International Centre for Settlement of Investment Disputes

DUKE ENERGY ELECTROQUIL PARTNERS
&
ELECTROQUIL S.A.

CLAIMANTS

v.

REPUBLIC OF ECUADOR

RESPONDENT

ICSID Case No. ARB/04/19

PROCEDURAL ORDER No. 1

Decision on Respondent's Request

Rendered by an Arbitral Tribunal composed of:

Prof. Gabrielle Kaufmann-Kohler, President
Mr Enrique Gómez Pinzón, Arbitrator
Prof. Albert Jan van den Berg, Arbitrator

Date of Dispatch to the parties: February 24, 2006

I. FACTS

1. This section briefly summarizes the factual background of this arbitration to the extent required to rule upon Respondent's Request of 6 February 2006 (hereinafter the "Request") that Claimants confirm that section II.A of their Reply on the Merits and Counter-Memorial on Jurisdiction dated 18 January 2006 (hereinafter "Claimants' Reply") contains allegations on the merits as opposed to jurisdiction, and that Claimants limit their allegations to jurisdiction and not address the merits of the case in their Rejoinder on jurisdiction due on 27 March 2006.

2. The following paragraphs are without prejudice to the facts, which the Tribunal will subsequently deem relevant to determine its jurisdiction and/or the merits of the dispute.

3. The first Claimant is Duke Energy Electroquil Partners (hereinafter "DEI"), a partnership incorporated and registered under the laws of the State of Delaware, USA.

4. DEI is the sole parent company of Duke Energy International del Ecuador Cía Ltda. (hereinafter "DEI Ecuador"), an Ecuadorian holding company, which at present owns 72.3% of Electroquil S.A. (hereinafter "Electroquil"), the second Claimant in this arbitration. Electroquil is a power generation company incorporated and registered under the laws of the Republic of Ecuador.

5. DEI and Electroquil will be jointly referred to as "Claimants" or "Duke".

6. Respondent in this arbitration is the Republic of Ecuador (hereinafter "Ecuador").

7. The current dispute arises from the conclusion of two power purchase agreements between the *Instituto Ecuatoriano de Electrificación* ("INECEL") and Electroquil (hereinafter the "Agreements"), namely the Power Purchase Agreement ("PPA 95") entered into on 31 October 1995 for the importation, assembly, installation and the putting into service by Electroquil of two new gas turbine generators (Units 1 and 2) and the Power Purchase Agreement ("PPA 96") entered into on 8 August 1996 in connection with two additional generating units (Units 3 and 4). Both Agreements provided that Electroquil was to perform its obligations by a specific date, failing which it would incur contractual penalties.

8. Shortly after the conclusion on 12 November 1997 of the letter of intent ("LOI") between Duke Energy International LLC ("Duke Energy") and Electroquil providing for the terms and conditions of Duke Energy's acquisition of a controlling interest in Electroquil, INECEL imposed the first in a series of fines that it would proceed to levy against Electroquil.

9. Following INECEL's dissolution in March 1999, the President of Ecuador ordered by decree dated 28 January 1999 that the Ecuadorian State, through the Ministry of Energy and Mines (hereinafter the "MEM"), assume the rights and obligations of INECEL under the Agreements as of 1 April 1999.

10. Within that framework, INECEL and Electroquil signed on 31 March 1999 an agreement setting forth the amounts owed by INECEL to Electroquil for capacity and energy payments under the Agreements (hereinafter the "Interim Liquidation Agreement").

11. On 1 June 1999, the State of Ecuador through the MEM entered into two subrogation agreements with Electroquil (hereinafter the "Subrogation Agreements"), whereby the Ecuadorian State assumed the rights and obligations of INECEL under the Agreements.

12. On 30 May 2000, the MEM and Electroquil entered into two identical Arbitration and Mediation Agreements (hereinafter the "Med-Arb Agreements") in connection with the disputes over the fines and over the first contractual year of performance that had arisen under the Agreements.

13. On 29 January 2001, Electroquil commenced arbitration against the MEM before the Arbitration and Mediation Center of the Guayaquil Chamber of Commerce.

14. In the midst of the local arbitration, a second set of fines was imposed against Electroquil in connection with PPA 95 on 14 August 2001, as well as in connection with PPA 96 on 18 December 2001.

15. On 27 November 2001, the MEM and Electroquil entered into a liquidation agreement in connection with the termination of PPA 95 (hereinafter the "95 Liquidation Agreement"), which *inter alia* identified the disputes pending between the Parties.

16. On 11 March 2002, the local arbitral tribunal issued an award, in which it determined that the Med-Arb Agreements were null and void.

17. On 28 August 2002, the MEM and Electroquil entered into a liquidation agreement in connection with the termination of PPA 96 (hereinafter the "96 Liquidation Agreement"), which also sets out the disputes pending between the Parties.

18. On 30 May 2003, the MEM, Electroquil and Petroecuador (the state-owned oil and gas monopoly which, in connection with the Agreements, had sold through its subsidiary Petrocomercial the fuel to operate and maintain the power plant) entered into the so-called *Convenio de Reconocimiento y Extinción Recíproca de Obligaciones* (hereinafter the "Reciprocal Obligations Agreement"), which provided for the extinction of the reciprocal fuel-related debts.

19. 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 (hereinafter the "Undisputed Amounts Interest Agreement").

20. On 26 April 2004, the Parties entered into an arbitration agreement (the "Arbitration Agreement"), which in its relevant parts reads as follows:

> "*2. Si las partes no alcanzaran un acuerdo dentro del término máximo de 70 días previstos* [...] *la RDE y las Inversionistas consienten en someter las diferencias descritas en el párrafo 3 de este instrumento, al Centro Internacional de Arreglo de Diferencias relativas a Inversiones (el "Centro") para que sean resueltas de forma completa y definitiva por medio de arbitraje en derecho conforme al Convenio de 1965 sobre Arreglo de Diferencias Relativas a Inversiones entre Estados y Nacionales de Otros Estados ("Convenio CIADI"), y del Tratado entre los Estados Unidos de América y la República de Ecuador sobre Promoción y Protección de Inversiones, firmado en Agosto 27, 1993 y que se encuentra vigente desde Mayo 11, 1997 (el "Tratado").*
>
> *3. Las siguientes diferencias se definen como "diferencias relativas u originadas en una inversión" para los propósitos de este Convenio, del consentimiento de las Partes establecido en el párrafo 2, el Convenio CIADI y el Tratado: Cualesquiera y todas las reclamaciones, controversias, demandas y causas originadas en o en conexión con (i) las multas y penalidades impuestas por la RDE en base del Contrato de Compraventa de Potencia y Energía suscrito en Octubre 31 de 1995 con ELECTROQUIL S.A. (PPA 95), y sus intereses y cualquier otro asunto y/o acuerdo relacionado con dichos conceptos (ii) las multas y penalidades impuestas por la RDE en base del Contrato de Compraventa de Potencia y Energia suscrito el 8 de Agosto de 1996 con ELECTROQUIL S.A. (PPA 96), y sus intereses y cualquier otro asunto y/o acuerdo relacionado con dichos conceptos.*
>
> *4. Las Partes renuncian a formular cualesquiera y toda impugnación a la jurisdicción de cualquier tribunal arbitral constituido en relación con este Convenio.*"

II. PROCEDURAL HISTORY

21. This section sets forth the chronological sequence of the arbitration proceedings to date leading to the present Order:

On 25 August 2004, Claimants filed their Request for Arbitration with the International Centre for the Settlement of Investment Disputes (ICSID).

On 18 May 2005, the Arbitral Tribunal was constituted.

On 15 June 2005, the Arbitral Tribunal and the Parties held the First Session at the offices of the World Bank in Washington, D.C. The Minutes of the First Session provided for two alternative procedural timetables depending on whether jurisdictional objections were raised by Respondent and on whether the stages on jurisdiction and the merits were joined accordingly.

On 2 September 2005, Claimants submitted their Memorial in Chief.

Pursuant to Respondent's letter dated 1 November 2005 advising that its then forthcoming jurisdictional defence was of such nature that it could be joined to the merits, the Arbitral Tribunal confirmed on 2 November 2005 the adoption of the procedural timetable including submissions on jurisdiction as set forth in the Minutes of the First Session dated 15 June 2005.

On 22 November 2005, Respondent filed its *Memorial de Contestación a la Demanda*, in which it raised its objections to jurisdiction.

On 9 January 2006, the schedule of pleadings was modified pursuant to the parties' agreement.

On 18 January 2006, Claimants filed their Reply Memorial and Counter-Memorial on Jurisdiction.

On 6 February 2006, Respondent filed its present Request.

On 15 February 2006, Claimants submitted its Answer to the Request (hereinafter the "Answer").

22. For the sake of completeness, the following submissions and events are still anticipated in this arbitration:[1]

On 6 March 2006, Respondent shall file its Rejoinder on the Merits and Reply on Jurisdiction.

On 14 March 2006, the Arbitral Tribunal and the Parties shall hold a pre-hearing telephone conference.

On 27 March 2006, Claimants shall file their Rejoinder on Jurisdiction.

From 24 April to 28 April 2006, the Arbitral Tribunal and the Parties shall hold a hearing on jurisdiction and on the merits of the dispute.

III. THE PARTIES' POSITIONS

3.1 ECUADOR'S POSITION

23. Ecuador alleges that Claimants' Reply presents a serious defect causing an irreparable breach of Respondent's procedural rights in this arbitration if not promptly remedied, given that Respondent will not have an adequate opportunity to comment thereon prior to the hearing scheduled in April.

24. Ecuador submits that Claimants have erroneously and improperly made allegations regarding the merits of the dispute in their arguments on jurisdiction, thereby unilaterally creating an additional procedural opportunity to address substantive issues raised by Respondent in its latest submission, namely its *Memorial de Contestación a la Demanda* dated 22 November 2005 (hereinafter "*Memorial de Contestación*").

25. In particular, Ecuador claims that Section II.A (paragraphs 21-44) of Claimants' Reply, especially footnote 9 to paragraph 21, makes reference to sections of Respondent's *Memorial de Contestación* in which it sets forth the facts and arguments relating to the merits of the dispute, namely those related to the liquidation of the Agreements by mutual consent. Ecuador further alleges that as of paragraph 22 of Claimants' Reply, there are numerous references made to such Agreements and the facts upon which Claimants have based their claims. In sum, Section II.A of Claimants' Reply addresses

[1] See Letter ICSID of 9 January 2006.

issues, which are exclusively and undoubtedly substantive with the consequence that ruling thereupon will entail according to Respondent "*un efecto preclusivo de cosa juzgada sobre las reclamaciones de las Demandantes y no sólo la inhabilidad del Tribunal de conocerlas.*"

26. According to Respondent, Claimants cannot circumvent the matter, let alone create a procedural imbalance, by grossly and falsely alleging that the arguments on the merits made in Section II.A of their Reply constitute a necessary premise to Ecuador's defence to the Arbitral Tribunal's jurisdiction. Respondent points out that its jurisdictional defence is clear and does not depend upon any determination of the merits of the dispute.

27. Therefore, Ecuador concludes that:

> "*La República del Ecuador solicita que dichas indicaciones se respeten por las Demandantes. Que éstas, en consecuencia, confirmen que la sección II.A de su escrito de Réplica contiene argumentos de fondo y no acerca de competencia o que, a falta de dicha confirmación, así lo indique el Tribunal con el fin que las Demandantes en su escrito de Dúplica, se limiten a las cuestiones sobre competencia.*"

3.2 DUKE'S POSITION

28. After recalling that the jurisdictional and merits phases of this arbitration are being dealt with together upon Respondent's request, Claimants submit that no action of the Arbitral Tribunal is required in this particular instance.

29. According to Claimants, Respondent's plea for the Tribunal to issue instructions based on its anticipation of how Claimants might present their final written submission on jurisdiction is nothing more than a shallow attempt to distract attention from the real issues in this arbitration and a pretext for Respondent to seek leave to file a responsive pleading to Claimants' next submission, which is inadmissible.

30. Claimants submit that Respondent has not and cannot point to any portion of Claimants' Reply in which Claimants have addressed issues falling outside of the substantive and procedural parameters established by the Tribunal and related to the nature of Claimants' claims. Respondent appears instead to take issue with the manner in which Claimants have chosen to address matters before the Arbitral Tribunal.

31. Ecuador's preference that Section II.A of Claimants' Reply appear under a merits heading rather that one on jurisdiction is not supported by any authority and does in fact not prevent Claimants from presenting their submission in the way they did.

32. Claimants further point out that, considering that Respondent has based its jurisdictional objection partly on the argument according to which certain of Claimants' claims have been settled or otherwise resolved, Claimants can only fully respond by showing that no settlement of claims has occurred and that all disputes remain subject to the Arbitral Tribunal's jurisdiction. In Claimants' view, these points cannot, as Ecuador suggests, be isolated from the issue of jurisdiction. Doing so would elevate form over substance to the point of distortion.

33. As a result, Claimants conclude that:

"*Claimants respectfully request that, to the extent that Respondent has actually requested any cognizable relief, such relief be denied.*"

IV. DISCUSSION

34. Having examined each party's submission, the Arbitral Tribunal is not minded to grant Respondent's Request on the following grounds.

35. Upon reading section II.A of Claimants' Reply in which Claimant discusses in turn the Interim Liquidation Agreement, the 95 Liquidation Agreement, the 96 Liquidation Agreement, the Reciprocal Obligations Agreement and the Undisputed Amounts Interest Agreement for the purpose of rebutting Respondent's allegation that certain disputes between the Parties have been settled, it appears that such analysis is conducted in order to substantiate Claimants' allegation that none of the agreements referred to above establish settlement, waiver or release of any of the claims submitted within the present arbitration proceedings. In the Tribunal's view, such discussion is legitimate, as it attempts to outline which disputes are allegedly still pending and subject to this Tribunal's jurisdiction in light of the Arbitration Agreement.

36. Further, the manner in which Claimants framed their arguments is left to their own appreciation when presenting their case. Claimants' Reply was to address both matters of jurisdiction and merits according to the agreed procedural timetable. Hence, the Arbitral Tribunal finds it unduly formalistic under the circumstances that each section

should be identified as relating to either jurisdiction or the merits. It is clear from the Reply which arguments relate to jurisdiction and which refer to the merits.

37. At any rate, Respondent still has an opportunity to address the issues of jurisdiction and the merits of the dispute in its forthcoming Rejoinder on the merits and reply on jurisdiction due on 6 March 2006. As a result, Respondent's procedural rights are not affected.

38. As for Claimants' Rejoinder on jurisdiction due on 27 March 2006, it shall obviously be limited to the issue of jurisdiction. The Tribunal trusts that Claimants will set forth their rejoinder arguments on jurisdiction in an appropriate manner, so as to preclude any other disagreements that might risk rendering the proceedings more cumbersome.

V. ORDER

39. On the basis of the foregoing reasons, having reviewed the Parties' submissions, the Arbitral Tribunal denies Respondent's Request.

Made on February 23, 2006

For the Arbitral Tribunal:

Prof. Gabrielle Kaufmann-Kohler