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International Arbitration Case Law

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ULYSSEAS, INC. V. THE REPUBLIC OF ECUADOR

Case Report by Charles B. Rosenberg**
Edited by Ignacio Torterola***

In a decision rendered on June 12, 2012, under the United States-Ecuador BIT and pursuant to the UNCITRAL Arbitration Rules, the Tribunal held that the Respondent had not breached any of its obligations under the BIT in relation to the Claimant's investment, dismissed all of the Claimant's claims, and ordered the Claimant to pay $2 million of the Respondent's costs.

Tribunal:
Piero Bernardini (President), Michael Pryles, and Brigitte Stern

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Digest

1. Introduction

Ulysseas, Inc. (the "Claimant") commenced international arbitration proceedings against the Republic of Ecuador in 2009 pursuant to the UNCITRAL Arbitration Rules, alleging multiple violations of the United States-Ecuador BIT. On September 28, 2010, the Tribunal rendered an Interim Award that held that the two objections presented by the Respondent did not deprive the Tribunal of its jurisdiction over the treaty claims presented by the Claimant. On June 12, 2012, the Tribunal issued a Final Award that held that the Respondent had not breached any of its obligations under the BIT in relation to the Claimant's investment, dismissed all of the Claimant's claims, and ordered the Claimant to pay $2 million of the Respondent's costs.

2. Facts and Allegations

The Claimant is a U.S.-based energy corporation. In 2003, the Claimant purchased two ocean-going power barges, Power Barge I ("PBI") and Power Barge II ("PBII"), for the purpose of generating electricity to be used by consumers on land. The Claimant imported and installed PBI and PBII in Ecuador in 2003 and 2005, respectively. The Claimant and the Consejo Nacional de Electricidad ("CONELEC"), the Ecuadorian government agency charged with regulating investment in the electricity sector, signed concession contracts for PBI and PBII in 2005 and 2006, respectively.

Under the concession contract for PBII ("PBII Contract"), the Claimant had to generate electricity for a period of 15 years starting from the date of signature. However, the Claimant never started power generation operations from PBII. According to the Claimant, the ever-worsening situation of the electricity sector left no other options than to attempt to conclude a power purchase agreement ("PPA") that would provide for an agreed price over the term of the agreement that would allow PBII to both cover its costs and make a return on its investment.

After negotiations for a PPA failed, the Claimant gave notice of *force majeure* pursuant to the PBII Contract, alleging that performance of the PBII Contract had become impossible in view of the degraded business environment for the electricity sector. However, CONELEC rejected the Claimant's grounds, stating that it was under no obligation to ensure that the Claimant had to receive commercially viable compensation in return for generation. CONELEC later

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informed the Claimant that since it had not initiated generation activities, CONELEC would temporarily assume the generation activities arising from the PBII Contract. CONELEC thus proceeded to take actual control of PBII by physically evicting the Claimant's crew from the vessel. Nearly a year later, the Claimant regained access to PBII, but allegedly discovered that serious damage had been caused to the engines. CONELEC terminated the PBII Contract in 2011, which allowed the Claimant to remove PBII from Ecuador.

3. Legal Issues

(a) Attribution

The Tribunal held that none of the acts performed by CONELEC, CENACE (the National Energy Control Center), CATEG (Corporation for the Temporary Administration of Electric Power of Guayaqul), PETROECUADOR (the state-owned company Pétroleos del Ecaudor), or PETROCHEMICAL (a state-owned company affiliated with PETROECUADOR) (collectively, the "Entities") were attributable to the Respondent, pursuant to Articles 4 or 5 of the ILC Articles or Article II(2)(b) of the BIT.

First, the Tribunal ruled that none of the Entities were organs of the Ecuadorian State, pursuant to Article 4 of the ILC Articles. The fact that the Ecuadorian Constitution defined all the Entities as part of the public sector and subjected all the Entities to a system of controls by the State was not sufficient to attribute their conduct to the State as its organs.[1] Second, the Tribunal found that, except in certain limited instances, none of the Entities exercised governmental authority in their relations with the Claimant, pursuant to Article 5 of the ILC Articles and Article II(2)(b) of the BIT.[2] The Tribunal emphasized that what matters is "the use of 'prérogatives de puissance publique' or governmental authority."[3]

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[1] *See* Award ¶ 135.

[2] Article II(2)(b) of the BIT provides that "[e]ach Party shall ensure that any state enterprise that it maintains or establishes acts in a manner that is not inconsistent with the Party's obligations under this Treaty wherever such enterprise exercises any regulatory, administrative or other governmental authority that the Party has delegated to it."

[3] Award ¶ 138 (quoting *Jan de Nul v. Egypt*).

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(b) Expropriation

The Tribunal ruled that there was neither a temporary expropriation nor an indirect expropriation of the Claimant's investment, pursuant to Article III(1) of the BIT.

The Tribunal dismissed the Claimant's argument that its investment had been temporarily expropriated, as a result of a direct physical seizure of PBII for nearly a year. The Tribunal found that CONELEC had seized PBII after the Claimant had breached its contractual obligation by failing to generate electricity for 15 years. The seizure of PBII, according to the Tribunal, was "'the ordinary behavior of a contractual counterparty', therefore not an exercise of governmental authority as 'puissance publique' attributable to the Ecuadorian State."[4] Thus any claim for damages allegedly caused to the barge during the seizure and temporary administration of PBII could only be settled in accordance with the applicable provisions of the PBII Contract.

The Tribunal also dismissed the Claimant's argument that its investment had been indirectly expropriated, as a result of the Respondent's effective stripping of all economic value from the investment. The Claimant had argued that the changes in the regulatory framework introduced by the Respondent left the Claimant with no other alternative than to generate at a loss, thus permanently depriving it of all expected economic benefit from its investment in Ecuador. However, the Tribunal ruled that the four reasons alleged by Claimant, whether considered in isolation or by their combined effects, "do not constitute a sufficient basis for the claimed substantial deprivation of the value of its investment resulting in an indirect expropriation or in measures tantamount to expropriation."[5]

First, the Tribunal found that a fine for the Claimant's failure to produce electricity is a sanction that the Claimant knew could be imposed by CONELEC under the PBII Contract. The Tribunal ruled that "[t]his measure therefore is not attributable to Respondent . . . [because] it was an action based on a contract and not an exercise of puissance publique."[6]

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[4] *Id.*
[5] *Id.* ¶ 200.
[6] *Id.* ¶ 185.

Second, the Tribunal found that the changes in the priority regime in 2007 and 2008 – which allegedly made it impossible for the Claimant to generate electricity, sell electricity on the spot market, and receive money for doing so – were not the cause of such a substantial deprivation of the economic value of the Claimant's investment as to amount to an indirect expropriation. The Tribunal recognized that there was no guarantee of profitability: The Power Sector Regime Law of 1996 clearly specifies that "the Ecuadorian State shall not guarantee the production price or profitability of investment and market for electricity to any generator whatsoever." The Tribunal furthermore found that "[t]he evolutionary character of the changes in priority order . . . deprives the alleged substantial deprivation of the value of Claimant's investment of the required permanent character."[7]

Third, the Tribunal ruled that the alleged impossibility to reach agreement for a commercially viable PPA cannot be imputed to the Respondent. The Tribunal found that the Claimant was unable to secure a PPA because it proposed price and other terms and conditions that no distribution company was willing to accept. The Tribunal noted that "[e]ven if some public authorities or officials might have given an expectation to Claimant by statements made in meetings that a viable PPA would be concluded by Claimant, the evidence in the file shows that no firm assurances had been given to Claimant in that regard."[8]

Fourth, the Tribunal observed that the fact that the Claimant was not allowed to quit Ecuador may not be imputed to the Respondent considering that: (i) the Claimant had undertaken to produce electricity for 15 years under freely accepted contractual conditions by entering into the PBII Contract; and (ii) under the PBII Contract, termination without sanction could only come about by mutual agreement.

(c) Fair and Equitable Treatment

[7] *Id.* ¶ 189.
[8] *Id.* ¶ 191.

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The Tribunal dismissed the Claimant's argument that the Respondent failed to provide fair and equitable treatment to its investment, pursuant to Article II(3)(a) of the BIT.

As a preliminary matter, the Tribunal observed that it would adhere to the fair and equitable treatment standard articulated by the ICSID tribunal in *EDF (Services) Limited v. Romania*: "Except where specific promises or representations are made by the State to the investor, the latter may not rely on a bilateral investment treaty as a kind of insurance policy against the risk of any changes in the host State's legal and economic framework. Such expectation would be neither legitimate nor reasonable."[9]

The Tribunal next explained that the four *Salini* factors "inform the determination of the moment when Claimant 'invested' in Ecuador in the ordinary sense and began relying on any legitimate expectations that it may have formed."[10] The Tribunal clarified that "for an 'investment' to arise in this sense, there must be an actual transfer of money or other economic value from a national . . . of a foreign State to the host State through the assumption of some kind of commtiment [sic] ensuring the effectiveness of the contribution and its duration over a period of time."[11] The Tribunal thus ruled that the Claimant's legitimate expectations were fixed as of 2006 when the Claimant entered into the PBII Contract. The Tribunal refused to find that the Claimant's legitimate expectations originated when PBII was imported into Ecuador in 2005 because "Claimant was still free, both subjectively and objectively, to leave Ecuador at any time in the absence of commitments compelling it to remain in the country."[12]

Finally, the Tribunal found that in 2006 the Claimant could not expect that generators such as the Claimant would: (i) be entitled to charge a price to at least cover its costs; and (ii) actually receive such a price.

(d) Full Protection and Security

[9] *Id.* ¶ 249.
[10] *Id.* ¶ 251.
[11] *Id.* ¶ 252.
[12] *Id.*

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The Tribunal dismissed the Claimant's argument that the Respondent beached the full protection and security standard of treatment, pursuant to Article II(3)(a) of the BIT.

The Tribunal rejected the Claimant's view that "full protection and security" and "fair and equitable treatment" can be considered together since "both treatments require the State to provide stability and predictability."[13] The Tribunal explained that the reference to the two standards in Article II(3)(a) of the BIT demonstrates that the two standards are autonomous. According to the Tribunal, the full protection and security standard "imposes an obligation of vigilance and care by the State under international law comprising a duty of due diligence for the prevention of wrongful injuries inflicted by third parties to persons or property of aliens in its territory or, if not successful, for the repression and punishment of such injuries."[14]

The Tribunal reasoned that since the temporary administration of PBII was performed by a third party pursuant to the PBII Contract, any physical damage caused to PBII should be settled according to the PBII Contract.

(e) Discriminatory Measures

The Tribunal dismissed the Claimant's claim of discriminatory measures, pursuant to Article II(3)(B) of the BIT.

The Claimant had alleged that national state-owned entities were operating in more favorable conditions than private generators, whether national or foreign, in similar situations. Specifically, the Claimant alleged that the guarantee of equal treatment to public and private business activities had been violated by: (1) changes in priority order, so that private generators have always ranked below state-owned generators; (2) state-owned transmission companies being consistently prioritized by rendering them immune at the expense of private generators; and (3) the cost structure of the electricity sector being such as to benefit the state-owned generators since the latter have no requirement to make profit, thus flooding the market with low-cost PPAs making it impossible for private generators to win viable PPAs.

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[13] *Id.* ¶ 271-72.

[14] *Id.* ¶ 272 (citing *El Paso Energy v. Argentina*).

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The Tribunal reasoned that "for a measure to be discriminatory it is sufficient that, objectively two similar situations are treated differently."[15] The Tribunal then proceeded to analyze and dismiss the Claimant's three allegations.

First, the Tribunal found that state-owned generators ranked below private generators with PPAs. The Tribunal distinguished between having a PPA and purchasing on the spot market, and concluded that "[t]here was clearly a State policy to promote generation companies, whether private or State-owned, to enter into PPAs."[16]

Second, the Tribunal found that "transmission companies are in a situation different from that of generation companies, so that no discrimination between the two categories may be deemed to exist."[17]

Third, the Tribunal noted that the Ministry of Finance was required to cover any shortfalls in payments to generators operating in the electricity sector. Importantly, however, the Claimant forego selling on the spot market or under a PPA.

(f) Arbitrary Treatment

The Tribunal dismissed the Claimant's claim of arbitrary treatment by the Respondent, pursuant to Article II(3)(b) of the BIT.

The Tribunal first dismissed the Claimant's claim that the Respondent acted arbitrarily when Minister Mosquera conveyed to the Claimant that CATEG would enter into a PPA on terms acceptable to the Claimant. The Tribunal noted that it was Claimant's obligation, freely undertaken by the signature of the PBII Contact, to generate electricity for Ecuador for 15 years. It was not for Minister Mosquera to offer the Claimant alternative solutions or allow PBII to leave Ecuador in the absence of grounds for terminating the PBII Contract.

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[15] *Id.* ¶ 293.
[16] *Id.* ¶ 294.
[17] *Id.* ¶ 295.

The Tribunal next dismissed the Claimant's contention that the Respondent acted arbitrarily by presenting a conflicting and uncertain regulatory framework. Reasoning that "a finding of arbitrariness requires that some important measure of impropriety is unfair," the Tribunal found that there was nothing "improper" in the enactment of Constituent Mandate No. 15 on 23 July 2008, which was intended to solve payment problems and to improve the functioning of the electricity sector by favoring PPAs.[18] The Tribunal stressed that all private generation companies were able to secure PPAs; Claimant was the one who failed to secure a PPA due to commercial considerations.

The Tribunal also rejected the Claimant's contention that the Respondent acted arbitrarily when Termoesmeraldas, a state-owned company, negotiated for seven months the purchase of PBII to then confirm that it did not have the necessary funds. The Tribunal emphasized:

> In its dealings with Claimant, Termoesmeraldas did not exercise governmental authority but acted merely on a commercial basis. Its conduct as a State entity is therefore not attributable to the Ecuadorian State. Whether it misbehaved in its negotiations with Claimant for the purchase of PBII is not for the Tribunal to judge in the absence of attribution of its conduct to the State.[19]

Finally, the Tribunal ruled that CONELEC did not act arbitrarily by fining the Claimant for its failure to commence generating electricity within the prescribed deadline. Rather CONELEC was entitled to do so under the PBII Contract.

(g) Costs

After noting that Article 40(1) of the UNCITRAL Arbitration Rules provides that the costs of the arbitration shall in principle be borne by the unsuccessful party, the Tribunal recalled that the Claimant had been successful as to jurisdiction, while the Respondent had been successful as to the merits. The Tribunal therefore ordered the Claimant to reimburse the Respondent's costs for legal representation and assistance in the amount of $2 million.

[18] *Id.* ¶ 319 (citing *Enron v. Argentina*).
[19] *Id.* ¶ 321.

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4. Decision

On June 12, 2012, the Tribunal issued a Final Award that held that the Respondent had not breached any of its obligations under the BIT in relation to the Claimant's investment, dismissed all of the Claimant's claims, and ordered the Claimant to pay $2 million of the Respondent's costs.

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