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International Arbitration Case Law

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CHEVRON CORPORATION, TEXACO PETROLEUM COMPANY
v.
THE REPUBLIC OF ECUADOR

Case Report by Sofia Castillo**
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First and Second Interim Awards on Interim Measures and Third Interim Award on Jurisdiction and Admissibility, decisions rendered on January 25, February 16, and February 27, 2012, respectively, under the Treaty Between the United States of America and the Republic of Ecuador concerning the Encouragement and Reciprocal Protection of Investment of August 27, 1993 and in accordance with UNCITRAL Arbitration Rules.

Tribunal:
Dr. Horacio Grigera Naon; Prof. Vaughan Lowe QC; Mr. V.V. Veeder, Presiding Arbitrator. Mr. Martin Doe, Administrative Secretary to the Tribunal, International Bureau of the Permanent Court of Arbitration, The Hague.

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Case Report

1. Facts of the Case

In 1964, Texaco Petroleum Company (TexPet), a legal entity organized under the laws of the United States of America with its principal place of business in the state of California, obtained a concession from the Ecuadorian government to explore and produce oil in Ecuador's Oriente region as part of a Consortium with Ecuador's Gulf Oil Company. After discovering oil in 1967, TexPet and Gulf entered into a new concession agreement in 1973 which was to last until 1992. By 1976, the state owned PetroEcuador ousted Gulf and purchased 62.5% of the Consortium. TexPet owned 37.5% and acted as operator of the Consortium. In 1990, PetroAmazonas, a subsidiary of PetroEcuador, took over the Consortium. At this point, TexPet and Ecuador agreed to conduct an environmental audit of the Consortium oil fields. The estimated cost of environmental remediation was determined to be between $8 million and $13 million.[1]

On December 14, 1994, the Ecuadorian Ministry of Energy and Mines, PetroEcuador and TexPet signed an MoU where they agreed to "negotiate the full and complete release of TexPet's obligations for environmental impact arising from the operations of the Consortium". This MoU led to two agreements. First, PetroEcuador, Ecuador and TexPet signed a "scope of work" where they identified the sites and projects that TexPet would be responsible for cleaning. TexPet also agreed to finance certain socio-economic projects and to negotiate with four municipalities in Oriente which claimed compensation for alleged environmental harm resulting from the Consortium's operations. Second, in 1995, PetroEcuador, Ecuador and TexPet made a "Settlement Agreement" where they stipulated that TexPet was to pursue "Environmental Remedial Work in consideration for being released and discharged of all its legal and contractual obligations and liability for Environmental Impact arising out of the Consortium's operations." This latter agreement released TexPet from any claims from Ecuador or PetroEcuador based on any environmental impact. This document, however, did not shield TexPet from individual claims for personal injury or damage to private property.[2]

From 1995 to 1998, TexPet, with the oversight and approval of both Ecuador and PetroEcuador, carried out a remedial action plan through the services of an environmental engineering contractor. TexPet also complied with the funding of local community projects and settled disputes with four municipalities in Oriente. These

[1] Third Interim Award, ¶¶ 3.5 - 3.10

[2] *Id.*, ¶¶ 3.12 - 3.18

settlements were all approved and confirmed by Ecuador's courts. Overall, TexPet spent approximately US$ 40 million on environmental remediation and community development. [3]

The US and Ecuador BIT entered into force in May 1997 and incorporated the 1976 UNCITRAL Arbitration Rules in Article VI(3)(a)(iii).[4]

On September 30, 1998, Ecuador, PetroEcuador and TexPet executed an Acta Final, that certified that TexPet had performed all of its obligations under the 1995 Settlement Agreement and released TexPet from any and all environmental liability arising from the Consortium's operations. Ecuador and PetroEcuador agreed to retain responsibility for any remaining and future environmental impact and remediation work. [5]

In 1993, US attorneys representing 30,000 residents of the Oriente Region filed a case against TexPet in the US federal District Court for the Southern District of New York for personal injuries and damage to property caused by TexPet during its time as the Consortium's operator. TexPet, supported by Ecuador, successfully sought to dismiss the claim on *forum non conveniens* grounds arguing that only Ecuador had a right to seek compensation for damages to Ecuadorean natural resources. Ultimately, after appeal and remand, the New York District Court dismissed the case on grounds of *forum non conveniens* subject to TexPet's consent to the jurisdiction of Ecuadorian courts which was expressed in writing in 1999. In 2002, the US Second Circuit Court of Appeals affirmed the decision.[6]

In 1999, Ecuador enacted the *Environmental Management Act* (the 1999 EMA) which allows individuals to file complaints to enforce collective environmental rights.[7]

In 2001, TexPet and all of its subsidiaries merged with Chevron under the laws of the USA.[8]

In 2003, a different but overlapping group of 48 Ecuadorian citizens filed a complaint before the Superior Court of Nueva Loja in Lago Agrio against TexPet, and impleaded Chevron as defendant due to the 2001 merger. The Lago Agrio plaintiffs claimed collective damages and other remedies for environmental remediation of former

[3] *Id.*, ¶¶ 3.20 - 3.24
[4] *Id.*, ¶¶ 1.12, 3.25
[5] *Id.*, ¶ 3.26
[6] *Id.*, ¶¶ 3.27 – 3.32
[7] *Id.*, ¶ 3.30
[8] *Id.*, ¶ 3.33

Consortium sites pursuant to a retroactive application of the 1999 EMA. Chevron requested dismissal of the Lago Agrio complaint on two grounds. First, Chevron argued that despite of the merger, Chevron remained a separate legal entity from TexPet and that it could not be held liable for TexPet's operation of the Consortium or TexPet's consent to Ecuadorean jurisdiction. Second, Chevron argued that the Lago Agrio complaint should be dismissed pursuant to the 1995 Settlement Agreement, and the 1998 Final Release. Chevron also notified Ecuador that the Lago Agrio complaint fell within the scope of the 1995 Settlement Agreement and the Final Release and that it was Ecuador and PetroEcuador who should bear financial responsibility for any obligation regarding the Consortium and any court rulings against Chevron.[9]

Claimants filed a Notice of Arbitration on September 23, 2009. In regard to the Lago Agrio litigation, the Claimants contend that: (1) Ecuador's actions and inactions constitute a breach of its obligations under the BIT to both Claimants; and, (2) Ecuador is improperly seeking to impose upon Chevron the public remediation obligations and liabilities that belong exclusively to Ecuador and PetroEcuador from which these two expressly released TexPet, its affiliates and principals.[10]

The Parties agreed on The Hague as place for the arbitration. Claimants appointed Dr. Horacio Grigera Naon as co-arbitrator; Ecuador appointed Professor Vaughan Lowe QC as co-arbitrator. The Permanent Court of Arbitration (PCA), pursuant to the Parties' agreement, appointed Mr. V.V. Veeder as presiding arbitrator. The Parties also agreed to appoint the PCA's International Bureau to administer these arbitration proceedings. Claimants submitted their Memorial on the Merits in September 6, 2010 and a Counter Memorial on Jurisdiction on November 6, 2010. Ecuador filed its Memorial on Jurisdiction and Admissibility on July 26, 2010; a Reply Memorial on Jurisdiction Objections on October 6, 2010 and a Rejoinder on Jurisdiction on November 6, 2010. Hearings on Jurisdiction took place on November 22 and 23, 2010.[11]

2. Legal Issues Discussed in the First Interim Award on Interim Measures

In this award, the Tribunal ordered Ecuador, pending oral hearings, to take all necessary measures to suspend the enforcement or recognition within and without Ecuador of any judgment against Chevron in the Lago Agrio Case. The Tribunal also

[9] *Id.*, ¶ 3.34- 3.38
[10] *Id.*, ¶¶ 1.18, 3.39
[11] *Id.*, ¶¶ 1.16 – 1.19

ordered Ecuador to keep the Tribunal informed on the measures Ecuador was taking to suspend the enforcement of the Lago Agrio Case against Chevron. [12]

3. Legal Issues Discussed in the Second Interim Award on Interim Measures

In this award, the Tribunal reiterated the orders of the First Interim Award. The Tribunal determined that the Claimants were legally responsible, jointly and severally, to the Respondent and ordered Claimants to deposit US$50 million with the PCA as security for any costs or losses that Ecuador may suffer in performing its legal obligations under this Second Interim Award.[13]

4. Legal Issues Discussed in the Third Interim Award on Jurisdiction and Admissibility

In this award, the Tribunal addressed only the Respondent's jurisdictional objections. The Tribunal focused its analysis on the 1995 Settlement Agreement because this was at the heart of the Claimants' claims against Ecuador.[14]

4.1 The *Prima Facie* Standard

Although the parties agreed that the Tribunal should apply a *prima facie* standard of review to determine whether the Tribunal had jurisdiction, they differed on the scope and application of the standard in this case. (4.3). The Tribunal, pursuant to the BIT and Article 21 of the UNCITRAL Arbitration Rules decided whether, if the Claimants' alleged facts were assumed to be true, the Claimants' claims could constitute breaches of the BIT. In order to determine jurisdiction, the Tribunal followed Judge Higgins' opinion in *Oil Platforms* and assumed "that the facts pleaded by the Claimants in the Notice of Arbitration are true unless such factual pleading is incredible, frivolous, vexatious or otherwise advanced by the Claimants in bad faith". (4.6). Ecuador had asked the Tribunal to demand the Claimants to establish their case with 51% chance of success. The Tribunal, however, set a much lower threshold whereby it would find jurisdiction of the Claimants' case was "decently arguable" or had "a reasonable possibility as pleaded". (4.8).

[12] First Interim Award, p. 16

[13] Second Interim Award, p. 3

[14] Third Interim Award, ¶1.31, 4.2

4.2 Article VI(1)(c) of the BIT – Notion of investment

Ecuador claimed that although TexPet did invest in Ecuador, this investment ended in 1992. Ecuador also argued that the 1973 Concession Agreement, which was in fact an investment, is not at issue in the Lago Agrio litigation. On the contrary, the Lago Agrio litigation related to the 1995 Settlement Agreement and the 1998 Final Release which were "stand-alone" agreements, not investments. Ecuador also claimed that the 2004 US Model BIT and *Pantechniki*, clearly defined "investment" to include *inter alia* the commitment of resources to the economy of the host State by the claimant entailing the assumption of risk in expectation of a commercial return. Ecuador argued that the settlement agreements lacked this defining characteristic. Ecuador also claimed that the US$40 million that TexPet spent in remediation as a result of the 1995 Settlement Agreement is a compensatory payment for TexPet's tortious acts, not an investment.[15]

In the alternative, Ecuador argued that even if the 1995 Settlement Agreement were to constitute an "investment", Chevron was never part of that agreement and therefore lacked standing to sue Ecuador for events pertinent to such. Ecuador explained that Chevron is not TexPet's "principal" in terms of agency law, rather Chevron is TexPet's indirect shareholder. Therefore, Chevron cannot sue Ecuador pursuant to the 1995 Settlement Agreement.[16]

The Tribunal ultimately decided that Article I(1)(a) of the BIT provided for a very broad definition of 'investment' with no time limits. Moreover, the Tribunal concluded that Article I(3) expressly provided that changes in the form in which assets are invested would not affect the character of an investment. To determine whether there was a *prima facie* case for an investment under the BIT, the Tribunal considered TexPet and Chevron separately. The Tribunal concluded that TexPet's investment did not end in 1992, as Ecuador claimed. Rather, the Tribunal considered that TexPet's 1973 Concession Agreement and the 1995 Settlement Agreement were inextricably linked and therefore could constitute one investment. The Tribunal concluded that "TexPet's investment satisfied the provisions set out in Article I(1)(a) of the BIT as: "a claim to performance having economic value, and associated with an investment" and "any right conferred by… contract"". For the Tribunal, TexPet's investment began in 1964, included the 1995 Settlement Agreement, continued with the Lago Agrio litigation and

[15] *Id.*, ¶¶ 3.62, 3.65, 3.67, 3.68

[16] *Id.*, ¶¶ 3.69-3.71

ultimately gave TexPet standing, as a matter of jurisdiction, to sue Ecuador pursuant to the BIT.[17]

The Tribunal decided to leave the matter of Chevron's standing to bring claims against Ecuador under the BIT for the merits phase. The Tribunal noted that it could not make a decision without a clear understanding of TexPet's and Chevron's legal status after the 2001 merger.[18]

4.3 Article VI(1)(a) of the BIT – Notion of investment agreement

Based on the 2004 US Model BIT, Ecuador argued that the agreement to release TexPet from claims concerning the environmental impact of its former operations cannot be an agreement upon which the "investor relies in establishing or acquiring a covered investment". Moreover, Ecuador insisted that Chevron was not part of the 1995 Settlement Agreement and, therefore, lacks standing to sue Ecuador.[19]

Here, the Tribunal also reviewed TexPet's and Chevron's individual positions to ultimately find the Tribunal had jurisdiction over disputes brought by TexPet. The Tribunal reiterated that the 1973 Concession Agreement, by itself, was an "investment agreement" within the meaning of BIT Article VI(1)(a). The Tribunal also explained that the 1995 Settlement Agreement was a continuation of the earlier concession agreement and, therefore, was part of an "investment agreement" within the meaning of BIT Article VI(1)(a). The Tribunal clarified, however, that the 1995 Settlement Agreement on its own could not constitute the basis for jurisdiction because it was an amicable settlement for past actual or alleged wrongs and not for investment purposes. Only when the 1995 Settlement is considered along with the 1973 Concession Agreement, the 1995 Settlement is part of an 'investment agreement'. Moreover, the Tribunal found that long term oil concessions must inevitably involve extensive cleanup costs and related responsibilities to others due to short and long term environmental consequences.[20]

The Tribunal held that it did not have sufficient information to determine whether Chevron became a "releasee", according to Article 5.1 of the 1995 Settlement Agreement, entitled to assert TexPet's legal rights against Ecuador. The Tribunal further explained that it needed more information on the consequences for the status of both TexPet and Chevron as a result of their 2001 merger. Ultimately, the Tribunal left

[17] *Id.*, ¶¶ 4.13, 4.15, 4.18 - 4.20
[18] *Id.*, ¶¶ 4.26, 4.27
[19] *Id.*, ¶¶ 3.72, 3.74
[20] *Id.*, ¶¶ 4.32, 4.33, 4.36

this question for the merits phase but considered the Claimant's argument that Chevron, as TexPet's parent company, is a releasee under the 1995 Settlement Agreement, to satisfy the *prima facie* standard of "seriousness".[21]

4.4 No *Prima Facie* Case on the Merits

Ecuador argued that neither Chevron nor TexPet had standing to sue Ecuador pursuant to the US-Ecuador BIT, the 1995 Settlement Agreement and the Lago Agrio litigation. According to Ecuador, Chevron lacked standing because it was not part of the 1995 Settlement Agreement and TexPet lacked standing because it was not a defendant in the Lago Agrio litigation. Therefore TexPet cannot be prejudiced by any of the pertinent alleged acts or omissions of Ecuador. Ecuador further argues that the 1995 and 1998 Settlement Agreements do not impose on Ecuador any obligation to intervene in private litigation by other third parties. Overall, Ecuador claimed that, in order to meet the *prima facie* standard, the Claimants had to satisfy the Tribunal that jurisdiction is established for each relevant provision of the BIT; the Tribunal must analyze objectively the basis of Claimants' arguments; and the Tribunal should decide whether the Respondent has shown that the Claimants' arguments have no factual basis on preliminary scrutiny.[22]

The Tribunal dismissed Ecuador's arguments and found that the Claimants satisfied the *prima facie* standard under the BIT and Arbitration Agreement regarding the merits of the dispute for purposes of jurisdiction and that the Claimants' pleaded case was serious and not advanced in bad faith; nor was their case incredible, frivolous or vexatious.[23]

4.5 Third Party Rights and Monetary Gold

The International Court of Justice (ICJ) decided in *Monetary Gold*, that under international law, although a Tribunal may have jurisdiction over a dispute it must not or should not exercise that jurisdiction if the very subject-matter of the decision would determine the rights and obligations of a State which is not a party to the proceedings.[24]

Ecuador asserted that the Tribunal lacked jurisdiction to adjudicate the Claimants' claims because doing so would require determining the rights of non-parties, contrary

[21] *Id.*, ¶¶ 4.39, 4.40, 4.53
[22] *Id.*, ¶¶ 3.75, 3.77
[23] *Id.*, ¶¶ 4.3 – 4.11
[24] *Id.*, ¶ 4.60

to the legal principles established by the ICJ in *Monetary Gold*. Ecuador argued that since Claimants' placed the Lago Agrio plaintiffs' rights at the center of their complaint, it would be impossible for the Tribunal to decide the Claimants' rights without also deciding the rights of third parties, i.e. the rights of the Lago Agrio plaintiffs who are not parties to nor represented in these arbitration proceedings.[25]

The Tribunal found that even if the *Monetary Gold* principle was extended to investor-State disputes, it would not affect the jurisdiction of the Tribunal in this case because the decision of the Tribunal would not necessarily affect the Lago Agrio plaintiffs. Ultimately, if the Tribunal found Ecuador breached its obligations under the BIT, the Lago Agrio plaintiffs would have to seek remedy from Ecuador. Moreover, the Tribunal held that, in deciding whether Ecuador violated the rights of the Claimants under the BIT with regards to the settlement agreements, the Lago Agrio plaintiffs do not have rights that are directly engaged by that question as they are not party to neither the BIT nor the settlement agreement.[26]

4.6 Fork in the Road

Article VI(3)of the 1997 BIT contains a fork in the road provision. Ecuador argued that the Tribunal lacked jurisdiction because TexPet and Chevron elected to pursue claims with the same fundamental basis before Ecuadorian courts as a result of TexPet's express consent in the aftermath of the New York District Court's ruling. In Ecuador's view, Lago Agrio was a continuation of the Aguinda litigation. Ecuador argued that, in a situation where a claim in a local court is contract-based and a claim in arbitration is treaty based, a Tribunal should only exercise jurisdiction where the fundamental basis of the contract and treaty claims are different. According to Ecuador, in this case, the fork in the road provision precludes TexPet from suing before the Tribunal since the Lago Agrio litigation before Ecuadorian courts has the same fundamental basis as the claims before the Tribunal.[27]

In deciding whether the Lago Agrio and Aguinda litigations and the BIT claims are fundamentally the same dispute, the Tribunal looked at BIT Article VI(3)(a) which expressly indicated that the fork in the road provision would be inapplicable if the "national or company concerned has not submitted the dispute for resolution". The Tribunal found that in the Lago Agrio litigation, the dispute was brought before Ecuadorian courts by the Lago Agrio Plaintiffs, not the Claimants. Moreover, Chevron

[25] *Id.*, ¶¶ 3.83-3.85
[26] *Id.*, ¶¶ 4.60, 4.66, 4.70
[27] *Id.*, ¶¶ 3.79 - 3.82

was a defendant in the Lago Agrio litigation and TexPet was not even a party to the Lago Agrio litigation at all. Ultimately, the Tribunal considered the fork in road provision in Article VI(3) of the BIT did not affect its decision on jurisdiction.[28]

4.7 Admissibility

Regarding Ecuador's challenges to the admissibility of the dispute, the Tribunal found that most of these overlapped with Ecuador's objections to jurisdiction. The Tribunal also found that those objections to admissibility that did not overlap with objections to jurisdiction should be treated in the merits phase pursuant to Articles 15 to 21 of the UNCITRAL Arbitration Rules. Moreover, the Tribunal explained that objections to admissibility actually assume the existence of jurisdiction.[29]

4.8 Costs

The Tribunal would decide on the issue of costs at the merits phase.[30]

5. Decision

The Tribunal held it had jurisdiction over the dispute that the Claimants had satisfied the *prima facie* standard and found that the facts of the case, according to the Claimants, were "decently arguable". The Tribunal rejected Ecuador's objections to jurisdiction on the notion of investment and investment agreement; the fork in the road provision; and the effect of the Tribunal's decisions on Third Parties. The Tribunal left the standing of Chevron to bring a claim against Ecuador and the issue of cost to the merits phase as this issue will depend on the status of Chevron after the 2001 merger with Texaco.

[28] *Id.*, ¶¶ 4.78, 4.79, 4.89
[29] *Id.*, ¶¶ 4.90, 4.91
[30] *Id.*, ¶ 4.97