

## ADVANCEMENTS AND RETROGRESSIONS OF ARBITRATION IN ECUADOR

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Ecuador is one of the countries of Latin America that, after having developed a good culture of ADR's in the 90's and the beginning of the 2000's, is somehow going backwards, at least temporarily, due to the tendencies of some governments or public officials.

1. The legal developments of arbitration in Ecuador go as far back as the beginning of the 20<sup>th</sup> Century with the enactment of the ancient –still in force with some reforms- Civil Procedure Code (CPC), in which Section 33<sup>rd</sup> “The Arbitral Lawsuit”, we could find a complex set of rules regarding arbitration; one of the articles expressed that the arbitral agreement, for its validity, should contain *all the claims of the claimant and the answers and counterclaims of the defendant*; that was a provision hard to abide by, for how would the parties to an arbitral agreement know what the points of fact of the complaint and the answers of the defendant would be ? (Unless, of course, the arbitral agreement would be signed after the controversy had arisen, as a clause separate from the contract itself), and even so it was difficult to determine such claims and counterclaims with precision.

Anyway, this was what we can call “*civil arbitration*” procedure rules. This kind of “*lawsuit*” (or “*juicio arbitral -“arbitral trial”-* as called by Professor and former Chilean President Patricio Alwyin) did not progress much in our legal practice, but since they were the only available rules, parties to contracts either civil or commercial would eventually resort to them to solve their disputes. The procedure was not well known or understood, and rarely used.

2. Then came the “Ley de Arbitraje Comercial” (LAC- Commercial Arbitration Law) decreed by the military Junta in 1963. This was a much more flexible and simple set of rules designed to be used by businessmen in their transactions. Although some business people resorted to this Law to settle their disputes, it was not widely accepted, mainly because of a provision which stated “*...taking into consideration the finality of commercial arbitration, the arbitrators are invested to decide the matters submitted to their knowledge according to their conscience, honest criterion and sense of equity. They are not obliged therefore to abide by other provisions than those contained in this Law.*” (emphasis added - Article15).

As we can deduct from the aforementioned text, it provided only for *ex aequo et bono* arbitration which in the opinion of scholars with whom I coincide, had three main problems: a) lack of knowledge by both arbitrators and counselors of the real meaning of *equity*; b) lack of knowledge about arbitration in general as it was not taught in law schools but as a subsidiary part of the Civil Procedure Code and even so many teachers did not have the time to teach that Section since it was at the end of the Code; c) as a consequence of the previously mentioned, and of the ambiguous text “*...They are not obliged...to abide by other provisions than those contained in this Law*”, legal practitioners feared that the arbitral tribunals could come to unfair decisions in their awards, thus making arbitration according to this Law not much recommended by attorneys to their clients.

This arbitration was institutional, under the administration of the Chambers of Commerce.

Section 33<sup>rd</sup> of the CPC was not derogated by this Law, and so it remained in force for many years afterwards, to be applied, as aforementioned, in “civil arbitrations”, that is to say arbitrations involving non commercial transactions, the kind of civil contracts contained in the Civil Code, among not merchants.

3. The insufficiencies of the abovementioned bodies of law, the ever growing amount of litigious matters in courts, and the need for a more modern, fast and reliable means of administering justice, made it indispensable that we thought in the necessity of proposing the legislative authorities of the time the enactment of a new law which would be suitable both for “commercial” and “civil” arbitration.

This was possible thanks to the assistance of some national and international organizations, as the Chambers of Commerce of Guayaquil, Quito and Bogotá, the ICC, the CIAC, the OAS, by organizing workshops, discussion forums, symposia, seminars, lectures and other events in which I actively participated either as lecturer or pupil, with distinguished Ecuadorian and foreign scholars especially Colombians; among them it is convenient and absolutely an act of fairness to mention the relevant participation of Dr. Adriana Polanía (ICDR arbitrator) by the Chamber of Commerce of Bogotá and the CIAC, a tremendously enthusiastic advocate of arbitration who “transmitted” her enthusiasm to us, members of the Commission to draft the project of Law for the legislature.

So the project was approved, only with a couple of unsubstantial changes, and published in the Official Registry the 4<sup>th</sup> of September, 1997. This Law derogated Section 30<sup>rd</sup> of the CPC, since arbitrations of all kinds are under its scope.

The procedural problems arose when the appellate courts did not know how to apply and take a decision on article 31 of the new Arbitration Law (Ley de Arbitraje y Mediación, LAM), “*the nullity recourse*”. The article as drafted was intended to provide for the only “*vertical*” remedy before the *Chairman* of the Superior (Provincial) Court of Appeals. The nullity causes were restricted to those affecting the validity of the arbitral proceedings because of lack of due process, which, once alleged by the petitioner were to be studied only by such judicial authority and resolved by himself in 30 days; however, some not very knowledgeable of arbitration judges thought it was a recourse to be known and resolved by the three-judges “*chambers*” (Salas) of the Courts of Appeals, therefore making it a long process with three not very pro and not very knowledgeable of arbitration judges to decide. So nullity recourses proceeds were stunned there, for months and even years.

4. In 1998, as deputy member of the Legislative Assembly to draft the new constitution I fostered the acceptance among peers, of arbitration, mediation and others, as “*alternative dispute resolution methods*” recognized officially by the State for the first time in history; *including mediation and arbitration in the Public*

*Sector.* The Constitution came into effect on August 10, 1998 when Dr. Jamil Mahuad was sworn as new constitutional President.

After that, although I lost for a while the track of ADR's from the private sector point of view, I had a new and luminous opportunity to introduce it in the Public Sector, as Attorney General sworn in September 1998. In order to make the constitutional principle operative, I had all public entities accept (not compulsorily but voluntarily) an ADR's clause in their contracts with suppliers of goods and services (contractors).<sup>1</sup> Both the Office of the Attorney General contracts counselors as well as other public entities attorneys were instructed on how to proceed regarding arbitration in the Public Sector. Soon we had all Public Entities include ADR's clauses in their contracts with private corporations or individual contractors.

Furthermore, we organized an independent mediation centre at the Procuraduría General del Estado (Office of the Attorney General) to deal mainly with public – private parties contracts. It was a success. Cases that had rested in the courts for many years due to lack of agreements and still remained unsolved thus causing losses to both the State and the particulars, were settled in the Centre in matters of weeks; so, public works that had been stunned for years were re-started after settlements, with the corresponding benefit to the State and its contractors.

5. The problem of Public entities submitting their disputes to arbitration, though, still exist, as Ecuadorian legislation does not have any provision regarding the matters in which the State cannot compromise –transact, settle-; and, needless to say, according to law and universal principles one of the indispensable elements of arbitrability is that the person who signs an agreement to arbitrate has to have the capacity to transact, compromise, settle, which means having the capacity to dispose of the objects matter of the transaction or settlement.

In fact, Article 2349, under Title XXXVIII "OF THE TRANSACTION", of the Civil Code, expresses: *"Only the person capable of disposing of the objects contained in the transaction (compromise, settlement) can compromise (settle)."* So, if someone is not the owner or is not invested by the owner of the power to dispose of the objects, there is no settlement; and since public officials cannot dispose of the *"res publicae"* (public property), they cannot compromise (settle) and consequently they cannot submit the State matters to arbitration. This is of course the legal reasoning of those opposing arbitration in the Public Sector.

And they are not too far from reality. Many public officials were reluctant to settle or compromise, as that might have meant "disposition" of funds or other things belonging to the State by transacting on contracts sanctions as fines, etc. for non fulfillment of the private party contractual obligations or when the public entity party in the mediation recognized a debt with a particular because of the contract involved; and thus the official could be subject to even criminal actions,

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<sup>1</sup> In Ecuador, one of the functions of the Attorney General is to act as State Counselor for public contracts, which cannot be signed without his approval.

and so were a couple of them when the “anti-arbitration wave” of government came forth in the country.

In fact, the Administrations of constitutional Presidents Mahuad and Noboa (August 1998 to January 2003) in which I occupied the post of Attorney General, were most favorable to arbitration in the Public Sector, so we were able to develop a good culture of ADR’s in public entities. We enforced the constitutional and legal principle that also the Public Sector entities can submit their disputes to ADR’s, as far as they obtained the consent of the maximum State authority in legal matters, the Attorney General, as provided by the 1998 Constitution by then in force, the Arbitration and Mediation Law and the new constitution in force since 2008:

**Constitution of 1998, article 191 (under the “Judicial Power” Title VIII: “... Arbitration, mediation and other alternative procedures are recognized as methods to solve disputes, pursuant the law.”** (That is, pursuant the Arbitration and Mediation Law, and other laws related to it).

**Arbitration and Mediation Law, article 4, “Capacity to resort to arbitration”:** *“Individuals or juridical persons who have the capacity to compromise (settle) may submit themselves to the arbitration regulated by this Law, fulfilling the requisites herein established.*

*The public sector entities can submit themselves to arbitration as long as, besides fulfilling the requirements established by this Law, they also fulfill the following additional requisites:*

- a) *Sign an arbitral agreement before the controversy arises; in case they want to sign the agreement once the controversy is arisen, the State Attorney General must be consulted, whose opinion will be obligatory;*
- b) *The legal relation to which the agreement refers must be of contractual nature;*
- c) *The procedure to select the arbitrators must be included in the arbitral agreement;*
- d) *The arbitral agreement by which the public sector institution waives to the ordinary jurisdiction, must be signed by the person authorized to contract on behalf of such institution.*

*The non fulfillment with the stated requisites will cause the nullity of the arbitration agreement.”*

6. Notwithstanding of the abovementioned constitutional and legal provisions, when the anti-arbitration wave -headed by my nationalistic successor in the Office as general counselor to the State- began to flourish in the Public Sector, the unknowledgeable of arbitration legislature, -by initiative of the Office of the Attorney General- passed a reform to the Arbitration Law restricting international arbitration and changing the paragraph on nullity of article 31 (Official Gazette nr. 532, February 25, 2005).

This reform, in what refers to international arbitration came as a response to arbitral procedures in which the State had accepted to submit disputes to international rules, as UNCITRAL, -for example the OXY case-, among others. The reformatory law was also intended to solve the problem of the nullity remedy, but instead of finding a solution, the matter was made more complicated.

In what refers to international arbitration, article 41 of the LAM was reformed in such a way that it included among the requisites for an arbitration to be considered as international, the fact that the matter of the arbitration when it refers to **an international business transaction**, has to be susceptible of compromise or settlement (which is correct) and **does not affect or damage the national interests or those of the community** - *...de la colectividad*- (expression added in paragraph c. by the reformatory law); This is of course, a too broad expression, for almost everything can affect the national interests or those of the community (meaning the interests of the country, the State, the Nation or citizens in general).

The reform, as previously mentioned, was against the “multinationals’ violation of sovereignty”. It refers specifically to the cases where the object of the arbitration is an international commercial operation that is susceptible of settlement and at the same time does not affect national or the people’s interest (?), and not to the other two cases mentioned in letters a) and b) of article 41, which texts are:

*“Art. 41.- Without prejudice to the provisions of international treaties an arbitration can be international when the parties have so agreed, as long as **any** (emphasis added) of the following requisites are complied with:*

*a) That the parties at the moment of signing the arbitral agreement, have their domiciles in different countries;*

*b) When the place of performance of a substantial part of the obligations or the place in which the object of the litigation has a closer relation, is situated out of the country in which, at least one of the parties has its domicile; **or** (emphasis added),*

*c) When the object of the litigation refers to an international business operation that is susceptible of transaction (settlement) and does not affect the national interests or those of the community.”*

So, as long as any of those requisites exist in the contractual relation, the parties can submit the disputes to *international* arbitration.

Let us suppose for a moment that there is an international sales contract signed by the Ministry of Public Works of Ecuador with Tractor Company to buy machinery for road construction (an international business transaction in which the State acts as if it were a particular and not a “sovereign”). Since there are national interests involved they cannot resort to international arbitration; or, if they do, the arbitral agreement could be nullified by a national court.

However, if in the contract there is not an international commercial transaction *per se* involved, for instance, the exploration and exploitation of gas and oil –which is not considered a “business transaction” but an administrative “concession” given by the State to the particulars, literally they could submit matters to arbitration, despite the fact that in the second example there could be many more chances of damaging the community in its environment and health and so affect the national interests. Also, if an Ecuadorian and a foreign corporation

submit a contract to international arbitration, and damages occur to the community as a result of that contract, the arbitral agreement could be considered null and void by a local court.

Reforms like the one mentioned certainly affect legal stability or “juridical security” as we call it in our system, for foreign parties to contracts with Ecuadorian individuals and especially with the Public Sector entities do not for surely know what the rules will be, as they frequently change.

In the respective paragraph of article 31, the nullity “recourse” was changed to an “action”, as the drafters of this reform thought it was not appropriate to call it a recourse or remedy because the law in article 30 states that “*the arbitral awards are not subject to any appeals recourse... either to any other recourse except as expressed by this Law*”; and what the Law provided for in article 31 was a nullity recourse **as the only one** (which was included in the expression “...except as expressed by this Law”), to be resolved, as previously mentioned, only by the Chairman –President- of the Superior (Provincial) Court of Justice, in 30 days.

So, the Chairmen of the Courts of Appeals of the country, also neither knowledgeable nor pro arbitration, were more confused about the application of the reformatory law passed by the legislature. An “action” in our legal terminology means the right of a person to recourse to the tribunals, whereas the process is the means by which the person exercises such right, that is by filing a complaint, summon defendants, filing of the answer and counterclaims to the complaint, conciliation hearing, go through the evidences, oral or written final statements by counsels, and finally the decision of the court. It is a long process; whereas, “recourse” (recurso) –in this case, nullity recourse- is a remedy which is decided by a sole judge or a “chamber” of three judges only on the merits.

Pursuant article 59 of the CPC, “*All judicial controversies which, according to the law, do not follow a special procedure, are subject to the ordinary procedure*”. So, according to the anti-arbitration opinion, since the “action” is the right to sue, to conduct a controversy, and the action mentioned in article 31 of the LAM does not have a special procedure, it has to follow the “ordinary” lawsuit process (long enough as to last 3 years). Nothing more erroneous, because in the reform itself there is a special, expedite procedure, the matter of nullity also as in the original version of the Law has to be decided by the Chairman of the Superior (now Provincial) Court of Justice; however, this is not too clear in the present version after the reform. And, attorneys at law who prefer to benefit from the old system of “ordinary” procedure convince superior courts judges of this opinion, and they remit the proceedings to the ordinary first level judges, for them to substantiate nullity causes as “actions”, that is, nullity lawsuits to last for years.

The main argument of the pro “ordinary” procedure judges and counselors is that, if this is an action it cannot be resolved without a due process where the plaintiff to the nullity lawsuit may present all his evidences about the causes of the specific nullity alleged.

By that year and until October 2008 I was Chief Justice of the Civil and Commercial Chamber of the Supreme Court and therefore could not engage in professional -included arbitration- matters. In the scarce free time, I had a couple of opportunities to be the guest speaker in professional national and international forums, and there I let them know my opinions about the inconveniences of such reforms, first because both foreign and national investors and entrepreneurs always look for the most expedite and fairest means of justice through international arbitration, and second because of the confusion that had been created by using the term “action” to mean “recourse”.

7. Although in my opinion it is not necessary to go through a whole legal process in order to examine the causes of nullity determined in article 31 of the LAM, and albeit my conviction that because of their nature they can be resolved by an “*ad limine*” study of the arbitral proceeds by the Chairman of the Court without new evidences, it is necessary to finally clarify the wording of article 31 in order to make it viable.

In fact, article 31, referring to the only nullity causes, expresses:

*“Art. 31. Any of the parties may try the nullity action of an arbitral award, when:*

- a) The complaint has not been legally served and the lawsuit has been followed and finished in contempt of court. It is necessary that the lack of service has impeded the defendant to present his exceptions and protect his rights and, besides, that the defendant claims for such omission at the time of intervening in the controversy; (meaning in the arbitral controversy)*
  - b) That any of the parties has not been notified with the tribunal orders and this fact impedes or limits the right to defense of that party;*
  - c) When it would have not been convoked (sic) (“it” must refer to the hearing; correction is needed), the summons would have not been notified, or after convoked, the evidences would have not been practiced, notwithstanding the existence of facts subject to proof;*
  - d) That the award refers to issues not submitted to the arbitration or grants more than claimed (“extra or ultra petita”); or,*
  - e) When there has been a violation of the procedures provided for in the Law or by the parties to designate arbitrators or form the arbitral tribunal.*
- ...”*

(Then follows the procedure, which as mentioned before, is expedite, and there is where the misunderstanding arises by the reformatory law use of the word “action”).

As we can easily deduct from reading the preceding paragraphs, at least those causes of nullity contained in letters a), b), c) and e) can be resolved by just studying the arbitration proceeds, on the merits.

8. The solution to these retrogressions is a short new reformatory law, which: 1) adds in article 4 (“Capacity to arbitrate”) specific –not many- matters in which the State cannot compromise and thus be subject to arbitration (for instance, tax matters, administrative sanctions as fines in public works and other public services contracts –in which the State acts as “sovereign”); 2) amends the concept

of international arbitration in letter c) of article 41, so as not to include such a broad exclusion as the aforementioned “...that does not affect or damage the national interests or those of the community”; 3) amends article 31, changing the wording again so that it reflects the intention of having as only “recourse” that of nullity, adding some short and very expedite proceeding which allows parties to present their evidences in 15 days, then their final written or oral arguments in 15 more days, and then 15 more days for the Chairman of the Provincial Court’s unappealable Decision, on the merits.

The present political situation of the country is not the most appropriate in order to impulse such a reform since the legislative assembly is under the control of left wing very nationalistic politicians, and so is the executive power. In fact, Ecuador under President Correa’s pressure, denounced the Treaty and pulled away from the ICSID (CIADI) nonetheless the fact that most ICSID arbitrations have been in favor of the State.

However, since I am back to private practice I have already established contacts with other colleagues in order to work for the best solution to these obstacles to arbitration in Ecuador. We will prepare a project; stones on the road are temporary; the war is not lost until the last battle is fought.

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