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The New Ecuadorian PPP Act: A New Opportunity for Foreign Investment? Some Caveats Regarding Arbitration

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Article 19 of the Incentives for Public-Private Partnerships and Foreign Investment Act ("PPP Act") recognizes local and international arbitration as one of the dispute resolution methods that has arisen in Public-Private Partnership agreements ("PPP agreements"). Article 20 of this Act and articles 19, 20, 21, and 22 of its Regulations set forth certain rules for these arbitrations to be performed. However, these provisions leave us with certain doubts regarding the viability of the arbitral system and its application to the scope of PPP agreements.

In this article, we will refer, specifically, to two limitations created by the framework that is currently in force: i) exclusions as to subject matter jurisdiction, and, ii) the requirement to exhaust administrative proceedings. This article only refers to the arbitral mechanism derived from a PPP agreement and sets aside possible claims that may arise from international investment treaties.

Matters Subject to Arbitration

Article 20 of the PPP Act expressly determines subject matter jurisdiction limitations and excludes "tax matters, as well as any other act *directly* derived from the State of Ecuador's *legislative and regulatory power*" (Emphasis added).

In principle, it appears that the provisions incur in an overly broad prohibition that could cause concern among investors. Apparently, any violation of the rights and benefits acquired by the private company or investor via a PPP agreement, that arises from the promulgation of a legal norm – even a mere resolution or regulation-, could not be subject to a claim brought before a local or an international arbitral tribunal.

Therefore, we must deconstruct each element of the prohibition in order to understand its scope. The prohibition covers acts directly derived from the state's legislative and regulatory power and establishes tax matters as an example of these acts.

PPP agreements, validity of tax matters and validity of general rules are closely related once PPP Act benefits are examined. On one hand, it provides tax incentives that, pursuant to article 17, will continue to be valid while the contract is in force. In turn, article 15 recognizes legal stability for

"regulatory affairs that have been declared as essential" in the respective agreements.

Does this perhaps mean that, if the state decides to eliminate tax incentives granted to a private party through the use of its legislative power or modify specific regulations declared to be essential in PPP agreements, the company would have no other option than to submit its claim to ordinary courts? Although we could intuitively answer this question affirmatively, a detailed and thorough analysis could lead us to think otherwise.

Acts derived directly from the state's legislative and regulatory power in PPPs, namely tax matters and specific industry regulations, do not directly affect the PPP agreement. Therefore, discussions such as those regarding the validity of those acts or their legitimacy should be decided by the litigious-tax jurisdiction or the litigious-administrative jurisdiction, as applicable. Indeed, the disputes related to these matters are not part of the PPP agreement, but rather, directly attack the challenged act.

The PPP agreement and the rights and obligations derived therefrom are indirectly affected by these general acts. Thus, in a dispute arising from the PPP agreement, parties do not directly discuss the state's legislative or regulatory power, but rather, the effects that this power has caused to the contractual rights of the private party, through concrete administrative events or acts. This way, the matter submitted to arbitration is not a direct expression of the state's power, but instead, of the effects that the power has indirectly caused.

These criteria must be reviewed under further scrutiny having to do with tax issues. Article 22.2 of the PPP Regulations expanded the scope of the prohibition of the PPP Act, qualifying "the disputes related, either *directly or indirectly, to matters with a tax nature*" as matters not capable of being submitted to arbitration (emphasis added). As opposed to the matters established in article 20 of the PPP Act, this would cause the impossibility of arbitrating even the indirect effects of tax matters. This legal provision apparently leaves investors without the possibility of resorting to a neutral forum that decides, for example, on the impacts derived from their tax incentives.

Fortunately, article 22 exclusion only refers to international arbitration and its scope must be exclusively interpreted for the arbitral agreement in the PPP agreement. Thus, the investor can sign other instruments recognized under the Ecuadorian legal framework, such as investment contracts, with an independent arbitral clause that would protect it from legal modifications regarding tax incentives.

Exhaustion of Administrative Proceedings

As a condition precedent for submission of an arbitration claim, article 20.2 of the PPP Act requires that parties exhaust the phase of direct negotiations and mediations, in addition to administrative proceedings available.

Upon the publication of the PPP Act, this last requirement caused surprise among practitioners because it revived a legal problem that had been overcome after the publication of the State Modernization Act in 1993. The latter eliminated the requirement of exhausting the administrative proceedings as a prerequisite to submit judicial claims challenging an administrative act. This was surely due to the influence of the Production, Trade, and Investment Code, issued in 2011, which disregarded the Modernization Act. Article 27 of the Code establishes the exhaustion of

administrative recourses as a requisite to submit disputes derived from investment contracts to international arbitration.

In any case, beyond this historical precision, the drafting of article 20 of the PPP Act did not permit an adequate interpretation regarding the scope of this requirement. Accordingly, it was not clear when arbitration should be brought nor what is understood by exhaustion of the administrative proceedings. Article 20.2 states that arbitration only applies provided that these proceedings are previously exhausted, while paragraph b) of that same section determines that ordinary courts have jurisdiction to resolve the disputes of PPP agreements in cases in which after "*the term contemplated for notice of the resolution to the interested party that exhausts the administrative proceeding, the action before the arbitral jurisdiction has not been exercised.*"

Exhaustion of these proceedings takes place through administrative acts, and parties must be served for these acts to enjoy efficacy. Therefore, administrative proceedings would be exhausted solely with the notice of these acts. On the other hand, the rule demands that the arbitral actions must be exercised prior to expiration of the term contemplated to notify the party of the resolution. Consequently, it is not clear whether this refers to a remission to the lapse of time contemplated in the term or to an arbitration request being submitted prior to the notice of the resolution. This last interpretation would lead to a contradiction of the rule and would cause evident insecurity to investors: On the one hand, Article 20.2requires the initiation of arbitration subsequent to exhaustion and; on the other hand, paragraph b)requires the arbitration request to be brought before the effective issuance of the resolution and its service —which constitutes the exhaustion of administrative proceedings itself—.

Further, it was also unclear as to what was understood by "exhaustion of administrative proceedings", as article 179 of the Executive Power's Administrative Regime Statute considers a series of hypotheses regarding a possible exhaustion. Article 20 of the PPP Regulations is more specific about the matter. It establishes that administrative proceedings would be understood to have concluded when the private company had exhausted all the ordinary administrative recourses, excluding the exhaustion of extraordinary recourses such as the extraordinary revision recourse. This provision also clarifies that once the recourses were exhausted, the private party would have a peremptory period of 30 days to file an arbitration claim.

Unfortunately, the referred provisions leave us without an answer as to a very important subject: What happens to the claims of a private company that do not arise out of an administrative act? Contractual breaches by the state regarding payment of agreed quantities are one example of this. It is not clear whether, in these cases, the private party should directly resort to arbitration or whether, instead, it should elicit an administrative act from the administration by filing claims to exhaust administrative proceedings. Both options appear to be plausible. Only administrative practice and interpretation performed by decisive bodies will provide certainty in this regard.

Conclusion

The PPP Act recognized arbitration as an alternative dispute resolution system derived from PPP agreements. However, its provisions relating to the limitations of matters that can be subject to arbitration and the requirement of exhaustion of administrative proceedings are replete with undefined legal concepts and unclear steps that must be followed to fulfill both requirements. In

certain cases, the PPP Regulations have provided private parties the power to submit their disputes to arbitration; in others, however, it has precluded them, generating important and unnecessary settlement costs, which could influence the decision of foreign corporations on investing in Ecuador. Lastly, the cases that the PPP Regulations have not been able to develop will fall to the judgment of the Public Administration in terms of determining their application. Therefore, the Ecuadorean Public Administration will have the duty of acting predictably, transparently, and pursuant to law so that the PPP Act can fulfill one of its purposes: attracting foreign investment.

This entry was posted on Sunday, February 19th, 2017 at 5:40 am and is filed under Arbitration Proceedings, Ecuador, Investment protection, Latin America, Uncategorized
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