

**International Centre for Settlement of  
Investment Disputes**

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**DUKE ENERGY ELECTROQUIL PARTNERS  
&  
ELECTROQUIL S.A.**

**(“Duke”)**

**CLAIMANTS**

**v.**

**REPUBLIC OF ECUADOR**

**(“Ecuador”)**

**RESPONDENT**

**ICSID Case No. ARB/04/19**

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**AWARD**

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**Rendered by an Arbitral Tribunal composed of:**

**Prof. Gabrielle Kaufmann-Kohler, President**

**Dr. Enrique Gómez Pinzón, Arbitrator**

**Prof. Albert Jan van den Berg, Arbitrator**

**Secretary of the Tribunal:**

**Mr. Gonzalo Flores**

**Date of Dispatch to the Parties: August 18, 2008**

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## TABLE OF ABBREVIATIONS

Arbitration Rules	ICSID Rules of Procedure for Arbitration Proceedings
BIT	Bilateral investment treaty; specifically "Agreement Between the United States of America and the Republic of Ecuador Concerning the Reciprocal Promotion and Protection of Investments" of 27 August 1993
Cl. Exh.	Claimants' Exhibit [Documentary evidence & legal materials]
Cl. 1 <sup>st</sup> PHB / 2 <sup>nd</sup> PHB	Claimants' First Post-Hearing Brief of 30 June 2006 / Second Post-Hearing Brief of 21 July 2006
Cl. Mem.	Claimants' Memorial in Chief of 2 September 2005
Cl. Rejoinder	Claimants' Rejoinder on Jurisdiction of 31 March 2006
Cl. Reply	Claimants' Reply Memorial and Counter-Memorial on Jurisdiction of 18 January 2006
ER	Expert Report
Exh. C-	Claimants' Exhibit [Request for Arbitration]
ICSID	International Centre for Settlement of Investment Disputes
ICSID Convention	Convention on the Settlement of Investment Disputes between States and Nationals of other States
MEM	Ministry of Energy and Mines
PPAs	Power Purchase Agreements (PPA 95 and PPA 96)
R. 1 <sup>st</sup> PHB / 2 <sup>nd</sup> PHB	Respondent's First Post-Hearing Brief of 30 June 2006 / Second Post-Hearing Brief of 21 July 2006
R. Answer	Respondent's Answer to the Memorial in Chief of 22 November 2005 ("Memorial de Contestación a la Demanda")
R. Exh.	Respondent's Exhibit [Documentary evidence & legal materials]
R. Reply	Respondent's Reply on Jurisdiction and Rejoinder on the merits of 6 March 2006
RforA	Request for Arbitration
Tr.	Transcript of the Hearing of 24-28 April 2006
WS	Witness Statement

## **I. FACTS**

1. This chapter summarizes the main facts of this dispute. Additional facts may be addressed in the chapter entitled “Analysis” as and when appropriate.

### **1. THE PARTIES**

#### **1.1 The Claimants**

2. The Claimants in these proceedings are (i) Duke Energy Electroquil Partners (“Duke Energy” or the “First Claimant”) and (ii) Electroquil S.A. (“Electroquil” or the “Second Claimant”) (collectively “Duke” or the “Claimants”).
3. The first Claimant, Duke Energy, is a partnership created and incorporated under the laws of the State of Delaware, USA (Exh. C-4 RforA). Its registered office is located at 5400 Westheimer Ct. 77056-5310, PO Box 1642, Houston, Texas, USA.
4. Duke Energy is the sole parent company of Duke Energy International del Ecuador Cía Ltda (“Duke Ecuador” or “DEI”), through which it acquired an ownership interest in Electroquil, on 23 February 1998.
5. The second Claimant, Electroquil, is a power generation company created and incorporated under the laws of Ecuador. Its registered office is located at Calle José Salcedo, no. 410, Guayaquil, Ecuador (Exh. C-5 RforA).
6. The Claimants are represented in this arbitration by Mr. Arif H. Ali and Mr. Baiju S. Vasani, Crowell & Moring L.L.P; Mr. C. Mark Baker, Mr. Anibal Sabater, Ms. Caroline M. Mew, Ms. Hdeel Abdelhady and Mr. David Chung, Fulbright & Jaworski L.L.P, and Dr. César Coronel and Dr. Hernán Pérez Loose, Coronel y Pérez Abogados, Guayaquil.

#### **1.2 The Respondent**

7. The Respondent is the Republic of Ecuador (“Ecuador” or the “Respondent”).
8. The Respondent is represented in this arbitration by Dr. Diego García Carrión, Procurador del Estado de la República del Ecuador, Mr. Alberto Wray Espinosa, Mr. Ernesto Albán Ricaurte, Mr. Alvaro Galindo, Estudio Jurídico Cabezas y Wray, Quito; and Mr. Robert Volterra, Latham & Watkins, London.

## 2. FACTUAL BACKGROUND

9. The present dispute arises out of several contracts entered into between the parties for electrical power generation in Ecuador. For the sake of clarity and expediency, the Tribunal will address the factual background thematically, each topic being developed chronologically, whenever possible.

### 2.1 The energy crisis in Ecuador

10. In 1973, the Government of Ecuador established the *Instituto Ecuatoriano de Electrificación* (“INECEL”) pursuant to the Basis Electricity Law of 1973, as a state-owned entity under the Ministry of Natural Resources and Energy, to carry out the functions of power generation, transmission, and distribution (Exh. C-11 RforA; Cl. Exh. 028). INECEL was the only entity authorized to produce and provide electricity.
11. The electricity sector began to deteriorate and, in 1992, a crisis resulted in a national power shortage (Exh. C-10 RforA). This event prompted Ecuador to issue the First Emergency Decree No. 3071 (the “First Emergency Decree”) on 7 February 1992, declaring a state of emergency “*because of the shortfall in power generation, due to the scarcity of rainfall*” (Art. 1) and ordering the Ministry of Finance to allocate funds to enable INECEL to purchase energy (Cl. Exh. 002).
12. “*In the midst of and in response*” to the electricity crisis (RforA, ¶ 18), Electroquil was created on 10 January 1992 (Exh. C-5 RforA, R. Exh. 003). It was the first private power generator established in Ecuador and the only private generator in the Guayaquil area. Mr. Gustavo Larrea Real became Electroquil’s Executive President in 1992 upon the request of his former employer, *La Cemento Nacional*, which was a large electricity consumer and a stakeholder of Electroquil.
13. In the month following its creation on 9 February 1992, Electroquil established the first non-hydro thermal power generation facility in Ecuador, located in the city of Guayaquil.
14. Three and a half years later, on 3 October 1995, the President of the Republic of Ecuador issued a Second Emergency Decree No. 3099 (the “Second Emergency Decree”). The Second Emergency Decree, in particular, reinstated the state of emergency and authorized INECEL to execute power purchase agreements on an emergency basis with private power generators to respond to the pressing demand for electricity (Exh. C-15 RforA; Cl. Exh. 004).

15. The Ecuadorian Parliament enacted the *Ley de Régimen del Sector Eléctrico* on 10 October 1996, providing inter alia that INECEL be liquidated within a certain time period. As explained by Dr. Juan Larrea Holguín and Dr. Alejandro Ponce Martínez in their legal report, this liquidation resulted from the process of liberalization of contracting in the electricity sector (ER, ¶ 3.7).

## **2.2 The subscription of the PPAs and other related agreements**

16. On 31 October 1995, INECEL and Electroquil entered into a power purchase agreement (the “PPA 95”) for the importation, assembly, installation, and putting into service by Electroquil of two new Stewart & Stevenson branded gas turbine generators (“Units 1 and 2”) of 42 megawatts each on Electroquil’s Guayaquil plant (the “Plant”) in order to remedy the power supply shortage (Clauses 2 and 5; Exh. C-18 RforA and Cl. Exh. 005/R. Exh. 006). Units 1 and 2 were to be put into service no later than the end of December 1995.
17. The PPA 95 was valid for a duration of five years from the commencement of commercial operation of the units (Clause 6.01).
18. As a fixed cost for the power it supplied to INECEL, Electroquil was to be paid a fixed amount of USD 12 per kilowatt provided as a charge for ISO capacity and a monthly energy payment of USD 0.0045 per kilowatt hour provided applicable to the monthly rounded-off amount of 433 hours of operation at ISO capacity, i.e. 5,200 hours per year (Clause 7.1 of PPA 95).
19. As a variable cost, at the end of each year, INECEL was to pay for the supply of power in excess of 5,200 hours at the rate of USD 0.0045 per kilowatt hour (Clause 7.2 of PPA 95). Furthermore, should the contract administrator not approve Electroquil’s invoices with regard to variable costs within five days, the invoice in question was to be considered approved and paid by INECEL within 30 days. On the other hand, if an invoice was disputed, the corresponding amount was to be transferred into a pending account awaiting final approval or denial, and any portion of the invoice which was accepted was to be processed and paid within 15 days. Electroquil was then to provide INECEL with all supporting documents pertaining to the disputed amounts, failing which, INECEL would deny the disputed amounts. If the disputed amounts were justified to INECEL’s satisfaction, the latter was to pay the invoice within 15 days.
20. Fuel was to be supplied by the *Empresa Estatal de Comercialización y Transporte de Petróleos del Ecuador* (“Petrocomercial”) for the plant operation and payment was to be reimbursed by INECEL on a monthly basis, within 30 days of receipt of the related



- invoice, based on the fuel consumption measured at the inlet to the turbines (Clauses 7.4 and 15.3 of PPA 95).
21. Prior to signing the PPA 95, Electroquil was to submit an unconditional, irrevocable and immediately collectible performance bond issued by a bank or surety company payable to INECEL in the amount of USD 3,052,800, representing 5% of the total value of the PPA 95 estimated at USD 61,056,000 (Clause 8).
  22. The PPA 95 also provided for several warranties and penalties in the event that such warranties were not met. In particular, if the availability of Electroquil's generating units was less than the warranted 7,500 hours per year (Clause 10.3), INECEL was entitled to impose a fine of USD 500 per hour of difference between the warranted and actual availability (Clause 12.1).
  23. Furthermore, if the number of kilowatt hours generated with a gallon of fuel was less than the amount warranted in Electroquil's offer, INECEL could impose a penalty equivalent to the cost of fuel required to produce the energy not generated for this reason during the month in question (Clause 12.2). The warranted performance was to be based on the fuel characteristics attached to PPA 95.
  24. Moreover, in the event that the actual energy provided was less than the amount warranted in Electroquil's bid, INECEL could impose a monthly penalty of USD 250 per percentage point below the amount warranted from the time operations commenced until the difference was corrected (Clause 12.3).
  25. These penalties could not be imposed if Electroquil's defaults were due to force majeure, or to an act of God, as provided in Article 3 of the Ecuadorian Civil Code, or to other reasons not attributable to Electroquil. Furthermore, within the same month, the penalties could not exceed the amount of the payment that Electroquil received monthly for the availability of the warranted power. If during a given month the penalties exceeded the latter amount, INECEL could take action to remedy such default depending on its seriousness, without prejudice to its right to terminate the PPA 95 if appropriate (Clause 12.4).
  26. The penalties were to be calculated once a year and paid within 15 days of INECEL's notice, failing which INECEL could partially call up the performance bond (Clause 12.5). Furthermore, the amount of the penalties was limited to 5% of the total value of the PPA 95 (Clause 12.6).

27. The PPA 95 also provided for penalties for delay in the commencement of the commercial operation of each unit. Electroquil was to pay INECEL a penalty of USD 5,000 for each day of delay, beginning 150 days from the execution of the PPA 95, except if it was not possible to continue the functional tests for safety reasons, in which case the testing period was to be extended by an equal number of days (Clause 12.7).
28. Patricio Burbano de Lara of INECEL was designated as contract administrator under the PPA 95 on 12 February 1996 (the "Contract Administrator"; R. Exh. 009).
29. On 3 May 1996, a letter of intent was signed between INECEL and Electroquil regarding the installment of an additional power generation unit by Electroquil and the selling of the additional energy generated to INECEL (the "LOI"; R. Exh. 011 and 066). This LOI was followed by an offer to INECEL, dated 17 May 1996, to install two new gas turbines, that later materialized in the signature of a second purchase agreement (Cl. Exh. 06).
30. The commercial operation of Units 1 and 2 began on 10 May 1996 (R. Exh. 012). However, on 26 June 1996, a technical failure occurred on Unit 2 leading to its replacement (R. Exh. 018).
31. An issue arose around that time regarding the payment by Electroquil of the fuel provided by Petrocomercial and its corresponding reimbursement by INECEL. To resolve this issue, the parties agreed that INECEL would buy the fuel directly from Petrocomercial and would then deliver it to Electroquil (Cl. Exh. 22). On 2 August 1996, a fuel supply agreement (the "Fuel Supply Agreement") was entered into between Petrocomercial and Electroquil, under which Petrocomercial was to supply fuel from the Libertad-Pascuales fuel pipeline to Electroquil's plant (Cl. Exh. 048).
32. As foreseen in the LOI and the subsequent Electroquil offer, INECEL and Electroquil entered into a second power purchase agreement on 8 August 1996 ("PPA 96"; PPA 95 and PPA 96 will be jointly referred to as the "Agreements" or "PPAs") for two additional generating units ("Units 3 and 4"; Clause 2 of PPA 96; Cl. Exh. 006).
33. INECEL agreed to pay Electroquil a monthly payment for both capacity and power for a 60-month period for Units 3 and 4. Rather than relying upon the ISO capacity to determine capacity payments like in PPA 95, the PPA 96 contemplated the invoicing of capacity based upon a contracted rate of 80 MW. The monthly capacity rate was set at US\$ 9 per kW while the rate for power was set at US\$ 0.0055 per kWh (Clause 8).

34. Unlike the PPA 95, the PPA 96 did not provide or guarantee Electroquil a payment for a minimum number of kWh (i.e. take or pay). Instead, the PPA 96 contemplated that Units 3 and 4 would provide a probable 250 hours per month of power. Actual payment for power would be based upon actual power delivered.
35. The terms and conditions of PPA 96 with respect to the penalty system (Clause 13) were similar (but not identical) to those of PPA 95. To avoid lengthy repetitions in this section, the relevant provisions will be referred to in more detail or quoted in the Chapter entitled "Analysis" when and where appropriate.
36. The commercial operation of Units 3 and 4 began on 19 June 1997.

### **2.3 The payments under the PPAs and the constitution of the Payment Trusts**

37. Fixed costs for the supply of energy were to be paid under Clause 7.1 of PPA 95 within 30 days of the invoice date through a payment trust established at the Central Bank of Ecuador in Electroquil's name. To establish such a trust, INECEL was to execute the corresponding payment trust agreements prior to the commercial operation of the Plant (Clause 7.1 of PPA 95). Variable costs for power in excess of 5,200 hours followed a different regime and were paid directly at the end of each year pursuant to Clause 7.2 of the PPA 95.
38. PPA 96 provided primarily for the payment of a fixed monthly charge (Clause 8.1), energy charges (Clause 8.2), and fuel costs (Clause 8.4). Payments were to be made on a monthly basis through a payment trust at the Central Bank of Ecuador in Electroquil's name which was also to be established before the commencement of the commercial operation of the plant. In addition, PPA 96 provided that the Minister of Finance would take part in the trust on behalf of the Ecuadorian State in order to make payments to Electroquil of funds from the Ministry's account at the Central Bank in the event that INECEL's or the trust's funds were insufficient (Clause 8.5 of PPA 96; Cl. Exh. 006).
39. By the time the Plants had entered into commercial operation, none of the payment trusts had been established. Payments under the PPAs were partial, irregular and made using different means such as cash and State bonds (R. Reply, ¶¶ 171-172).
40. The first step towards establishment of the payment trusts was the issuance by the President of the Republic of the Payment Guarantee Decree No. 804 (the "Payment Decree") on 10 November 1997. This Decree authorized the Minister of Finance to act on behalf of the State and create the guarantees of payment for the trusts to be

established at the Central Bank by INECEL and Electroquil. These guarantees empowered the Central Bank to transfer from the Ministry of Finance to the trusts the necessary funds to pay Electroquil's outstanding invoices in the event that INECEL failed to make payments under the PPAs (Cl. Exh. 007). In addition, the Payment Decree stipulated that INECEL should authorize the trusts to retain from its accounts the necessary funds in order to assure payment of the monthly invoices submitted by Electroquil under the PPAs. As the Tribunal understands it, payment trusts and collateral trusts are often used in project finance transactions, as the trust allows a single lender to control all the security interests, reducing administration and transaction costs, and facilitating the enforcement of the security interests.

41. Subsequently, on 17 February 1998, the Ministry of Finance, INECEL and the Central Bank of Ecuador executed two identical payment trusts under the PPAs (the "Payment Trusts", the "Payment Trust Agreements" or the "95 Payment Trust" and the "96 Payment Trust"). Clause 5 of each Payment Trust provided that, as authorized by the Payment Decree, the Ministry of Finance grant INECEL a "*guarantee to secure compliance with the payment obligations assumed by*" INECEL to Electroquil under the PPAs. To this end, the Payment Trusts authorized the Central Bank of Ecuador to debit the Ministry of Finance's accounts in the event that INECEL were unable to meet its obligations (Cl. Exh. 010, Cl. Exh. 011, R. Exh. 054).

#### **2.4 The fines imposed during the execution of the PPAs**

42. As of mid-1996, INECEL started levying a series of fines against Electroquil under the PPAs for years 1 to 4 of operation. Six fines were levied against Electroquil prior to Duke Energy's investment from July 1996 to late 1997 in relation to the supply of energy and the delay in starting commercial operations. Electroquil was then fined five times in 1998. No fines were imposed during the next three years. However, a series of new fines were imposed from August 2001 to June 2002. In total Electroquil was fined 15 times for USD 8.18 million. Eleven of these fines are now discussed in this arbitration for a nominal amount of USD 7,292,114 million.
43. The following chart sets out the disputed fines, the dates on which they were imposed and settled (by set-off or otherwise), and the date on which Electroquil objected to their imposition.

Fine No.	Date	Fines	Set-off or date of liquidation <sup>1</sup>	Date of Electroquil's Objections
Fine No. 1	8/07/96	INECEL levied a <b>USD 400,000</b> fine in connection with the alleged start-up delay under PPA 95. (Exh. C-24 RforA, Cl. Exh. 047, R. Exh. 013)	Set-off against invoice No. 008 which was paid on 17/07/96 (Statement of Mr. Tumbaco, Annex 5, page 1).	31/07/96, (R. Exh. 014)
Fine No. 2	18/11/97	INECEL imposed a USD 619,102 fine, of which, <b>USD 550,000</b> was for the delay in starting up Units 3 and 4 under PPA 96. (Exh. C-25 RforA, Cl. Exh. 073, Cl. Exh. 075, R. Exh. 074)	Set-off against Electroquil's invoice No. 137 dated 31 October 1997 in the amount of USD 864,616, which was paid on 23/12/97 (Tumbaco, annex 5, page 3).	22/05/98 (R. Exh. 075)
Fine No. 3	12/03/98	INECEL imposed a <b>USD 901,637</b> fine in connection with PPA 96, claiming that Electroquil had failed to meet the contractual energy generation quotas for the month of February 1998. (Exh. C-28 RforA, Cl. Exh. 080, Cl. Exh. 81, Cl. Exh. 083, R. Exh. 088)	Set-off against invoice No. 165 dated 28 February 1998 which was liquidated on 15/03/98 (Tumbaco, annex 5, page 3, R. 1 <sup>st</sup> PHB, ¶ 150).	16/03/98 (Cl. Exh. 082, R. Exh. 089)
Fine No. 4	20/04/98	INECEL imposed a <b>USD 554,592</b> fine in connection with PPA 96, claiming that Electroquil had failed to meet the contractual energy generation quotas for the month of March 1998. (Exh. C-29 RforA, Cl. Exh. 084, Cl. Exh. 088, R. Exh. 096)	Set-off against Electroquil's invoice No. 171 dated 31 March 1998. Date of payment or liquidation could not be established.	Prompt objection according to Duke (annex A of Cl. 1 <sup>st</sup> PHB but no evidence on record)
Fine No. 5 Fine No. 6 Fine No. 7	29/05/98	INECEL imposed fines on Electroquil totaling USD 748,118 as follows: (i) an amount of <b>USD 274,550</b> based on the alleged unavailability of Units 1 and 2 during the first year of commercial operation, (ii) an amount of <b>USD 444,387</b> based on the alleged excessive consumption of diesel by Electroquil's turbines, and (iii) an amount of <b>USD 29,181</b> based on a claim that Electroquil had failed to reach the contractually guaranteed power output due to the lack of chillers. (Exh. C-31 RforA, Cl. Exh. 091, R. Exh. 022)	Set-off against invoices No. 135, 149 and 150 which were liquidated with the 95 Liquidation Agreement on 27/11/01.	23/06/98 (R. Exh. 032)
Fine No. 8 Fine No. 9 Fine No. 10	14/08/01	The Contract Administrator imposed fines totaling USD 3,467,250 as follows: (i) an amount of <b>USD 2,243,675</b> based on the alleged unavailability of Units 1 and 2 for at least 7,500 hours per year per unit during years 2 to 5 of PPA 95, (ii) an amount of <b>USD 1,019,033</b> based on the alleged excessive consumption of fuel during years 2 to 5 of PPA 95, and (iii) an amount of <b>USD 204,542</b> based on a claim that	Alleged set-off against invoices No. 135, 149 and 150, which were liquidated with the 95 Liquidation Agreement on 27/11/01. (R. Exh. 052)	16/08/01 (R. Exh. 048)

<sup>1</sup> The determination of the payment date of the fine or rather the date on which it was set-off or liquidated proved to be critical. The Claimants did not address this issue. The date indicated by the Respondent in Annex A attached to its 1<sup>st</sup> PHB are not always consistent with the exhibits. Therefore, the Tribunal has based itself on the information contained in Annex 5 of the first witness statement of Mr. Tumbaco, controller and CFO for Electroquil since 2000, to which the Respondent also referred.

Fine No.	Date	Fines	Set-off or date of liquidation <sup>1</sup>	Date of Electroquil's Objections
		Electroquil had failed to reach the contractually guaranteed power output during years 2 to 5 of PPA 95. (Exh. C-33 RforA, Cl. Exh. 109, R. Exh. 047).		
Fine No. 11	10/12/01	The Contract Administrator imposed a fine of USD 641,469 on Electroquil, which was raised to <b>USD 734,366</b> on 24 July 2002, based on the alleged unavailability of Units 3 and 4 during October and November 2001. (Exh. C-34 and C-35 RforA, Cl. Exh. 113, R. Exh. 100) On 24 July 2002, the Contract Administrator revised Fine No. 11 and reduced it to USD 560,913.68 with respect to the month of October 2001 and to USD 173,452.74 with respect to the month of November 2001, i.e. a total of USD 734,366.42. (Cl. Exh. 114, R. Exh. 104).	Liquidated with the 96 Liquidation Agreement on 28/08/2002 (R. Exh. 105)	14/12/01 (R. Exh. 101)

## 2.5 Duke Energy's indirect involvement in the PPAs through its investment in Electroquil

44. Duke Energy entered the scene, on 12 November 1997, when it signed a letter of intent for the acquisition of a controlling interest in Electroquil (Cl. Exh. 017). A few months later, on 23 February 1998, it indeed acquired a 51.5% ownership of Electroquil for an amount of USD 45 million through its wholly-owned subsidiary, DEI (Exh. C-17 RforA, Cl. Exh. 008, Annex NAV-15 to 1<sup>st</sup> ER Kaczmarek). Allegedly, Duke Energy's actual investment represented only USD 38.5 million due to certain trade receivables on the books of Electroquil (Cl. 1<sup>st</sup> PHB, ¶ 208). Duke Energy's share of Electroquil's capital increased over time. At the time of the Request for Arbitration, DEI owned 72.3% of Electroquil's share capital, which later went up to 79.7% (Cl. Exh. 026, Cl. Exh. 027).

## 2.6 Ecuador's direct involvement in the PPAs

45. The Ecuadorian Parliament provided in "Ley 98-14" of 30 September 1998 that INECEL was to enter into a liquidation process and would cease to exist as of 31 March 1999 (Cl. Exh. 015), as envisaged under *the Ley de Régimen del sector Eléctrico* of 16 October 1996.
46. As a consequence of INECEL's liquidation, the President of Ecuador ordered, by Executive Decree No. 506 of 28 January 1999, that the Ecuadorian State, through the Ministry of Energy and Mines ("MEM"), assume the rights and obligations of INECEL

under the PPAs as of 1 April 1999 (Cl. Exh. 016). INECEL was accordingly dissolved on 31 March 1999.

47. INECEL and Electroquil then signed an agreement, on 31 March 1999, setting out the amounts owed by INECEL to Electroquil for capacity and energy payments under the Agreements in order to “*settle the outstanding payment figures and to establish in a transparent and accurate manner all those areas that have been the subject of administrative claims from Electroquil S. A. until March 31, 1999*” before the State’s subrogation of INECEL’s obligations (the “Interim Liquidation Agreement”; Cl. Exh. 103; R. Exh. 116).
48. Later that year, on 25 May 1999 and 1 June 1999, the State of Ecuador, through the MEM, entered into two subrogation agreements with Electroquil (the “Subrogation Agreements”). Through these agreements, the Ecuadorian State assumed the rights and obligations of INECEL under the PPAs (Exh. C-12 RforA, C-13 RforA, Cl. Exh. 017, Cl. Exh. 018).

## **2.7 The Med-Arb Agreements**

49. On 30 May 2000, the MEM and Electroquil entered into two identical arbitration and mediation agreements (the “Med-Arb Agreements”) in connection with the disputes over fines and the first year of performance of the PPAs (Exh. C-37 and Exh. C-38 RforA, Cl. Exh. 019, Cl. Exh. 020).
50. Electroquil and the MEM entered into mediation on 19 December 2000 under the auspices of the Center for Mediation of the Office of the State Attorney-General. The mediation failed, as evidenced in the related certificate (Cl. Exh. 105).
51. As a consequence, on 29 January 2001, Electroquil commenced arbitration against the MEM before the Arbitration and Mediation Center of the Guayaquil Chamber of Commerce (Cl. Exh. 106; the “local arbitration”).
52. In March 2001, the Attorney-General submitted to the local arbitrators that the Med-Arb Agreements were null and void for breach of Article 4 of the Arbitration Law (Exh. C-44 RforA).
53. The local arbitral tribunal suspended the proceedings on the merits to review its jurisdiction on 27 July 2001 (Tr., Vol. 3, 26 April 2006, Dr. Álvarez Grau, pp. 762-763, Cl. Exh. 120).

54. On 3 August 2001, the local arbitral tribunal dismissed the Attorney-General's objection to jurisdiction and asserted jurisdiction after having heard the observations of the MEM, the Attorney-General and Electroquil (Exh.C-43 RforA). The Attorney-General filed a motion for reconsideration on 27 August 2001 (Cl. Exh. 110). The local tribunal reiterated its denial of the jurisdictional objection in an order of 20 September 2001 (Exh. C-45 RforA). The president of the local arbitral tribunal, Mr. Álvarez Grau, confirmed during his examination that the August and September orders were "firm decisions" (Tr. Vol. 3, 26 April 2006, pp. 728-729).
55. Nonetheless, the local arbitral tribunal issued a final award on 11 March 2002, declaring that, pursuant to Ecuadorian Arbitration Law, the arbitration was null and void due to the invalidity of the arbitration clause (Cl. Exh. 023).

## **2.8 The liquidation of the PPAs and related agreements**

56. The MEM and Electroquil entered into a liquidation agreement on 27 November 2001 (the "95 Liquidation Agreement") in connection with the termination of PPA 95, which inter alia identified the disputes pending between the parties. This agreement showed a final balance in favor of Electroquil of USD 4,173,718.65 (Clause 6.2.2) (Exh. C-46 RforA, Cl. Exh. 022, R. Exh. 052).
57. In connection with the termination of PPA 96, the MEM and Electroquil entered into a liquidation agreement on 28 August 2002 (the "96 Liquidation Agreement"), which also set out the disputes pending between the parties and the amounts due. This second agreement showed a final balance in favor of Electroquil of USD 96,980.64 (Clause 6.2.2) (Exh. C-47 RforA, Cl. Exh. 024, R. Exh. 105).
58. Both Liquidation Agreements expressly acknowledged the existence of pending arbitral proceedings under the Med-Arb Agreements (Clause 7 of the 95 and 96 Liquidation Agreements).
59. By letter dated 3 September 2002, the MEM requested from the Ecuadorian Central Bank that the liquidation amount of USD 96,980.64 be paid to Electroquil (R. Exh. 108).
60. Other contractual relationships were also liquidated at that time. The MEM, Electroquil and Petroecuador (the state-owned oil and gas monopoly which had sold the fuel to operate and maintain the power plant through its subsidiary, Petrocomercial) entered into the so-called *Convenio de Reconocimiento y Extinción Recíproca de Obligaciones* (the "Reciprocal Obligations Agreement") on 30 May 2003. This agreement provided for (i) the extinction of the payment obligation in favor of Electroquil, which had been



recognized by the MEM in the 95 Liquidation Agreement, of USD 4,173,718.65; (ii) the extinction of Electroquil's payment obligation towards Petrocomercial of USD 4,173,718.65 for outstanding payments for fuel purchases; and (iii) the extinction of Petroecuador's obligations towards the Ecuadorian State of USD 3,693,190 (R. Exh. 059) for the payment of due financial obligations.

61. Almost a year later, on 23 April 2004, an agreement was signed for the offset of the reciprocal interest accrued on the delayed fuel payments between Electroquil, the Ecuadorian Government and Petrocomercial (the "Undisputed Amount Interest Agreement"; R. Exh. 063).
62. Finally, Duke Energy and Electroquil, both referred to as the "Investors", and Ecuador entered into an arbitration agreement (the "Arbitration Agreement"; Exh. C-1 RforA, Cl. Exh. 025) on 26 April 2004 to submit to the jurisdiction of ICSID certain disputes that had not been addressed by the Liquidation Agreements. The relevant provisions of the Agreement will be described and analyzed below.

## **2.9 The proceedings relating to customs duties exemptions**

63. On 23 June 1989, the Ecuadorian Government passed "*Ley Número 30 de Exoneración de Impuestos a Importaciones del Sector Público para Obras y Servicios Prioritarios*" (Law Number 30 on the Exoneration of Taxes for Imports of the Public Sector for Primary Works and Services; "Law Number 30"). According to Law Number 30, goods imported into Ecuador were entitled to duty exemptions if (a) the goods were needed for an industry or activity that CONADE (*Consejo Nacional de Desarrollo* – the National Council for Development) had listed as a priority for the country, and (b) the Ministry of Finance had specifically authorized their exemption.
64. Responding to a request from Electroquil, CONADE declared on 8 November 1995 that goods needed for the generation of electricity were a priority for the country and, therefore, were eligible for duty free importation under Law Number 30. In addition, on 23 November 1995, the Ministry of Finance of Ecuador confirmed that the turbines imported under PPA 95 were tax and duty exempt in light of Clause 23.01 PPA 95.
65. Upon Electroquil's request, CONADE reaffirmed its view, on 19 September 1996, that goods required to generate electricity were a national priority and were thus eligible for tax-free importation. On 11 December 1996, the Ministry of Finance of Ecuador confirmed that the turbines under PPA 96 were tax and duty exempt in light of Clause 24.1 PPA 96.

66. In May 1998, after several months of operation, one of the turbines that Electroquil had imported in connection with PPA 96 ("Turbine 185-209") broke down and had to be shipped back to its manufacturer in the United States for repair.
67. The Ecuadorian State passed "*Ley Orgánica de Aduanas*" (the "Customs Law") on 13 July 1998. This law established inter alia that a public body (*Corporación Aduanera Ecuatoriana*, "CAE") had exclusive competence over customs-related matters. Under the Customs Law, only certain public institutions were eligible for duty exemption. The Customs Law did not provide for duty exemption for private companies.
68. Turbine 185-209, which had been repaired in the United States, was loaded on a vessel to be shipped back to Ecuador on 30 July 1998. Two days later, the vessel sank in the port of Houston and the turbine was lost. Consequently, the turbine manufacturer offered to ship a spare turbine 185-207, identical to the lost Turbine 185-209, to Ecuador at no additional cost to Electroquil. Electroquil agreed and the manufacturer shipped turbine 185-207 on 31 August 1998.
69. On 1 September 1998, Electroquil requested from the CAE a duty exemption of USD 1,008,614, for the replacement turbine. Having received no response, it filed a second request before the Ministry of Finance on 24 March 1999. On 14 May 1999, the latter replied that as a consequence of the entry into force of the Customs Law, this was a matter to be resolved by the CAE, thus declining to deal with the duty exemption request.
70. One month later, on 17 June 1999, the CAE denied the duty exemption requested by Electroquil.
71. In November 2001, Electroquil then filed a claim before the Ecuadorian district tax court on the grounds of denial of duty exemption. This claim was dismissed on 28 January 2004 (R. Exh. 125 and R. Exh. 126). Electroquil appealed this decision before the Ecuadorian Supreme Court (R. Exh. 127) on 5 March 2004.
72. The Ecuadorian Supreme Court declared Electroquil's appeal admissible on 15 July 2004. A hearing was scheduled for 27 January 2005, which Electroquil did not attend (R. Exh. 128).
73. In April 2005, the President of Ecuador dismissed all justices on the Ecuadorian Supreme Court. The Supreme Court was re-established on 30 November 2005. The parties have not rendered evidence as to any later events in this respect.

## **II. PROCEDURAL HISTORY**

### **1. INITIAL PHASE**

74. On 25 August 2004, Duke submitted its Request for Arbitration to ICSID accompanied by 48 exhibits (Exh. C-1 to C-48).
75. On 30 August 2004, the Centre, in accordance with Rule 5 of the ICSID Rules of Procedure for the Institution of Conciliation and Arbitration Proceedings (“Institution Rules”), acknowledged receipt and transmitted a copy of the Request for Arbitration to Ecuador and to the Ecuadorian Embassy in Washington D.C.
76. On 7 October 2004, the Secretary General of ICSID registered the Request for Arbitration and notified the parties of the registration in accordance with Rules 6 and 7 of the Institution Rules. The Secretary General further invited the parties to proceed to the constitution of an Arbitral Tribunal.
77. In the absence of an agreement between the parties, on 9 December 2004, Duke elected to submit the arbitration to a panel of three arbitrators pursuant to Article 37(2)(b) of the ICSID Convention and appointed Dr. Enrique Gómez Pinzón, a national of Colombia, as arbitrator. On 10 January 2005, Ecuador appointed Prof. Albert Jan van den Berg, a national of the Netherlands, as arbitrator. On 4 May 2005, the parties agreed to appoint Prof. Gabrielle Kaufmann-Kohler, a national of Switzerland, as the President of the Tribunal
78. In accordance with Rule 6(1) of the ICSID Rules of Procedure for Arbitration Proceedings (“Arbitration Rules”), the Secretary General of ICSID notified the parties, on 18 May 2005, that all three arbitrators had accepted their appointments and that the Tribunal was therefore deemed to be constituted and the proceedings to have begun on that date. The same letter informed the parties that Mr. José Antonio Rivas, ICSID Counsel, would serve as Secretary to the Tribunal. By letter of 27 December 2005 from the Centre, the Tribunal was informed that Mr. Gonzalo Flores, ICSID Senior counsel, would replace Mr. Rivas as the Secretary of the Tribunal.
79. The Arbitral Tribunal and the parties held the first session of the Arbitral Tribunal at the seat of the Centre in Washington, D.C., on 15 June 2005. During the first session, the parties in particular agreed to the constitution of the Tribunal and to the application of the Arbitration Rules which came into force on 1 January 2003, and of certain additional procedural rules. The Minutes of the First Session further provided for two alternative procedural timetables depending on whether jurisdictional objections were

raised by the Respondent. In the event that jurisdictional objections were raised, the timetable provided for further alternatives depending on whether the proceedings on jurisdiction and on the merits would be joined. It was also specified that the language of the proceedings would be English and Spanish and that the Tribunal would render its decision and award in both languages.

## **2. PRE-HEARING WRITTEN PHASE**

80. In accordance with the timetable agreed on during the first session and revised upon the parties' request on 9 January 2006, the parties filed the following written briefs with accompanying submissions.
81. On 2 September 2005, the Claimants submitted their Memorial in Chief accompanied by supporting documents (Cl. Exh. 001-117), as well as the witness statements of Messrs. Gustavo Larrea Real, Mickey John Peters, John Theodore Sickman, Ramiro Tumbaco, Dr. Jacinto Velázquez Herrera, Dr. Santiago Velázquez Coello, and the expert reports of Mr. Brent C. Kaczmarek, Prof. Dr. Rudolf Dolzer, Dr. Juan Larrea Holguín and Dr. Alejandro Ponce Martínez.
82. The Respondent informed the Tribunal by a letter of 1 November 2005 that it would raise objections to jurisdiction that could be joined to the merits. On 2 November 2005, the Arbitral Tribunal thus confirmed that the objections to jurisdiction would be joined to the merits and that the timetable provided in the Minutes of the first session for such situation would be followed.
83. On 22 November 2005, the Respondent filed its Answer to the Memorial in Chief accompanied by supporting documents (R. Exh. 001-115) and legal authorities (R. Exh. D-001-075), as well as the witness statements of Messrs. Hernán Salgado Pesantes, Galo García Feraud, Walter Spurrier Baquerizo, Edgar Santos Játiva and Ms. Ximena Cárdenas Yandún, and the expert reports of Messrs. Nico Schrijver, Luis Parraguez Ruiz, Juan Pablo Aguilar, Alfredo Mancero Samán.
84. On 18 January 2006, the Claimants submitted their Reply Memorial and Counter-Memorial on Jurisdiction accompanied by Exhibit 118, the witness statement of Mr. Wilson Vergara, the rebuttal witness statements of Messrs. Gustavo Larrea Real and Ramiro Tumbaco, and the rebuttal expert reports of Mr. Brent C. Kaczmarek, Prof. Dr. Rudolf Dolzer, Dr. Juan Larrea Holguín and Dr. Alejandro Ponce Martínez.

85. The Arbitral Tribunal issued Procedural Order No. 1 ("PO 1") on 24 February 2006, denying the Respondent's request of 6 February 2006 regarding the alleged broad scope of the Claimant's rejoinder.
86. On 6 March 2006, the Respondent filed its Reply on Jurisdiction and Rejoinder on the Merits accompanied by supporting documents (R. Exh. 116-124) and legal authorities (R. Exh. D-076-097), as well as the witness statements of Messrs. Pablo Terán Ribadeneira, Raúl Baca Carbo, Fidel Jaramillo, the rebuttal witness statements of Messrs Edgar Santos Játiva and Ms. Ximena Cárdenas Yandún, and the rebuttal expert reports of Messrs. Nico Schrijver, Luis Parraguez Ruiz, Juan Pablo Aguilar, Alfredo Mancero Samán. On 6 March 2006, the Secretary of the Tribunal informed the Arbitral Tribunal and the parties that it was distributing a written statement submitted by Dr. Vladimiro Álvarez Grau.
87. On 14 March 2006, the President of the Arbitral Tribunal and the parties held a pre-hearing telephone conference pursuant to Article 12 of the Minutes of the first session, in order to discuss any outstanding organizational matters. Decisions made during the pre-hearing telephone conference were restated in Procedural Order No. 2 ("PO 2") of 23 March 2006.
88. On 31 March 2006, the parties simultaneously exchanged their lists of witnesses and experts for the hearing.
89. On that same date, the Claimants filed their Rejoinder on Jurisdiction, together with supporting documents (Cl. Exh. 119) and the rebuttal expert opinion of Prof. Dr. Rudolf Dolzer.

### **3. HEARING**

90. The Arbitral Tribunal and the parties held the hearing on jurisdiction and the merits from 24 to 27 April 2006 at the seat of the Centre in Washington, D.C.
91. The following witnesses and experts testified on behalf of Duke at the hearing:
  - Gustavo Larrea Real
  - Mickey John Peters
  - John Theodore Sickman
  - Ramiro Tumbaco

- Alejandro Ponce Martínez
- Brent C. Kaczmarek

The following witnesses and experts testified on behalf of Ecuador at the hearing:

- Edgar Santos Játiva
- Pablo Terán Ribadeneira
- Vladimiro Álvarez Grau
- Luis Parraguez Ruiz
- Alfredo Mancero Samán
- Walter Spurrier Baquerizo.

92. An audio-recording and a verbatim transcript of the hearing were made and later distributed to the Tribunal and the parties (“Tr.”).

#### **4. POST-HEARING WRITTEN PHASE**

93. On 4 May 2006, the Arbitral Tribunal issued Procedural Order No. 3 (“PO 3”) in which it confirmed and supplemented the decision made at the end of the hearing. Specifically, it granted both parties time limits for their post-hearing briefs and, without limiting the parties’ freedom to put forward any aspect deemed appropriate, it invited the parties to address certain specific matters.
94. On 30 June 2006, the parties simultaneously submitted their First Post-Hearing Brief and their submissions on costs.
95. On 21 July 2006, the parties simultaneously submitted their Second Post-Hearing Brief and further submissions on costs.
96. On 30 August 2007, counsel for the Claimants submitted a letter to the Centre, calling the Tribunal’s attention to certain “new facts.” By email of 31 August 2007, counsel for the Respondent requested the ICSID Secretariat not to transmit the above letter to the Tribunal “*until the parties have been heard on the question of further submissions on points of fact and law.*” By letter of 4 October 2007, the Secretary, acting on behalf of the Tribunal, invited the parties to state their position on this matter and informed them that the Tribunal was close to completing its task and to communicating its findings to

the parties. By letter of 12 October 2007, the Claimants withdrew their letter of 30 August 2007.

97. On 11 June 2008, the Tribunal declared the proceedings closed pursuant to Rule 38(1) of the Arbitration Rules.

### **III. PARTIES' POSITIONS**

98. The positions of the parties are summarized in this Chapter and will be further elaborated upon in the Chapter entitled "Analysis" as and when a specific issue is reviewed.

#### **1. PARTIES' POSITIONS ON JURISDICTION**

99. The Claimants invoke the ICSID arbitration provision contained in the Arbitration Agreement and alternatively Article VI of the "Agreement between the United States of America and the Republic of Ecuador Concerning the Reciprocal Promotion and Protection of Investments", dated 27 August 1993 (the "BIT" or "Treaty"), which entered into force on 11 May 1997 (Exh. C-48 RforA and Cl. Exh. 003) to support their complaint regarding the following conduct of the Respondent:

- (i) late and inappropriate implementation of the Payment Trusts;
- (ii) non-payment of interest on late payments;
- (iii) wrongful imposition of fines and penalties;
- (iv) disregard of customs duties application; and
- (v) failure to entertain the Claimants' suits under local arbitration.

#### **1.1 Ecuador's objections to jurisdiction**

100. Ecuador acknowledges the Tribunal's jurisdiction for disputes regarding fines and penalties pursuant to the Arbitration Agreement but objects to the Tribunal having jurisdiction over claims relating to the Payment Trusts, interest on late payments and customs duties. Ecuador's argument can be summarized as follows:

101. The scope of the Tribunal's jurisdiction, as defined in paragraphs 2 and 3 of the Arbitration Agreement, does not cover claims regarding the Payment Trusts, interest on late payments and customs duties.

102. The Claimants cannot bring additional claims before the Arbitral Tribunal pursuant to the BIT. The parties have agreed that the present proceedings would be based exclusively on the Arbitration Agreement. Therefore, failing express consent by the parties to proceed otherwise, Treaty claims cannot be combined with claims arising out of the Arbitration Agreement.

## **1.2 Duke's response to Ecuador's objections to jurisdiction**

103. In response to Ecuador's objections, the Claimants put the following arguments forward:

- (i) The Arbitration Agreement, at paragraphs 2 and 3, extends the Tribunal's jurisdiction over all of the claims.
- (ii) In the event that the Tribunal were to consider that its jurisdiction does not extend to matters of Payment Trusts, interest on late payments and customs duties under the Arbitration Agreement, the BIT provides a parallel basis for jurisdiction and the Claimants would thus be entitled to submit these three claims pursuant to the BIT. Neither the Arbitration Agreement nor the ICSID Convention prevent parties from combining their claims in a single arbitration. The Arbitration Agreement was not meant as a waiver of the Claimants' right to pursue any potential claims under the BIT.

## **2. PARTIES' POSITIONS ON THE MERITS**

### **2.1 Duke's position**

#### ***2.1.1 Duke's arguments***

104. Duke has made the following main contentions:

- (i) Ecuador failed to meet its obligation to establish the Payment Trusts prior to commercial operation. It has generally breached the payment regime of the PPAs by not complying with the calendar and manner of performing payments – including poor implementation of the Payment Trusts – and with the penalty regime, by assessing fines both without justification and in violation of the agreed time frames. It has also breached the customs duties regime of the PPAs in violation of the PPAs, Ecuadorian law and its general obligation of good faith.
- (ii) Article II(3)(c) of the BIT constitutes an umbrella clause, which entails that Ecuador is bound to observe any and all obligations – including contractual ones



– with regard to the investment and, namely, its payment obligations and the penalty and customs duties regimes under the PPAs.

- (iii) Ecuador has failed to treat Duke's investment fairly and equitably pursuant to Article II(3)(a) of the BIT.
  - (iv) Ecuador has breached Article II(3)(b) of the BIT and impaired the Claimants' investment by arbitrary conduct.
  - (v) Ecuador has failed to provide the Claimants with effective means of asserting claims and enforcing rights with respect to their investment, in violation of Article II(7) of the BIT, which amounts to a denial of justice.
105. As a result, the Claimants request the Tribunal to declare that Ecuador has breached the PPAs, the Payment Trust Agreements, Ecuadorian law and the BIT and that they are therefore entitled to damages for the impairment of their investment and the losses suffered by Electroquil.

### **2.1.2 Duke's prayers for relief**

106. In their Reply, the Claimants request the following relief:

*Claimants hereby respectfully request the following relief, which reflects, inter alia, supplemental damage calculations performed since the time of Claimants' initial filing:*

1. a. *The amount of US\$ 24,720,904, representing Electroquil's damages as a result of Ecuador's unlawful conduct. This amount includes interest, compounded annually, through December 31, 2005. See Table 2 to Expert Reply Report of Brent C. Kaczmarek, CFA*
- b. *In the alternative to the amount stated in (1)(a), the amount of US\$ 19,263,434, representing the impairment to the value of DEI's investment in Electroquil as a result of Ecuador's unlawful conduct. This amount includes interest, compounded annually, through December 31, 2005. See paragraph 67 to Expert Report of Brent C. Kaczmarek, CFA*
2. *The amount of US\$ 358,954, representing the damages incurred based on Ecuador's denial of justice, measured by the costs incurred in arbitration in Guayaquil. This amount includes interest, compounded annually, through December 31, 2005. See Table 5 to Expert Reply Report of Brent C. Kaczmarek, CFA*
3. *All costs and attorneys' fees associated with this arbitration*
4. *Post-December 31, 2005 pre-award and post-award interest, as appropriate in light of the other items of relief requested, at the highest lawful rate*
5. *Such other and further relief as the Tribunal may deem appropriate*

(Cl. Reply, pp. 121-122)

107. In their 1<sup>st</sup> PHB, the Claimants make the following final request:

*Claimants respectfully request that their claims be heard in their entirety, that their requested relief be granted, that they be awarded interest at the applicable rate until the time of payment, that all costs and attorneys' fees associated with this arbitration be awarded against Respondent, and that the Tribunal award such other and further relief as the Tribunal may deem appropriate.*

(Cl. 1<sup>st</sup> PHB, p. 121)

## **2.2 Ecuador's position on the merits**

### **2.2.1 Ecuador's arguments**

108. In its written and oral submissions, Ecuador has raised the following main contentions:

- (i) The facts of the case do not establish any violation of the Payment Trusts, of the PPAs, nor more generally, any violation of Ecuadorian Law or the BIT.
- (ii) The scope of the umbrella clause in Article II(3)(c) of the BIT does not cover Ecuador's conduct in the present case, as such a provision requires that the host State breach its obligations in its sovereign capacity. At any rate, Ecuador denies any breach of its obligations under the PPAs, whether with respect to payment or fines, and in relation to customs duties.
- (iii) Ecuador has not violated its obligation to provide fair and equitable treatment guaranteed in Article II(3)(a) of the BIT. This obligation cannot be extended beyond the standards provided by customary international law; it does not protect the investor from commercial risk.
- (iv) Ecuador denies any discriminatory or arbitrary conduct within the meaning of Article II(3)(b) of the BIT.
- (v) Ecuador has not violated its duty to provide an adequate and impartial dispute resolution forum as set forth in Article II(7) of the BIT.
- (vi) Duke is not entitled to any damages for the impairment of its investment.

### **2.2.2 Ecuador's prayers for relief**

109. In its 2<sup>nd</sup> PHB, Ecuador requests the following relief:

*On the basis of the evidence submitted throughout this proceeding, the Republic of Ecuador ratifies its request to the Tribunal:*

- a) *To uphold the objections to jurisdiction, limiting its ruling on the merits to the dispute over the fines;*

- b) *To reject the Claimants' request for reimbursement of the value of the fines with their respective interest, as it is a purely contractual matter over which no conduct from the Republic of Ecuador that can be considered in breach of the BIT has been proven; and*
- c) *To order the Claimants to pay the costs and expenses associated to this proceeding, for having advanced a frivolous claim. In no other way can be qualified the attempt to bring before the Tribunal matters that clearly fall outside the scope defined by the Arbitration Agreement, with the obvious purpose of increasing the value of a claim that should have been brought before the courts envisaged in the contract.*

(R. 2<sup>nd</sup> PHB, ¶ 137, Spanish original, Tribunal's translation)

#### **IV. ANALYSIS**

110. Before turning to the analysis of the jurisdiction (2), the applicable law (3), and of the merits (4), the Tribunal wishes to briefly address certain preliminary matters (1).

##### **1. PRELIMINARY OBSERVATIONS**

111. The Tribunal is faced with two complex issues: first, the potential combination of two different bases for ICSID jurisdiction: the Arbitration Agreement and the BIT, and secondly, the dual invocation of the BIT as a basis for jurisdiction and as the applicable law under the Arbitration Agreement.

112. The Claimants invoke the Arbitration Agreement as the primary basis for the Tribunal's jurisdiction. Only as an alternative option – in the event of lack of jurisdiction under the Arbitration Agreement – they rely on the BIT for the rest of their claims. They have not invoked the BIT as a general basis for jurisdiction, nor has it been discussed as such by the parties.

113. In addition, in their Memorial in chief, the Claimants initially distinguished between violations of the PPAs and Ecuadorian law on the one hand, and violations of the BIT on the other. In their subsequent submissions, however, they focused on violations of the BIT, while stating in general terms, in a footnote in their first PHB, that they did not waive prior arguments.

114. While the Respondent opposes the invocation of the BIT as a basis for jurisdiction, it expressly acknowledges the application of the BIT as part of the “substantive framework” of the disputes covered by the Arbitration Agreement. It insists, however, that the principal source of law be, in any event, Ecuadorian Law.

115. Accordingly, the Tribunal will first determine the proper basis for its jurisdiction (2) and the applicable law (3). It will then proceed to examine the Claimants' claims in light of the contractual provisions and Ecuadorian law (4.1), to then determine whether Ecuador's conduct breached the BIT (4.2). Finally the Tribunal will analyze the arguments regarding damages and decide whether the Claimants are entitled to compensation.
116. Before turning to its analysis, the Tribunal would like to comment on the relevance it will accord to ICSID precedents in this case since both parties have relied extensively on previous ICSID decisions and awards in support of their position, either to conclude that the same solution should be adopted in the present case or in an effort to explain why this Tribunal should depart from that solution.
117. While the Tribunal considers that it is not bound by previous decisions, it is of the opinion that it must pay due consideration to earlier decisions made by other international tribunals. It believes that, subject to compelling contrary grounds, it has a duty to consider the solutions consistently established in prior similar cases. Subject to the specifics of a given treaty and of the circumstances of the case under review, it has a duty to seek to contribute to the harmonious development of investment law, and thereby to meet the legitimate expectations of the community of States and investors towards establishing certainty in the rule of law<sup>2</sup>.

## **2. JURISDICTION**

118. There is no dispute as to the jurisdiction of this Tribunal to decide the jurisdictional challenges raised by Ecuador (Art. 41 of the ICSID Convention). The issue of jurisdiction has been joined to the merits of the dispute with the result that the Tribunal will deal with it as a preliminary matter within the present award (Art. 41(2) of the ICSID Convention).
119. Given that the principal basis for jurisdiction invoked by the Claimants is the Arbitration Agreement, the Tribunal will analyze its jurisdiction under the agreement and will determine which of the claims are encompassed by it (2.1.1). Having done so, it will proceed to verify whether the conditions imposed by the ICSID Convention are fulfilled with regard to these claims (2.1.2). The Tribunal will subsequently examine whether the Claimants can rely upon the BIT as an additional basis for jurisdiction for the claims not

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<sup>2</sup> On the precedential value of ICSID decisions, Gabrielle Kaufmann-Kohler, *Arbitral Precedent: Dream, Necessity or Excuse?* *Arbitration International* 2007, p. 357.

covered by the Arbitration Agreement (if any) and, in the affirmative, whether the requirements for jurisdiction under the ICSID Convention and the BIT are met (2.2).

## 2.1 Tribunal's jurisdiction under the Arbitration Agreement

120. The Arbitration Agreement (Cl. Exh. 025) contains the following relevant provisions:

2. *If the Parties fail to reach an agreement within 70 days, as provided in Item 1, following the date this Agreement is signed, the RDE and the Investors agree to submit the differences described in Item 3 of this instrument to the International Center for Settlement of Investment Disputes (the "Center") for full and final resolution by legal arbitration pursuant to the 1965 Convention on the Settlement of Investment Disputes Between States and Nationals of Other States ("ICSID Convention") and the Treaty between the United States of America and the Republic of Ecuador on Promotion and Protection of Investments signed on August 27, 1993, in effect since May 11, 1997 (the "Treaty").*
3. *The following differences are defined as the "differences related to or originating from an investment" for the purposes of said Convention, of the Parties' consent established in Item 2, of the ICSID Convention, and of the Treaty: **Any and all claims, controversies, complaints, and causes originating from or in connection with (i) the fines and penalties imposed by the RDE based on the Power Purchase Agreement signed on October 31, 1995 with ELECTROQUIL S.A. (PPA 95), plus interest, and any other matter and/or agreement related to said concerns, (ii) the fines and penalties imposed by the RDE under the Power Purchase Agreement signed on August 8, 1996 with ELECTROQUIL S.A. (PPA 96), plus interest, and any other matter and/or agreement related to said concerns.***
4. *The Parties waive the right to challenge the jurisdiction of any arbitration court constituted under this Agreement.*
5. *PPA 95, PPA 96, and the interest of Duke Energy Electroquil in Electroquil will constitute jointly and separately and "investment" for the purposes of the ICSID Convention.*
- [...]
9. *The Court will rule on the Differences regarding Investment in accordance with the laws of the Republic of Ecuador and the applicable principles of International Law. All matters related to the validity, efficacy, application or interpretation of this Agreement will be resolved by the Court in accordance with International Law. [...]*
- [...]
12. *The Arbitration held pursuant to this Agreement will be the exclusive means for resolving all Differences related to the Investment. Neither the Investors nor the RDE will perform any act or initiate any proceeding to detain, prevent or terminate the arbitration proceeding provided hereunder.*
13. *At the end of the seventy-day period provided in the first item hereunder, the RDE will not demand that the Investors exhaust local administrative or judicial remedies or any other type of remedy as a condition precedent for giving consent to the arbitration hereunder.*
14. *This Agreement replaces any other agreements or understandings that may have been entered into by the Parties regarding resolution of*

*Differences regarding Investment.* (Emphasis added, Spanish original, English translation provided by the Claimants)

### **2.1.1 The scope of the Arbitration Agreement**

#### **a) Definition of the issue**

121. As noted above, the Claimants object to the following conduct of the Respondent: (i) late constitution and poor implementation of Payment Trusts; (ii) non-payment of interest on late payments; (iii) wrongful imposition of fines and penalties; (iv) disregard of customs duties application; and (v) failure to entertain the claims made in the local arbitration. The Respondent contends that the only basis for jurisdiction is the Arbitration Agreement and that it only covers claims relating to fines and penalties.
122. The Tribunal must establish whether it has jurisdiction to consider all of the Claimants' claims. In order to do so, it must first determine the scope of the Arbitration Agreement: Does it cover only claims relating to fines and penalties and, if so, which claims relate to fines and penalties?
123. The starting point for its analysis are the relevant clauses 2 and 3 of the Arbitration Agreement, mentioned above, that read:
2. *If the Parties fail to reach an agreement within 70 days, as provided in Item 1, following the date this Agreement is signed, **the RDE and the Investors agree to submit the differences described in Item 3 of this instrument to the International Center for Settlement of Investment Disputes (the "Center") for full and final resolution by legal arbitration pursuant to the 1965 Convention on the Settlement of Investment Disputes Between States and Nationals of Other States ("ICSID Convention") and the Treaty between the United States of America and the Republic of Ecuador on Promotion and Protection of Investments signed on August 27, 1993, in effect since May 11, 1997 (the "Treaty").***
  3. *The following differences are defined as the "differences related to or originating from an investment" for the purposes of said Convention, of the Parties' consent established in Item 2, of the ICSID Convention, and of the Treaty: **Any and all claims, controversies, complaints, and causes originating from or in connection with (i) the fines and penalties imposed by the RDE based on the Power Purchase Agreement signed on October 31, 1995 with ELECTROQUIL S.A. (PPA 95), plus interest, and any other matter and/or agreement related to said concerns, (ii) the fines and penalties imposed by the RDE under the Power Purchase Agreement signed on August 8, 1996 with ELECTROQUIL S.A. (PPA 96), plus interest, and any other matter and/or agreement related to said concerns.*** (Emphasis added, Spanish original, English translation provided by the Claimants)

**b) Parties' positions**

124. It is the Respondent's view that the phrase "*originating from or in connection with*" contained in paragraph 3 of the Arbitration Agreement must be interpreted restrictively and relates only to the claims for fines and penalties. Neither the claim for customs duties nor the claim for interest on late payments relate to fines and penalties. The former has been awaiting a decision of the Ecuadorian Supreme Court since March 2004, meaning a contrario, that it was not covered by the Arbitration Agreement entered into in April 2004 (Counsel for the Respondent, Tr. pp. 98-100). The Respondent finds support in Electroquil's letter of 26 April 2004, which it reads as confirmation that the parties intended to exclude such claims from the scope of the Arbitration Agreement.
125. By contrast, the Claimants argue that the Arbitration Agreement should receive a broad interpretation and that the parties had intended to arbitrate the entirety of their disputes before an ICSID tribunal. The phrase "*any and all claims, controversies, complaints and causes of action arising out of or in connection with*" is the result of due consideration and negotiation. It was included to ensure that any differences could be submitted to an ICSID tribunal. In this respect, the Claimants evoke the same letter of 26 April 2004 from Electroquil to the Ecuadorian Government, in which they state that their understanding of the Agreement was disclosed to Ecuador at the time the Arbitration Agreement was entered into. In addition, the Claimants allege that Mr. Larrea, Electroquil's Executive President, explicitly required that the words "*matter and/or agreement*" be added to the wording of paragraph 3.
126. The Claimants insist further that claims for interest on late payments are connected with the claims related to fines and penalties, as Ecuador improperly used fines and penalties to offset Ecuador's outstanding payment obligations. The Claimants have never waived their rights nor released their claims regarding delayed payment interest. Similarly, customs duties were paid in connection with the importation of a turbine, which was needed to implement the PPAs.

**c) Tribunal's determination**

127. In view of the parties' divergences as to the scope of the relevant provisions of the Arbitration Agreement, the Tribunal first needs to determine the applicable principles for their interpretation (i). On the basis of its findings, it will then proceed to interpret these provisions (ii).

(i) *Principles governing the interpretation of the Arbitration Agreement*

128. The parties have specified in paragraph 9 of the Arbitration Agreement that “[a]ny issue concerning the validity, efficacy, construction, scope or interpretation of this [Arbitration] Agreement shall be decided by the Tribunal in accordance with International Law”.
129. Must consent to arbitration be interpreted restrictively, as the Respondent claims, or broadly, as the Claimants submit? Numerous decisions – ranging from *Holiday Inns v. Morocco* to *Tradex v. Albania*, including *Amco v. Indonesia*, *SOABI v. Senegal* and *SPP v. Egypt*, to which Ecuador refers – have insisted on the need to interpret the real intentions of the parties in light of the circumstances and have refused to consider sovereignty as a factor limiting a State’s consent to arbitrate.
130. Without addressing the details of these decisions, the Tribunal is of the opinion that the middle ground approach advocated in *SPP v. Egypt* is appropriate when interpreting a State’s consent to ICSID jurisdiction:

*Thus, jurisdictional instruments are to be interpreted neither restrictively nor expansively, but rather objectively and in good faith, and jurisdiction will be found to exist if – but only if – the force of the arguments militating in favor of it is preponderant<sup>3</sup>.*

131. This middle ground approach is echoed by other ICSID Tribunals, such as the tribunal for *ČSOB v. The Slovak Republic*<sup>4</sup>:

*[I]n determining how to interpret agreements to arbitrate under the ICSID Convention, the Tribunal is guided by an ICSID decision [Amco v. Indonesia] which held that ‘a convention to arbitrate is not to be construed restrictively, nor, as a matter of fact, broadly or liberally. It is to be construed in a way which leads to find out and to respect the common will of the parties [...] Moreover [...] any convention, including conventions to arbitrate should be construed in good faith, that is to say by taking into account the consequences of the commitments the parties may be considered as having reasonably and legitimately envisaged’. (footnote omitted)*

132. In ascertaining the parties’ real intentions, a tribunal looks inter alia to the expectations of the parties in light of the agreement seen as a whole<sup>5</sup>. The importance of the parties’

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<sup>3</sup> See *Southern Pacific Properties (Middle East) and Southern Pacific Properties Ltd v. The Arab Republic of Egypt*, ICSID Case No. ARB/84/3, Decision on Jurisdiction, 14 April 1988, 3 ICSID Reports 143/4.

<sup>4</sup> *Ceskoslovenska Obchodni Banka, A.S. (CSOB) v. The Slovak Republic*, ICSID Case No. ARB/97/4, Decision on Jurisdiction, 24 May 1999, ¶ 35, 14 ICSID Rev. – FILJ 251 (1999).

<sup>5</sup> See *Amco Asia Corp. v. Republic of Indonesia*, ICSID Case No. ARB/81/1, Award of 25 September 1983, ¶ 14, 1 ICSID Reports 389.



reasonable and legitimate expectations in interpreting arbitration agreements has, for instance, been emphasized in *SOABI v. Senegal*<sup>6</sup>:

*In other words, the interpretation must take into account the consequences which the parties must reasonably and legitimately be considered to have envisaged as flowing from their undertakings. It is this principle of interpretation, rather than one of a priori strict, or, for that matter, broad and liberal construction, that the Tribunal has chosen to apply.*

(ii) *Interpretation of the relevant provisions of the Arbitration Agreement*

133. Having identified the relevant principles of interpretation under the applicable international law, the Tribunal will now examine whether the parties' intent, expressed in paragraph 3 of the Arbitration Agreement, was to submit all of the claims at stake to ICSID arbitration.

134. In order to establish their intent, the parties have taken recourse to contemporary documents relating to the Agreement. Two of these documents appear to be of particular relevance. First, the authorization of the Attorney-General to sign the Arbitration Agreement dated 26 April 2004, which is attached to the Agreement as "supporting documentation" (in the Claimants' translation) or "*documentos habilitantes*" in the original Spanish version. In his authorization, the Attorney-General states that "[...] *the State Attorney General authorizes submitting the dispute, related exclusively to fines or penalties arising from the execution of the mentioned contracts, to international arbitration*" (Spanish original, Tribunal's translation). As a "*documento habilitante*", this authorization sets the limits on the State's consent to arbitration. It is therefore clear that the State did not intend to give its consent to arbitrate disputes other than those related to fines and penalties.

135. Second, the Claimants invoke a letter from Mr. Larrea, Executive President of Electroquil, to the Minister of Energy and Mines of the same day as the Attorney-General's authorization, i.e. 26 April 2004, which is also the date of the execution of the Arbitration Agreement. On such date, Mr. Larrea wrote to the MEM regarding the amendments to be made to the draft Arbitration Agreement that had been submitted to Electroquil (Cl. Exh. 118). The pertinent parts of this letter read as follows:

*The following disputes are defined as the "disputes related to or arising from an investment" for the purposes of this Agreement, the consent of the Parties established in Paragraph 2, the ICSID Convention, and the Treaty: Any and all claims, controversies, demands and causes of action arising from or in connection with (i) the fines and penalties imposed by the RDE based on the Power Purchase Agreement entered into on October 31, 1995*

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<sup>6</sup> *SOABI v. Senegal*, ICSID Case No. ARB/82/1, Award, 25 February 1988, ¶ 4.10, ICSID Rev. – FILJ 125 (1991).

with ELECTROQUIL S.A. (PPA 95), and any interest thereon and any other matter and/or agreement related to such items, (ii) the fines and penalties imposed by the RDE under the Power Purchase Agreement entered into on August 8, 1996 with ELECTROQUIL S.A. (PPA 96), and any interest thereon and any other matter and/or agreement related to these items.

[...]

*In addition to the foregoing, and independently thereof, Duke notes for the record that the exclusion in Paragraph 3 of the Agreement proposed by the Government of any reference to the subject of customs duties payable for the importation of the turbines as well as any other matter related to the investors' business operation in Ecuador, may not be interpreted as either an agreement or acquiescence by Duke or its subsidiary ELECTROQUIL to the effect that any dispute related to such subjects is not arbitrable. (Emphasis added, English version provided by the Claimants)*

136. Electroquil's addition of the words "*and/or agreement*" just quoted features in the final executed version of the Arbitration Agreement. The Claimants argue that Electroquil made this addition specifically to ensure that the Liquidation Agreements and the Med-Arb Agreements would be covered (Cl. Mem., ¶ 56). In his witness statement, Mr. Larrea also explains that the second paragraph of his letter of 26 April 2004 concerning customs duties insisted for such claims to become subject to the same arbitration (WS, ¶ 81).
137. The Tribunal cannot follow these arguments. First, they run contrary to the clear wording of the letter of the Attorney-General of the same date. Second, they are inconsistent with the Tribunal's understanding of the second paragraph of Mr. Larrea's letter. Indeed, it understands this passage to mean that, while Duke accepted that claims for customs duties would not be covered by the Arbitration Agreement, it did not acknowledge that they may not be submitted to arbitration at all. As a result, the Tribunal interprets the parties' intent to be that the Arbitration Agreement covers only claims relating to fines and penalties.
138. This said, the language referring to "*finer and penalties*" is broad. Terms such as "*any and all claims, controversies, complaints, and causes originating from or in connection with*" as well as "*any other matter and/or agreement related to said concerns*" appear to include a wide range of claims, provided these claims relate to "*finer and penalties*". The Tribunal must thus determine whether the claims regarding late payment, the Payment Trusts, the Med-Arb Agreements, and the customs duties are covered by the Arbitration Agreement because they bear a connection with fines and penalties and/or any agreement related to these items.
139. First, the Tribunal considers that the late payment of Electroquil's invoices was indeed connected with the imposition and disbursement of penalties. In this context, it notes the Claimants' contentions that Ecuador improperly used the fines and penalties to

offset Ecuador's outstanding payment obligations, that only 37 out of 122 invoices issued by Electroquil were paid within 30 days, and that, in any event, payment rarely covered the entire invoiced amount (1<sup>st</sup> ER Kaczmarek, ¶¶ 49 and 50). More importantly, it observes that the 96 Liquidation Agreement refers to the "*finas deducted from the amounts invoiced by Electroquil*" (Spanish original, Tribunal's translation). Similarly, the opinion of the attorney of the MEM on the Arbitration Agreement states that fines of USD 7,982,187 were imposed on Electroquil and that this amount was "*deducted from Electroquil's outstanding invoices*" (R. Exh. 117, Spanish original, Tribunal's translation).

140. Second, the Tribunal turns to the connection between the fines and the Payment Trusts. The Claimants argue that Fines No. 1 and No. 2 were unfairly imposed as the delay in starting the units was caused by the late establishment of the Payment Trusts. To this extent, there is a relation between the claims regarding the establishment of the Payment Trusts and the fines. The same is not true with respect to the implementation of the payment guarantee, which the Claimants also allege to have been violated. Indeed, none of the fines shows a link to the implementation of the Payment Trusts. Therefore, the Tribunal is of the opinion that, in accordance with the parties' intent, it has jurisdiction under the Arbitration Agreement over any claim in connection with the establishment of the Payment Trusts but not their implementation. It will review below whether it has jurisdiction over such latter claims on the basis of the BIT.
141. Third, the Tribunal finds that the Med-Arb Agreements were directly related to fines and penalties. They were the initial recourse used by the Claimants to settle the disputes concerning fines levied from 1996 to 1998 (i.e. fines Nos. 1 to 7). This is recognized in the 95 and 96 Liquidation Agreements and further acknowledged by the Respondent in its Reply: "*The proper understanding is that there must be a direct relationship with the fines [footnote omitted], as is the case of the claims submitted to local arbitration*" (R. Reply, ¶ 33, Spanish original, Tribunal's translation).
142. By contrast, the Tribunal does not see any connection between the customs duties and the fines and penalties. The customs duties are connected with the imposition of taxes; they are not related to any contractual mechanisms for the imposition of fines and penalties.
143. On the basis of these considerations, the Tribunal considers that it has jurisdiction under the Arbitration Agreement to decide over the claims presented in this arbitration, except those relating to the implementation of the Payment Trusts and to the customs duties.

144. The Tribunal must now consider whether the requirements of the ICSID Convention are met in connection with the claims for which it has jurisdiction under the Arbitration Agreement (2.1.2). It will subsequently determine whether it has jurisdiction over the claims regarding the implementation of the Payment Trusts and the customs duties on the basis of the BIT since the Claimants have relied upon the Treaty in the event that the Tribunal denies jurisdiction under the Arbitration Agreement (2.2).

### **2.1.2 ICSID jurisdictional requirements**

145. The jurisdictional requirements are set forth in Article 25(1) of the ICSID Convention in the following terms:

*The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by that State) and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre. When the parties have given their consent, no party may withdraw its consent unilaterally.*

146. Ecuador does not challenge the fact that (i) the disputes regarding fines and penalties are of a legal nature; (ii) they arise directly out of an investment; (iii) they exist between a contracting State and a national of another contracting State; and (iv) they have been submitted in writing to ICSID arbitration within the meaning of Article 25(1) of the ICSID Convention (R. Answer, ¶ 48). Moreover, the Tribunal assesses that, in paragraph 4 of the Arbitration Agreement, the parties agree that they would not challenge the Tribunal's jurisdiction over the disputes described in its paragraph 3.

147. The Tribunal notes, in particular, that the parties have agreed, in paragraph 5 of the Arbitration Agreement, that the Claimants would be treated as nationals of the United States of America. It further observes that, at the time of the Arbitration Agreement, there was no doubt that Electroquil was under foreign control and thereby meeting the requirement established by Article 25(2)(b) of the Washington Convention.

148. The Arbitration Agreement also specifies, in paragraph 5, that the PPAs and the interest which Duke Energy Electroquil holds in Electroquil constitute an investment for the purpose of the ICSID Convention. Hence, the Tribunal will assume here that, for the purposes of the ICSID Convention, both Duke Energy and Electroquil have an investment.

149. The Tribunal is therefore satisfied that the requirements of Article 25(1) of the ICSID Convention are met with respect to the disputes regarding fines and penalties which include:

- claims regarding the establishment of the Payment Trusts;
- claims for interest on late payments of Electroquil's invoices;
- claims for fines and penalties *stricto sensu*; and
- the claim regarding the Med-Arb Agreements.

## **2.2 Alternative jurisdiction under the BIT**

150. The Claimants have invoked the BIT as an additional basis for jurisdiction should certain claims not be covered by the Arbitration Agreement. The Tribunal will now consider whether the BIT can in fact be invoked in the present case.

### **2.2.1 Parties' positions**

151. The Respondent raises three fundamental objections to the Claimants' invocation of the BIT. First, it contends that treaty claims cannot be combined with claims arising out of the Arbitration Agreement. In its view, the Claimants cannot bring claims under the BIT in these proceedings because (i) they failed to invoke such basis in their Request for Arbitration; and (ii) the terms of the Agreement expressly exclude the possibility of cumulating contract-based proceedings with arbitration based on the BIT. Second, the Respondent alleges that customs duties, in any event, relate to tax matters that are outside the scope of the BIT pursuant to Article X(2)(c). Finally, it argues that the Claimants have not met the jurisdictional and procedural requirements under the BIT and the ICSID Convention.

152. To defend their claim for alternative jurisdiction under the BIT, the Claimants argue first that they had expressed their consent under the BIT in their Counter-Memorial (Cl. Reply, ¶ 99) and that claims would, in any event, be admissible as ancillary claims under Article 46 of the ICSID Convention and Arbitration Rule 40. In addition, they assert that nothing in the Arbitration Agreement or the ICSID Convention limits the number of instruments by which consent can be expressed, the sole requirement being that consent be "in writing". Second, the Claimants deny that they request the review of a matter of taxation within the meaning of Article X(2)(c) of the Treaty and state that, even if it were the case, claims for customs duties would fall within the exceptions of Article X(2). Finally, the Claimants submit that the jurisdictional and procedural requirements under both the ICSID Convention and the BIT are met.

## **2.2.2 Tribunal's determination**

153. The Tribunal must first address whether the Claimants properly invoked the BIT (a). It must then consider whether it can assert jurisdiction both under the Arbitration Agreement and the Treaty (b). Finally, the Tribunal must determine whether the claims regarding the implementation of the Payment Trusts and customs duties fall within the scope of the BIT dispute resolution mechanism and, if so, whether the requirements for jurisdiction under the Treaty and the ICSID Convention are met (c to e).

154. Article VI of the BIT reads as follows:

*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.*

*2. In the event of an investment dispute, the parties to the dispute should initially seek a resolution through consultation and negotiation. If the dispute cannot be settled amicably, the national or company concerned may choose to submit the dispute, under one of the following alternatives, for resolution:*

- (a) to the courts or administrative tribunals of the Party that is a party to the dispute; or*
- (b) in accordance with any applicable, previously agreed dispute-settlement procedures; or*
- (c) in accordance with the terms of paragraph 3.*

*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:*

*(i) to the International Centre for the Settlement of Investment Disputes ("Centre") established by the Convention on the Settlement of Investment Disputes between States and Nationals of other States, done at Washington, March 18, 1965 ("ICSID convention"), provided that the Party is a party to such Convention; or*

*(ii) to the Additional Facility of the Centre, if the Centre is not available; or*

*(iii) in accordance with the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL); or*

*(iv) to any other arbitration institution, or in accordance with any other arbitration rules, as may be mutually agreed between the parties to the dispute.*

*(b) once the national or company concerned has so consented, either party to the dispute may initiate arbitration in accordance with the choice so specified in the consent.*

*4. Each Party hereby consents to the submission of any investment dispute for settlement by binding arbitration in accordance with the choice specified in the written consent of the national or company under paragraph 3. Such consent, together with the written consent of the national or company when given under paragraph 3 shall satisfy the requirement for:*

- (a) *written consent of the parties to the dispute for Purposes of Chapter II of the ICSID Convention (Jurisdiction of the Centre) and for purposes of the Additional Facility Rules; and*
  - (b) *an "agreement in writing" for purposes of Article II of the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, done at New York, June 10, 1958 ("New York Convention").*
5. *Any arbitration under paragraph 3(a) (ii), (iii) or (iv) of this Article shall be held in a state that is a party to the New York Convention.*
6. *Any arbitral award rendered pursuant to this Article shall be final and binding on the parties to the dispute. Each Party undertakes to carry out without delay the provisions of any such award and to provide in its territory for its enforcement.*
7. *In any proceeding involving an investment dispute, a Party shall not assert, as a defense, counterclaim, right of set-off or otherwise, that the national or company concerned has received or will receive, pursuant to an insurance or guarantee contract, indemnification or other compensation for all or part of its alleged damages.*
8. *For purposes of an arbitration held under paragraph 3 of this Article, any company legally constituted under the applicable laws and regulations of a Party or a political subdivision thereof that, immediately before the occurrence of the event or events giving rise to the dispute, was an investment of nationals or companies of the other Party, shall be treated as a national or company of such other Party in accordance with Article 25 (2) (b) of the ICSID Convention.*

**a) *The late invocation of the BIT***

155. The Tribunal believes that the fact that the Claimants had not invoked the BIT as basis for jurisdiction until their Counter-Memorial on jurisdiction should not preclude them from relying upon it and agrees with the Claimants that holding otherwise would be excessively formalistic. Indeed, the Claimants have since invoked the BIT as an alternative basis for jurisdiction in response to the Respondent's objections. The Claimants cannot be considered to have waived this basis for jurisdiction by not mentioning it in their Request for Arbitration given that there would have been no grounds for raising such an argument at that point.

**b) *Combined jurisdictional bases***

156. The Tribunal sees nothing in the ICSID Convention that would prevent it from pursuing proceedings relying upon a cumulative basis for jurisdiction. What matters is the "*consent of the parties*". Consent by the parties for ICSID arbitration can take the form of an arbitration clause, or of a general offer by a State in a BIT, or in its national legislation followed by acceptance of this offer by the investor. The only requirement is that such consent be stated in writing<sup>7</sup>. If consent can be verified in both cases, nothing

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<sup>7</sup> Lucy Reed, Jan Paulsson and Nigel Blackaby, "Guide to ICSID Arbitration", (2004) Kluwer Law International, pp.21 et seq.

- seems to prevent cumulative reliance upon the diverse instruments for which such consent is expressed.
157. In the present case, consent for claims relating to fines and penalties is encompassed within the Arbitration Agreement. With regard to other matters relating to the Claimants' investment, Ecuador made an open and general offer for ICSID arbitration in the Treaty that was later accepted by the Claimants when instituting these proceedings and, in particular, when invoking the BIT as a basis for the jurisdiction of the Tribunal.
158. As a second objection against cumulative jurisdiction, the Respondent contends that the terms of the Agreement expressly rule out any reliance upon the BIT. It views paragraph 12, which provides that “[t]he Arbitration held pursuant to this Agreement will be the exclusive means for resolving all Differences related to the Investment” as proscribing the Claimants from commencing ICSID proceedings on the basis of the BIT. The Claimants reply that they did not waive their rights to invoke the BIT by entering into the Arbitration Agreement and that paragraph 12 was included simply to prevent potential conflicts with any other dispute resolution arising out of the parties' relationship.
159. The Tribunal finds that the fact that the parties agreed to submit some of their investment disputes to ICSID arbitration in the Arbitration Agreement, does not in and of itself preclude the Claimants from availing themselves of the Treaty for additional claims outside the scope of the Arbitration Agreement. It is true that the situation would be different had the Claimants specifically waived their right to invoke the Treaty. However, such a waiver, as the Claimants' expert, Professor Dolzer, notes, would have to be explicit and this is not the case<sup>8</sup>.
160. Moreover, paragraph 12 of the Arbitration Agreement and the exclusivity of proceedings contemplated therein only apply to claims encompassed in such Agreement. As neither the customs duties claim nor the claim concerning the poor implementation of the Payment Trusts are encompassed by the Arbitration Agreement, they cannot be affected by this exclusivity.
161. Finally, the Tribunal notes that the Respondent does not generally oppose the submission of these claims to ICSID proceedings under the BIT. It merely objects to their submission in this arbitration, as stated in the Reply: “Of course the Claimants may submit other claims under the BIT, but not in this proceeding” (R. Reply, ¶ 40, Spanish original, Tribunal's translation).

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<sup>8</sup> Second Opinion of Professor Dr. Rudolf Dolzer, 17 January 2006, ¶ 19.



162. Consequently, the Tribunal concludes that there is no reason to rule out reliance upon different bases of jurisdiction for different claims brought in the same ICSID arbitration and that the Claimants have not waived their right to invoke the BIT for claims not covered by the Arbitration Agreement.

**c)        *The implementation of the Payment Trusts and the scope of the BIT***

163. The Tribunal held above that the implementation of the Payment Trusts does not relate to fines and penalties and that it thus lacks jurisdiction under the Arbitration Agreement over claims arising out of such implementation. It follows that the Tribunal must therefore now examine whether it has jurisdiction over this claim on the basis of the BIT following the Claimants' general contention that the BIT could be used as a basis for jurisdiction for any claim not falling under the purview of the Arbitration Agreement. The Tribunal does not ignore that the Claimants did not invoke jurisdiction on this basis with respect to this particular claim. However, assessing jurisdiction in this fashion is in line with their general argument that the BIT constitutes an alternate basis for jurisdiction over claims not within the scope of the Arbitration Agreement. It is also in line with the methodology adopted by the Tribunal above (§ 119) and the duty to ascertain jurisdiction under a treaty *ex officio*.

164. Article VI of the BIT provides that a dispute "*arising out of or relating to*" an investment between a party to the Treaty and a national of the other party which "*cannot be settled amicably*" may be submitted to ICSID arbitration provided it has "*not been submitted for resolution to [other mechanisms]*" and "*six months have elapsed from the date on which the dispute arose*". These requirements have been met.

165. There is no doubt that Duke Energy qualifies as a national of the United States for the purpose of the BIT. Similarly, Electroquil may be deemed a national of the United States for the purpose of the BIT since it can be considered as an "investment" of Duke Energy under Article VI(8) of the BIT.

166. The Tribunal is further satisfied that there is a dispute arising out of or relating to an alleged breach of a right conferred by the Treaty with respect to an investment. In this respect, it notes that Article I(1) of the BIT defines "investment" as including "*a claim to money or a claim to performance having economic value and associated with an investment*" and "*any right conferred by law or contract*".

167. The Tribunal is also satisfied that the dispute could not be settled amicably and that it was not previously submitted to the other resolution mechanisms provided in the Treaty. Indeed, the Med-Arb Agreements do not deal with the implementation of the

Payment Trusts. In addition, the dispute related to the implementation of the Payment Trusts arose more than six months before the Claimants consented to submit it to ICSID arbitration. It follows that the Claimants validly consented to submit the dispute to ICSID, Ecuador's consent being contained in Article VI of the BIT.

168. The Tribunal also notes that the dispute relating to the implementation of the Payment Trusts arose after the Trusts were established, i.e. after 17 February 1998, and thus falls within the scope *ratione temporis* of the BIT.

169. The Tribunal further finds that the requirements of the ICSID Convention are met with regard to this claim as well as in accordance with its earlier findings (¶¶ 145-148).

170. For these reasons, the Tribunal concludes that it has jurisdiction over the dispute arising out of the implementation of the Payment Trusts under the BIT.

**d) Customs duties and the scope of the BIT on matters of taxation**

171. The Respondent alleges that the claim for customs duties is outside the scope of the BIT since it is a matter of taxation excluded by virtue of Article X(2)(c). The Claimants contend that this claim does not involve a matter of taxation within the meaning of Article X(2) of the Treaty, but arises out of the Respondent's failure to reimburse the Claimants for customs charges paid in connection with the importation of a turbine for the power plant pursuant to the PPAs (Cl. 2<sup>nd</sup> PHB, ¶ 46). The Claimants further argue that, even if the claim were to be considered a matter of taxation, it would fall within the exceptions of Article X(2) since the PPAs are "investment agreements" following the ruling rendered in *OEPC v. Ecuador* (Cl. 2<sup>nd</sup> PHB, ¶ 47).

172. Article X(2) of the BIT reads as follows:

*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 or authorization as referred to in Article VI (1) (a) or (b), to the extent they are not subject to the dispute settlement provisions of a Convention for the avoidance of double taxation between the two Parties, or have been raised under such settlement provisions and are not resolved within a reasonable period of time.*

173. Therefore, the Tribunal must answer the following questions: (i) whether the claim for customs duties is a matter of taxation within the meaning of Article X; and, if so, (ii) whether such claim falls within the exceptions provided in paragraph 2 of this Article.

The Tribunal will take recourse to the rules on treaty interpretation of the Vienna Convention on the Law of Treaties, in particular to Article 31, which provides that, “[a] treaty shall be interpreted in good faith and in accordance with the ordinary meaning given to the terms of the treaty in their context [...]”.

174. The Treaty does not define the term “matters of taxation”. In seeking to elucidate its meaning, the ruling in *EnCana v. Ecuador* appears to be of particular relevance. In connection with a provision of the Canada-Ecuador BIT referring to the exclusion of “taxation measures” the tribunal noted that “[i]t is in the nature of a tax that it is imposed by law” and added that “a taxation law is one which imposes a liability on classes of persons to pay money to the State for public purposes”<sup>9</sup>.
175. The exemption from customs duties, which is the subject of this claim, was instituted by *Ley No. 30 de Exoneración de Impuestos a Importaciones del Sector Público para Obras y Servicios Prioritarios* allegedly modified by *Ley Orgánica de Aduanas* of 13 July 1998. These statutes provide for the exemption from duties on goods imported for the needs of an industry that is considered to be a national priority. They also detail the means for determining the scope of such exemptions and nominate the competent authority for their application. From their title and even more from their purpose, *Ley No. 30 and Ley Orgánica de Aduanas* must be deemed to constitute taxation legislation. Indeed, as stated by the EnCana tribunal, “[a] measure providing relief from taxation is a taxation measure just as much as a measure imposing the tax in the first place”<sup>10</sup>. It is therefore clear that the claim for customs duties relates to matters of taxation.
176. The Claimants further allege, in this context, that their claim stems from the application of the terms of the PPAs. The Tribunal is not persuaded by this argument. Although the Claimants cite provisions of the PPAs in their Memorial in Chief, the current dispute relates to the modification of the customs regime established by Law Number 30. To claim an exemption from customs duties, the Claimants have themselves relied upon Ecuadorian tax laws, not upon the PPA 96. In their Memorial in Chief, they note:

[...] based on a request from *Electroquil*, CONADE reaffirmed its view that goods required for the generation of electricity were a priority for the country and therefore eligible for tax-free importation under Law Number 30. *Electroquil* relied upon these representations that all goods that it needed to import in order to comply with the PPAs would be duty exempt.

(Cl. Mem, ¶ 157)

<sup>9</sup> *EnCana Corporation v. Republic of Ecuador*, LCIA Case No. UN3481, UNCITRAL, Award, 3 February 2006, ¶ 142.

<sup>10</sup> *Op.cit.*

177. The Claimants have never explained how the provisions of the PPA 96 applied nor how they interacted with the taxation laws. The Respondent has not provided its views on these provisions either. It appears that it was not a disputed point. Consequently, the Tribunal concludes that the customs duty claim must be deemed a matter of taxation.
178. Further, the Tribunal notes the open wording of Article X(2), which excludes all taxation matters except for those expressly included within the scope of (a) to (c). The scope of Article X(2) was specifically discussed in *OEPC v. Ecuador*, in the award rendered by the LCIA tribunal under the US-Ecuador BIT<sup>11</sup>, and in the subsequent decision by Justice Aikens of the Queen’s Bench Division dismissing Ecuador’s application against the award<sup>12</sup>. This later decision stated that the wording of Article X(2) “*makes it clear that, apart from matters of taxation that come within the three identified exceptions, all matters of taxation are outside the ambit of the BIT*”<sup>13</sup>.
179. Having found that the claim on customs duties relates to matters of taxation, the Tribunal will now examine whether it falls under any of these exceptions. The Claimants allege that their customs duty claim falls under the exemption detailed in Article X(2)(c) of the BIT since it relates to Ecuador’s obligation under the PPAs to reimburse Claimants and because the PPAs are investment agreements. The Tribunal notes that the Claimants do not explain how the PPAs are investment agreements and merely refer to ¶¶ 71-72 of the *OEPC* award.
180. According to Article X(2)(c), claims on matters of taxation are covered by the BIT if they relate to the:

*[...] observance and enforcement of terms of an investment agreement or authorization as referred to in Article VI (1) (a) or (b) to the extent they are not subject to the dispute settlement provisions of a Convention for the avoidance of double taxation between the two Parties, or have been raised under such settlement provisions and are not resolved within a reasonable period of time.*

181. The Tribunal is faced with two questions: (a) whether the PPAs are indeed investment agreements, as referred to in Article VI(1)(a) or (b); and (b) as put by the tribunal in

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<sup>11</sup> This case dealt with the issue of a VAT refund, provided for in the provisions of the participation contract between the foreign investor and the state-owned oil corporation. *Occidental Exploration and Production Company (OEPC) v. The Republic of Ecuador*, LCIA Case No. UN3467, UNCITRAL, Final Award, 1 July 2004.

<sup>12</sup> Second Queen’s Bench Decision, 2 March 2006, [2006] EWHC 345 (Comm).

<sup>13</sup> Second Queen’s Bench Decision, 2 March 2006, [2006] EWHC 345 (Comm), ¶ 93.

*OEPC “whether the observance and enforcement of the terms of an investment agreement concerning matters of taxation is at issue in this dispute”<sup>14</sup>.*

182. While the Treaty offers no definition for “investment agreement”, Article X(2)(c) points to the type of agreement referred to in Article VI(1)(a) in its definition of “investment dispute”:

*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 or relating to (a) an investment agreement between that Party and such national or company [...]*

183. Accordingly, Justice Aikens notes that, for the purposes of Article VI, an investment agreement has to be one that “*is between a State Party and a national or company of the other State Party*”<sup>15</sup>. In this case, the PPAs were entered into by INECEL – a state-owned entity – and Electroquil, a company incorporated in Ecuador that, at the time of subscription of the Agreements, was not owned by foreign investors. It appears therefore that, for the purpose of Article VI(1)(a) – as required by Article X(2)(c) – the PPAs cannot be considered as investment agreements.

184. In addition, the Claimants’ reference to the *OEPC* award is not sufficient to demonstrate the existence of an investment agreement. In fact, the *OEPC* award leads to the opposite conclusion. The *OEPC* case concerned a concession agreement signed between a foreign investor (*OEPC*) and Petroecuador, an Ecuadorian State-owned corporation. The tribunal in that case accepted Ecuador’s argument that the concession contract qualified as an investment agreement in accordance with the *Lanco* Decision “*in so far as this decision identified a concession contract [...] with an investment agreement*”<sup>16</sup>.

185. The same is not true here. First, the PPAs are not concession contracts, but contracts for the installation of certain equipment and the sale and purchase of electricity to INECEL. Second, even if the PPAs were concession contracts, they would still not qualify as investment agreements in the terms of the BIT. The *Lanco* decision did not equate concession contract with investment agreement in general. Applying a clause of the Argentina-USA BIT identical to the one at issue here, it reviewed the position of the parties and their obligations and held as follows:

*This [the existence of an investment for the purposes of applying the Argentina-U.S. Treaty] does not make the Concession Agreement an*

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<sup>14</sup> *OEPC v. Republic of Ecuador, op. cit.*, ¶ 71.

<sup>15</sup> Second Queen’s Bench Decision, 2 March 2006, [2006] EWHC 345 (Comm), ¶ 102.

<sup>16</sup> *Op. cit.* ¶ 44.

*investment agreement, since not all parties are legally situated in like manner. However, it is also clear that insofar as LANCO is a party to this agreement as awardee and guarantor, the Concession Agreement, with respect to the foreign investor, can be characterized as an investment agreement [...]*<sup>17</sup>.

186. Duke Energy did not sign the PPAs nor did it acquire any obligations under their terms. Further, the Ecuadorian State was not a party to such agreements. Accordingly, the Tribunal concludes that the PPAs cannot be deemed investment agreements for the purposes of Article VI(1)(a) – as required by Article X(2)(c).
187. Finally, the Tribunal notes that, even if the PPAs were regarded as investment agreements because of the later involvement of the State and the acquisition of the majority of Electroquil's stake by Duke Energy, the claims on customs duties would still be outside the scope of Article X(2). Indeed, the Tribunal is not satisfied that the dispute relates to the "observance and enforcement" of the terms of the alleged investment agreements. As discussed above, the dispute relates to the modification of the customs regime established by Law Number 30.
188. For these reasons, the Tribunal concludes that the claim for customs duties does not fall within the scope of the BIT. Therefore, it lacks jurisdiction to decide over such claim.
189. In light of this conclusion, it is unnecessary to examine the third objection raised by the Respondent as to the lack of compliance with the jurisdictional requirements under the BIT and the ICSID Convention. As a result, the Tribunal will now turn to analyzing the second of the two questions arising from the particular circumstances of this dispute, which is the question of the applicable law.

### **3. APPLICABLE LAW**

190. The BIT is not only invoked as a basis for jurisdiction but also as the applicable law under the Arbitration Agreement. This distinction does not appear to have always been clearly drawn by the parties during the proceedings, resulting in a certain confusion. The Tribunal has sought to discern the arguments of the parties dealing with the applicable law to reach its conclusion.

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<sup>17</sup> *Lanco International, Inc. v. Argentine Republic*, ICSID Case No. ARB/97/6, Decision on Jurisdiction, 8 December 1998, ¶ 16.

### 3.1 Parties' positions

191. According to the Claimants, the parties unambiguously agreed in the Arbitration Agreement that their disputes would be decided in accordance with the BIT and that the Tribunal would determine the investment dispute “*under the laws of Ecuador and the applicable principles of international law [...] the standard of review being based on the terms of the BIT*” (Cl. Reply, ¶ 204).
192. The Claimants request the application of the substantive standards of the BIT and “*in any event protection and guarantees no less than the minimum standards guaranteed under customary international law*” (Cl. Rejoinder, ¶ 44). In their view, in assessing whether the substantive protections contained in the BIT have been breached, the Tribunal may make reference to Ecuadorian law to the extent that it is not inconsistent with international law (Cl. Reply, ¶ 44). The Claimants' position as to the law governing damages is more complex and has evolved throughout the proceedings. The Tribunal will revert to it in the discussion on damages.
193. The Respondent agrees that the Arbitration Agreement provides that the disputes be resolved in accordance with Ecuadorian law and the principles of international law. The Respondent also acknowledges that the BIT applies as part of international law pursuant to paragraph 9 of the Arbitration Agreement (R. Answer, ¶ 441). Nonetheless, the Respondent considers that the Claimants seek to circumvent the application of domestic law by solely invoking the provisions of the BIT. Like the Claimants, the Respondent's position with respect to the law governing damages will be set forth in the discussion on damages.

### 3.2 Tribunal's determination

#### 3.2.1 Applicable law

194. Article 42(1) of the ICSID Convention contains the following rule:

***The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable.*** (Emphasis added)

195. The parties acknowledge that their agreement in respect of the applicable law is contained in Article 9 of the Arbitration Agreement, which reads as follows:

9. *The Court will rule on the Differences regarding Investment in accordance with the laws of the Republic of Ecuador and the applicable principles of International Law. All matters related to the*

*validity, efficacy, application or interpretation of this Agreement will be resolved by the Court in accordance with International Law. The Court is not authorized to, nor may it, rule on the Differences, either ex aequo et bono or as amiable compositor, or based on any other doctrine or principle other than this Agreement or Applicable Law.*  
(Spanish original, English translation provided by the Claimants)

196. The Tribunal finds that the parties' choice of law is clear: both Ecuadorian law and the principles of international law should apply. The question is whether the reference to the "*applicable principles of international law*" includes the provisions of the BIT. The Claimants allege that the parties unambiguously agreed to such inclusion. The Respondent accepts the application of the BIT as the "*substantive framework*" for the resolution of the disputes covered by the Arbitration Agreement (R. Reply, ¶ 35). In addition, when asked by the Tribunal to explain the reference to the BIT in paragraph 2 of the Arbitration Agreement, counsel for the Respondent answered that "*the BIT helps the parties in defining the precise formulation of the principles of international law that the Tribunal may apply*" (Tr., p. 106). As a result, the Tribunal concludes that the parties intended the reference to "*applicable principles of international law*" to include the BIT standards.

197. Having reached this conclusion, the Tribunal observes that the parties agree, in practice, first to the application of the PPAs and their provisions in light of Ecuadorian law, and second, to the application of the BIT standards. The Tribunal considers this to be the right approach and will consequently follow it in its analysis of the merits. Accordingly, the Tribunal will first review the contractual issues under Ecuadorian law and then the compliance with the BIT standards. The standards which apply to the damages will be addressed if and when the issue arises.

### **3.2.2 Application *ratione personae/temporis* of the BIT**

198. Before turning to the examination of the Respondent's conduct, the Tribunal will address the question of the application *ratione temporis* and *ratione personae* of the substantive provisions of the Treaty<sup>18</sup>.

199. While the Claimants apply the BIT standards to all of their claims without distinction, the Respondent's position has evolved during the proceedings. It initially claimed that the BIT should apply only to investments made after 23 February 1998, i.e. after Duke Energy acquired ownership in Electroquil (R. Answer, ¶ 441). Later, in its discussion on damages, the Respondent argued that only acts subsequent to the entry into force of

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<sup>18</sup> This issue was not discussed in the analysis on jurisdiction as the Tribunal preferred examining it after having made a determination as to the applicable law.



the BIT, on 11 May 1997, could be taken into account (R. Answer, ¶ 563). In its Reply, it noted<sup>19</sup>:

*[...] The Arbitration Agreement considerably broadens the scope of jurisdiction that the tribunal would have had, should the Claimants have instituted proceedings solely under the BIT [footnote omitted]. In particular: the Arbitration Agreement submits to arbitration disputes that arose before the entry into force of the BIT. The first fines under each PPA were levied before May 11, 1998 date in which the BIT entered into force. Without the negotiation and conclusion of the Arbitration Agreement, the Claimants would have been unable to submit to the jurisdiction of the Tribunal its claims for the initial fines. (R. Reply, ¶¶ 83-84, Spanish original, Tribunal's Translation)*

200. The Respondent further noted in its first Post Hearing Brief, when addressing the Tribunal's question regarding the reference to the BIT in the Arbitration Agreement:

*It is important to mention, in second place, that, as demonstrated by the RDE, a number of the fines were imposed prior to the entry into force of the BIT and also prior to the existence of the Claimants' investment. Therefore, have the Arbitration Agreement not been signed, the Claimants could not rely, as they do now, on the TBI regarding several of the fines and penalties under PPA95 and PPA96. The second meaning of the reference to the BIT, therefore, is to cover a certain conduct of the RDE which would otherwise have fallen outside the *ratione temporis* scope of the BIT.*

*[Footnote No. 12 stated: Regarding the fines imposed before Duke's investment, it is still doubtful that they could give rise to a dispute in the *ratione personae* terms of Article 25 of the ICSID Convention. The RDE however, does not seek to challenge what she herself has agreed in the Arbitration Agreement, but precisely to enforce it] (R. 1<sup>st</sup> PHB, ¶ 29, Spanish original, Tribunal's translation)*

201. On this basis, the Tribunal has but to conclude that the parties agreed to the application of the BIT standards to all of the claims covered by the Arbitration Agreement: (i) claims related to fines and penalties, including fines imposed before the entry into force of the BIT and the acquisition of Duke Energy's investment in Ecuador; (ii) claims related to the establishment of the Payment Trusts; and (iii) claims related to the implementation of the Payment Trusts covered by the BIT.

#### **4. MERITS**

202. According to the Claimants, Ecuador violated the PPAs and Ecuadorian law by delaying the establishment of the Payment Trusts, poorly implementing them, and failing to comply with the contractual regime agreed upon in connection with fines and penalties. The Claimants argue that these violations amount to a violation of the

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<sup>19</sup> Note that the BIT entered into force on 11 May 1997 and not on 11 May 1998, as incorrectly stated by the Claimants.

principle of good faith under Ecuadorian law and give rise to breaches of the BIT. The Respondent denies being responsible for any breach of Ecuadorian law or the BIT.

203. In light of the parties' claims and in accordance with its finding on the applicable law to the dispute, the Tribunal will first examine the position under the provisions of the PPAs and Ecuadorian law (4.1) starting with the payment obligations under the PPAs and the Payment Trust Agreements (4.1.1), continuing with the interest on late payments (4.1.2), the fines and penalties (4.1.3), the Med-Arb Agreements (4.1.4), and ending with the claims of bad faith (4.1.5). It will subsequently evaluate the Respondent's compliance with the BIT standards (4.2). In this context, it will define the issues to be determined (4.2.1) and review the umbrella clause (4.2.2), fair and equitable treatment (4.2.3), impairment of the investment (4.2.4), and the application of Article II(7)(4.2.5).

204. Before doing so, the Tribunal notes that the PPAs were entered into by INECEL, an entity separate from the State. It also notes that, as mentioned above (¶¶ 45-48), the MEM, acting under Executive Decree No. 506 (Cl. Exh. 016), entered into the Subrogation Agreements in May and June 1999. Through these agreements, the Ecuadorian State assumed the rights and obligations of INECEL under the PPAs (Cl. Exh. 017, Cl. Exh. 018). Therefore, unlike with respect to many other investment disputes, the issue of whether Ecuador is responsible for INECEL's (contractual) acts and omissions does not need to be discussed, and was actually not discussed. This is so because the Respondent's responsibility derives clearly from the terms of the Subrogation Agreements. This position does not, however, rule out the possibility of an independent assumption of responsibility of the State in relation to the Payment Trusts.

#### **4.1 Did Ecuador breach the PPAs and Ecuadorian law?**

##### ***4.1.1 Claims for violation of the payment obligations***

205. The Tribunal will first recall the parties' position (a) prior to examining whether the Respondent complied with the contractual payment mechanism (b).

##### ***a) Parties' positions***

##### ***(i) Claimants' position***

206. The Claimants submit that the Respondent failed to comply with its payment obligations embedded in the PPAs, the Payment Decree and the Payment Trust Agreements.

207. First, the establishment of the Payment Trusts was a condition precedent to commercial operation identified in the PPAs, i.e. 31 March 1996 in the PPA 95 (Clause 12.7) and 5 January 1997 in the PPA 96 (Clause 13.1) (Cl. Mem., ¶ 112). According to the Claimants, the guarantee provided by the Payment Trusts was necessary in order to secure loans to finance the acquisition of the turbines generating the electricity to be supplied by Electroquil under the PPAs. As a matter of fact, the turbine manufacturer Stewart and Stevenson delayed shipment until it received confirmation that the Payment Trusts had been put in place. Despite the numerous reminders sent to INECEL, the Ecuadorian Government failed to set up the Payment Trusts, which almost led to Electroquil's insolvency (Cl. Mem., ¶¶ 112-116; Cl. 1<sup>st</sup> PHB, ¶¶ 13-20). The Claimants further contend that fines No.1 and 2 were imposed as a result of the late start-up caused by the non-implementation of the Payment Trusts.
208. Second, both with and without the Payment Trusts in place and both prior to and after Duke Energy's investment, Ecuador consistently failed to pay Electroquil as required under the PPAs. Only 37 of the 122 invoices submitted by Electroquil were paid within 30 days. Furthermore, when Ecuador made payment to Electroquil, it rarely settled the entire amount of the invoice. INECEL had no right to offset unpaid fines and penalties against amounts it owed to Electroquil in connection with the regular monthly or annual payment required under the PPAs (Cl. 1<sup>st</sup> PHB, ¶ 39).
209. Third, Ecuador failed to provide the guarantee of payment it undertook in the Payment Decree and the Payment Trust Agreements. For the Claimants, the Payment Trusts were envisioned as payment guarantees of INECEL's payments to Electroquil under the PPAs. Ecuador's obligation was not only to establish the Payment Trusts but also to comply with them and guarantee their implementation (Cl. Reply, ¶¶ 119-120). Once established, the Payment Trusts should have ensured the full and timely payment of all amounts due by Ecuador.

(ii) *Respondent's position*

210. The Respondent alleges that it put the Payment Trusts into place on 17 February 1998, once all the essential requirements under Ecuadorian law had been satisfied and that there was no harmful intention or negligence in their delayed establishment (R. Answer, ¶ 293).
211. In response to the Claimants' argument based on the *exceptio non adimpleti contractus* with respect to the delay in putting the Payment Trusts into place, Ecuador points out that the constitution of the Payment Trusts was not an essential obligation like the one

related to the provision of energy and that the *exceptio* does apply to obligations of a different nature, as set out in Article 1568 of the Ecuadorian Civil Code. Finally, Ecuador denies that “*reasons not attributable to Electroquil*” constitute grounds for separate and distinct exemption.

212. It further submits that Electroquil’s invoices were not paid in a timely manner due to catastrophic and unforeseen economic conditions in the country. The Respondent submits that Electroquil was aware of the country’s financial difficulties due to successive political and economic events, such as the armed conflict with Peru, the drop in fuel prices, the effects of El Niño, the shutdown of external credit, the collapse of the financial sector, and the change in the monetary system. The delays in the payments were due to these difficulties and were not attributable to negligence or bad faith. All payments were nevertheless eventually made to Electroquil’s satisfaction without any reservation (R. Answer, ¶¶ 384-389). In addition, offset was authorized under the PPAs and INECEL did not breach the PPAs in that regard.
213. Finally, the Payment Trusts were not meant to serve as a guarantee but were merely understood as a payment mechanism for the PPAs, an understanding which Electroquil never opposed. By the Payment Decree, Ecuador undertook to be INECEL’s guarantor (“*aval*”). However, INECEL, which was a separate and distinct entity from the State (R. Reply, ¶ 160), remained the direct debtor of the payment obligation until March 1999, when Ecuador assumed INECEL’s rights and obligations upon INECEL’s liquidation. Accordingly, Ecuador met his obligation under the Payment Decree by setting up the Payment Trusts which enabled the invoices to be paid on a monthly basis. In addition, the Payment Trusts excluded the State’s liability should the funds be insufficient to make the relevant payments.

**b) Tribunal’s determination**

214. The Tribunal will now examine whether (i) the Payment Trusts had been established in accordance with the timetable set by the PPAs; (ii) the Payment Trusts were properly implemented; (iii) the payment of Electroquil’s invoices was delayed; and whether (iv) offset was allowed under the PPAs. It will review in subsequent sub-sections below whether interest for late payments is due and whether INECEL complied with the penalty regime of the PPAs.

(i) *Establishment of the Payment Trusts*

215. The provisions of the PPAs relating to the Payment Trusts read as follows, starting with PPA 95:

*Fixed costs: a) INECEL shall pay the Contractor a fixed monthly amount of twelve American Dollars (US\$12.00) per kilowatt as a charge for ISO capacity. In addition, INECEL shall pay the Contractor a monthly energy charge of US\$0.0045 per kilowatt hour, applicable to the monthly rounded-off amount of four hundred thirty-three (433) hours of operation at ISO capacity (five thousand two hundred (5200) hours annually). b) **The amounts indicated in the preceding section shall be paid through a payment trusts account in the Central Bank of Ecuador in the Contractor's name, for the purposes of which INECEL shall process and execute the appropriate payment trusts agreement payable to the Contractor or its designated beneficiary, which shall be signed prior to commercial operation by the plant. INECEL shall have thirty days (30) to make the payment.***

(Clause 7.1 PPA 95; Cl. Exh. 010, emphasis added, Spanish original, English translation provided by the Claimants)

216. And continuing with PPA 96:

*The amounts indicated in Sections EIGHT.ONE, EIGHT.TWO and EIGHT.FOUR shall be paid monthly within thirty (30) days after the date of delivery and receipt of such invoices and those indicated in Section EIGHT.FIVE, if any, shall be paid annually and shall also be paid within thirty (30) days after the date of the delivery and receipt of each invoice. **Payment shall be made through a payment trusts account in the Central Bank of Ecuador in the Contractor's name, for the purposes of which INECEL shall process and execute the appropriate payment trusts agreement for the benefit of the Contractor or its designated beneficiary, which shall be signed prior to commercial operation by the Plant. The Minister of Finance and Public Credit shall also be a party to such payment trusts agreement, on behalf of and representing the Republic of Ecuador, in accordance with Order number three thousand ninety-nine, dated the twenty-seventh of September of nineteen ninety-five, and it shall provide that the accounts that the Ministry has with the Central Bank of Ecuador will be debited, providing the necessary funds, on the required dates, in the event that the funds in INECEL's accounts, or in the payment trusts account, are insufficient. To implement this mechanism, it will be sufficient for INECEL to send the Ministry of Finance and Public Credit a notice seven days in advance of the date of payment to make the payments in accordance with the provisions of Subsection b) of Section seven point zero point one of the clause of the power purchase agreement (PPA) [ie, PPA 96].***

(Clause 8.6 PPA 96; Cl. Exh. 011, emphasis added, Spanish original, English translation provided by the Claimants)

217. The commercial operation of Units 1 and 2 started on 10 May 1996, i.e. approximately one and a half months after the scheduled dates. The commercial operation of Units 3 and 4 began on 19 June 1997, i.e. approximately six months after the scheduled dates.

218. As of January 1996, Electroquil drew INECEL's attention to the Payment Trust required under Clause 7.1 of the PPA 95 (Cl. Exh. 039, Cl. Exh. 040, Cl. Exh. 045). In response,

on 13 March 1996, INECEL sent a request to the Central Bank of Ecuador to initiate the necessary procedures to put the Payment Trusts in place (Cl. Exh. 040). It was not before 10 November 1997, however, that the Payment Decree requiring the Central Bank of Ecuador to constitute the Payment Trusts was issued, and not before 17 February 1998 that the Payment Trusts were established accordingly.

219. Therefore, it is clear that the Payment Trusts were not established prior to commercial operation of Units 1, 2, 3 and 4.

(ii) *Failure to implement the Payment Trusts*

220. The issue before the Tribunal is twofold: first, did INECEL – until 1999 – and Ecuador – thereafter – breach the PPAs and the Payment Trust Agreements by not properly implementing them? Second, did Ecuador, through its Ministry of Finance, guarantee the timely payment of Electroquil's invoices under the Payment Decree and the Payment Trusts?

221. In addition to the above quoted provisions contained in the PPAs, it is useful to examine the wording of the Payment Decree and the Payment Trusts.

222. The Payment Decree reads:

*Art. 1.- The Minister of Finance and Public Credit is hereby authorized to personally or by delegation to subscribe the obligation of payment guarantee, (GUARANTEE), of the Ecuadorian State in the two trust agreements that INECEL, as Grantor, Central Bank of Ecuador as Trustee, and ELECTROQUIL, S.A., as Beneficiary, will subscribe, by means of which INECEL expressly and irrevocably authorizes the trustee to monthly retain, in the proportions deemed appropriate, the funds from the account or accounts that INECEL may hold in Central Bank of Ecuador, as well as the income that INECEL may possess or that in the future may be assigned through the Issuer Institute to it, in order to pay the monthly invoices, in accordance with the amount, term and financial conditions determined in each bulk power purchase agreements signed between INECEL and the company ELECTROQUIL S.A. on October 31, 1995, and August 8, 1996 respectively.*

*Art. 2.- This payment guarantee that it will be included in the two trust agreements, enables Central Bank of Ecuador, in the event INECEL does not have sufficient resources to face the payments it must fulfill in accordance with the bulk power purchase agreements signed with ELECTROQUIL S.A., to debit from the accounts the Ministry of Finance and Public Credit could have in Central Bank of Ecuador, the sufficient amounts, and in the required dates, for the full payment of the respective invoices, and to deposit such amounts in the special Trust that may be established for that purpose, in order to fulfill payments to ELECTROQUIL S.A. (Cl. Exh. 007, emphasis added, Spanish original, English translation provided by the Claimants)*

223. The 1995 Payment Trust (Cl. Exh. 010) reads, in relevant parts, as follows:

[Recital] 1.4 *As a result of the approval granted by the Ministry of Finance and Public Credit in Ministerial Order No. STCP-97-124, dated September 12, 1997, Executive Decree No. 804 was issued, which was published in Official Register No. 190 on November 10, 1997, under which said Ministry was authorized to sign the guarantee of payment of the obligations arising under the aforementioned contract, such guarantee to be provided by the Republic of Ecuador in the trust agreement to be entered into with the Central Bank of Ecuador.*

**TWO. FORMATION OF THE TRUST AND PROCEDURE:** *Based on the foregoing recitals, the Ecuadorian Institute of Electrification (INECEL) expressly and irrevocably authorizes the retention, on a monthly basis, and in the proper proportions, of a debit from the funds in account No. 01310016 that the Ecuadorian Institute of Electrification (INECEL) maintains with the Central Bank of Ecuador or any other account that it has with such institution, as well as from any income that it holds or that is allocated to it in the future through the Issuing Institute, to make the payment of the dividends, according to the amount, the time and financial terms and conditions determined in Clause Seven "Prices and Manner of Payment" of the Bulk Power Purchase Agreement executed on October 31, 1995, before Notary Thirty-five of the Canton of Guayaquil.*

*To make this mechanism operational, the Ecuadorian Institute of Electrification (INECEL) shall provide the Central Bank, fifteen days in advance of the date of payment, a copy of the invoices, duly legalized, in order for the payment procedures to be carried out.*

*The amounts retained pursuant to the preceding paragraph shall be deposited by the trustee Bank in a special account that shall be named: "TRUST-INECEL-ELECTROQUIL S.A." The payment shall be made to Electroquil S.A. from this account in accordance with the instructions issued for such purpose by such company, which are set out in Letter No. PEJ-97-12-1124, dated December 11, 1997.*

*The Central Bank of Ecuador agrees to provide the trust services under the terms and conditions of this instrument, in accordance with the provisions of Article 120 of the Monetary System and State Bank Law.*

**FIVE. GUARANTEE OF PAYMENT:** *The Ministry of Finance and Public Credit, duly authorized by Article 2 of Decree No. 804, published in Official Register No. 190 on November 10, 1997, hereby grants, on behalf of the Republic of Ecuador, for the benefit of the Ecuadorian Institute of Electrification (INECEL), the guarantee to secure compliance with the payment obligation assumed by the Ecuadorian Institute of Electrification (INECEL) to Electroquil S.A. under the Bulk Power Purchase Agreement executed on October 31, 1995 before Notary Thirty-five of the Canton of Guayaquil, Roger Arosemena Benites, Attorney at Law.*

*For the purposes thereof, the Ministry of Finance and Public Credit irrevocably authorizes the Central Bank of Ecuador, in the event that the Ecuadorian Institute of Electrification (INECEL) does not have funds sufficient in its accounts to comply with the aforementioned payment obligation, to debit any accounts that the Ministry of Finance and Public Credit maintains in the Central Bank of Ecuador for sufficient amounts, on the dates on which they are required for the total payment of the specific invoices, and to make the deposits in the special trust account that is established for such purpose by this instrument.*

**SIX. THE TRUSTEE'S LIABILITY:** *The obligations that the Central Bank of Ecuador assumes by this agreement shall terminate if the resources in the*

*special trust account or in the accounts of the Ministry of Finance and Public Credit, as the case may be, are insufficient and, in general, in the event that it is physically or legally impossible for the Central Bank of Ecuador to comply with the commitment assumed hereby.*

*In addition, the Central Bank of Ecuador does not assume any liability for the obligations assumed under the Bulk Power Purchase Agreement between the Ecuadorian Institute of Electrification (INECEL) and Electroquil S.A. executed on October 31, 1995 before Notary Thirty-five of the Canton of Guayaquil. (R. Exh. 054, emphasis added, Spanish original, English translation provided by the Claimants)*

224. The 1996 Payment Trust contains similar provisions (Cl. Exh. 011).
225. Upon the reading of Clause 7.1 of PPA 95 quoted above, INECEL's monthly payment for fixed costs was to be made through a payment trust. Under Clause 8.3 of the PPA 96, it appears that all INECEL's monthly payments were also to be made through a payment trust. Clauses 2 of the Payment Trust Agreements do not appear to condition INECEL's payment in any way. The Tribunal therefore understands the Payment Trusts to be the main contractual mechanism for payment of Electroquil's invoices with regard to energy supply.
226. In order for the payments to be carried out through the Payment Trusts, INECEL was to approve Electroquil's invoices pursuant to the provisions of the PPAs, and provide a copy to the Central Bank fifteen days prior to the date of payment (Clause 2 of the Payment Trusts; Tr. G. Larrea, p. 277).
227. Mr. Larrea states in his first witness statement "*[o]n few occasions, we were able to draw some money from the Trusts, as had been promised under the Payment Guarantee Decree. Usually though, we would be told that there was simply no money on INECEL's account.*" (1<sup>st</sup> WS G. Larrea, ¶ 51). In his second statement, he mentioned that, at the end of 1998, INECEL's general manager delayed the delivery of Electroquil's invoices to the Central Bank to prevent the payment (2<sup>nd</sup> WS G. Larrea, ¶ 27). Mr. Larrea also wrote that, at the beginning of 1999, INECEL transferred its funds from the Central Bank to a private bank (2<sup>nd</sup> WS, ¶ 28). At the hearing, Mr. Larrea stated "*instead of sending the invoices to the Central Bank, simply they didn't send. They kept the invoices*" (Tr. p. 277). For his part, the Claimants' expert assumed that the Payment Trusts were not used before March 2000. He notes that eventually, after INECEL's liquidation, the Trusts were used between March 2000 and March 2001 for a payment of USD 8.6 million (1<sup>st</sup> ER Kaczmarek, ¶ 47).
228. Be this as it may, it is undisputed that the Payment Trusts did not function as provided for under the PPAs. Electroquil's invoices were nevertheless sometimes paid within the relevant time but, more often, with delay, both prior to and after the establishment of



the Payment Trusts. The Tribunal notes that payment of the invoices that were actually settled was made by the Ministry of Finance which handled the invoice payment (E. Santos, INECEL's contract administrator from 1999 to the Liquidation, Tr. p. 492).

229. The Tribunal further understands that the Payment Trusts also contain a guarantee from the Ministry of Finance that, in the absence of sufficient funds in INECEL's trust account, payment would be made through the Ministry of Finance account with the Central Bank. A provision to that effect was already included in the PPA 96. The Tribunal cannot concur with the Respondent that the Ministry of Finance's responsibility terminated with the establishment of the Payment Trusts, nor that the Payment Trusts Agreement excluded the State's liability. The Tribunal notes that no specific procedure to implement the State's guarantee was included in the Payment Trust Agreements. While it is unclear from the record as to whether this guarantee was ever triggered by the Central Bank, it seems that it was not. This said, the record does not contain any letter from Electroquil sent to the Ministry of Finance in this regard.

230. The Payment Trusts were thus a significant mechanism of a mixed nature: they provided for a contractual payment mechanism and also for a guarantee of the State if the contractual mechanism was not complied with. The latter is a contractual obligation undertaken by the State vis-a-vis Electroquil in its sovereign capacity. Under the Payment Trust Agreements, this obligation did not extend to Duke Energy, which was not party to the Agreements. These elements will be further discussed below in the BIT analysis.

231. It appears therefore that the conditions for the payment of Electroquil's invoices as set out in the PPAs and in the Payment Trust Agreements were not complied with by INECEL and the Respondent, which in turn led to late payment of Electroquil's invoices.

*(iii) The late payments*

232. The Claimants have produced an expert report with several tables analyzing Ecuador's alleged failure to pay Electroquil's invoices, together with copies of such invoices, extracts from Electroquil's accounting system showing date of payment, letters from Electroquil acknowledging receipt of payment and/or documents from INECEL regarding payment (Annex NAV-18, NAV-19 to 1<sup>st</sup> ER Kaczmarek). The Claimants' expert report and the documents appended thereto establish late payments of Electroquil's invoices and show the number of days of delay under each PPA (Annex NAV-6 to 1<sup>st</sup> ER Kaczmarek). The late payments can be illustrated by the balance due

to Electroquil. For example, when the Payment Trusts were signed, the overdue balance owing to Electroquil was approximately of USD 7.2 million (1<sup>st</sup> ER Kaczmarek, ¶ 43). In March 1999, such balance amounted to USD 20.7 million before being partially settled and reduced to USD 11.3 million through the issuance of government bonds. The overdue balance owing to Electroquil was reduced to USD 9.2 million as of March 2000 when payment in dollars was made through the Payment Trusts (1<sup>st</sup> ER Kaczmarek, ¶ 47). The payments of certain invoices were also divided in installments. Overall, the Tribunal understands that Electroquil's total invoices amounted to USD 124,224,305 million (1<sup>st</sup> ER Mancero Samán, ¶ 44).

233. The Claimants' expert report also contains a computation of interest on such late payments in the amount of USD 8,421,050. The Tribunal notes that no capital is claimed on any invoices (Table 13 and Annex NAV-1 to 1<sup>st</sup> ER Kaczmarek).

234. The Respondent does not challenge the delays in payment. It argues, however, that the late payment of Electroquil's invoices is excused because it was attributable to events over which Ecuador had no control.

235. As opposed to the provisions of the PPAs on fines and penalties (Clause 12 of PPA 95 and Clause 8 of PPA 96), the clauses regarding INECEL's payment obligations do not stipulate any grounds for liability exemption (Clause 7 of PPA 95 and Clause 8 of PPA 96). Under the PPAs, INECEL was thus bound to effect payment on time irrespective of the prevailing political or economic conditions.

236. The question remains whether the delays may be excused by *force majeure*. The occurrence of the political and economic events referred to in paragraph 212 above is not disputed. Nor is it disputed that the Claimants knew about them (R. Exh. 55).

237. While acknowledging the burden which these events may have represented for the country, the Tribunal cannot but note that Ecuador has not demonstrated that they amount to *force majeure*, nor that any of the conditions for its application were met. Nor has it shown what impact they may have had on INECEL's payment obligations under the PPAs. The Tribunal notes, in particular, that the testimony of Mr. Spurrier, one of the witnesses for Ecuador, has shown that the financial crisis was foreseeable.

(iv) *Was set-off admissible?*

238. It seems that one of the reasons lying behind certain late payments was INECEL's practice to set-off certain fines against Electroquil's invoices as established in Section 2.4 above in the factual part of this Award.

239. The parties debated the validity of such practice. Ecuador submits that there was no impediment to set-off pursuant to Article 1671 of the Ecuadorian Civil Code to the extent that the invoices and the fines are both monetary claims that are due.
240. The Claimants do not dispute that Article 1671 of the Civil Code is relevant to the issue, but argue that the PPAs did not allow the Respondent to offset the fine amounts from invoices due and payable to Electroquil, although it could have offset them from the performance bonds.
241. Interpreting Clause 12 PPA 95 and Clause 13 PPA 96 on penalties (which will be set out in more details below) beyond their wording and within their context pursuant to Clause 4 PPA 95 and Clause 4 PPA 96 and Title XIII of the Ecuadorian Civil Code referred to therein, the Tribunal does not consider that these specific contractual provisions were meant to exclusively govern claims and debts under the contracts.
242. As a matter of fact, set-off was expressly provided for in Clause 18.1 PPA 95 and Clause 19.1 PPA 96 at the PPAs' liquidation phase. Hence, the PPAs envisaged the principle of set-off and there is no reason why set-off could not be used during the term of the PPAs, provided the legal requirements, i.e. two monetary claims mutually due, were met (Art. 1672 and 1673 of the Ecuadorian Civil Code). This said, the Tribunal does not consider that INECEL's set-off practice could justify the late payments; in other words INECEL still had to comply with the other contractual provisions.

(v) *Conclusion*

243. It follows that (i) INECEL breached the PPAs by not establishing the Payment Trusts prior to the commercial operation of Units 1 to 4; (ii) INECEL and the Respondent failed to operate satisfactorily the Payment Trusts; (iii) INECEL and the Respondent proceeded to late payments under the PPAs; and (iv) set-off was allowed under the PPAs.

**4.1.2 Claims for interest on late payments**

244. Having ascertained that INECEL and the Respondent were late in the payment of Electroquil's invoices, the Tribunal will determine whether interest is due (a) prior to deciding if Electroquil has waived its claim to interest (b).

**a) *Is interest due?***

**(i) *Parties' positions***

245. The Claimants argue that the accrual of interest in Electroquil's favor as a result of Ecuador's persistent late payments constitutes customary business and legal practice. It claims that Electroquil reserved its right to claim late interest on several occasions and that Ecuador cannot reasonably argue that such a claim be excused on the grounds of *force majeure* or that it has been waived, settled or released by virtue of the Interim Liquidation Agreement, the 95 and 96 Liquidation Agreements, the Subrogation Agreements, the Reciprocal Obligations Agreement and/or the Undisputed Amounts Interest Agreement.

246. Ecuador relies on Article 1611 of the Ecuadorian Civil Code to argue that, since Electroquil did not make any reservations with respect to the non-payment of interest, interest on late payments is presumed to have been paid. It also argues that it is for the party opposing this presumption to prove that reservations were made, which the Claimants have not done.

247. The Respondent further argues that interest has, in any event, been waived or settled with respect to the Interim Liquidation Agreement, the 95 and 96 Liquidation Agreements, the Reciprocal Obligations Agreement and the Undisputed Amounts Interest Agreement. Indeed, all pending payment obligations, except those related to the fines, were subject to liquidation pursuant to such agreements, and Electroquil never objected to the liquidation.

**(ii) *Tribunal's determination concerning right to interest***

248. Both parties have relied upon Article 1611 of the Ecuadorian Civil Code, which provides as follows:

***Art. 1611.*** *If principal and interest are both due, payment shall be applied first to interest, unless the creditor expressly consents that it be applied to principal.*

*If the creditor gives a letter of acquittance of the principal, without mentioning interest, the interest is presumed paid.*

(Spanish original, Tribunal's translation)

249. On the one hand, the Claimants argue that a presumption exists pursuant to which interest was to be paid when principal and interest were owed, the debtor was to make a partial payment, and the creditor approved the payment without expressly reserving its interest claim. They allege that these requirements were not fulfilled, as Electroquil

never approved the payments made by the Ecuadorian Government, nor issued any receipt of payment in this respect. Further, they submit that Electroquil made several clear reservations of rights with respect to its interest claim, thus leaving any presumption without effect (Cl. 1<sup>st</sup> PHB, ¶ 59, Cl. 2<sup>nd</sup> PHB, ¶ 39).

250. On the other hand, Ecuador submits that the presumption laid in Article 1611(2) of the Ecuadorian Civil Code does apply and that no interest for late payment is owed. It contends that Electroquil did not make any reservations when it received and endorsed payment (R. 1<sup>st</sup> PHB, ¶¶ 173-174, R. 2<sup>nd</sup> PHB, ¶ 11).

251. In order to determine whether the presumption of Article 1611(2) of the Ecuadorian Civil Code applies, the Tribunal must primarily examine whether there is a right to interest and whether the Claimants made any reservations with regard to interest when INECEL and Ecuador paid the invoices.

252. Article 1575 of the Ecuadorian Civil Code reads as follows:

*Art. 1575. If the obligation is one to pay a sum of money, damages for delay in performance are subject to the following rules:*

- 1. Conventional interest continues to run, if the conventional interest is higher than the legal interest, or the legal interest begins to apply in the contrary situation; saving the special rules authorizing the collection of interest at the current rates in certain cases.*
- 2. The creditor is not required to show prejudice when he collects interest only; the fact of the delay is sufficient.*
- 3. Delayed interest does not produce interest.*
- 4. The preceding rules apply to all kinds of incomes, land rents, and periodic payments.*

(Spanish original, Tribunal's translation)

253. Ecuador's legal expert has submitted that interest is only payable in the event of a complete failure by the debtor to perform its obligation, not in the event of a mere delay in payment. In addition, he holds that the delays were excused on the grounds of *force majeure*, and that, in any case, public entities are not held to paying interest on delayed payment, except if the delays disrupt the economic balance of the contract.

254. By contrast, Duke's legal expert has submitted that interest was due as soon as a delay was evidenced, and that the rule applied equally to public entities.

255. Having reviewed the legal opinions and Article 1575 of the Ecuadorian Civil Code, the Tribunal comes to the conclusion that Ecuadorian law provides for a right to interest for late payment irrespective of the public or private status of the debtor. The parties themselves were well aware of this right when they acknowledged that the question of

interest was disputed in the different agreements seeking to resolve their disagreements<sup>20</sup>.

256. Moreover, the Tribunal finds no indication that interest would only accrue in the event of a complete non-performance by the debtor and not already in the event of delayed performance. Finally, as noted above, the Respondent has failed to demonstrate the occurrence of *force majeure*.

(iii) *Tribunal's determination on reservation of interest*

257. The Claimants argue that Clause 7 in fine of the 95 Liquidation Agreement and Clause 7.6 of the 96 Liquidation Agreement constitute a reservation of interest for late payment of invoices. In their original versions, these provisions read as follows:

*The parties reserve their right to claim their interests under the law.*

(Cl. Exh. 22 and 24, English translation provided by the Claimants)

258. According to the Claimants, the Liquidation Agreements specifically enumerate each party's pending obligations and the corresponding amounts owed. The reference to interest included after such enumeration is clearly designed to cover interest related to the obligations listed in the Liquidation Agreements, not interest related to obligations which are not the subject matter of the Liquidation Agreements (R. 1<sup>st</sup> PHB, ¶ 175).

259. The Respondent denies that these provisions constitute a reservation of the right to claim interest for late payment.

260. The purpose of the Liquidation Agreements was to implement Clause 18.1 of PPA 95 and Clause 19.1 of PPA 96 which, in their relevant parts, read as follows:

*After the expiration of [the term of] this Agreement, or if it has not been possible to continue with the relationship created by this instrument, the parties shall prepare and execute a **Certificate of Settlement of Accounts** [...] stating in detail the technical and financial-accounting aspects thereof, and **also stating the volume of capacity and energy supplied during this period, the amounts that INECEL has paid to the Contractor, and any that remain to be paid to it**, those that must be deducted or repaid, for any reason, and applying the appropriate adjustments. For the purposes thereof, any appropriate setoffs may be made. (Cl. Exh. 010 and 011, emphasis added, Spanish original, Tribunal's translation)*

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<sup>20</sup> The Tribunal is comforted in its decision by the MEM's acknowledgment that Electroquil had a right to interest for non-payment by the State of its obligation, interest "that was legally established in favor of that company" (Clause 7 "De los intereses", Reciprocal Obligations Agreement, R. Exh. 059, Spanish original, Tribunal's translation). This was further confirmed in the Undisputed Amounts Interest Agreement (see *infra* ¶ 61).

261. Specifically, the 95 Liquidation Agreement states that the Contract Administrator had authorized payment of Electroquil's invoices, detailed in the appended financial settlement, which inter alia took the Interim Liquidation Agreement (Cl. Exh. 103, R. Exh. 116) into consideration (Clause 6.2, Cl. Exh. 22). After calculating the balance for fuel and transportation and the balance for power separately, the parties agreed upon a final balance of USD 4,173,718.65 in favor of Electroquil (Clause 6.2.2). Clause 7 of the 95 Liquidation Agreement went on to specify that it did "*not resolve or settle any of the matters submitted to arbitration*", i.e. the fines imposed under PPA 95. Clause 7 in fine of the 95 Liquidation Agreement added the parties' reservation of rights to claim interest.
262. As for the 96 Liquidation Agreement, it followed in substance the same structure as the 95 version and determined that the final balance in favor of Electroquil amounted to USD 96,980.64 (Cl. Exh. 24).
263. The Liquidation Agreements were entered into to liquidate the PPAs. It is clear that the liquidation included invoices unpaid or partially paid. Such invoices were taken into account for the calculation of the final balance.
264. In light of the parties' agreement upon the invoices paid by INECEL and Ecuador and those pending within the liquidation phase of the PPAs, the Claimants' argument according to which Electroquil never approved payments or acknowledged receipt of payments is unpersuasive. As a matter of fact, even prior to the Liquidation Agreements, Electroquil had sent letters to INECEL acknowledging receipt of payment of certain invoices although not systematically (see Annex NAV-18 and NAV-19 to 1<sup>st</sup> ER Kaczmarek).
265. At the same time, the Tribunal agrees with the Claimants that they expressly reserved in the Liquidation Agreements the right to claim interest on the final balance owed after settling the obligations pending under the PPAs, whether such obligations were the payment of Electroquil's invoices for the provision of power or the payment of fuel costs and transportation.
266. As the Respondent rightly points out (R. 2<sup>nd</sup> PHB, ¶ 20), the reservation of interest was only made with respect to the final amounts of USD 4,173,718.65 and USD 96,980.64 respectively set forth in the Liquidation Agreements. This view will be confirmed upon examining the Reciprocal Obligations Agreement in conjunction with the Undisputed Amounts Interest Agreement (see infra ¶¶ 60-61).

267. Since the Respondent accepts that a reservation of the right to claim interest was made in the Liquidation Agreements, the Tribunal can dispense with examining the Claimants' additional arguments, i.e. that a reservation was made by way of the claim brought to local arbitration and that the payment of late interest constitutes ordinary business practice.

**b) *Alleged "waiver" to claim interest***

268. The next issue that arises for determination is whether Duke's claim for interest was waived or settled by way of agreement, as the Respondent argues. The Tribunal will proceed to examine in turn each of the agreements to which the parties referred.

269. First, the Interim Liquidation Agreement (Cl. Exh. 103, R. Exh. 116) was entered into between the parties in 1999 for the purpose of settling the outstanding payment obligations under the PPAs as a result of the liquidation of INECEL and the subrogation of rights and obligations under the PPAs by the Ecuadorian Government through the MEM (Recitals Interim Liquidation Agreement, point 6, p. 2).

270. The Claimants submit that the Interim Liquidation Agreement was not intended to deal with interest. Had the parties wished to do so, whether by way of settlement or waiver, they would have stated it. By contrast, the Respondent contends that the absence of any mention of interest implies a waiver and that the presumption of Article 1611 of the Civil Code applies.

271. In other words, the parties concur that interest is not mentioned in the Interim Liquidation Agreement, but draw different consequences from that fact. As was set out in connection with the Liquidation Agreements, if the creditor does not expressly reserve the right to claim upon interest payment of the principal, interest is presumed to be paid<sup>21</sup>. In the present instance, the Interim Liquidation Agreement contains no reservation of interest. Therefore, the Tribunal will apply the presumption and conclude that the Claimants lost their right to interest by not making an express reservation, unlike what they did in the Liquidation Agreements with regard to the final balance. In this latter respect, the Tribunal finds that the fact that interest was reserved for the final amounts due under the PPAs in the Liquidation Agreements cannot reasonably be overruled by a lack of reservation in prior agreements.

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<sup>21</sup> Although the parties have used the terms waiver, the Tribunal notes that Article 1611 contains a presumption of payment of the interest when the creditor provides a receipt of payment without reserving the right to claim for the interest.



272. The latter reasoning equally applies to the Subrogation Agreements entered into between the parties in 1999 (Cl. Exh. 17 and 18).
273. Further, the Reciprocal Obligations Agreement entered into between the parties and Petroecuador provided for the extinction of Ecuador's obligation in favor of Electroquil in the amount of USD 4,173,718.65 resulting from the 95 Liquidation Agreement, as well as for the extinction of Electroquil's obligation in favor of Petrocomercial in an amount of USD 4,173,718.65 (Clause 4 of Reciprocal Obligations Agreement). In other words, upon Electroquil's request, the amount that Ecuador owed Electroquil was to be transferred to Petrocomercial - which had a claim against Electroquil - with the effect of extinguishing in part both Electroquil's and Ecuador's debts (Clause 1.11, Clause 2.1 and Clause 4 of Reciprocal Obligations Agreement). The Reciprocal Obligations Agreement provided for the payment of interest in the amount of USD 4,173,718.65.
274. The Claimants contend that the Reciprocal Obligations Agreement did not lead to a settlement or a waiver of any of their claims against Ecuador which are the subject matter of the present arbitration. They assert that Duke's claim for interest has been preserved by virtue of Clause 7 of the Reciprocal Obligations Agreement. The Respondent does not deny that the Reciprocal Obligations Agreement provided for the payment of interest in the amount of USD 4,173,718.65. It alleges, however, that such interest was paid under the Undisputed Amounts Interest Agreement (R. 2<sup>nd</sup> PHB, ¶ 23).
275. Clause 7 of the Reciprocal Obligations Agreement provides as follows:

*The Ministry will recognize in favor of ELECTROQUIL the interest generated by the untimely payment of the obligation specified in the first paragraph of numeral 2.1 of the Second Clause of this agreement, which was legally established in favor of that company.*

*In any case, interest will be stipulated in a separate agreement in conjunction with those referred to in paragraph 2.3 of the Second Clause of this agreement, in exactly the same terms as to the type of interest rate applicable.*

(Spanish original, Tribunal's translation)

276. Clause 2.1, to which Clause 7 of the Reciprocal Obligations Agreement refers, reads as follows:

*In accordance with numeral 6.2.2 of the Sixth Clause of the Liquidation Agreement of Contract No. 020/95, signed on November 27, 2001 between representatives of the MINISTRY and ELECTROQUIL, the latter states owing Electroquil the amount of US\$ 4,173,718.65 [...].*

*For its part, the STATE manifests that, pursuant to Executive Decree No. 506, and in consideration to the Payment Trust referred to in numeral 6 of*

*the First Clause, is a guarantor of payment of the MINISTRY'S obligations with ELECTROQUIL.*

(Spanish original, Tribunal's translation)

277. Finally, the Undisputed Amounts Interest Agreement (R. Exh. 63) sought to implement Clause 7 of the Reciprocal Obligations Agreement. In the former agreement, the parties expressly agreed that interest was due to Electroquil (Clause 2.1 of the Undisputed Amounts Interest Agreement). They also agreed upon the liquidation and extinction of all interest claims in favor of Electroquil for late payment of the invoices for fuel costs as referred to under Clause 7.4 of PPA 95 (Clause 3 of the Undisputed Amounts Interest Agreement).
278. The Undisputed Amounts Interest Agreement makes it clear that no interest can be claimed for the amounts pending under PPA 95 in accordance with the 95 Liquidation Agreement.
279. It follows that interest is only due upon the amount of USD 96,980.64 set forth in the 96 Liquidation Agreement. Indeed, the presumption of Article 1611 is rebutted with respect to this Agreement as a result of an express reservation (see supra ¶ 265).
280. Therefore, the Tribunal considers that interest for late payment of Electroquil's invoices cannot be claimed in light of the presumption of Article 1611, subject to interest on the amount of USD 96,980.64 arising out of the 96 Liquidation Agreement.

#### **4.1.3 Fines and penalties imposed during the execution of the PPAs**

281. The Tribunal will begin by reviewing the parties' general allegations in respect of the imposition of fines and penalties (a) and the applicable provisions of the PPAs (b). It will subsequently analyze the arguments raised in connection with each of the contested fines (c).

##### **a) Parties' positions**

282. According to the Claimants, both PPAs expressly excused technical breaches by Electroquil under specific circumstances. While certain circumstances may have permitted the imposition of a fine, in almost every instance, other circumstances were also present which justified not imposing the fine. Ecuador's imposition of fines under circumstances where its own contractual breaches caused Electroquil's technical defaults was clearly improper and runs contrary to the spirit of Clause 12.4 of PPA 95 and Clause 13.4 of PPA 96.

283. The Claimants further argue that, aside from the clauses referred to above and the general provisions of the PPAs governing the settlement of contractual disputes, the PPAs were silent with regard to how fines were to be imposed and collected. Ecuador was not entitled to offset the fine amounts from invoices due and payable to Electroquil. Furthermore, the PPAs did not contemplate any lump sum imposition and collection of fines at the expiry of the PPAs.

284. For its part, Ecuador argues that INECEL's right to impose fines upon Electroquil was granted to INECEL in order to ensure the proper performance of the PPAs. The PPAs set out specific situations that would justify the imposition of the fines, especially insufficient energy supply within a certain time limit and under certain technical circumstances. Thus, as soon as the relevant facts justifying imposition of a fine occurred, INECEL was entitled to exercise its rights, which were in no way limited or time-barred, under the PPAs.

285. Furthermore, as already indicated Ecuador submits that there was no impediment to set-off pursuant to Article 1671 of the Ecuadorian Civil Code.

286. Before examining the parties' arguments and each fine in detail, the Tribunal considers it of use to briefly review the grounds for penalties set forth in the PPAs.

**b) Contractual regime**

287. Pursuant to Article 12 of PPA 95, INECEL can impose a fine for:

- shortfalls between the availability guaranteed in the contract and the actual availability for each unit (Clause 12.1);
- excessive fuel consumption (Clause 12.2);
- failure to reach the guaranteed output (Clause 12.3); and
- delays in start-up (Clause 12.7).

288. The penalties under PPA 95 were to be calculated once a year and paid within 15 days. They could not exceed 5% of the value of PPA 95 (Clause 12.6). Clause 12.4 of PPA 95 specified that no fine could be imposed if Electroquil's defaults were due to *force majeure*, an act of God or for duly proven reasons not attributable to Electroquil.

289. Pursuant to Article 13 of the PPA 96, INECEL can impose a fine for:

- delays in start-up (Clause 13.1);

- failure to meet the energy generation quotas or excessive fuel consumption (Clause 13.2); and
  - shortfall in availability (Clause 13.3).
290. The penalties under PPA 96 were to be paid on a monthly basis and could not exceed 5% of the total value of PPA 96 (Clauses 13.5 and 13.6). No penalty could be imposed under PPA 96 in the event that the defaults were proven not to be attributable to Electroquil (Clause 13.4).
291. Taking the main arguments and contractual provisions referred to above into consideration, the Tribunal will examine each fine and the specific objections thereto in the table below.

c) **Tribunal's review of the fines**

Fines	Imposition and objection	Parties' arguments		Findings of the Tribunal
		Claimants	Respondent	
<p><b>Fine No. 1 of USD 400,000, dated 8 July 1996, based on the late start-up of Units 1 and 2 under PPA 95</b></p>	<ul style="list-style-type: none"> <li>On 8 July 1996, INECEL levied Fine No. 1 in connection with the start-up delay under PPA 95 (Exh. C-24 RforA, Cl. Exh. 047, R. Exh. 013).</li> <li>On 31 July 1996, Electroquil objected to Fine No. 1 on the grounds of <i>force majeure</i> (R. Exh. 014).</li> </ul>	<p>The essence of Electroquil's challenge against Fine no. 1 lies in the fact that the Government failed to put the Payment Trust in place before the commencement of commercial operation. Additionally, Electroquil also claimed the existence of a <i>force majeure</i> event (i.e. a snow storm in Washington, D.C., which delayed the project finance for a few days). The Claimants have further demonstrated that the Payment Trusts were of critical importance for Electroquil, particularly in connection with its ability to obtain working capital loans and other financing.</p> <p>Based on the foregoing, the Claimants submit that Electroquil's failure to commence operations under PPA 95 on time is excused due to (i) the existence of "events not attributable to Electroquil"; and (ii) the Ecuadorian Government's own failure to fulfill its obligations under PPA 95 ("<i>exceptio non adimpleti contractus</i>").</p>	<p>The Respondent fully denies the Claimants' allegations, especially in light of Clause 19 of PPA 95, and contends that Fine No. 1 was entirely justified under the circumstances.</p>	<p>1. Clause 12.7 of PPA 95 provides:</p> <p><i>The Contractor shall pay INECEL a penalty equivalent to FIVE THOUSAND American Dollars (US\$5,000.00) for each day of delay in the commencement of commercial operation of each unit starting one hundred and fifty (150) calendar days after the execution of this agreement.</i></p> <p>It is undisputed that Units 1 and 2 commenced commercial operation on 10 May 1996 instead of 31 March 1996 as provided for under the PPA 95. That is 40 days later than the contract date. Under Clause 17.7, 40 days of delay results in a USD 200,000 penalty for each unit and to USD 400,000 for both.</p> <p>2. The fine imposed amounted to USD 400,000. The Claimants contend that the USD 200,000 balance was offset against Electroquil's invoice No. 002 which was inadmissible.</p> <p>Notwithstanding the fact that set-off is deemed admissible, the Claimants have not demonstrated how Fine No. 1 was improperly set-off or what the ensuing amount would be, had there been ineffective set-off.</p> <p>Furthermore, the record does not show that the Claimants objected to set-off at the time Fine No. 1 was imposed.</p> <p>3. The Claimants further argue that Electroquil's failure to commence operations under PPA 95 on time was excused due to <i>force majeure</i> and the existence of "events not attributable to Electroquil", i.e. an alleged snow storm in Washington, D.C.</p> <p>Clause 19 of PPA 95 provided that <i>force majeure</i> was to be defined under Article 30 of the Ecuadorian Civil Code (i.e. <i>unforeseeable event, which is not possible to resist, such as shipwreck, earthquake, seizure by enemies, acts of authority, etc</i>) and that any such event should be notified to the other party within 10 days following its occurrence together with an</p>

Fines	Imposition and objection	Parties' arguments		Findings of the Tribunal
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				<p>explanation as to how it affected the performance of PPA 95 and supporting documents. It appears from a letter of 31 July 1996 (R. Exh. 14) that Electroquil initially referred to the event in a letter dated 25 January 1996. However, there is no convincing evidence on record that the Claimants explained how such an event affected the performance of PPA 95.</p> <p><b>4.</b> With respect to the Claimants' objection to Fine No. 1 based upon the <i>exceptio non adimpleti contractus</i>, Clause 5.0.1 of the PPA 95 and 5.1 of the PPA 96 make it clear that Electroquil had exclusive responsibility for the timely start-up of the generation units. It was Electroquil's risk and duty to import, assemble, install, operate and maintain the turbines. Electroquil committed in its offer of 16 August 1995 to the installment of two new generation units by 31 December 1995 (PPA 95, Clause 2.0.2). Electroquil's obligation in this respect does not appear to be directly linked to the Payments Trusts. There seems to be no correlation between INECEL's obligation to pay for the energy provided by Electroquil and the latter's obligations to start the commercial operations of the units under the PPAs.</p> <p>In addition, contrary to the Claimants' assertion, the record does not show that the manufacturer refused to ship the turbines because the 95 Payment Trust was not set up. The evidence shows that Electroquil and the manufacturer corresponded regarding the delay in shipment, but it does not establish any causation with the failure to constitute the 95 Payment Trust prior to commercial operation (Cl. Exh. 034, 035, 037, 039, 041 and 042). The testimony of Mr. Tumbaco, of Electroquil's accounting division, does not alter this finding. His mere recollection of an alleged document evidencing the manufacturer's insistence as to the establishment of the 95 Payment Trust does not convince the Tribunal, absent any such document on record (Tr. pp. 442-444). As for Mr. Larrea's testimony, his analysis of the Claimants' Exhibits 034, 037 and 039 does not prove that the manufacturer actually subordinated shipment to the constitution of the 95 Payment Trust (Tr. pp. 235-237). Upon reading Claimants' Exhibit 037 in conjunction</p>

Fines	Imposition and objection	Parties' arguments		Findings of the Tribunal
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				<p>with Claimants' Exhibit 039, it cannot be established that the manufacturer made the shipment conditional upon the Payment Trusts. Actually, the Minutes of the Board of Directors of Electroquil, dated 4 October 1995, and attached to PPA 95, mention under point 4 that the contract with Stewart and Stevenson would become effective after the 15% down payment, which was delayed because of Stewart and Stevenson itself. The latter was to make a loan for the turbines in the event the financing could not be obtained from Eximbank. To accelerate the process, Electroquil decided to make the 15% down payment through a bridge loan. No mention was made of any Payment Trust in this document, which was issued prior to the conclusion of PPA 95. As a result, the bridge loan referred to in Claimants' Exhibit 039 had no connection with the absence of the Payment Trust. Mr. Larrea confirms in his testimony that "a manufacturer can't impose such conditions" (Tr. p. 206).</p> <p>The Tribunal is of the view that the PPAs did not permit Electroquil to delay commencement of commercial operations on the grounds of the belated constitution of the Payment Trusts. In addition, the Claimants have not shown that the failure to put the 95 Payment Trust into place actually led to the delay in the start-up of Units 1 and 2. Accordingly, the <i>exceptio non adimpleti contractus</i> does not apply.</p> <p><b>On the basis of the foregoing considerations, Fine No. 1 was justified under the circumstances.</b></p>
<p><b>Fine No. 2 of USD 550,000, dated 18 November 1997, based on the late start-up of Units 3 and 4 under PPA 96</b></p>	<ul style="list-style-type: none"> <li>On 18 November 1997, INECEL imposed Fine No. 2 on Electroquil in connection with the delay in starting up Units 3 and 4 under PPA 96 (Exh. C-25 RforA, Cl. Exh. 073, Cl. Exh. 075, R. Exh.</li> </ul>	<p>The Claimants argue that Fine No. 2 was improperly offset against Electroquil's invoice No. 137. The Claimants also argue that the fine's imposition was untimely in that it came five months after the month in which the events giving rise to the fine occurred. Accordingly, Fine No. 2 is time-barred, as it was imposed beyond a reasonable time under PPA</p>	<p>The Respondent argues that the Claimants have not shown that the performance of the PPAs was conditional upon the constitution of the Payment Trusts. Further, it is irrelevant to claim that INECEL's alleged non-performance of PPA 95 could justify Electroquil's breach of PPA 96. Finally, Ecuador denies that its</p>	<p>1. Clause 13.1 of PPA 96 provides:</p> <p><i>The Contractor shall pay INECEL the sum of FIVE THOUSAND AND 00/100 DOLLARS for each day of delay in the commencement of commercial operation after the period of one hundred and fifty days committed to in this Agreement, provided that such delay is not attributable to INECEL.</i></p> <p>The date scheduled for the commencement of commercial operation of Units 3 and 4 being 5 January 1997, Electroquil began commercial operation on 19 June 1997, therefore 164</p>

Fines	Imposition and objection	Parties' arguments		Findings of the Tribunal
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	<p>074).</p> <ul style="list-style-type: none"> <li>On 22 May 1998, Electroquil objected to Fine No. 2 on the grounds of the Respondent's failure to constitute the Payment Trusts (R. Exh. 075).</li> </ul>	<p>96.</p> <p>In addition, Electroquil's failure to commence operations on time was the result of its lack of cash flow in view of Ecuador's late payments under PPA 95 and the difficulties to obtain financing to purchase Units 3 and 4, which stemmed from the Government's failure to implement the Payment Trusts.</p>	<p>right to impose a fine was limited in time.</p>	<p>days later. As noted by the Respondent (R. Answer ¶ 228), INECEL justified the delay of 54 days imposing a fine only for the remaining 110 days in the amount of USD 550,000.</p> <p><b>2.</b> Fine No. 2 was allegedly offset against Electroquil's invoice No. 137. Given that set-offs are considered admissible within the framework of the PPAs (see above), the Claimants' argument in this respect does not succeed. At any rate, the Claimants fail to demonstrate how set-off was improperly implemented in that particular instance and what the ensuing amount would have been had it not been offset.</p> <p><b>3.</b> The Claimants also argue that Electroquil's failure to commence commercial operation on time was caused by its lack of cash flow, itself the result of Ecuador's late payments under PPA 95 and the Government's failure to implement the 96 Payment Trust.</p> <p>In this respect, the record shows that Electroquil advised INECEL several times of its financial difficulties and the need for the 96 Payment Trust (Cl. Exh. 052, 061 and 062).</p> <p>A first letter of 2 September 1996 from Electroquil to INECEL related to the lack of payment of certain invoices under PPA 95 leading to cash flow concerns and the necessity to implement the 95 Payment Trust. Such document cannot <i>per se</i> constitute evidence of events not attributable to INECEL within the meaning of Clause 13.1 of PPA 96, as it relates to PPA 95 and circumstances arising thereunder.</p> <p>On the other hand, two other letters dated 6 January 1997 and 3 April 1997 from Electroquil to INECEL, indicate that Electroquil informed INECEL of the risk of encountering financial difficulties, bringing the performance of Units 3 and 4 to a standstill.</p> <p>As seen above, irrespective of the fact that actual financial difficulties have not been established, the Tribunal is of the view that the PPAs do not permit Electroquil, as contractor, to delay performance on the grounds of the belated constitution of</p>



Fines	Imposition and objection	Parties' arguments		Findings of the Tribunal
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				<p>the Payment Trusts.</p> <p>Fine No. 2 is thus justified because no delay attributable to INECEL within the meaning of Clause 13.1 of PPA 96 has been established.</p> <p><b>4.</b> Finally, the Claimants argue that Fine No. 2 was time-barred, because Clause 13.5 provided that the penalties were to be paid monthly by Electroquil. In the Tribunal's view, this provision cannot be interpreted as barring the assessment of a penalty at a different time during the performance of PPA 96.</p> <p><b>Therefore, under the circumstances, Fine No. 2 was justified.</b></p>
<p><b>Fine No. 3 dated, 12 March 1998, of USD 901,637 and Fine No. 4, dated 20 April 1998, of USD 554,592 based on the failure to meet energy generation quotas under PPA 96</b></p>	<ul style="list-style-type: none"> <li>On 12 March 1998, INECEL imposed Fine No. 3 claiming that Electroquil had failed to meet the contractual energy generation quotas for the month of February 1998 (Exh. C-28 RforA, Cl. Exh. 080, Cl. Exh. 81, Cl. Exh. 083, R. Exh. 088).</li> <li>On 16 March 1998, Electroquil objected to Fine No. 3 on the basis of the alleged inadequacy of the fuel provided by Ecuador (Cl. Exh. 082, R. Exh. 089).</li> <li>On 20 April 1998,</li> </ul>	<p>The Claimants argue that, prior to the notification of these fines by INECEL, Electroquil had complained about the poor quality of the fuel supplied by the Government and warned that this was likely to lead to turbine damage and Electroquil's inability to meet the generation quotas. Furthermore, Electroquil had informed the Contract Administrator that, due to serious damage to the vanes at the first stage of the high-pressure turbine for Unit 4, the turbine should not be operated until repaired in order to avoid damage to the entire unit.</p> <p>INECEL denies that Electroquil can rely on <i>force majeure</i> to excuse its non-performance. However, INECEL fails to take into account the real issue, i.e. the poor quality of the fuel which is not attributable to Electroquil. Therefore, any performance breaches stemming from the poor fuel quality are</p>	<p>The Respondent alleges that Electroquil incurred a shortage in the energy quota of 7231.880 Kwh for February 1998, which justified Fine No. 3, and of 4.717.885 Kwh for March 1998, which justified Fine No. 4.</p> <p>Further, any damage caused to the equipment was to be assumed by the manufacturer, which replaced the defective equipment. The Claimants omit to mention that the manufacturer had itself characterized the turbine corrosion problem as a manufacturing defect, for which it suggested a replacement under the warranty. At any rate, Electroquil should have resorted directly to Petrocomercial or not accept the fuel from Petrocomercial at all.</p>	<p><b>1.</b> Clause 13.3 of PPA 96 provides:</p> <p><i>If the Contractor does not comply with the established quota for the month, INECEL shall impose on it a penalty for each kilowatt-hour not delivered equivalent to the price of the "emergency energy", with a surcharge of one hundred percent. According to the SNI Rate Schedule then in effect.</i></p> <p>Clause 15.7 of PPA 96 provided the quota mentioned in the preceding paragraph, as follows:</p> <p><i>The Contractor warrants availability for each of the units of: Six hundred fifty (650) hours in each of the months of October, November, December, January and March of each year; Six hundred (600) hours in the month of February of each year; Three thousand six hundred (3600) hours during the period from April to September of each year.</i></p> <p><b>2.</b> The Claimants argue that the amounts were improperly offset against the amounts due to Electroquil under invoices 165 (Cl. Exh. 080) and 171 (Cl. Exh. 084). The Claimants' argument fails insofar as set-off has been deemed admissible (see above). Further, the Claimants do not state what amount would be due were set-off to be inadmissible. What the Claimants ultimately seek is the reimbursement of the full amount of the fine on the grounds that it was not justified</p>

Fines	Imposition and objection	Parties' arguments		Findings of the Tribunal
		Claimants	Respondent	
	INECEL imposed Fine No. 4 claiming that Electroquil had failed to meet the contractual energy generation quotas for the month of March 1998 (Exh. C-29 RforA, Cl. Exh. 084, Cl. Exh. 088, R. Exh. 096).	excused.		<p>without explaining how the set-off affected that amount. The Claimants' argument is essentially that Ecuador arbitrarily interrupted Electroquil's cash flow by offsetting the fines, which has not been substantiated (Cl. 1<sup>st</sup> PHB, pp. 46-48).</p> <p>3. The Claimants further argue that the imposition of Fines No. 3 and 4 was ill-founded, because the low generation quotas were due to <i>force majeure</i> or to events not attributable to them, i.e. to the poor quality of the fuel causing turbine corrosion.</p> <p>Clause 8.4 of PPA 96 provided that INECEL would bear the fuel costs but Electroquil would purchase the fuel, in the present instance, from Petrocomercial in accordance with the Fuel Supply Agreement (Cl. Exh. 048).</p> <p>Clause 13.4 of PPA 96 provides that a fine could not be imposed if reasons for the fuel shortage not attributable to Electroquil could be proven.</p> <p>Clause 21 of PPA 96 provides that <i>force majeure</i> was to be defined by reference to Article 30 of the Ecuadorian Civil Code (i.e. <i>unforeseeable event, which is not possible to resist, such as shipwreck, earthquake, seizure by enemies, acts of authority, etc</i>) and that any such event should be notified to the other party within 10 days following its occurrence together with an explanation as to how it affected the performance of PPA 95 and supporting documents.</p> <p>The record shows that Electroquil warned INECEL about the poor fuel quality and the impact on the corroded turbine (Cl. Exh. 079 and 082), which it regarded as a <i>force majeure</i> event. The Tribunal would tend to agree with INECEL's response in this respect (Cl. Exh. 085). The interruption of the plant operation cannot constitute <i>force majeure</i> within the meaning of Clause 21 of PPA 96, since the corroded unit was still under the manufacturer's warranty and repairable (Cl. Exh. 079).</p> <p>Having said that, one should consider the underlying cause of corrosion, i.e. the poor fuel quality. The record shows that Electroquil was not in a position to test the fuel, as INECEL was itself in charge of purchasing the fuel from Petrocomercial</p>

Fines	Imposition and objection	Parties' arguments		Findings of the Tribunal
		Claimants	Respondent	
				during the relevant period of time (Clause 6.2.1 96 Liquidation Agreement; Cl. Exh. 024).  <b>As a result, Ecuador could not justifiably impose Fines No. 3 and 4 on Electroquil.</b>
<b>Fine No. 5 dated, 29 May 1998, of USD 274,550 based on unavailability during the first year of operation under PPA 95</b>	<ul style="list-style-type: none"> <li>On 29 May 1998, INECEL imposed Fine No. 5 based on the alleged unavailability of Units 1 and 2 during the first year of commercial operation (Exh. C-31 RforA, Cl. Exh. 091, R. Exh. 022).</li> <li>On 23 June 1998, Electroquil objected to Fine No. 5 and requested a meeting to discuss the fine (R. Exh. 032).</li> </ul>	<p>The Claimants argue that Electroquil exceeded the requisite number of available hours under PPA 95. PPA 95 states that Electroquil was required only to make both units available for at least 7,500 hours per year. The evidence demonstrates that Electroquil clearly satisfied the aforementioned contractual standard of availability: Unit 1 was available for over 8,500 hours that year and Unit 2 was available for over 8,200 hours.</p> <p>Notwithstanding the unambiguous language governing hours of unavailability under PPA 95, a self-serving definition of unavailability was applied. Indeed, INECEL interpreted unavailability under PPA 95 to be those periods in which units were requested and were not able to operate, regardless of compliance with the 7,500 hours of guaranteed availability. INECEL consequently pointed to 140.4 hours (Unit 1) and 408.7 hours (Unit 2), as periods during the first year of operation, in which the turbines needed to be operable, but were not. INECEL's interpretation of the contract misreads the plain meaning of the terms of PPA 95.</p> <p>Moreover, even if this Tribunal allows</p>	<p>According to the Respondent, there were 549.1 hours of unavailability for Units 1 and 2 during the first operating year, which gave rise to Fine No. 5. Electroquil did not dispute these facts at the time.</p> <p>As regards the Claimants' defense based on reasons not attributable to Electroquil, Ecuador points out that Duke's allegations in this respect all relate to the second operating year and Units 3 and 5 under PPA 96 and are thus irrelevant in determining the present issue.</p>	<p>1. Clause 12.1 of PPA 95 provides: <i>If the availability of the Contractors' generating units is less than the warranted seven thousand five hundred (7,500) hours a year, INECEL shall impose a fine of five hundred American Dollars (US\$500.00) per hour of difference between the warranted availability and the actual availability.</i></p> <p>The record shows that the parties disagreed upon the interpretation of availability hours at the time of the performance of PPA 95 (Cl. Exh. 090). On one hand, INECEL alleged that unavailability time corresponded to periods in which units were not able to operate upon request, regardless of the 7,500 hours of guaranteed availability. On the other hand, Electroquil considered that Clause 12.1 of PPA 95 was clear in that the penalty was to be based upon the difference between guaranteed and actual availability.</p> <p>2. Clause 4.1 of PPA 95 provides in substance that the terms of PPA 95 were to be interpreted literally or in the context thereof so as to determine the intent of the parties.</p> <p>Availability was defined under PPA 95 as the number of hours annually during which each unit was available for commercial operation (Clause 4.3 PPA 95).</p> <p>In light of the above, it is clear that Clause 12.1 referred to the difference between the guaranteed and actual available hours of commercial operation, irrespective of any request, as the Respondent alleges. INECEL's interpretation of unavailability cannot be followed.</p> <p>The Claimants have established that the hours of availability for the first operating year were 8,580.3 for Unit 1 and 8,213.9 for Unit 2 (Cl. Exh. 090).</p>

Fines	Imposition and objection	Parties' arguments		Findings of the Tribunal
		Claimants	Respondent	
		Ecuador to depart from the plain terms of PPA 95 in evaluating unavailability, this fine is still improper because Electroquil's unavailability during the first operating year was often caused by acts not attributable to it. The Claimants present several letters demonstrating Electroquil's timely declarations of its need to suspend operations for various reasons.		<b>As a result, under the circumstances, the assessment of Fine No. 5 in the amount of USD 274,550 was not justified. Accordingly, the Tribunal may dispense with examining the Claimants' arguments regarding set-off, as well as their defense based on reasons not attributable to Electroquil.</b>
<b>Fine No. 6, dated 29 May 1998, of USD 444,387 based on excessive fuel consumption under PPA 95</b>	<ul style="list-style-type: none"> <li>On 29 May 1998, INECEL imposed Fine No. 6 based on the alleged excessive consumption of diesel by Electroquil's turbines (Exh. C-31 RforA, Cl. Exh. 091, R. Exh. 022).</li> <li>On 23 June 1998, Electroquil objected to Fine No. 6 and requested a meeting to discuss the fine (R. Exh. 032).</li> </ul>	According to the Claimants, this fine was improperly offset against invoices 135, 149 and 150. Further, this fine should not have been imposed because Electroquil's excessive fuel consumption was caused by the poor quality of the fuel supplied by Petrocomercial. The poor quality of the fuel made it impossible for Electroquil to meet the fuel consumption limits established in the PPAs; thus, Electroquil's technical breach was caused by an act not attributable to it.	<p>The Respondent alleges that the fuel consumption for the first operating year of Units 1 and 2 was 689,734 gallons in excess, justifying Fine No. 6.</p> <p>The Respondent further argues that according to the Fuel Supply Agreement, Electroquil was to check the quality of the fuel Petrocomercial provided and was in a position to take measures in order to remedy the alleged poor fuel quality. In addition, the fuel could have been purchased from entities other than Petrocomercial.</p>	<p>1. Pursuant to Clause 12.2 of PPA 95, if the number of kilowatt-hours generated with a gallon of fuel was less than the amount warranted in Electroquil's offer, INECEL could impose a penalty equivalent to the cost of fuel required to produce the energy not generated for this reason during the month in question.</p> <p>The Claimants do not challenge the calculation of Fine No. 6 on the basis of the excessive fuel quantity but dispute the alleged set-off operated in the fine itself against invoices No. 135, 149 and 150.</p> <p>2. Set-off being admissible (see above), the Tribunal may dispense with examining the Claimants' argument in this respect. At any rate, the document the Claimants rely upon (Cl. Exh. 091) does not reflect such set-off. Further, the Claimants do not provide any explanation or document to show how set-off was improperly operated.</p> <p>3. The Claimants further argue that the excessive fuel quantity was due to the poor quality of the fuel supplied.</p> <p>Clause 12.2 of PPA 95 provided that the warranted performance was to be based on the fuel characteristics attached to PPA 95, namely diesel No. 2 at an unsubsidized price of S/.2,900 a gallon (Cl. Exh. 005). This is consistent with the definition provided under Clause 4.3 of PPA 95.</p> <p>Further, Clause 15.3 of PPA 95 provided that INECEL was to</p>

Fines	Imposition and objection	Parties' arguments		Findings of the Tribunal
		Claimants	Respondent	
				<p>use its influence in connection with the execution of an agreement between Petrocomercial and Electroquil in order to guarantee the timely provision of No. 2 diesel fuel, which eventually led to the Fuel Supply Agreement (Cl. Exh. 048). INECEL was to reimburse Electroquil for the cost of the purchased fuel (Clause 7.4 PPA 95).</p> <p>However, from September 1996 until 31 March 1999, INECEL took over the purchase of fuel from Petrocomercial and delivered it to Electroquil (Clause 6.2.1 95 Liquidation Agreement; Cl. Exh. 022).</p> <p>During that period, Electroquil informed INECEL of the poor quality of the fuel, that it was contrary to contract specifications and of the related consequences (Cl. Exh. 064; Exh. R-24; Tr. 507;16-21).</p> <p>In light of the above, Electroquil was not in a position to check the quality of the fuel Petrocomercial provided to INECEL.</p> <p>As to Ecuador's arguments that Electroquil could have taken measures to remedy the deficient fuel quality or that such fuel could have been purchased elsewhere, the record shows that on the one hand, certain remedial measures (e.g. centrifuging), which were taken pursuant to Clause 15.2 of PPA 95, could not fully correct the problem, and on the other hand, Petrocomercial had a <i>de facto</i> monopoly over the fuel in Ecuador (Tr. 190:16-191:2, 509:2-511:3).</p> <p><b>As a result, the Tribunal considers that the poor fuel quality leading to the excessive fuel consumption was not attributable to Electroquil, and that Fine No. 6 was not justified under the circumstances.</b></p>
<p><b>Fine No. 7, dated 29 May 1998, of USD 29,181 based on failure to install chillers</b></p>	<ul style="list-style-type: none"> <li>On 29 May 1998, INECEL imposed Fine No. 7 claiming that Electroquil had failed to reach the contractually</li> </ul>	<p>The Claimants submit that this fine was improperly offset against invoices 135, 149 and 150. The Respondent has acknowledged that Electroquil's inability to reach the guaranteed power output resulted</p>	<p>Ecuador replies that Electroquil entered into the agreement for the purchase of the chillers four months before the scheduled date for installation and that the chillers were available for installation on</p>	<p>1. Clause 5.1 of PPA 95 provided that Electroquil was to supply 84.8 MW with real power and to this end, import and install the turbines on Units 1 and 2. Clause 5.1 specifies that the turbines were to be equipped with chillers, which were to be operational 5 months after commercial operation.</p> <p>Where the real power was less than the warranted amount,</p>

Fines	Imposition and objection	Parties' arguments		Findings of the Tribunal
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<p><b>in a timely manner under PPA 95</b></p>	<p>guaranteed power output due to the lack of chillers (Exh. C-31 RforA, Cl. Exh. 091, R. Exh. 022).</p> <ul style="list-style-type: none"> <li>On 23 June 1998, Electroquil objected to Fine No. 7 and requested a meeting to discuss the fine (R. Exh. 032).</li> </ul>	<p>from the lack of chillers. The Respondent fails to acknowledge, however, its role in preventing Electroquil from installing the chillers on time. It was INECEL's payment defaults which prevented the timely acquisition and installation of the chillers. Moreover, Electroquil was unable to install the chillers on time due to circumstances beyond its control, specifically the failure of the manufacturer to assure timely delivery of the chillers. Consequently, this should have been excused based on the doctrine of <i>exceptio non adimpleti contractus</i> and Clause 12.4 of PPA 95.</p>	<p>that date.</p>	<p>INECEL could impose a monthly penalty of USD 250.00 per percentage point of power produced less the amount warranted at the time operations commenced until the difference was corrected (Clause 12.3 PPA 95).</p> <p>The Claimants do not challenge the calculation of Fine No. 7 but dispute the alleged set-off operated in the fine itself against invoices No. 135, 149 and 150.</p> <p><b>2.</b> Set-off being considered as admissible (see above), the Tribunal may dispense with examining the Claimants' argument in this respect. At any rate, the document the Claimants rely upon (Cl. Exh. 091) does not reflect such set-off. Further, the Claimants do not provide any explanation or documentation to show how set-off was improperly operated.</p> <p><b>3.</b> The Claimants further argue that it was INECEL's payment default which prevented the timely acquisition and installation of the chillers. In addition, Electroquil was unable to install the chillers on time due to the manufacturer's failure to deliver the chillers on time.</p> <p>Commercial operation of Units 1 and 2 began on 10 May 1996 (R. Exh. 12), with the result that the chillers were to be operational five months later, i.e. on 10 October 1996, pursuant to Clause 5.1 of PPA 95.</p> <p>The record shows that, on 22 April 1996, Electroquil informed INECEL of the delay in the delivery of the chillers (Cl. Exh. 043).</p> <p>On 28 October 1996, Electroquil informed INECEL that the chillers were available at the Plant but could not be installed in the absence of sufficient funds due to INECEL's payment defaults. Electroquil added that it would proceed to install the chillers as soon as INECEL made the required payment (R. Exh. 33).</p> <p>The record shows that the Respondent failed to make timely payments of some of Electroquil's invoices (see <i>supra</i> Section D(b)(cc)(b) above). Having said this, causation with the alleged ensuing delay in installing the chillers has not been established</p>

Fines	Imposition and objection	Parties' arguments		Findings of the Tribunal
		Claimants	Respondent	
				nor have any actual financial difficulties been shown. <b>As a result, under the circumstances, Fine No. 7 was justified.</b>
<b>Fine No. 8 of USD 2,243,675 (for unavailability of Units 1 and 2 through operating years 2 to 5), Fine No. 9 of USD 1,019,033 (for excessive fuels consumption during operating years 2 to 5) and Fine No. 10 of USD 204,542 (for failure to reach guaranteed level of output during operating years 2 to 5) dated 14 August 2001 under PPA 95.</b>	<ul style="list-style-type: none"> <li>On 14 August 2001, the Contract Administrator imposed Fine No. 8 based on the alleged unavailability of Units 1 and 2 for the required minimum of 7,500 hours per year per unit during years 2 to 5 of PPA 95; Fine No. 9 based on the alleged excessive consumption of fuel during years 2 to 5 of PPA 95; and Fine No. 10 based on a claim that Electroquil had failed to reach the contractually guaranteed power output during years 2 to 5 of PPA 95 (Exh. C-33 RforA, Cl. Exh. 109, R. Exh. 047).</li> <li>On 16 August 2001, Electroquil objected to Fines No. 8, 9 and 10 on the grounds that they were overdue (R. Exh. 048)</li> </ul>	<p>According to the Claimants, INECEL determined the amounts of the appropriate fines based on Electroquil's breaches at the end of each operating year. The Claimants claim, however, that the delays in imposing these fines – over three years in the case of the operating-year-2 fines – were attributable to the time it took for the parties to fully discuss those fines. In view of the fact that the operating-year-5 fines were discussed, disputed, and imposed all within four months following the end of that operating year, it is clear that the delay with respect to the fines for the other operating years was arbitrary, as well as retaliatory, in light of the local arbitration between the parties. In addition, the fines for operating years 2 and 3 ran contrary to the Interim Liquidation Agreement settling all accounts for the first operating year fines up to 31 March 1999.</p> <p>Further, Electroquil's unavailability of Unit 2 was directly attributable to Ecuador, as a result of the low quality fuel it supplied to Electroquil, which in turn caused, as Ecuador has acknowledged, corrosion on Unit 2 and its discontinuance, as well as excessive fuel consumption.</p>	<p>The Respondent alleges that Fines No. 8-10 were entirely based upon the terms of PPA 95. Pursuant to the parties' common liquidation of operating years 2 to 5, a 4,487.35-hour unavailability was determined giving rise to Fine No. 8 in the amount of USD 2,243,675. In this respect, the Respondent further alleges that Electroquil was expected to test the quality of the fuel Petrocomercial provided and was in a position to take measures in order to remedy the alleged poor fuel quality. In addition, the fuel could have been purchased from entities other than Petrocomercial.</p> <p>According to Ecuador, the account liquidation also established an excessive fuel consumption during operating years 2 to 4, giving rise to Fine No. 9 in the amount of USD 1,019,033, as well as the failure to reach the warranted output, giving rise to Fine No. 10 in the amount of USD 204,542.</p> <p>None of those fines were, in Ecuador's view, untimely. The PPAs contemplate specific circumstances that justify the imposition of fines, which is not in</p>	<p>1. The Parties do not dispute the imposition of Fines No. 8-10 under Clauses 12.1 to 12.3 of PPA 95 (Cl. Exh. 109). The disagreement is regarding Clause 12.5 of PPA 95, especially, the timing of such fines. Fines No. 8 to 10 were imposed on 14 August 2001.</p> <p>Clause 12.5 of PPA 95 provides:</p> <p><i>Penalties shall be calculated once a year and shall be paid by the Contractor within fifteen (15) days after notice from INECEL. If a penalty is not paid within the stipulated period of time, the appropriate portion of the performance bond shall be enforced.</i></p> <p>The record shows that the parties jointly drafted liquidation reports at the end of operating years 2 and 3 (R. Exh. 42, R. Exh. 43). Such reports, together with the one relating to operating year 4, were in turn approved by the operation committee in January 2001 (R. Exh. 44).</p> <p>Even though the reports were only approved in 2001, Ecuador was in a position to assess the fines based upon the elements contained in the reports at the end of each operating year. However, Ecuador did not do so until 14 August 2001, that is after expiration of the term of PPA 95.</p> <p>2. As for the Claimants' argument based on the Interim Liquidation Agreement, the Tribunal fails to see how it settled the accounts for the first operating year fines up to 31 March 1999, given that the parties agreed to refer the then current claim for penalties to local arbitration (Cl. Exh. 103). Furthermore, the Claimants have not established that the fines were in fact retaliatory, in view of this local arbitration.</p> <p>3. Finally, the Claimants argue that the underlying events were not attributable to Electroquil given the poor fuel quality. The</p>

Fines	Imposition and objection	Parties' arguments		Findings of the Tribunal
		Claimants	Respondent	
			any way limited or time-barred.	Tribunal refers to its reasoning under Fine No. 6 above.  <b>Accordingly, Fines No. 8-10 were not justified pursuant to Clause 12.5 of PPA 95.</b>
<b>Fine No. 11, dated 10 December 2001, of USD 734,366 based on unavailability of Units 3 and 4 in October 2001 under PPA 96</b>	<ul style="list-style-type: none"> <li>On 10 December 2001, the Contract Administrator imposed Fine No. 11 in an initial amount of USD 641,469, which was raised to USD 734,366 on 24 July 2002, based on the alleged unavailability of Units 3 and 4 during October and November 2001 (Exh. C-34 and C-35 RforA, Cl. Exh. 113, Cl. Exh. 114, R. Exh. 100, R. Exh. 104).</li> <li>On 14 December 2001, Electroquil objected to Fine No. 11 and advised it would communicate its reasons at a later date (R. Exh. 101).</li> </ul> <p>The Tribunal notes that there is no document evidencing these reasons.</p>	According to the Claimants, this fine was improperly offset against invoices issued by Electroquil. Further, INECEL ignored the fact that Electroquil's unavailability during October and November 2001 was the result of a countrywide fuel shortage, which directly affected Electroquil's ability to operate during those months. Because this unavailability is attributed to INECEL, as it was responsible for ensuring the delivery of sufficient fuel to Electroquil, this fine was improper.	The Respondent alleges that, pursuant to the Fuel Supply Agreement, Electroquil was responsible for the fuel to be delivered to the Plant.	<p>1. In their submissions, the Claimants do not dispute the calculation of Fine No. 11 on the basis of Clauses 8.1 and 13.3 of PPA 96 regarding the monthly energy quota (R. Exh. 100, R. Exh. 104). In this respect, the addition of the two separate amounts in R. Exh. 104 is equal to that imposed in R. Exh. 100 so that the issue of reduction raised by the Respondent (R. 1<sup>st</sup> PHB, p. 44) becomes moot.</p> <p>2. On the other hand, the Claimants dispute the alleged set-off operated in the fine itself against certain invoices, without providing any indication as to specifically which invoices are involved. Since set-off was deemed admissible, this argument fails.</p> <p>3. The Claimants further rely on Clause 13.4 of PPA 96, providing that a fine could not be imposed if reasons not attributable to Electroquil could be duly proven.</p> <p>First, there is no element on record evidencing the alleged countrywide fuel shortage.</p> <p>Second, Fine No. 11 was imposed in 2001, with the consequence that the following provisions of PPA 96 govern the issue.</p> <p>Clause 8.4 of PPA 96 provides that, while INECEL would bear the fuel costs, Electroquil would purchase the fuel, in the present instance, from Petrocomercial, in accordance with the Fuel Supply Agreement.</p> <p>Further, Clause 15.6 stipulates that, in addition to installing all equipment for fuel supply and storage, Electroquil was to maintain a reserve sufficient to allow the operation of the plant for 7 days at base load.</p> <p>As for the Fuel Supply Agreement, it provides that Electroquil supply fuel to the Plant depending on Petrocomercial's</p>



Fines	Imposition and objection	Parties' arguments		Findings of the Tribunal
		Claimants	Respondent	
				<p>availabilities, and that it be responsible for the storage of the fuel and the maintenance of the related equipment (Clause 3.1 Fuel Supply Agreement; Cl. Exh. 048).</p> <p><b>Therefore, considering that Electroquil was responsible for the fuel supply at the time of Fine No. 11 and that no grounds for exoneration have been established, Fine No. 11 was justified.</b></p>

292. In conclusion, the Tribunal concurs with the Claimants that fines No. 3, 4, 5, 6, 8, 9 and 10 were not justified and dismisses the Claimants' allegations raised in connection with the other fines.

#### **4.1.4 The Med-Arb Agreements and the local arbitration**

##### **a) Parties' positions**

293. The Claimants consider that a final and binding award on the matter of jurisdiction and on the validity of the Med-Arb Agreements was rendered on 20 September 2001 (Exh. C-45 RforA) and was reversed on 11 March 2002 (Exh. C-44 RforA, Cl. Exh. 23). They submit that there was no legitimate reason for the local arbitral tribunal to revisit *sua sponte* its decision on jurisdiction. Further, the Claimants assert that the Attorney-General failed to honor the State's arbitration commitment.

294. Ecuador asserts that the arbitration proceedings under the 2000 Med-Arb Agreements constituted a local proceeding subject to local law, and that the Attorney-General was thus entitled to raise the nullity of the Med-Arb Agreement. The Attorney-General's previous statement that the disputes between INECEL and Electroquil could be submitted to arbitration was conditional upon compliance with the rules governing arbitration and mediation. The Respondent further submits that international law does not prohibit a State from invoking the nullity of an arbitration provision pursuant to national law, as provided in the New York Convention and the UNCITRAL Model Law.

295. In addition, the Respondent denies any involvement in the making of the award of March 2002. It emphasizes that the local arbitral tribunal conducted the proceedings under the auspices of the Guayaquil Chamber of Commerce, a private entity which has no connection with the State.

##### **b) Tribunal's determination**

296. The Tribunal will first examine whether INECEL and/or Ecuador have violated any of the provisions of the PPAs, Ecuadorian law or the Med-Arb Agreements.

297. By letter dated 18 August 1998, INECEL asked Ecuador's Attorney-General for an opinion as to its capacity to submit any disputes with Electroquil to local arbitration (Cl. Exh. 013, R. Exh. 039). On 9 September 1998, the Attorney-General answered:

*The arbitration agreement may be made independently of the contract, or it may be included in the text of the contract. If this resolution mechanism is not established, then the parties have the power to subject their controversy to this procedure, unless the controversy is an issue that is already pending*

*judgment in the ordinary judicial process, in which case the opinion of the Office of the Attorney General of the State is required.*

*Pursuant to Rule 18 of the Article 7 of the Civil Code, the laws in effect at the time of executing the contract are understood to be part and parcel thereof, except for laws concerning the manner of bringing forth a legal claim with regard to the rights acquired in the contract.*

*The Law of Arbitration and Mediation having been issued with specific procedures and without establishing any limitation on extra-judicial resolution of controversies, provided that there is no pending trial on the matters about which you have consulted me, I consider it pertinent to proceed pursuant to the regulations of that Law.*

(Cl. Exh. 014, R. Exh. 040, Spanish original, English translation provided by the Claimants)

298. This letter is expressly quoted in paragraph 1.5 of the Med-Arb Agreements entered into one and a half years later on 30 May 2000. It appears from the record that the parties did not consult the Attorney-General on the text of the agreements at that time. They rather relied upon the answer given by the Attorney-General in 1998 before the disputes had fully arisen. As noted by the local arbitral tribunal in its award, “[c]onsequently, in this proceeding, it has not been demonstrated that any consultation or opinion whatsoever, with respect to the texts of the arbitration agreements signed on May 30, 2000 have been carried out” (Cl. Exh. 023, Spanish original, English translation provided by the Claimants).

299. Article 4 of the 1997 Mediation and Arbitration Law of Ecuador requires that the parties seek the determination of the Attorney-General prior to submitting an existing dispute with a public sector entity to arbitration. Article 4 reads as follows:

*Art. 4.- All individuals and legal persons with capacity may submit to arbitration under this Law and the requirements herein established. In addition to the requirements addressed in this Law, public sector entities shall meet the following requirements to be entitled to submit a dispute to arbitration:*

*they shall have entered into an arbitration agreement before the dispute arises;*

*where the arbitration agreement is to be signed after the dispute arises, the Attorney-General shall be requested to render an opinion and compliance with such opinion shall be compulsory;*

*the legal relationship to which the arbitration agreement refers, shall be of a contractual nature;*

*the arbitration agreement shall include the method by which arbitrators are to be appointed;*

*the arbitration agreement by which the public sector Institution waives its right to recourse to the jurisdiction of the ordinary courts shall be signed by a person authorized to contract on behalf of said institution.*

*Failure to comply with the above requirements shall result in the invalidity of the arbitration agreement.*

(Cl. Exh. 071, Spanish original, Tribunal's translation)

300. The parties did not consult the Attorney-General prior to proceeding to arbitration. As a result, the local tribunal ruled that the arbitration agreement was invalid. It did so in reliance upon Article 1724 of the Ecuadorian Civil Code, which provides that “*any act or contract which lacks any of the requirements prescribed by law for the validity of the act or contract itself, according to its type and the capacity of status of the parties, is null and void*” (Cl. Exh. 023, Spanish original, English translation provided by the Claimants). It is true that the procedure followed by the local arbitral tribunal which first accepted jurisdiction by two “firm decisions”, to later dismiss the case for lack of jurisdiction, is at best surprising. Be this as it may, it is not disputed that the local arbitral tribunal was a private body acting under the aegis of the Guayaquil Chamber of Commerce, which is a private entity as well. There is no indication on record that the conduct of the local tribunal may be attributed to the State.
301. By contrast, the acts of the MEM or the Attorney-General are attributable to Ecuador. Did they breach the PPAs, Ecuadorian law or the Med-Arb Agreements by raising a defense of lack of jurisdiction and thus negating the consent given by the MEM?
302. Article 4 of the Mediation and Arbitration Law is clear when it subjects the conclusion of an arbitration agreement with a public sector entity after a dispute has arisen to the prior mandatory consultation of the Attorney-General. This requirement was not met when the MEM and Electroquil entered into the Med-Arb Agreements in 2000. The Tribunal does not understand the Attorney-General's opinion of 1998 to lift the requirements of the Arbitration Law. Hence, on the face of Article 4 of the Mediation and Arbitration Law, the Tribunal cannot identify a violation of Ecuadorian law. It does not observe a violation of the PPAs either as the PPAs contained no arbitration clause. Similarly, it finds no violation of the Med-Arb Agreements, which provided for arbitration in Ecuador and were thus subject to Ecuadorian law, specifically to the Arbitration Law including its Article 4.
303. Having said that, the Tribunal has asked itself whether it should go further and review whether Ecuadorian law contains other provisions which would lead to a different conclusion. In this respect, it notes that it has not been alleged by the Claimants that Ecuadorian law contains any provision to the effect that the State or a State entity cannot object to the validity of an arbitration clause to which it has agreed. While the Claimants briefly mention in their Memorial the doctrine of *venire contra factum proprium* or common law estoppel (Cl. Mem., ¶ 236), they do not allege that it applies under Ecuadorian law in the context of a local proceeding. Indeed, it is critical to note here that the arbitration at issue was a domestic and not an international arbitration.

304. Because of the parties' contractual choice of law, which includes "*the applicable principles of International Law*", the Tribunal has further asked itself whether it should resort to the widely accepted international principle that a State cannot invoke its own law to resist international arbitration<sup>22</sup>. The parties' choice of law leaves broad discretion to the Tribunal to determine which of the chosen legal systems shall govern a specific issue<sup>23</sup>. In the present instance, the issue hinges upon the validity of an arbitration clause providing for domestic arbitration under municipal law. It appears in conformity with the nature of the issue to submit it to Ecuadorian rather than to international law.

305. Therefore, the Tribunal concludes that the Attorney-General and the MEM did not breach the PPAs, Ecuadorian law and the Med-Arb Agreements. This conclusion does not foreclose the possibility of a violation under the BIT discussed below (¶¶ 384-404).

#### **4.1.5 Did Ecuador fail to act in good faith?**

##### **a) Parties' positions**

306. The Claimants allege in their Memorial in Chief that by not implementing the Payment Trusts in a timely manner, by breaching the PPAs's penalty regimes, by defaulting on its payment obligations, by imposing customs duties and by breaching the Med-Arb Agreements, Ecuador at the same time breached its obligation of good faith.

307. The Claimants argue that Article 1562 of the Ecuadorian Civil Code provides for performance of contracts in good faith. This obligation to perform in good faith also stems "*from a general duty of the administration and the government to comply with the social policies that support the activities conducted or obtained through contracts*" (Cl. Mem., ¶ 165, referring to the legal opinion filed by Mr. Ponce Martínez). Therefore, the Claimants contend that the duty of good faith is a primary and independent duty under international and Ecuadorian law. The duty to perform in good faith is heightened when the State undertakes obligations towards a private party in furtherance of a public purpose since it is the custodian of the public interest. Accordingly, the PPAs were a

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<sup>22</sup> See e.g, *Framatome SA et al. v. Atomic Energy Organization of Iran*, (Prof. Berthold Goldman, Pres., Prof. Jacques Robert, Prof. Pierre Lalive), Award on Jurisdiction, 30 April 1982, ICC Case No. 3896, J.D.I. 72 (1984); *Benteler v. Belgium*, Award, 18 November 1983, 1989 Rev. arb. 239 discussed by Jan Paulsson in *May a State Invoke its Internal Law to Repudiate Consent to International Commercial Arbitration?*, ARB. INT'L 90 (1986). See also Pierre Lalive, *Transnational (or Truly International) Public Policy and International Arbitration, Report for the ICCA New York Arbitration Congress 1986*, at p. 295. See also Veijo Heskanen, *May a State invoke its domestic law to evade its international obligations?*, TDM, Vol. 2, November 2005.

<sup>23</sup> The Tribunal need not discuss here the application of Article 42 of the ICSID Convention since the choice of law of the parties includes both Ecuadorian law and the applicable principles of international law.

means for the State to carry out its legal, social and economic obligations to provide adequate levels of electric power to the people of Ecuador.

308. While its legal expert, Dr. Parraguez Ruiz, acknowledges the existence of the principle of good faith in the Ecuadorian Civil Code, the Respondent denies having breached its duty to act in good faith.

**b) *Tribunal's determination***

309. With regard to the performance of the PPAs and the subsequent agreements pursuant to Ecuadorian law, the Tribunal found no indication in the record according to which Ecuador would not have complied with the principle of good faith.

310. The position is less evident with respect to the Med-Arb Agreements. The conduct of the Attorney-General could be deemed an improper interference in Ecuador's performance of the Agreements. However, since it concluded that the Attorney-General acted in accordance with Ecuadorian law and did not breach the Med-Arb Agreements, the Tribunal rules out any bad faith conduct in this context as well.

**4.2 Did Ecuador violate the BIT?**

***4.2.1 Issues to be determined***

311. The Tribunal has found that INECEL and Ecuador violated the PPAs provisions and Ecuadorian law by the late establishment and the poor implementation of the Payment Trusts, the irregular imposition of certain fines and penalties, and the non-payment of interest in connection with the amounts due under the 96 Liquidation Agreement. In this section, the Tribunal will determine whether such violations, together with Ecuador's conduct in relation to the claims covered by the Arbitration Agreement, constitute breaches of the applicable principles of international law and, in particular, of the BIT standards.

312. In doing so, the Tribunal will pay close attention to the State's conduct in light of its contractual and international undertakings. Accordingly, the Tribunal will establish whether said conduct resulted in (i) a breach of Ecuador's obligations with regard to the Claimants' investments pursuant to Article II(3)(c) of the BIT (4.2.2); (ii) unfair and inequitable treatment of the investment pursuant to Article II(3)(a) of the BIT (4.2.3); (iii) arbitrary treatment pursuant to Article II(3)(b) of the BIT (4.2.4); and (iv) a denial of justice for having failed to arbitrate disputes locally pursuant to Article II(7) of the BIT (4.2.5).

313. Before turning to the analysis of these issues, the Tribunal will recall the content of the relevant provisions of the BIT, i.e. Articles II(3) and II(7):

3. (a) *Investment shall at all times be accorded fair and equitable treatment, shall enjoy full protection and security and shall in no case be accorded treatment less than that required by international law.*
- (b) *Neither Party shall in any way impair by arbitrary or discriminatory measures the management, operation, maintenance, use, enjoyment, acquisition, expansion, or disposal of investments. For purposes of dispute resolution under Articles VI and VII, a measure may be arbitrary or discriminatory notwithstanding the fact that a party has had or has exercised the opportunity to review such measures in the courts or administrative tribunals of a Party.*
- (c) *Each Party shall observe any obligation it may have entered into with regard to investments.*

[...]

7. *Each Party shall provide effective means of asserting claims and enforcing rights with respect to investment, investment agreements, and investment authorizations.*

#### **4.2.2 Did Ecuador violate the duty to observe obligations entered into with respect to the investment (Art. II(3)(c) of the BIT)?**

##### **a) Parties' positions**

314. The Claimants submit that Ecuador has breached the Payment Guarantee Decree, the Payment Trusts, the PPAs and the Med-Arb Agreements and that these instruments embody obligations in connection with the investment within the meaning of Article II(3)(c) of the BIT.

315. According to the Claimants, the Tribunal must identify Ecuador's obligations in connection with their investment. For the purpose of such identification, the Claimants rely on *Eureka B.V. v. Republic of Poland* to claim that any and all obligations entered into with regard to the investment fall under the umbrella clause. They add that cases concerning the scope of an umbrella clause, such as *Noble Ventures, Inc. v. Romania*, uphold the view that all host-State obligations are covered by the umbrella clause, not only acts performed in the exercise of sovereign powers. Such conclusion is said to be further supported by the interpretation of umbrella clauses derived from the 1992 US Model BIT.

316. By contrast, Ecuador contends that mere contractual disputes should not be decided in accordance with the principles of international law by virtue of an umbrella clause such as Article II(3)(c) of the BIT. For the latter to apply, the Claimants would have to show that Ecuador either interfered with the contractual obligations at stake in its sovereign capacity and thus altered the legal framework of the investment, or disregarded in any

way such obligations. In light of *El Paso v. Argentine Republic*, Ecuador denies any extensive interpretation of the BIT umbrella clause and thus of its obligations (R. Reply, ¶¶ 217-218, R. 2<sup>nd</sup> PHB, ¶ 46).

**b) Tribunal's determination**

317. Art. II(3)(c) reads as follows:

*Each party shall observe any obligation it may have entered into with regard to investments.*

318. On its face and bearing in mind Article 31(1) of the Vienna Convention, which requires interpretation to be “*in good faith in accordance with the ordinary meaning to be given to the terms of the treaty*”, the conditions for a breach of this article are that (i) there exists an “*obligation*” of the State which is (ii) “*entered into with regard to investments*” and which (iii) has not been observed.

319. The significance of umbrella clauses has been heavily debated since *SGS Société Générale de Surveillance SA v. Pakistan* and no consistent view has emerged from cases so far. Whether an umbrella clause in a BIT necessarily elevates any breach of contract by a State to the level of a breach of treaty is a controversial question. Indeed, some tribunals have included into the scope of an umbrella clause contractual obligations such as payment<sup>24</sup> when others have favored obligations assumed through law or regulation<sup>25</sup>.

320. Another open question is whether sovereign interference is needed to constitute a breach of an umbrella clause. While, as indicated by Respondent, language to that effect appears in some cases such as *CMS v. Argentina*<sup>26</sup> and *Pan American Energy & BP v. Argentina* and *El Paso v. Argentina*<sup>27</sup> a majority of decisions do not formulate such distinction.

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<sup>24</sup> See e.g. *Fedax N.V. v. Venezuela*, ICSID Case No. ARB/96/3, Award, 9 March 1998, ¶ 29 and *SGS Société Générale de Surveillance S.A. v. Republic of the Philippines*, ICSID Case No. ARB/02/6, Decision on Jurisdiction, 29 January 2004, ¶¶ 127-128.

<sup>25</sup> See e.g. *SGS Société Générale de Surveillance S.A. v. Pakistan*, ICSID Case No. ARB/01/13, Decision on Jurisdiction, 6 August 2003, ¶ 166; and *LG&E v. Argentine Republic*, ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006, ¶ 175.

<sup>26</sup> *CMS Gas Transmission Company v. Argentine Republic*, ICSID Case No. ARB/01/8, Award, 12 May 2005, ¶¶ 299-300.

<sup>27</sup> *Pan American Energy LLC & BP Argentina Exploration Company v. Argentine Republic*, ICSID Case No. ARB/03/13, Decision on Preliminary Objections, 27 July 2006, ¶¶ 108, 109; *El Paso Energy Company v. Argentine Republic*, ICSID Case No. ARB/03/15, Decision on Jurisdiction, 27 April 2006, ¶¶ 79-81.



321. Given the circumstances of this case, this Tribunal need not address such issues here. First, it notes that the wording of Article II(3)(c) is broad as it refers to “any obligation”. Second, there is an express agreement by the parties in the Arbitration Agreement that the BIT applies to contract disputes relating to the imposition of fines and claims during the execution of the PPAs.
322. Third, an executive decree was specifically issued when Ecuador decided to assume INECEL’s rights and obligations under the PPAs. By Presidential Decree No. 506 of 28 January 1999, the Ecuadorian State, through the MEM, subrogated INECEL in the sales agreements concluded with Electroquil, Ecuapower and Energy Corp. The preamble of such decree insists on the existence of an obligation of the State:

*It is an obligation of the State to honor the obligations contracted with the generators described in this Decree, concerning the performance bonds of the state of Ecuador contained in the trust agreements that were signed as backup for the power and electric energy purchase agreements executed with each of these companies.*

(Cl. Exh. 016, emphasis added, Spanish original, English translation provided by the Claimants)

323. Accordingly, there is no doubt that there exists an obligation of the State vis-a-vis Electroquil in the present case. The first requirement for the application of Article II(3)(c) is thus met. Having said that, the Tribunal notes that Ecuador’s obligation under Decree No. 506 was towards Electroquil and not towards Duke Energy, as Ecuador had not undertaken any obligation, be it of a contractual or another nature, to the benefit of the latter.
324. Turning to the second requirement, i.e. that the obligation of the State relates to an investment, the words “with regard to [an investment]” in their ordinary meaning denote a link, a relation between the obligation and the investment that also seems broad in effect. In this case, the link between the obligations assumed by the Respondent and the investment is clear. For the purpose of the ICSID Convention and the Arbitration Agreement, an investment is defined at paragraph 5 of the Arbitration Agreement as including the PPA 95 and the PPA 96<sup>28</sup>. The primary obligation of the parties, including

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<sup>28</sup> Article I of the BIT further defines investment as:

- (a) *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; and includes:*
- (i) *tangible and intangible property, including rights, such as mortgages, liens and pledges;*
- (ii) *a company or shares of stock or other interests in a company or interests in the assets thereof;*

INECEL and later the State, is to perform the PPAs in accordance with their terms. It follows that the second requirement is equally met.

325. In connection with the third requirement, the Tribunal finds that the Respondent violated its obligations vis-à-vis Electroquil under the PPAs and Ecuadorian law in respect of the late establishment of the Payment Trusts, their poor implementation, the irregular imposition of fines and the non-payment of interest for late payment arising under the 96 Liquidation Agreement. In this manner, the Respondent breached its obligations under the umbrella clause of Article II(3)(c).

**4.2.3 Did Ecuador violate the duty of fair and equitable treatment (Art. II(3)(a) of the BIT)?**

326. After recalling the position of the parties (a), the Tribunal will determine the standard it will apply to assess whether Ecuador breached Article II(3)(b) of the BIT (b), and decide if there is a breach thereof (c).

**a) Parties' positions**

327. According to the Claimants, it is obvious that Ecuador failed to act fairly and equitably with regard to their investment. This is whether the Tribunal concludes that Ecuador failed to maintain a stable and predictable framework for the Claimants' investment, or failed to act transparently and in accordance with the Claimants' reasonable and legitimate expectations. The Claimants submit that they made their investment with the reasonable and legitimate expectations that the Government of Ecuador would act strictly in accordance with its laws and contractual obligations. Ecuador's commitments to the Claimants were echoed in written and oral assurances which were provided by high-ranking government officials prior to the investment and were not complied with.

328. The legal framework for the Claimants' investment encompassed Ecuador's 1997 Law on the Promotion and Guarantee of Foreign Investments, the Payment Decree, the Payment Trusts, the PPAs, the Ecuadorian Constitution and the Civil Code. Ecuador's failure to implement the law by refusing to act in accordance with its contractual commitments or its own Payment Decree constituted a change in the applicable legal structure in violation of international law. Ecuador's failure to pay Electroquil in

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*(iii) a claim to money or a claim to performance having economic value, and associated with an investment;*

*(iv) intellectual property which includes, inter alia, rights relating to [...]; and*

*(v) any right conferred by law or contract, and any licenses and permits pursuant to law.*

accordance with the Payment Decree, the Payment Trusts and the PPAs, as well as its failure to adhere to the contractually-prescribed penalty regime, and the Med-Arb Agreements, clearly constitutes unfair and inequitable treatment in violation of international law.

329. Ecuador denies any such violation of Article II(3)(a) of the BIT. It submits that the facts of the case do not establish that it took any regulatory measures in its sovereign capacity which altered the legal framework surrounding the investment and maintains that it observed its contractual commitments.

330. As to the investor's alleged expectations, the Respondent argues that the Claimants distort the conditions imposed by international law in order to protect the Claimants against commercial risk. The Claimants have neither shown that their expectations were based upon the State's conduct, nor that such expectations were destroyed as opposed to merely upset, nor that this was the result of obscure State conduct, nor that the Treaty seeks to protect against the consequences of poor business decisions.

331. The Respondent claims that, during and after the performance of the PPAs, it maintained a stable framework for the Claimants' investment and adopted a transparent approach. In any event, the Respondent alleges that the duty to grant fair and equitable treatment under the BIT cannot be extended beyond what customary international law provides with respect to foreign investment.

**b) *Applicable standard***

332. The Tribunal will first address whether the standard contained in the Treaty is an autonomous standard or merely reflects customary international law (i). It will then determine its content (ii).

*(i) Nature of the standard*

333. As to this first aspect, the Tribunal is of the opinion that the discussion about the autonomous character of the standard is irrelevant given the circumstances of the case. It also appears overtaken by the evolution in the latest ICSID decisions.

334. As a first element, the Respondent's reliance on *Occidental v. Ecuador*, in which the same provision of the US-Ecuador BIT was at stake, is of little assistance. The Occidental tribunal found Ecuador in breach of Article II(3)(a) of the US-Ecuador BIT for not refunding VAT whilst such refund was a legitimate expectation of the Claimant. The Occidental tribunal further determined whether the relevant legal and business

framework met the requirements of stability and predictability under international law. It found that “*there is certainly an obligation not to alter the legal business environment in which the investment has been made*”<sup>29</sup> leaving aside the question of whether a treaty standard may be more demanding than customary law. The Respondent’s arguments based on Occidental are therefore of no help.

335. Second, the Tribunal finds useful guidance in *Azurix v. Argentina*<sup>30</sup>. The Azurix tribunal analyzed Article II.2(a) of the US-Argentina BIT, which is similar to Article II(3)(a) of the BIT and reads as follows: “*Investment shall at all times be accorded fair and equitable treatment, shall enjoy full protection and security and shall in no case be accorded treatment less than required by international law*”. It thus sought to determine whether such language entailed obligations additional to those required by the minimum standard of treatment of aliens under customary international law.

336. In proceeding to this determination, it considered the treaty language as a floor and not a ceiling and held that the standards under the treaty and under customary international law were substantially similar:

361. [...]. *The last sentence ensures that, whichever content is attributed to the other two standards, the treatment accorded to investment will be no less than required by international law. The clause, as drafted, permits to interpret fair and equitable treatment and full protection and security as higher standards than required by international law. The purpose of the third sentence is to set a floor, not a ceiling, in order to avoid a possible interpretation of these standards below what is required by international law. While this conclusion results from the textual analysis of this provision, the Tribunal does not consider that it is of material significance for its application of the standard of fair and equitable treatment to the facts of the case. As it will be explained below, the minimum requirement to satisfy this standard has evolved and the Tribunal considers that its content is substantially similar whether the terms are interpreted in their ordinary meaning, as required by the Vienna Convention, or in accordance with customary international law.* (Footnote omitted, emphasis added)

337. The Tribunal concurs with this statement and with the conclusion that the standards are essentially the same<sup>31</sup>. This conclusion was also reached by the CMS tribunal in the following terms:

284. *While the choice between requiring a higher treaty standard and that of equating it with the international minimum standard might have relevance in the context of some disputes, the Tribunal is not persuaded that it is relevant in this case. In fact, the Treaty standard of fair and equitable treatment and its connection with the required stability and predictability of the business environment, founded on solemn legal and contractual commitments, is not*

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<sup>29</sup> *OEPC v. Republic of Ecuador, op. cit.*, ¶ 191.

<sup>30</sup> *Azurix Corp. v. Argentine Republic*, ICSID Case No. ARB/0/12, Award of 4 July 2006.

<sup>31</sup> *Ibid.* ¶ 364.

different from the international law minimum standard and its evolution under customary law<sup>32</sup>. (Emphasis added)

(ii) *Content of the standard*

338. Turning to the content of the standard, the Preamble of the Treaty specifies that “*fair and equitable treatment of investment is desirable in order to maintain a stable framework for investment and maximum effective utilization of economic resources*”.

339. The Tribunal concurs with the findings of the tribunals in *CMS, Tecmed, Occidental v. Ecuador*, discussed by the parties, pursuant to which a stable and predictable legal and business environment is considered an essential element of the fair and equitable treatment standard. It is also in agreement with the decision in *LG&E v. Argentina*<sup>33</sup> and finds that a standard of fair and equitable treatment in international law has indeed emerged in the following terms:

*125. Several tribunals in recent years have interpreted the fair and equitable treatment standard in various investment treaties in light of the same or similar language as the Preamble of the Argentina – U.S. BIT. These tribunals have repeatedly concluded based on the specific language concerning fair and equitable treatment, and in the context of the stated objectives of the various treaties, that the stability of the legal and business framework in the State party is an essential element in the standard of what is fair and equitable treatment. As such, the Tribunal considers this interpretation to be an emerging standard of fair and equitable treatment in international law. (Footnotes omitted, emphasis added)*

340. The stability of the legal and business environment is directly linked to the investor’s justified expectations. The Tribunal acknowledges that such expectations are an important element of fair and equitable treatment. At the same time, it is mindful of their limitations. To be protected, the investor’s expectations must be legitimate and reasonable at the time when the investor makes the investment<sup>34</sup>. The assessment of the reasonableness or legitimacy must take into account all circumstances, including not only the facts surrounding the investment, but also the political, socioeconomic, cultural and historical conditions prevailing in the host State. In addition, such

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<sup>32</sup> *CMS Gas Transmission Company v. Argentine Republic*, ICSID Case No. ARB/01/8, Award of 12 May 2005.

<sup>33</sup> *LG&E Energy Corp. et al. v. Argentine Republic*, ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006.

<sup>34</sup> See *Tecmed*, ¶ 154. See also, *Occidental*, ¶ 185, and *LG&E*, ¶ 127.

expectations must arise from the conditions that the State offered the investor and the latter must have relied upon them when deciding to invest<sup>35</sup>.

341. The Tribunal also notes that it appears from a consistent line of cases that a breach of fair and equitable treatment does not presuppose bad faith on the part of the State<sup>36</sup>.
342. In the present case, most of the Claimants' allegations under Article II(3)(a) deals with the non-compliance of the Respondent's contractual obligations. At least in the context of provisions other than the umbrella clause, it is now a well-established principle that in and of itself the violation of a contract does not amount to the violation of a treaty. This is only natural since treaty and contract breaches are different things, responding to different tests, subject to different rules. This is true even in this case, in which the parties have agreed on the BIT as the law governing their contractual relationship.
343. Numerous tribunals have held that a State may breach a contract like an ordinary party without incurring international responsibility. As a consequence, as was for instance held in *RFCC v. Morocco*<sup>37</sup>, "[p]our que la violation alléguée du contrat constitue un traitement injuste ou inéquitable au sens de l'Accord bilatéral, il faut qu'elle résulte d'un comportement exorbitant de celui qu'un contractant ordinaire pourrait adopter" or, in English, "in order for the alleged contract violation to constitute unfair or inequitable treatment within the meaning of the bilateral Agreement, it must result from conduct exorbitant from the one which a regular contractor could have adopted" (Tribunal's translation).
344. Similarly, when the *Impregilo*<sup>38</sup> tribunal reviewed a claim in respect of unforeseen geological conditions, it stressed that the claim did not raise issues beyond the application of a contract:

268. Claims in Respect of Unforeseen Geological Conditions: *Applying the approach outlined above, the Tribunal considers that Impregilo's claims in respect of unforeseen geological conditions, which were the subject of DRB Recommendation 14, and which have since been referred to the Lahore arbitration pursuant to the dispute resolution provisions of the Contracts, are*

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<sup>35</sup> See *Southern Pacific Properties (Middle East) and Southern Pacific Properties Ltd v. The Arab Republic of Egypt*, ICSID Case No. ARB/84/3, Award of 20 May 1992, ¶ 82; *LG&E v. Argentine Republic*, ¶¶ 127-130 and *Tecmed*, ¶ 154.

<sup>36</sup> See *CMS Gas Transmission Company v. Argentine Republic*, *op. cit.*, ¶ 280; *Azurix Corp v. Argentine Republic*, *op. cit.*, ¶ 372 referring to *Mondev International Ltd v. United States of America*, *Loewen v. United States of America*, *Waste Management Inc. v. United Mexican States*, *TECMED v. United Mexican States*.

<sup>37</sup> *Consortium RFCC v. Kingdom of Morocco*, ICSID Case No. ARB/00/6, Award, 22 December 2003, ¶ 51.

<sup>38</sup> *Impregilo S.p.A. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/03/03, Decision on Jurisdiction, 22 April 2005.

not capable of constituting “unfair or inequitable treatment” or “unjustified or discriminatory measures” for the purposes of Article 2 of the BIT. These are matters that concern the implementation of the Contracts, and do not involve any issue beyond the application of a contract, and the conduct of contracting parties. In particular, the matter does not concern any exercise of ‘puissance publique’ by the State. (Emphasis added)

345. The Tribunal concurs with these statements. Establishing a treaty breach is a different exercise from showing a contract breach. Subject to the particular question of the umbrella clause, in order to prove a treaty breach, the Claimants must establish a violation different in nature from a contract breach, in other words a violation which the State commits in the exercise of its sovereign power.

**c) Tribunal’s determination**

346. The Tribunal will review whether Ecuador was in breach of the guarantee of fair and equitable treatment from three perspectives: in the context of the PPAs (i), in the context of the poor implementation of the payment guarantee (ii), and with regard to the Med-Arb Agreements (iii).

347. The Tribunal will examine whether Ecuador failed to secure a stable and predictable legal framework and whether the expectations held by the Claimants when making their investment were reasonable. To identify such expectations and to assess their reasonableness, it may be useful to recall that the investment was made in the political and economic context of Ecuador’s energy crisis and national shortage.

(i) *Did Ecuador violate the fair and equitable treatment in the context of the PPAs?*

\* *The performance of the PPAs*

348. The Tribunal is of the opinion that the delay in the establishment of the Payment Trusts, their poor implementation, the irregular imposition of contract fines and the non-payment of interest on late payments due under the PPAs did not involve the exercise of sovereign power on the part of INECEL or of the State. These acts constitute conduct which any contract party could adopt; they are thus not capable of amounting to a breach of fair and equitable treatment.

\* *Duke Energy and the penalties*

349. Duke Energy argues that it had reasonable expectations regarding the fines which were deceived and that it was denied its right of due process.

350. First, Duke Energy insisted that it had reasonable expectations that there would be no outstanding penalties under the PPAs when it made its investment. As pointed out by the Respondent's expert, it is clear that Duke Energy knew that Ecuador's payments were regularly delayed when it made the investment. At that time, the PPAs for the years 1995 and 1996 had already reached 46.7% and 30% completion respectively and substantial delays in payment had already occurred (1<sup>st</sup> ER Mancero Samán, ¶¶ 43-44). Equally, Electroquil had already been fined six times for a total of USD 1.5 million (idem, ¶¶ 45). In other words, Duke Energy was aware of past penalties when it invested. The Claimants' expert Mr. Kaczmarek testified that "*the fines that had been imposed prior to the investment were taken into account in the capital subscription agreement*" (Tr., p. 904). Mr. Larrea, for his part, stated that at the time of the negotiation "*Duke had already done the complete due diligence of the company, and so it was aware of the situation and how things stood financially, technically with the contracts, so everything entered into the negotiation package*" (Tr., p. 289).
351. Duke Energy was thus aware of the risk that Electroquil could be fined for non-performance and it assumed the related business risk<sup>39</sup>. It appears, however, to have expected that no fines were yet to be imposed on account of facts that predated the investment<sup>40</sup>. The Tribunal does not believe that this expectation can be viewed as reasonable when one bears in mind the manner in which payments were handled and the opacity that prevailed in the administration of the contract prior to Duke Energy's investment. In view of the contract history, the expectation could only have been deemed reasonable if it had been based on clear assurances from the Government.

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<sup>39</sup> See cross-examination of Mickey Peters (PanEnergy's Project Manager (a company acquired by Duke Power Corporation) and Duke Energy's Managing Director of Business Development of Northern Latin America and Vice President of North Latin America responsible for Ecuador), Tr. pp. 362-363:

*Q: Your economic model does allow, however, for penalties to be imposed after your investment?*

*A: The assumption that we make is that we never assumed that you're not going to be able to comply with your contractual commitments. You assume that you will be able to comply, and you don't assume penalties. We knew the contract. We didn't assume that we were going to incur penalties.*

*Q: But there was a risk that you could incur penalties for non performance?*

*A: Yes, of course.*

<sup>40</sup> *Ibid.*, Tr. pp. 362-363:

*Q: So, this would have been a condition precedent of your investment, that there were no penalties outstanding?*

*A: I'm not sure we had that as a condition precedent to our investment, specifically that there were no penalties outstanding, but we made the assumption in our economic model there were no penalties outstanding, no penalties that were yet to be assessed.*



352. The Tribunal has found no assurances on record concerning outstanding penalties. It is true that the Claimants refer to assurances given in meetings held with the Government (see Reply, ¶ 177, 2<sup>nd</sup> WS Gustavo Larrea Real, ¶ 6-16; 1<sup>st</sup> WS Mickey Peters, ¶ 22 and WS John Sickman, ¶ 26). However, the former Minister of Energy and Mines, as well as the Minister of Finance, categorically deny having given such assurances. In the meetings they only explained the economic difficulties faced by Ecuador and expressed their satisfaction with Duke's intention to invest in the country. (WS Raúl Baca Carbo, former Minister of Energy and Mines and WS of Fidel Jaramillo, former Minister of Finance). In view of such contradictory declarations and of the lack of contemporaneous written evidence, the Tribunal cannot but conclude that the existence of assurances is not established.

353. Second, Duke Energy also argues that the State violated its obligation of fair and equitable treatment when the contract administrator imposed fines for alleged past wrongdoing after the Liquidation Agreements had been executed (Cl. Mem., ¶ 197). It does not develop this argument further.

354. In the two instances just referred to, it has not been established that either INECEL or the State imposed the fines under the PPAs in a capacity other than that of a "normal" contract partner. Indeed, the record does not show any use of sovereign power in the fine process. Private contract parties can agree to empower one of them to impose sanctions on the other for unlawful performance of the contract. Such mutually agreed delegation of power derives from the parties' autonomy under the law of contracts. It must be distinguished from the power of the State to impose sanctions in the exercise of its sovereign power. The Tribunal thus concurs with the Respondent when it states that there was no use of the State's "*imperium*" in this context (R. Answer, ¶ 465). Accordingly, such a contract breach is not susceptible of rising to the level of a violation of fair and equitable treatment.

(ii) *Did Ecuador violate the fair and equitable treatment by not implementing the payment guarantee?*

355. It is correct that Ecuador did not take any regulatory measures or legislative actions in its sovereign capacity that altered the existing framework. The State did not interfere directly with the contract. On the contrary, the Claimants complain of Ecuador's lack of intervention, which allegedly destroyed the Claimants' expectations<sup>41</sup>. To assess the

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<sup>41</sup> The Claimants do complain, however, of active measures taken by INECEL (Cl. Reply ¶ 131). These are, however, irrelevant in the present context.

merits of this claim, one must distinguish between the expectations of Electroquil and those of Duke Energy, as they are not necessarily identical.

\* *Electroquil's expectations*

356. According to the Claimants' expert, Electroquil posted losses until 1995<sup>42</sup>. It then signed the PPAs with INECEL with guaranteed revenues of USD 114 million. Electroquil's expectations can thus be said to be embodied in the text of the PPAs.
357. At the time of the PPA 95, Electroquil's expectations were that INECEL would establish and implement the 95 Payment Trust. Contrary to what the Claimants assert, the text of the PPA 95 does not contain any undertaking of a payment guarantee on the part of the Ministry of Finance. The Tribunal understands that the undertaking of the Ministry of Finance applied to payments under the PPA 95 at a later date. It did not apply at the time when Electroquil made its first investment.
358. In addition, here again, it does not appear that INECEL behaved vis-à-vis Electroquil in a manner different from a "normal" contract party. The establishment of the Payment Trust did not imply the exercise of sovereign power. As the Tribunal understands it, any private contractor can undertake to establish a payment trust. It results from these considerations that Electroquil's expectations under the PPA 95 must be regarded as "mere" contractual expectations which are not protected under the BIT.
359. The issue is different with respect to the PPA 96. Indeed, here it appears that Electroquil entered into the PPA 96 with the expectation that the Ministry of Finance would comply with the payment mechanism provided in Clause 8.6 of PPA 96. The Ministry of Finance was to take part in the 96 Payment Trust and to provide a payment guarantee. In the Tribunal's opinion, the Ministry of Finance engaged the responsibility of the State at this juncture and it was reasonable for Electroquil to rely on the Ministry's express commitment.
360. The expectations which this commitment created cannot be deemed "mere" contractual expectations. The Ministry of Finance was not Electroquil's regular contract counterpart. It intervened in the contract framework for the sole purpose of providing the State's payment guarantee. That guarantee entailed the exercise of sovereign power as it implied that funds would be drawn from the Ministry and Public Credit's account.

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<sup>42</sup> 1<sup>st</sup> ER Kaczmarek, page 7.

361. One could ask whether Electroquil's expectation that the Ministry comply with the guarantee was reasonable, considering that payments required INECEL's approval. The Claimants' expert considers that the risk involved in the payment procedure was nil since the invoicing system was "*fairly simple*" (Tr. p. 950). Be this as it may, the Tribunal finds that Electroquil could reasonably rely on the State's representation that it would guarantee INECEL's payments under the 96 Payment Trust. Accordingly, the Tribunal is of the opinion that the Respondent failed to grant fair and equitable treatment to Electroquil's investment by not implementing the payment guarantee.

\* *Duke Energy's expectations*

362. Duke Energy invested in a different context than Electroquil. It was aware of the circumstances surrounding the performance of the PPAs, in particular of the late payments and the imposition of heavy fines. As a result, it appears that Duke Energy requested certain guarantees from the State as a condition precedent to its investment, notably the Payment Decree and the establishment of the Payment Trusts (M. Peters, Tr. p. 305). In fact, it was only after the adoption of the Payment Decree on 10 November 1997 that Duke signed the Letter of Intention on 18 November 1997. Thereafter, it was only after the Payment Trust Agreements had been executed on 17 February 1998 that Duke acquired its stake in Electroquil on 23 February 1998. The Payment Trust Agreements included the express guarantee that the State would pay Electroquil's invoices should INECEL's funds be insufficient.

363. Duke Energy's alleged expectations were that the overdue balance of USD 7.2 million would promptly be "eliminated" through the establishment of the Payment Trusts (Cl. Mem., ¶ 71, 1<sup>st</sup> ER Kaczmarek, ¶ 43). When seeking to determine whether these expectations were reasonable in the circumstances, one might ask whether an experienced investor such as Duke Energy should not have paid closer attention to the procedure set up to implement the payment guarantee. In light of the clear terms of the Payment Trust Agreements and of the Payment Decree, which Duke Energy considered as conditions precedent to its investment, the Tribunal finds that the latter was reasonably entitled to rely on the commitment of the Government. In other words, Duke Energy's expectations must be deemed reasonable<sup>43</sup>.

364. The Tribunal therefore reaches the conclusion that, by not implementing the payment guarantee, the Respondent deceived Duke Energy's reasonable expectations and thus

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<sup>43</sup> Whether Duke Energy made a prudent business judgment is a distinct issue that will be discussed in the damages section.

breached the guarantee of fair and equitable treatment with respect to the Payment Trusts.

(iii) *Claimants' expectations with regard to the Med-Arb Agreements*

365. In the context of the Med-Arb Agreements, one could question that the conduct of the Attorney-General and the MEM was in line with Electroquil's legitimate expectations. This being said, it is true that such conduct was adopted in conformity with Ecuadorian law. It is also true that there is an agreement to say that the Claimants should have been more cautious in their interpretation of the terms of the Mediation and Arbitration Law. Be this as it may, the legitimate expectations which are protected are those on which the foreign party relied when deciding to invest<sup>44</sup>. The Med-Arb Agreements were concluded more than two years later and can thus in no event give rise to expectations protected under the fair and equitable treatment standard.

366. Hence, the Tribunal holds that there has been no breach of the guarantee of fair and equitable treatment in relation to the Med-Arb Agreements.

**4.2.4 Did Ecuador violate the duty not to impair the investment by arbitrary conduct (Art. II(3)(b) of the BIT)?**

367. After recalling the position of the parties (a), the Tribunal will determine the applicable standard under Article II(3)(b) of the BIT (b), before deciding whether Ecuador breached such standard (c).

**a) Parties' positions**

368. The Claimants submit that Article II(3)(b) of the BIT is a stand-alone provision independent from the fair and equitable treatment guarantee. They claim that the Respondent breached Article II(3)(b) because it impaired the Claimants' management, operation, maintenance, use, enjoyment, acquisition, expansion, or disposal of the investment through arbitrary measures.

369. To support such claim, the Claimants put forward that the ordinary meaning of the term "arbitrary" is "*lacking in proper foundation or restraint*" (Cl. Mem., ¶ 201) and refer to the ELSI case to further define the concept of arbitrariness. They further explain that impairment consists of an interference with an investment, or a disruption which proximately causes an injury to the investment (*idem*, ¶ 202, Cl. Reply, ¶ 193), but

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<sup>44</sup> See citations in footnote 34 above.

which does not require complete dispossession of the investment. They add that the impairment standard provides far greater protection than general law.

370. The Claimants contend that Ecuador's capricious and persistent conduct was arbitrary under the BIT. Late payments, imposition of fines and failure to provide an adequate and impartial dispute resolution forum demonstrate a blatant disregard for domestic and international law. Ecuador's conduct was also arbitrary because the Respondent acted outside the scope of any discretion. Further, the Respondent's behavior, both in the local arbitration and before this Tribunal, where it challenged the jurisdiction of the Tribunal, demonstrate that Ecuador did not believe that it had to honor its commitments.
371. The Respondent's acts hampered Duke's management, operation, maintenance, use and enjoyment of its investment and caused Electroquil to make losses of nearly USD 19 million for Duke. Such acts cannot be excused on the ground of the energy crisis.
372. The Respondent considers that there is no separate impairment standard. Relying inter alia on *Saluka*, it argues that the concept of impairment is part of the fair and equitable treatment standard.
373. Ecuador denies having engaged in any arbitrary conduct. It argues that it observed its contractual commitments at all times and used its prerogatives in good faith in reliance on clear and legitimate public purposes, including in the context of the energy crisis. It also observes that the fact that the Claimants agreed to the method of payment in the Liquidation Agreements, except for the fines, shows that there was no arbitrariness or discrimination on the part of the Respondent (R. Reply, ¶ 226).
374. It further submits that impairment requires complete dispossession, as illustrated in *Occidental v. Ecuador* where no impairment was found because the Claimants continued to exercise their rights in a manner fully compatible with the rights to property (¶ 161 of the award, R. Answer, ¶ 497 and seq.).

**b) Applicable standard**

375. Article II(3)(b) of the BIT reads as follows:

*Neither Party shall in any way impair by arbitrary or discriminatory measures the management, operation, maintenance, use, enjoyment, acquisition, expansion, or disposal of investments. For purposes of dispute resolution under Articles VI and VII, a measure may be arbitrary or discriminatory notwithstanding the fact that a party has had or has exercised the opportunity to review such measures in the courts or administrative tribunals of a Party.*

376. The Tribunal notes that no discrimination has been alleged by the Claimants as such. It will thus limit its inquiry to the issue of arbitrariness.
377. In view of the structure of the provisions of the BIT, the Tribunal has difficulty following Ecuador's argument that there is only one concept of fair and equitable treatment which encompasses a non-impairment notion. The Tribunal will thus make a separate determination to decide whether the contested measures were arbitrary and have impaired the Claimants' management, operation, maintenance, use, or enjoyment of the investment.
378. For the sake of its determination, the Tribunal will rely on the ICJ's definition of arbitrariness set forth in *ELSI* as being "*not so much something opposed to a rule of law, as something opposed to the rule of law [...] willful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety*"<sup>45</sup>.
379. It will also refer to the decision rendered in the ICSID case *RFCC v. Morocco*<sup>46</sup>, in which the tribunal considered the articulation between arbitrary conduct and contract breaches in the following terms:

*Le Tribunal n'a pas à procéder à l'examen détaillé des inexécutions contractuelles dont s'accusent mutuellement les parties. Il doit vérifier si le Royaume du Maroc a respecté ses obligations au titre de l'Accord bilatéral. Dans cette perspective, il relève que le refus par ADM de prolonger les délais d'exécution et, partant, l'application des pénalités de retard, ne sont pas des décisions prises en l'absence de tout motif objectif, de façon unilatérale et arbitraire.*

*En réalité, le désaccord des parties, en fait et en droit, ne dépasse pas le cadre normal d'un litige purement contractuel entre le maître de l'ouvrage et l'entrepreneur. (¶ 104)*

and in English

*The Tribunal does not need to proceed to a detailed analysis of the contractual non-performance alleged by each party against the other. It must check whether the Kingdom of Morocco complied with its obligations under the Bilateral Agreement. In that sense, it notes that ADM's refusal to extend the time period for the performance of the contract, and, hence, the application of penalties for late performance, are not decisions that were taken without objective grounds, in a unilateral and arbitrary manner.*

*In fact, the parties' factual and legal disagreement does not go beyond a normal contractual dispute between an owner and a contractor. (Tribunal's translation)*

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<sup>45</sup> *Eletronica Sicula S.p.A. (ELSI) (United States of America v. Italy)*, Judgment, 20 July 1989, ICJ Reports 1989, ¶ 128.

<sup>46</sup> *Consortium RFCC v. Kingdom of Morocco, op. cit.*

**c) Tribunal's determination**

380. The Tribunal cannot share Duke's view that the Respondent breached Article II(3)(b) of the BIT.
381. It is true that INECEL and the Respondent breached the PPAs in certain instances and did not implement its payment guarantee. But contractual breaches do not amount, in themselves, to arbitrary conduct and the Claimants have shown no differences going "*beyond a normal contract dispute*" to use the words of the *RFCC* tribunal. With respect to the payment guarantee of the State, the Tribunal does not consider that Ecuador's behavior "*shocked a sense of juridical propriety*", especially since Electroquil's invoices were paid, albeit late.
382. With respect to the local arbitration and the Med-Arb Agreements, it has not been established that the actions of the local arbitral tribunal could be attributed to the Respondents. In addition, the conduct of the Attorney-General and the MEM, though attributable to Ecuador, complied with local law and can thus not be regarded as arbitrary.
383. Accordingly, the Tribunal holds that Ecuador has not breached Article II(3)(b) of the BIT.

**4.2.5 Did Ecuador violate the duty to provide effective means of asserting claims (Article II(7) of the BIT)?**

384. Prior to determining this issue (b), the Tribunal will summarize the positions of the parties (a).

**a) Parties' positions**

385. The Claimants allege that Ecuador committed a denial of justice by failing to entertain their claims in the local arbitration as well as their tax claims in a timely fashion.
386. With respect to the local arbitration, the Claimants essentially put forward the following arguments:
- Their "*hopes to avail themselves of a fair dispute resolution mechanism were crushed*" (Cl. Mem., ¶ 226) when the local arbitral tribunal rendered its final award on 11 March 2002, denying jurisdiction and reversing two earlier decisions under the pressure of the Government.

- The argument on which the Government relied to “*obtain the nullification of the Med-Arb Agreements, was that the Attorney-General never authorized the execution of the Med-Arb Agreements*” (Cl. Mem., ¶ 228). This argument shocks the conscience because authorization was not required, and even if authorization had been required, it had in reality been given, and had it not been given, the Attorney-General could have remedied the fault.
- The State participated in the pre-arbitration mediation without raising the issue of the nullity of the Med-Arb Agreements. Any objection to jurisdiction was thus untimely and contrary to the doctrine of *venire contra factum proprium* (Cl. Mem., ¶ 236).
- As a matter of international law, “*once the Government agreed to arbitrate its dispute with Claimants [sic] through the Med-Arb Agreements, [...] it was required to uphold that promise*” and its failure to do so is “*a textbook example of the denial of justice*” (Cl. Reply, ¶ 212; see also Cl. 1<sup>st</sup> PHB, ¶ 225).
- Ecuador’s counterargument that the Claimants failed to exhaust local remedies is irrelevant because the international wrong consisted in the State’s frustration of the arbitration agreement. Moreover, no remedies were available in any event.

387. With respect to the tax claims, the Claimants recall that on 16 November 2001 Electroquil filed a petition before a local tax court to claim the reimbursement of customs duties (Cl. Exh. 112). That petition was dismissed and Electroquil appealed on 5 March 2004 to the Ecuadorian Supreme Court which was dismantled by a presidential decree in April 2005 and was not reformed by the time of the filing of the ICSID request (Cl. Mem., ¶ 241). The Claimants argue that this delay is in itself a denial of their tax claims. They further submit that the fact that Ecuador’s judicial system was decapitated by a presidential decree and left without the ability to fully administer justice, is contrary to the host State’s obligation to provide an adequate system of justice to foreign investors under the BIT.

388. The Respondent denies any violation of Article II(7) of the BIT. With respect to the local arbitration, it submits essentially the following main arguments:



- It was not involved in the making of the award of March 2002. The local arbitration was conducted under the auspices of the Guayaquil Chamber of Commerce, a private entity which has no connection with the State.
  - Relying on *Waste Management*, the Respondent submits that a defense raised in local proceedings cannot amount to a denial of justice.
  - In any event, the local arbitral tribunal observed the standards of due process. The award of 20 September 2001 was only a preliminary decision and the Claimants could have sought the annulment of the award of March 2002, a remedy existing under Ecuadorian law, of which the Claimants chose not to make use. The Claimants thus failed to exhaust local remedies and cannot allege any denial of justice. In any event, the dispute is now submitted to this Tribunal by consent of both parties, which rules out a denial of justice.
389. With respect to the customs duties claim, the Respondent contends that any alleged delay in the local proceedings was due to Electroquil, whose counsel did not appear at the hearing set on 29 January 2005. It further explains that the Ecuadorian Supreme Court was reinstated on 30 November 2005 and that a delay between April and November 2005 cannot amount to a denial of justice.

**b) Tribunal's determination**

390. Article II(7) of the BIT reads as follows:

*Each Party shall provide effective means of asserting claims and enforcing rights with respect to investment, investment agreements, and investment authorizations.*

391. Such provision guarantees the access to the courts and the existence of institutional mechanisms for the protection of investments. As such, it seeks to implement and form part of the more general guarantee against denial of justice.
392. As a preliminary comment, the Tribunal notes that the existence and availability of the Ecuadorian judicial system and of recourse to arbitration under the Mediation and Arbitration Law are not at issue here. What is at issue and must be reviewed by the Tribunal is how these mechanisms performed, as well as the alleged failure of the State to respect its promise to arbitrate.
393. The Tribunal will examine these issues with respect to the local arbitration, which was between the MEM and Electroquil (and not Duke Energy as the Claimants seem to suggest in their Reply, ¶ 212). It will not entertain the same issues in connection with

the tax claims as it has determined that it has no jurisdiction over tax matters. Admittedly, one might argue that the present claim deals with access to courts primarily and with taxation only secondarily and that it is therefore covered by the BIT. The Tribunal is disinclined to follow this avenue. It is of the opinion that jurisdiction should not be accepted unless the related intent of the Contracting States can be clearly proven, which is not the case here.

394. It appears not to be seriously disputed, and rightly so, that the acts of the local arbitral tribunal and of the local arbitral institution cannot be attributed to Ecuador. These are private actors whose conduct does not engage the responsibility of the State. The Tribunal will thus focus its inquiry on the behavior of the MEM and of the Attorney-General. In this respect, it notes that it has not been established that the Government exercised pressure on the local arbitrators to reverse the decisions on jurisdiction. It is true that the sequence of events in the local arbitration is puzzling. After having dismissed the Attorney-General's objection to jurisdiction in two decisions on 3 August 2001 and upon reconsideration again on 20 September 2001, the local arbitral tribunal issued a final award denying jurisdiction six months later on 11 March 2002. The evidence given by the president of the tribunal in the present arbitration failed to convince the Tribunal of the merits of such a course of action. This said, the Tribunal does not find that there are sufficient elements on record to conclude that undue influence was exerted.
395. Turning now to the behavior of the MEM and the Attorney-General, the Claimants' argument that the State had participated in the mediation without raising an objection as to the validity of the Med-Arb Agreements does not appear relevant in the present context. Indeed, the rule which is generally accepted in comparative law pursuant to which a defense of lack of jurisdiction must be raised in *limine litis* does not apply to pre-arbitral stages.
396. The Claimants argue that it is widely accepted under international law that a State which refuses to respect its promise to arbitrate with a foreign party commits a denial of justice. Doing so, it fails to recognize that Ecuador's promise related to a domestic arbitration with a local company. The arbitration had its seat in the country, was governed by the local arbitration law, and conducted under local institutional rules. The alleged ground for nullity arose under the law governing the arbitration. This situation differs from that in which a State agrees to international arbitration with a foreign party and then raises a defense of lack of jurisdiction arising from an incapacity under its own law while the arbitration agreement is valid under the law governing the arbitration.

397. By contrast, the Respondent asserts that the mere fact that a State raises a defense of lack of jurisdiction in a proceeding does not amount to a denial of justice. It relies on *Waste Management II*. As aptly summarized by Paulsson: “*The City [of Acapulco] was clearly entitled to raise jurisdictional objections without being deemed to commit an international delict. Even if the objection had been absurd, the delict would have arisen only if the Mexican legal system had upheld it*”<sup>47</sup>. The question therefore is whether the Ecuadorian legal system has upheld the Attorney-General’s objection.
398. The short answer is that Electroquil did not challenge the final award of 11 March 2002 issued by the local arbitral tribunal before the courts of Ecuador and that, as a consequence, the Ecuadorian legal system never came into play to rule on the award of the local tribunal.
399. The Claimants contend that their claim for denial of justice is founded even though they did not challenge the local award because the requirement to exhaust local remedies does not apply when a State reneges on its promise to arbitrate and when no effective and adequate remedies existed in any event. Citing Paulsson, they state that the “*victim of a denial of justice is not required to pursue improbable remedies*” (Cl. Reply, ¶ 217). By contrast, the Respondent insists on the exhaustion of local remedies and contends that Article 31 of the Ecuadorian Mediation and Arbitration Law contains remedies in the event of excess of power or violation of due process.
400. The Claimants are right to point out that there is no obligation to pursue “improbable” remedies. Article 31 of the Mediation and Arbitration Law provides for an action for annulment of arbitral awards on several grounds<sup>48</sup>. The Respondent contends that this

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<sup>47</sup> See Jan Paulsson, *Denial of Justice in International Law*, Cambridge, 2006, p.153-154.

<sup>48</sup> *NULIDAD DE LOS LAUDOS*

*Art. 31.- Cualquiera de las partes podrá intentar la acción de nulidad de un laudo arbitral, cuando:*

*a) No se haya citado legalmente con la demanda y el juicio se ha seguido y terminado en rebeldía. Será preciso que la falta de citación haya impedido que el demandado deduzca sus excepciones o haga valer sus derechos y, además, que el demandado reclame por tal omisión al tiempo de intervenir en la controversia; o,*

*b) No se haya notificado a una de las partes con las providencias del tribunal y este hecho impida o limite el derecho de defensa de la parte; o,*

*c) Cuando no se hubiere convocado, no se hubiere notificado la convocatoria, o luego de convocada no se hubiere practicado las pruebas, a pesar de la existencia de hecho que deban justificarse; o,*

*d) El laudo se refiera a cuestiones no sometidas al arbitraje o conceda más allá de lo reclamado.*

and in English translation provided by the Claimants with notes in brackets by the Tribunal.

provision permits challenges on the ground that a tribunal exceeded its powers by declining jurisdiction (R. Reply, ¶ 247). On the face of the text, none of the grounds expressly address jurisdiction. They appear to deal with instances of breach of due process (a-c) and of excess of powers (d). The decision of the Superior Court of Quito, which the Respondent cites in support of its contention, also deals with an excess of power, the tribunal having ruled on a claim not before it, a situation different from the one at issue.

401. In other words, it is established that an award may be annulled on grounds such as excess of power and breach of due process. It is unclear from the record, however, whether Ecuadorian courts would assimilate an erroneous decision dismissing jurisdiction to an excess of power, as would be for instance the case under Art. 52(1)(b) of the ICSID Convention. Yet, lack of clarity it is not sufficient to demonstrate that a remedy is futile. In other words, the Claimants have not established to the satisfaction of the Tribunal that it was improbable that the Ecuadorian courts would have made such an assimilation.
402. On this basis, the Tribunal concludes that the Claimants have failed to show that no adequate and effective remedies existed.
403. For all these different reasons, the Tribunal concludes that Ecuador has not breached Article II(7) of the Treaty.

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#### NULLITY OF AWARDS

*Article 31. Either of the parties may file a nullity appeal against the arbitration award in the following cases:*

- a) When a party was not notified of the arbitration request as provided by law, and the arbitration was carried out and concluded in default of appearance; and the lack of notification prevented the respondent from submitting exceptions or enforcing his rights. The respondent must request time to participate in the controversy due to such omission; or*
- b) If either of the parties were not notified of the court's decisions, and this fact prevented or restricted the party's right to defense; or [recte: the procedural actions taken by the tribunal]*
- c) When the hearing was not announced or notification of the announcement was not made or, after notification, evidence was not submitted in spite of the need for justification of events; or*
- d) The award refers to questions not submitted to arbitration or goes beyond the arbitration request. [recte: what is claimed or the request for relief] (Exh. C 71)*

### 4.3 Damages

404. The Tribunal has held that Ecuador did not comply with the payment mechanism provided under the PPAs nor with the Payment Trust Agreements, that it owed Electroquil interest on late payments on the amount of USD 96,980.64, and that it imposed certain unjustified fines, i.e. Fines Nos 3, 4, 5, 6, 8, 9 and 10.
405. The Tribunal has also held that such violations resulted in the breach of the umbrella clause with regard to Electroquil and of the principle of fair and equitable treatment with regard to both Claimants.
406. Prior to determining whether the Claimants are entitled to compensation, as a result of such violations, the Tribunal will summarize the positions of the parties (4.3.1). It will then establish the applicable principles and assess the amounts due (4.3.2), starting with the Applicable law (a), the consequences of the violation of the PPAs and Ecuadorian law (b), continuing with the consequences of the violation of the BIT (c), and ending with the choice of the currency (d) and with the beneficiary of the award (e).

#### 4.3.1 Parties' positions

##### a) Claimants' position

##### (i) Applicable law and measure of damages

407. The position of the Claimants has evolved throughout the proceedings. In their Memorial, the Claimants stated that the amount of damages was dictated by the terms of the applicable law upon which the affected investor relied “[...] namely, in this case, the U.S.-Ecuador BIT and Ecuadorian law, as well as the general principles of international law” (Cl. Mem., ¶ 244). In addition, they invoked Article 2229 of the Ecuadorian Civil Code that provides that “any damage that can be attributed to malice or the negligence of another person must be repaired by the latter” (Cl. Mem. ¶ 246). However, at the hearing and in their final post-hearing brief, the Claimants submitted that damages must be determined according to international not municipal law (Tr.p. 38, 1<sup>st</sup> PHB, ¶ 233).
408. In any event, and in reliance on *Chorzów Factory* in particular, the Claimants essentially submit that damages should make them whole (Cl. Reply, ¶ 228). With regard to the measure of damages, they note that there is no “universally accepted measure of damages” for breach of the standards of fair and equitable treatment or for arbitrary treatment and that the Treaty does not articulate a standard either (Cl. Reply,

¶ 225). In their view, this gap should be filled by international law (Cl. Reply, ¶ 226, Cl. 1<sup>st</sup> PHB, ¶ 233) and the measure of damages should be determined in accordance with international law principles. They conclude that “*whatever measure of damages is used*”, the damages should make them whole and “*should be fair, and not result in an unfair outcome*” (Cl. Reply, ¶ 228). On this basis, the Claimants request prompt, full and adequate compensation in US dollars, the currency used in the PPAs.

(ii) *Compensation for losses suffered*

409. The Claimants present two alternative methods of calculation: (i) the losses caused to Electroquil; and (ii) the impairment of Duke Energy’s investment. They note that these two measures of economic loss are not “*mutually exclusive*”. Since Duke Energy’s investment losses are essentially a component of the losses sustained by Electroquil, an award for Electroquil’s losses would compensate both Duke Energy and Electroquil for the loss they have collectively suffered (Cl. Mem., ¶ 247, 1<sup>st</sup> ER Kaczmarek, ¶ 81).

\* *Losses caused to Electroquil*

410. In their Memorial, the Claimants requested USD 24,061,426, which they amended to USD 24,720,904, in their Reply of 31 December 2005. The initial amount of USD 24,061,426 was composed of the following sums (1<sup>st</sup> ER Kaczmarek, Table 13)<sup>49</sup>:

- USD 8,421,050 for interest on late payments.
- USD 14,425,051 for the 11 unjustified fines, i.e. USD 7,292,114 for nominal amount of the fines and USD 7,233,936 for the interest<sup>50</sup>. Fines of USD 4,615,368.83 were imposed under the PPA 95 and fines of USD 2,676,745.35 under the PPA 96<sup>51</sup>.
- USD 1,113,326 for customs duties, i.e. USD 1,008,614 for the duties and USD 105,712 for the interest.

411. These amounts are said to reflect Electroquil’s losses under a commercial damages analysis for breach of the PPAs and of the umbrella clause, which can be summarized as follows:

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<sup>49</sup> No breakdown was given with respect to the second figure advanced.

<sup>50</sup> In total, Electroquil was fined USD 8.18 million. USD 883,703 of those fines was settled for USD 523,881 in the Liquidation Agreements and USD 7,292,114 remained in dispute (1<sup>st</sup> ER Kaczmarek, ¶ 98).

<sup>51</sup> 1<sup>st</sup> ER Kaczmarek, Table 12.

- First, to estimate the amount of interest owed, the Claimants' expert adopts a corporate perspective (a commercial damages analysis) rather than an investor perspective (a diminution of value analysis) (1<sup>st</sup> ER Kaczmarek, ¶ 70). Accordingly, the expert builds an invoicing and payment model taking into account all PPA invoices, accounts receivable records and remittances from Electroquil's accounting department to provide a daily record of the amounts invoiced by Electroquil and the amounts paid to it under the PPAs. The model also computes the daily outstanding receivables owed by Ecuador as well as the daily receivables expected from Ecuador. The difference between the receivables represents the overdue balance owed by Ecuador (1<sup>st</sup> ER Kaczmarek, ¶ 72). To determine the interest accrued on the overdue balance, the expert computes the weighted average active rate (i.e. the lending rate by opposition to the borrowing rate) in US dollars (currency stipulated in the PPAs), as quoted monthly by the Central Bank of Ecuador (i.e. an average of 13.9% between 1996 and 2005) (Cl. Mem., ¶ 75). The overdue balance with interest is then carried forward throughout the effective period of the PPAs, accounting for payments made and invoices issued until 10 September 2002. The resulting overdue balance, with interest, reflects the balance of interest owed due to late payment. To calculate its current value, the balance of interest is then carried forward to 31 August 2005 (the date of filing of the first report).
- Second, to calculate the damage resulting from the imposition of the fines, the expert uses the same invoice and payment model and subtracts each fine from the model. This subtraction increases the overdue balance with interest amount as of 31 August 2005. The Claimants insist that the relevant date from which to calculate interest on fines is the date of assessment because Ecuador improperly used the fines to set off its outstanding payment obligations to the Claimants (Cl. Reply, ¶ 232, 2<sup>nd</sup> ER Kaczmarek, ¶ 40). The Claimants apply a single interest rate to all the items claimed, namely the Ecuador active US dollar rate.
- Third, in order to estimate the harm caused by the imposition of the USD 1,008,614 customs duty charge, the Claimants' expert applies the same weighted average monthly active rate to this amount from the period beginning 1 July 2004 through to 31 August 2005.

\* *Impairment model*

412. As an alternative, with reference to the violations of Article II(3)(b) and (c) of the BIT, the Claimants seek to recover the value of the impairment of their investment as of 31 December 2005 in an amount of USD 19,263,434.
413. This claim is based on an impairment damage analysis based on a scenario of timely payment and absence of fines. The Claimants' expert chose not to apply the standard formula for determining damages by merely calculating the decrease of the fair value of the investment because the amount which Duke Energy invested in Electroquil did not represent the fair market value of the shares acquired (2<sup>nd</sup> ER Kaczmarek, ¶ 48 and seq.)<sup>52</sup>.
414. The formula retained for determining impairment damages is based on the funds committed by Duke Energy to its investment in Electroquil. In other words, it is based on the value of the conditions precedent confirmed by Ecuador prior to Duke's investment (2<sup>nd</sup> ER, ¶ 52). It relies on the "*difference between Duke's contemporaneous expectations for the investment and Duke's expectations for the investment had Duke known INECEL, MEM, and Ecuador would not pay Electroquil's invoice on 30-day terms and would improperly impose penalties and duties on Electroquil*" (Cl. Mem., ¶ 203, 1<sup>st</sup> ER Kaczmarek, ¶ 60). This computation is made by comparing Duke's Electroquil investment model (the Base Expectation Model which yields a 12.95% rate of return) and the Adjusted Expectation Model (which yields a 11.68% rate of return)<sup>53</sup> to determine the loss of return on investment caused by the Respondent's misconduct (Cl. Mem., ¶ 108, 1<sup>st</sup> ER Kaczmarek, ¶¶ 60-64). "*To account for Ecuador's late payment of invoices, we incorporated the actual net charge in the receivables and payables balance from Electroquil's audited financial statements into the Adjusted Expectation investment Model*" (1<sup>st</sup> ER, ¶ 62).
415. This led the Claimants' expert to the following conclusions:

*62. [...] Prior to 2000, invoices were paid so late that Electroquil suffered negative cash flows. Part of the negative cash flow was offset by withholding payment to suppliers. However, in 1998 and 1999, Electroquil was unable to stretch its suppliers as much as Ecuador stretched Electroquil. This imbalance created a negative impact on Electroquil's cash flows and Duke's expected return on investment. In 2000 and 2001, this pattern reversed itself because Ecuador began to pay down the overdue amount owed to Electroquil. Therefore, the working capital impact is essentially a shift of*

<sup>52</sup> If the fair market value were to apply, the Claimants' expert acknowledges that it should be reduced to the 51.5% interest held by Duke Energy (2<sup>nd</sup> ER Kaczmarek, ¶ 47).

<sup>53</sup> That model includes the unexpected fines after Duke Energy's investment, the unplanned working capital requirement due to late payments, and the duty charge.



*cash flow from earlier years to later years. The shifting of cash flow to later years, however, does have an overall negative impact on Duke's expected return on investment.*

*63. After adjusting the Base Expectation Model for 1) unplanned and disputed penalties and duties, and 2) actual working capital requirements created by Ecuador's untimely payment of invoices, the return on investment drops from 12.95 percent to 11.68 percent. **Therefore, it can be concluded that the penalties, duties and late payment of invoices lowered Duke's expected investment returns by 1.27 percent.***

(1<sup>st</sup> ER Kaczmarek, footnotes omitted, emphasis added)

416. According to the Claimants' expert, two logical methodologies can be employed to calculate the economic impact of the lower rate of return.
417. The first approach is based on the assumption that Duke Energy would have reduced its US\$ 38.5 million investment if it had known that the Payment Guarantee and the Trusts would not ensure timely payment and that Electroquil would be improperly fined and charged duties. The reduction of the amount invested would have increased the rate of return on the investment (1<sup>st</sup> ER, ¶ 66). A reduction of the investment of USD 7,271,832 would have restored Duke Energy's expected rate of return of 12.95% (1<sup>st</sup> ER, ¶ 67). Brought to the value of 31 December 2005, this methodology results in an amount of USD 19,263,434 (1<sup>st</sup> ER Kaczmarek, ¶ 67).
418. The second methodology that can be employed to measure the impairment to Duke Energy's investment due to the lower expected rate of return is an alteration of the Adjusted Expectation Model to include a cash inflow or payment at the end of 2005 that would restore the expected return on investment to 12.95%. In application of this method, a payment of USD 19,274,106 at the end of 2005 would have restored the expected rate of return. The difference between the two approaches of USD 10,672 being due to a rounding error, as both approaches should yield the same result mathematically (1<sup>st</sup> ER Kaczmarek, ¶ 68).
419. The Claimants' expert considers that the sum of USD 19,263,434 represents approximately 91% of Duke's total loss (2<sup>nd</sup> ER Kaczmarek, ¶ 54). The portion of the loss not accounted for relates to risks which Duke Energy willingly took, such as the risk involved in converting the plant from diesel to natural gas (Tr., p. 925).
420. In the event that the Tribunal decides that certain fines were justified, the Claimants submit that the value of each justified fine can be subtracted from the impairment model (Tr., p. 871).

(iii) *Law applicable to and computation of interest*

421. With respect to interest, the Claimants argue that it is international law, not Ecuadorian law, which ultimately governs the principle, type, and rate of interest. Accordingly, the Claimants consider that an award of compound interest at the active rate would make them whole (Cl. Reply, ¶ 239, Cl. 1<sup>st</sup> PHB, ¶ 237). In response to the question posed by the Tribunal during the hearing as to whether the active US dollar interest rate applied equally to Electroquil and Duke, the Claimants answered in their first PHB that such rate applied to the commercial damages analysis, while Duke Energy's rate of return applied to the impairment model computation:

*If the Tribunal awards damages based on Claimants' Umbrella Clause claim, which utilizes a commercial damages analysis, the active US dollar interest rate is appropriately applied for this award, which is directed to the company Electroquil as a whole (including Duke Energy's ownership interest in Electroquil). If the Tribunal awards damages based on Claimants fair and equitable treatment claim and/or arbitrary impairment claim, which utilizes an impairment model damages analysis, the multiplier for rendering a present-day value for Duke Energy's losses is not based on a general interest rate, but rather, the IRR for Duke Energy's investment – 12.95%. (¶ 249)*

(iv) *Claim relating to the local arbitration proceedings*

422. Regarding the claim relating to the local arbitration proceedings, the Claimants request an award of USD 271,532.78 plus annual compound interest, i.e. USD 358,954. This amount represents the costs incurred by the Claimants for their participation in the local arbitration proceedings (see Table 5 to 2<sup>nd</sup> ER Kaczmarek).

**b) Respondent's position**

(i) *Applicable law and measure of damages*

423. The Respondent contends that damages must be assessed pursuant to Ecuadorian contract law because the Claimants' allegations fall within the contractual framework and because the BIT contains no standards as to assessment of damages, except for cases of expropriation, which are inapplicable here. They add that Ecuadorian contract law also governs damages for breach of treaty based on the umbrella clause (R. Answer, ¶ 548, R. Reply, ¶¶ 256-257, R. 2<sup>nd</sup> PHB, ¶ 84 and seq.).

424. As to Ecuadorian law, the Respondent alleges that the relevant provisions are those of contractual responsibility and not those wrongly invoked by the Claimants relating to extra-contractual responsibility, notably Article 2229 of the Ecuadorian Civil Code (R. Answer, ¶ 548).

425. In any event, the Claimants cannot obtain higher compensation under the BIT than under Ecuadorian law (R. 2<sup>nd</sup> PHB, ¶ 58). The Respondent also asserts that no claims can be raised under the BIT which arose before the Treaty entered into force, such as the customs duties (R. Reply, ¶ 563 (a)).

(ii) *Compensation for losses suffered*

\* *Electroquil's losses*

426. First, in the Respondent's opinion, the Claimants' expert report is irrelevant and lacks impartiality because it fails to consider the facts and legal arguments presented by the Respondent and wrongly quantifies the Claimants' claims, assuming that they are all well-founded (R. Answer, ¶ 549).

427. The Respondent's second objection deals with the interest claims. The Respondent's expert argues that damages based on improper fines and customs duties should not include an award of interest since these claims cannot give rise to default interest (*intereses de mora*) but only to an adjustment of the face of the amount of the fine or to a duty to compensate for the loss of value during the time of retention. Indeed, they cannot be considered as a commercial debt paid late but must be deemed a revocation of penalty (2<sup>nd</sup> ER Mancero Samán, ¶ 21.1). Therefore, the interest rate should be different.

428. If any of the fines had been unjustified, the compensation would be:

*An adjustment of their nominal amount to compensate for the loss of value during the time of retention, and, accordingly, the application of the active interest rate in dollars and the calculation of interest over interest would be inapposite. This adjustment of the nominal amount of the fines, with the dollar inflation rate, would amount to US\$ 1,125,433 and the present value of all retentions would amount to US\$8,417,546 (at 31 Dec 2005).<sup>54</sup>*

Table 2

<i>Item</i>	<i>Nominal Amount</i>	<i>Adjustment</i>	<i>Total</i>
<i>Fines PPA 95 y PP 96</i>	<i>7,292,113</i>	<i>1,125,433</i>	<i>8,417,545</i>

(R. 2<sup>nd</sup> PHB, Annex D, ¶ 1.2, Spanish original, Tribunal's translation)

429. As it is evident from the quotation above, the Respondent also objects to the use of the active interest rate (*tasa activa*), which only applies to loans by private banks to the Corporate sector (Annex D, R. 2<sup>nd</sup> PBH, ¶ 3.2). The application of an active interest

<sup>54</sup> This position was also explained by the Claimant's expert during his expert report (Tr., vol 4, 27 April 2006, p. 984-985).

rate would result in another unjust enrichment on the part of the Claimants (R. 2d PHB, ¶ 124). Under Ecuadorian law, unless the parties agree otherwise, the applicable rate is the “legal interest rate” (R. Answer, ¶ 558). This rate corresponds to the “risk free rate” established weekly by the Central Bank on the basis of the “basic rate” of the average return of public bonds (2<sup>nd</sup> ER, ¶ 25.3), or in other terms to the passive rate (“*tasa pasiva preferencial*”). “*Tasa pasiva preferencial*” was available before and after the dollarization of the Ecuadorian economy; it generally exceeds the inflation rate of the US dollar (Annex D, R. 2<sup>nd</sup> PHB, ¶ 6.4). Indeed, the applicable rate should at least maintain the value of the disputed amounts and should reflect the lost value caused by the passing of time. Since the PPAs were to be paid in US dollars and damages are to be calculated in the same currency, the inflation of the US dollar is therefore the best measure of such deterioration. In the Respondents’ view, the preferential passive rate is the rate that most accurately reflects the deterioration caused by the inflation and, in consequence, should be the applicable rate (2<sup>nd</sup> ER Mancero Samán, ¶¶ 24, 25, R. 2<sup>nd</sup> PHB, ¶ 125). Indeed,

*If there is something to reimburse with interest, the rate to be used, should reflect value for money, in terms that at least the capital value of the judgment remains intact, i.e. the interest rate chosen shall not be less than the inflation rate that best reflects the deterioration of the value of the currency.*

*(R. 2nd PHB, ¶ 125, Spanish original, Tribunal's translation)*

430. In the event that the Tribunal decides that fines have been wrongly imposed, the Respondent considers that interest should be calculated as of the date of payment collection rather than the date of assessment, as held by Claimants (R. Answer, ¶ 554).
431. As for interest on late payment, the Respondent argues that it can give rise to default interest (R. Answer, ¶ 560), which should be capped at 10% as provided by the Central Bank’s regulations (R. 1<sup>st</sup> PHB, Annex D, 11.1).
432. Finally, the Respondent objects to the use of compound interest on the ground that it is prohibited under Ecuadorian law. (R. Answer, ¶ 559, R. Reply, ¶ 261, R. 1<sup>st</sup> PHB, ¶ 207). It adds that, even under international law, an award of compound interest would not be in conformity with earlier decisions in investment disputes. In reliance on *Santa Elena*, in particular, as well as on *Aucoven* and *Marvin Feldman*, it notes that compound interest may be awarded for expropriation but not for contract claims. With reference to writings by John Gotanda, it also argues that an award of compound interest would result in unjust enrichment (R. 2<sup>nd</sup> PHB, ¶ 105 and seq.). In addition, compound interest may only apply as of the date of the Request for Arbitration (R. 2<sup>nd</sup> PHB, ¶ 117).

433. The Respondent's last objection refers to the currency of the debt. It contends that the claim computation fails to distinguish between "*the period within which the obligation to pay must be fulfilled in sucres [...] and a second period beginning with the substitution of the monetary regime and the adoption of the dollar as legal currency [...]*" (R. Reply, ¶ 556, Spanish original, Tribunal's translation). Indeed, prior to the dollarization in January 2000, Electroquil collected its invoices at the conversion rate of the date of payment. Considering the loss of value of the sucre vis-à-vis the dollar, this payment system resulted in an advantage to Electroquil (R. Reply, ¶ 557). Moreover, certain of the fines at stake were imposed under the sucre regime (44.08%), while the rest were assessed after the dollarization in January 2000 (1<sup>st</sup> ER Mancero Samán, ¶ 32). If any of the fines should be held unfounded, the damage calculation should take account of the effects of the abandonment of the sucre in favor of the dollar.

\* *Impairment of Duke Energy's investment*

434. The Respondent further contests the impairment model used by the Claimants' expert in terms of methodology and underlying assumptions. It especially disputes the assumption about Duke Energy's expectations, since the latter had knowledge of the administration of the PPAs.

435. For the Respondent's expert, there is no impairment related to the fines and the arrears accumulating in paying the invoices and there is therefore no need to provide an alternative calculation (Tr., p. 976). Duke Energy should have calculated its expected rate of return on the basis of the then current contingencies, including fines and delays (Tr., p. 981). The Respondent's expert recalls that in its letter of intent for the acquisition of a controlling interest in Electroquil of 12 November 1997, Duke Energy had mentioned a rate of return of 11.79% for an investment of USD 45 million (1<sup>st</sup> ER Mancero Samán, ¶ 40). He also puts forward that no further loss of profits could arise after the liquidation of the PPAs since there were no further operations.

436. In addition, Ecuador contends that Duke Energy's entitlement is limited to its participation in the share capital of Electroquil at the time when the acts that were complained about occurred, which amounted to 51% (R. Reply, ¶ 563 (b)). Any compensation in excess of this amount would be speculative and would make Ecuador liable for commercial risks which Duke Energy had assumed.

(iii) *Law applicable to and computation of interest*

437. For the Respondent, interest is governed by Ecuadorian law, which allows only simple interest. As already mentioned in detail above (¶429), Ecuador contends that the relevant rate is the *tasa pasiva preferencial*.

(iv) *Damages arising out of the local arbitration proceedings*

438. Aside from its general objection against compound interest, the Respondent has not expressed a position as to the quantum of this particular claim.

**4.3.2 The Tribunal's analysis**

439. The determination of damages will follow the analysis of the claims on the merits. The Tribunal will first address the issues relating to the breach of the PPAs and Ecuadorian law (b) and subsequently the breaches of the BIT standards (c). It will first deal with the applicable law (a).

**a) Applicable law**

440. Having reviewed the parties' arguments, the Tribunal sees no reason to depart from its ruling on the law governing the merits of this dispute in general. Hence, it will assess the damages by application of the law of Ecuador as well as by application of the relevant principles of international law. It will discuss which rules to apply if and when the issue arises, including with regard to interest.

441. The question is not about the preeminence of one rule over the other but about applying the relevant rule depending on the type of norm that has been breached. It is the Tribunal's task to identify the specific rules that dictate the consequences for each of these breaches. Once these rules have been identified and their consequences established, the Tribunal will address the question of possible overlapping claims for reparation in such a fashion as to avoid double recovery.

**b) Consequences of the violation of the PPAs and Ecuadorian law**

442. The Tribunal found that the Respondent has violated its obligations with regard to the Payment Trusts and the imposition of certain fines and owes Electroquil interest on late payments. As rightly noted by the Respondent, these breaches primarily derive from the PPAs and it is therefore the contractual regime that applies to determine the consequences of such breaches. In light of the PPAs' silence in this respect, the general contractual regime of the Ecuadorian Civil Code applies.

443. The starting point is Article 1599 of the Ecuadorian Civil Code, which provides that compensation for unlawful contract performance includes actual costs and lost profits:

*Art. 1599.- Compensation for damages includes damages and loss of profits, whether they arise from not having performed the obligation, or from faulty performance, or from delay in performance.*

(Spanish original, Tribunal's translation)

444. Accordingly, the failure to fulfill an obligation or its late fulfillment entitles the creditor to compensation ("*indemnización*"). This compensation includes *damnum emergens* and *lucrum cessans*. Additional provisions of the Ecuadorian Civil Code provide that the debtor is only responsible for the damages that were or could have been foreseen at the time of conclusion of the contract if the inobservance of the obligation does not result from willful misconduct ("*dolo*")<sup>55</sup>. Further, when the obligation is an obligation to pay an amount of money, the creditor need not provide proof of any harm. The harm is presumed by the passage of time and reflected in the rate of interest agreed by the parties. If the rate has not been agreed, "legal interest" is due from the date when the wrongful conduct occurred<sup>56</sup>.

445. The Tribunal also notes that this regime includes the notion of "*mora*", a notion that has been extensively discussed by the parties. It refers to the situation in which the debtor has not fulfilled its obligations on time. When the compensation is owing to late performance, it must be paid as from the time when the "*mora*" occurs<sup>57</sup>.

446. After careful examination, the Tribunal reaches the conclusion that to quantify the contractual damages, the Tribunal will resort to the method based on commercial losses incurred by Electroquil, which is the most appropriate method at this juncture.

(i) *Payment Trusts*

447. The Tribunal has found that the Payment Trusts were not established prior to commercial operation and were poorly implemented. Having said that, the Tribunal must review whether this caused any injury to Electroquil.

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<sup>55</sup> Art. 1601.- If wrongful conduct (*dolus*) cannot be attributed to the debtor, he will only be responsible for the damages that were foreseen or could have been foreseen at the time of the contract. (Spanish original, Tribunal's translation)

<sup>56</sup> Art. 1600.- Compensation for damages is owed from the time of the debtor's default or, if the obligation is to refrain from doing something, from the moment of the contravention. (Spanish original, Tribunal's translation)

<sup>57</sup> *Ibid.*

448. It should be borne in mind that the establishment of the Payment Trusts and their subsequent implementation were substantial obligations on the part of INECEL and the State. The record shows that the violation of this obligation resulted in the late payment of Electroquil's invoices. Indeed, according to Mr. Tumbaco, the poor operation of the Payment Trusts and the late payment of the invoices significantly reduced the income and cash flow of Electroquil, which resulted in the latter posting losses in all fiscal years from 1996 to 1999 (1<sup>st</sup> WS, ¶ 31). Mr. Tumbaco alleged that the late payments resulted in four specific categories of damages (i) expenses incurred to refinance the liabilities, (ii) loss of income, (iii) imposition of additional fines on behalf of the Government, and (iv) outstanding interest (*idem*, ¶ 51). The Tribunal notes that part of these four categories of damages is compensated by interest for late payments and by the repayment of unjustified fines (see (ii) and (iii) below). For the rest, no corresponding figures were presented in the report of the Claimants' expert. Indeed, Electroquil's additional working capital costs incurred due to late payments have not been claimed by Electroquil but by Duke Energy in the form of a claim of reduced return on its investment. These items will thus be analyzed when assessing the alleged impairment of Duke Energy's investment.

449. Beyond these damages, the record contains no evidence of other damages resulting from the late establishment and subsequent inadequate implementation of the Payment Trusts.

*(ii) Compensation for late payments*

450. The Tribunal has held that no interest was due for late payment except on the amount of USD 96,980.64 arising out of the 96 Liquidation Agreement (see ¶ 279 above).

451. The Tribunal must now determine the applicable interest rate, whether interest must be simple or compound, and the period during which interest accrues.

452. With respect to the applicable interest rate, pursuant to Article 2110 of the Ecuadorian Civil Code, interest is to be paid at the rate quoted by the Central Bank. The Ecuadorian Central Bank quotes weekly an active and a passive rate. The Tribunal is of the opinion that the applicable rate should be the active rate of the Ecuadorian Central Bank quoted in dollars. Indeed, the active rate was the one to apply to the Claimants' borrowings and the Tribunal does not see any reason to choose the passive rate in such circumstances. The Tribunal is mindful that the rate of conversion in US dollars is high but it is the rate that applied in Ecuador before and after the dollarization to local companies (see Annex D, R. 2<sup>nd</sup> PHB, ¶ 4.2).



453. In its second post hearing brief, the Respondent invoked Article 5 of the *Regulaciones del Directorio del Banco Central de Ecuador, Título VI, Sistema de Tasas de Interés; Capítulo VI, Tasas de interés de mora y sanción por desvío* (Spanish original, Tribunal's translation) which reads as follows:

*Article 5 .- For acts or contracts that have been agreed outside the financial system, incurred in arrears, the rate of arrears will be obtained by applying a surcharge of up to 10% (0.1 times) to the stipulated rate. Such surcharge, plus the agreed interest rate, will constitute the arrears to be applied from the date of maturity of the obligation, which will run only until the date on which payment is made.*

(Annex D, R. 2nd PHB, Spanish original, Tribunal's translation)

454. The Respondent concluded that *"if the Tribunal decides to grant compensation with default interest, it should consider that the maximum surcharge of "up to 10%" would apply to the TPR stipulated in the award, as from the expiration date of the obligations"* (R. 2<sup>nd</sup> PHB, Annex D, ¶ 11.4, Spanish original, Tribunal's translation).

455. The Tribunal notes that the Respondent's allegations were made in its last written pleading and thus remain unanswered, a situation which may raise concerns of due process. It further recalls that the Parties had not agreed on an interest rate in the PPAs. Hence, in this case, there is no *"tasa estipulada"* or *"tasa convenida"* to which the maximum 10% *"recargo"* may apply. As a result, the Tribunal will not rely on Article 5 of the Central Bank Regulation quoted above.

456. The Respondent also argues that the appropriate interest rate should be equivalent to the correction of the inflation on the U.S. dollar (R. 2<sup>nd</sup> PHB, Annex D, ¶ 1.2). The Tribunal cannot follow this argument. The inflation in the U.S. does not appear to be the appropriate measure of late interest for debts owing in Ecuador even though the Ecuadorian economy is dollarized. Indeed, mere compensation for inflation would not make the creditor whole for the deprivation of the money unduly withheld. To compensate for the lack of funds, the creditor will have to borrow at a rate that includes an inflation component but also comprises a price for the use of the funds lent.

457. The Tribunal must further decide whether simple or compound interest should be awarded. It agrees with the Respondent's argument in favor of simple interest. Indeed, Ecuadorian law prohibits compound interest in the present case. Specifically, Article 244 of the Ecuadorian Constitution prohibits compound interest in the context of credits. Similarly, Article 2140 of the Civil Code provides that *"it is prohibited to stipulate interest on interest"* (Spanish original, Tribunal's translation). The same prohibition is contained in the Code of Commerce (R. 2<sup>nd</sup> PHB, Annex C, ¶ 2.3).

458. Finally, the Tribunal must establish the date from which interest is to be applied. It considers that interest on late payments should begin to be applied as from 28 August 2002, i.e. from the date of execution of the 96 Liquidation Agreement, until payment of that sum had been made. Whilst the payment is said to have been made (R. Answer., ¶ 278) –and this has not been disputed – the exact date of the payment of that sum does not appear to be on record. The only recorded mention of such payment seems to appear in a letter of 3 September 2002, in which the MEM requested the Central Bank of Ecuador to proceed with that payment (R. Exh. 108).

(iii) *Fines and penalties*

459. While the parties are in agreement as to how to calculate compensation for the wrong imposition of fines, which is to be determined by the nominal amount of the wrongly imposed fine plus interest, they disagree on the type and rate of interest.

460. The wrongful imposition of fines and penalties resulted from the wrongful application of the contractual provisions. Therefore, the consequences must be measured by application of the contractual regime. The compensation for the non-compliance with the contractual provisions must thus include the amount of the fine imposed and the interest on such amount from the date on which the fine was set off by INECEL, i.e. from the date on which the Claimants were effectively deprived of the use of the monies.

\* *Principal*

461. According to the Claimants, the principal amount of the alleged damages based on fines and duties was USD 8,300,727 (1<sup>st</sup> ER Kaczmarek, Table 13, p. 30).

462. Taking into account its determinations on liability, the Tribunal considers that the principal amount due is USD 5,578,566. It reaches this amount by deducting from the amount claimed the claims for customs duties (USD 1,008,614) and the fines which it deemed unjustified, namely fines No. 1 (USD 400,000), No. 2 (USD 550,000), No. 7 (USD 29,181) and No. 11 (USD 734,366).

\* *Interest*

463. Having established the principal amount owing, the Tribunal must now determine the applicable interest, specifically the rate, whether interest must be simple or compound, and the period during which interest must accrue.

464. The total amount of interest claimed amounts to USD 7,233,936 (1<sup>st</sup> ER Kaczmarek, Table 13, p. 30).
465. The considerations set forth above with respect to the calculation of interest on late payments apply equally to the computation of interest on the fines.
466. As for the starting date, interest must run from the date on which INECEL proceeded to setting off the fines, when the date of set-off can be established, or from the date of the liquidation of the fines when the alleged set-off date cannot be established on the basis of the record. Thus interest shall run from:
- 15 March 1998 for fine No. 3;
  - 20 May 1998 for fine No. 4;
  - 29 June 1998 for fines No. 5 and No. 6;
  - 27 November 2001 for fines No. 8, No. 9 and No. 10.

**c) Consequences of the violations of the BIT standards**

*(i) Standard of reparation*

467. The Claimants are correct in stating that the consequences of the breach of an international obligation should be determined by recourse to international law. Under international law, it is well established that the principal consequence of committing a wrongful act is the obligation for the party to repair the injury caused by that act<sup>58</sup>. However, controversy remains regarding the applicable standard and measure of compensation as well as the proper method of calculating such compensation.
468. In the circumstances, the Tribunal considers that the principle of the *Factory at Chorzów* according to which any award should “as far as possible wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed”<sup>59</sup> constitutes good guidance. The Tribunal notes that the principle of “full” compensation has been further codified in Article 31 of the International Law Commission Articles on Responsibility of States for Internationally Wrongful Acts and sees no reason not to apply this provision by analogy to investor-state arbitration. Having said that, the Tribunal wishes to

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<sup>58</sup> *Case concerning the Factory at Chorzów (Germany v. Poland)*, 1928, PCIJ, Series A No. 17, p.21.

<sup>59</sup> *Ibid.* p. 47.

emphasize that compensation will only be awarded if there is a sufficient causal link between the breach of the BIT and the loss sustained by the Claimants.

(ii) *Compensation*

469. The Claimants have asked this Tribunal to provide compensation rather than restitution. The Tribunal will thus proceed to determine the principles applicable to determine the measure of compensation. The BIT contains no guidance for evaluating damages arising from breaches other than expropriation. In accordance with relevant case law<sup>60</sup>, the Tribunal must therefore identify the measure of compensation which is most appropriate in the circumstances of this case.

\* *Umbrella clause*

470. The Tribunal must examine which damages Electroquil is entitled to in respect of the breach of the umbrella clause.

471. The Tribunal has decided above that the Respondent has violated its obligations vis-à-vis Electroquil under the PPAs and Ecuadorian law in respect of the late establishment of the Payment Trusts, their poor implementation, the irregular imposition of fines and the non-payment of interest for late payment arising under the 96 Liquidation Agreement. On this basis, it has held that Electroquil is owed compensation with regard to (i) its payment of interest on late payments and (ii) its payment of unjustified fines (see ¶¶ 450-466 above).

472. The Tribunal is of the opinion that compensation for the breach of the umbrella clause is subsumed in the compensation already awarded. Indeed, Electroquil has suffered the same financial consequences from the violation of the PPAs and Ecuadorian law and the breach of the umbrella clause.

473. More precisely, as far as payment of interest on late payments is concerned, the Tribunal finds no reason to depart from the determination it made above as to the applicable rate of interest (see ¶¶ 455-457 above). It considers that the prohibition of compound interest contained in local law must be enforced especially considering Article VIII of the BIT which specifies that the Treaty shall not derogate from the laws and regulations of the host State. In addition, although increasingly common in ICSID practice, the award of compound interest is not a principle of international law.

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<sup>60</sup> See for instance *CMS v. Argentine Republic*, ¶ 409. See also *S.D. Myers, Inc v. Government of Canada*, UNCITRAL Rules, Second Partial Award, 21 October 2002, ¶ 309; *Marvin Feldman v. United Mexican States*, ICSID Case No. ARB(AF)/99/1, 16 December 2002, ¶ 195.

474. In addition to the amount of the unjustified fines, the Tribunal also awarded to Electroquil interest at a simple rate (¶ 457). The Tribunal considers that this award also adequately compensates Electroquil for the breach of the umbrella clause. The reasoning applied in the foregoing paragraph with regard to interest applies here too.
475. As already indicated (¶ 449 above), the only financial consequence that has been claimed with regard to the late establishment of the Payment Trusts and their subsequent inadequate implementation, including the non-implementation of the State's payment guarantee, is working capital costs incurred due to late payments. This said, Electroquil has not claimed any damages in this respect. Indeed, Duke Energy has claimed the additional working capital costs incurred by Electroquil due to late payments in the form of a claim of reduced return on its investment, which will be reviewed below (¶ 482).
476. The Tribunal thus concludes that, what was awarded under the PPAs and Ecuadorian law, encompasses the compensation owed with regard to the violation of the umbrella clause of the Treaty, and represents full reparation in light of the *Factory at Chorzów*. In addition, the Tribunal is satisfied that such a decision avoids the risk of double recovery.

\* *Fair and equitable treatment*

477. The Tribunal must now examine the financial consequences of the violation of fair and equitable treatment under Article II(3)(a) of the BIT with regard to the late establishment of the Payment Trusts, their poor operation and the resulting late payments.
478. Electroquil incurred additional working capital costs that have been claimed by Duke Energy in the form of a claim of reduced return on its investment. As seen above, the Claimants' expert concluded that "*the penalties, duties, and late payment of invoices lowered Duke's expected investment returns by 1.27 percent*" (1<sup>st</sup> ER Kaczmarek, ¶ 63). This allegedly yielded an economic loss of USD 19,263,434 million measured at the end of December 2005 (1<sup>st</sup> ER Kaczmarek, ¶ 69).
479. The Tribunal cannot rely on the Claimants' figures to assess the damages claimed. The 1.27% decrease of the rate of return is caused by three compounded factors: the penalties, customs duties, and late payments. Now, it has held that Ecuador did not breach the guarantee of fair and equitable treatment with respect to the penalties and it has declined jurisdiction over the customs duties. Hence, the only remaining factor causing the reduction is that of the late payments.

480. According to the evidence of the Claimant's expert, prior to 2000, invoices were paid so late that Electroquil suffered negative cash flows. These delays altered Electroquil's working capital requirements significantly. This pattern was reversed in 2000 and 2001 with the result that *"the working capital requirement impact is essentially a shift of cash flows from earlier to later years"* (1<sup>st</sup> ER Kaczmarek, ¶ 62). To account for such a reversal, the Claimants' expert incorporated *"the actual net change in the receivables and payable balances from Electroquil's audited financial statements"* into his adjusted expectation model (1<sup>st</sup> ER Kaczmarek, ¶ 62), which is one of the tools used to compute the impairment of Duke Energy's investment. This said, the evidence does not show what proportion of the 1.27% reduction in the rate of return was due to the increased working capital requirements. In addition, the Tribunal also stresses that no element on record establishes Duke's Energy's alleged expected rate of return of 12.95%.
481. Moreover, when monies are paid late, interest is generally meant to compensate the creditor for the lack of the funds. Admittedly, the creditor may, under certain circumstances, show that its actual damage exceeds the amount of interest incurred and claim additional compensation. Unlike interest, such compensation requires proof of the excess damage. For the reasons stated in the foregoing paragraph, the Tribunal is of the opinion that the excess damage resulting from the late payments and their impact on the working capital and the rate of return has not been proven. At the same time, it recalls that it has found that interest for late payments is due on the amount of USD 96,980.64 on the basis of the 96 Liquidation Agreement entered into between the MEM and Electroquil. The contractual limitations to which Electroquil consented during the course of the performance of the PPAs cannot but apply to Duke Energy's claims under the Treaty.
482. Finally, the Tribunal notes that Electroquil has not claimed the additional working capital costs it incurred in relation with late payments, which were claimed by Duke Energy.
483. For all the reasons set forth in the preceding paragraphs, the Tribunal concludes that Duke Energy is not entitled to compensation for the alleged impairment of its investment in relation with the late payment of Electroquil's invoices.

**d) Currency of the Award**

484. Paragraph 11 of the Arbitration Agreement provides that the award shall be in US currency.

485. Moreover, the contract currency for accounting purposes was the US dollar. Pursuant to Clause 7.3 of the PPA 95, the “*dollar amounts determined in the preceding sections shall be paid by INECEL to the Contractor in sucres, for the purposes of which the rate of exchange for the purchase of such currency established by the Central Bank of Ecuador on the date of payment shall be used*”. Clause 8.7 of the PPA 96 contains a similar provision. Accordingly, amounts were accounted for and invoiced in US dollars but were payable in local currency at the spot market exchange rate according to the Central Bank of Ecuador on the date of payment (1<sup>st</sup> ER Kaczmarek, footnote 83). In addition, the claims have been formulated in US dollars.

486. For these reasons, the Tribunal will award the amounts due in US currency.

**e) Beneficiary of the Award**

487. The amounts deriving from the fines and penalties and the non-payment of interest due to late payment arise originally out of the PPAs to which Electroquil, not Duke Energy, was a party. Similarly, the violation of the umbrella clause only related to obligations owed to Electroquil.

488. In these circumstances, the Award will only be payable to Electroquil. This does not mean that Duke Energy will not be compensated. It rather means that Duke Energy will be made whole through its shareholding in Electroquil, a fact that Duke Energy has impliedly acknowledged when it stated that “[*b*]ecause the loss suffered by Duke (US\$ 19,263.434) is a component of the loss suffered by Electroquil (US\$ 24,061.426), an award of US\$ 24,061.426 would compensate both Duke and Electroquil for the loss they have collectively suffered due to late payment and improper penalties and duties.” (Cl. Mem., ¶ 247, 1<sup>st</sup> ER Kaczmarek, ¶ 81).

**4.4 Costs**

489. Paragraph 11 of the Arbitration Agreement provides that the provisions of the ICSID Convention and the Arbitral Award will govern with respect to costs and professional fees incurred in connection with the arbitration.

490. In the exercise of its discretion in matters of allocation of costs and considering all circumstances of this case, the Tribunal finds it fair that the parties bear the costs of the arbitration equally and that each party bears its own legal and other costs.

## V. RELIEF

491. On the basis of the foregoing reasons, the Tribunal renders the following decision:

1. The Tribunal has jurisdiction over all the claims presented in this arbitration, except for the claims on customs duties;
2. The Respondent breached Article II(3)(a) of the BIT in relation to its guarantee of payment, the PPAs, Ecuadorian law and Article II(3)(c) of the BIT in relation to fines Nos 3, 4, 5, 6, 8, 9 and 10;
3. Accordingly, the Respondent shall pay to Electroquil a nominal amount of USD 5,578,566, plus interest at the simple active rate quoted by the Central Bank of Ecuador from the date on which each fine became due and payable as established above (¶ 466) until payment in full;
4. The Respondent breached the PPAs and Article II(3)(c) of the BIT for having paid some of Electroquil's invoices late;
5. Accordingly, the Respondent shall pay to Electroquil interest at a simple active rate as quoted by the Central Bank of Ecuador on the sum of USD 96,980.64 between 28 August 2002 and the date on which this sum was actually paid by the Respondent;
6. The Respondent did not breach Articles II(3)(b) and II(7) of the BIT;
7. The parties shall bear the costs of the arbitration in equal shares;
8. Each party shall bear its own costs and legal fees;
9. All other claims are dismissed.



Done in English and Spanish, both versions being equally authentic and authoritative.

Place of arbitration: Washington, D.C.

[*signed*]

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Enrique Gómez Pinzón  
August 12, 2008

[*signed*]

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Prof. Albert Jan van den Berg  
July 24, 2008

[*signed*]

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Prof. Gabrielle Kaufmann-Kohler  
July 21, 2008