ultimately, the Tribunal decided that the Adjustment Sum and the Entitlement referred to in paragraph 504 of the Partial Final Award amount to USD 57.1 million and zero, respectively. (¶ 84).

As a result of the Entitlement amounting to zero, the Tribunal decided that there were neither pre-award nor no post-award interest in the Sum of Figure A and Figure B referred to in paragraph 522 and 548(viii) of the Partial Final Award. Therefore, the value of the damages in the Partial Final Award amount to USD 7,136,121. (¶ 84).