Kluwer Arbitration Blog

"Even innocent clients may not benefit from the fraud of their attorney": Second Circuit upholds RICO judgment in favor of Chevron

Daniela Páez-Salgado (Assistant Editor for South and Central America) (Herbert Smith Freehills) · Monday, August 22nd, 2016

The Second Circuit's decision on *Chevron Corporation v. Steven Donziger et. al.,* one more chapter of the "Chevron Saga" (discussed by the author here), arose out of a federal action commenced by Chevron Corporation in 2011 against American lawyer Steven Donziger, his law firm and the plaintiffs in the Lago Agrio claim initiated against Chevron in 2003 (the "RICO proceedings").

On March 4, 2014, after more than three years of litigation before the New York courts, Chevron was able to persuade District Judge Lewis Kaplan that Donziger and his litigation team engaged in conspiracy and criminal conduct in order to obtain a US$ 9,5 billion judgment against Chevron, formerly Texaco, for alleged environmental damage caused during its operations in the Amazon in Ecuador (the "Lago Agrio Judgment"). The Lago Agrio Judgment awarded the plaintiffs damages for harm to the environment and human health, ordered Chevron to issue a public apology within 15 days and instructed that the plaintiffs establish a trust for Chevron to pay the damages awarded, directly to that trust.

In *Chevron Corporation v. Steven Donziger et. al.,* Chevron contended that the defendants procured the judgment arising out of that claim by "a variety of unethical, corrupt and illegal means." In short, the District Court findings of fact showed that the plaintiffs' legal team: (i) hired an environmental engineer to inflate the remediation costs to a US$ 6 billion sum based on a "SWAG" (an acronym for a "scientific wild ass guess"); (ii) forged an expert report on the alleged pollution caused by the operations of Texaco; (iii) secretly paid "neutral experts" to criticize the party appointed experts; (iv) coerced the Ecuadorian judge to rule for the Plaintiffs in several procedural matters such as appointing a global expert to designated by the legal team; (v) contracted a Colorado consultant firm to secretly write the global experts report setting the amount of damages at US$ 16.3 billion; (vi) paid the formerly appointed judge to the case to ghostwrite the presiding judge's orders on the case and to do so on the plaintiffs' advantage; and (vi) ghostwrote the Lago Agrio Judgment and paid the judge to sign it.

The District Court concluded that as a result of the "fraudulent, coercive and corrupt

acts" orchestrated by Donziger, Chevron was entitled to equitable relief to prevent the defendants from profiting from their frauds and corruption. Further, the court (i) enjoined the defendants from seeking to enforce the Lago Agrio Judgment in the United States against the plaintiff Chevron, and (ii) imposed a constructive trust for Chevron's benefit on any property defendants have received or may receive anywhere in the world that is traceable to the Ecuadorean judgment or its enforcement. Subsequently, the defendants appealed the judgement.

In its August 2016 decision, the Court of Appeals for the Second Circuit emphasized that the defendants, now appellants, did not base their appeal in lack of sufficient evidence to support the District Court's findings of fact, and, therefore, the court accepted them as true. The court rejected each of the grounds raised by the appellants: (i) lack of federal jurisdiction to hear the case; (ii) judicial estoppel; (iii) technical grounds under the RICO Act, (iv) foreclosure of the court's ruling by the Second Circuit's decision in *Naranjo*; and (v) considerations of international comity. Due to its relevance, I will only address the last four grounds.

1. Judicial estoppel

Prior to the action initiated by the Ecuadorian plaintiffs in the Lago Agrio courts, they brought the same claim against Texaco before the New York courts in 1999. This claim was dismissed on the ground of *forum non convenience* and plaintiffs were forced to bring their claim in Ecuador in 2003. During this proceeding, Chevron had offered "to satisfy any judgements in plaintiff's favor, reserving its right to contest their validity only in the limited circumstances permitted by New York's Recognition of Foreign Country Money Judgments Act." (the "Recognition Act").

The appellants used this representation to argue that Chevron was judicially estopped from challenging any Ecuadorian judgment against it in the RICO proceedings. The Second Circuit agreed with the district court in that Texaco, at the time, had "reserved its right to challenge any judgment issued in Lago Agrio on the grounds…that the judgment itself was obtained by fraud" and therefore, there was no inconsistency in Chevron's position in bringing the RICO claim before the New York courts.

1. Challenges under the RICO Act

The Racketeer Influenced and Corrupt Organizations Act ("RICO Act") is a federal law designed to prosecute and impose civil penalties for racketeering activity performed as part of an ongoing criminal enterprise. The District Court found that Donziger had committed numerous indictable acts under the RICO definition of "racketeering activity" such as extortion, wire fraud, money laundering, obstruction of justice and violations of the Travel Act. The appellants challenged those findings arguing that (i) Chevron had suffered no quantifiable and redressable injury (because the judgment had not been enforced yet against it); and (ii) the RICO Act does not authorize the granting of equitable relief to a private plaintiff.

As to the first ground, the Court found that both, the imposition of a wrongful debt – the US$ 8.646 million judgment debt- as well as the attachments placed on Chevron's assets, constituted an injury to Chevron's property. Once the Lago Agrio Judgment was confirmed by the Court of Appeals in Ecuador, the plaintiffs obtained orders to attach Chevron's intellectual property rights in Ecuador, funds going into or leaving Ecuador to Chevron's bank accounts abroad and the US$ 96 million final award issued against the Republic of Ecuador in *Chevron I*. The Court considered those attachments as actual injuries against Chevron, even if its assets were never transferred to the plaintiffs.

As to the second ground raised by the appellants, the Court recognized that neither the Supreme Court nor the Second Circuit had decided the question of whether the RICO Act authorizes a court to award equitable relief to a private party. However, the court looked into the holding of the Seventh Circuit in *National Organization for Women, Inc v. Scheidler* (upholding the granting of a permanent injunction for a private party under the RICO Act) to conclude affirmatively.

1. The Court's holding in *Naranjo*

As part of its claims, Chevron sought, under the Recognition Act, a declaratory judgment that the Lago Agrio Judgment was invalid and the issuance of an injunction against its enforcement anywhere in the world. The district court issued a preliminary injunction on that basis and the defendants filed an interim appeal before the Court of Appeals for the Second Circuit.

In that appeal, known as *Naranjo,* the Second Circuit vacated the injunction holding that the Recognition Act did not authorize a judgment debtor to attack a foreign judgment affirmatively. The Act provides "exceptions from the circumstances in which a holder of a foreign judgment can obtain enforcement of that judgment in New York." Since the Lago Agrio plaintiffs had not sought to enforce any judgment before the courts of New York against Chevron, the Recognition Act was not applicable.

In their appeal to the RICO proceeding's judgment, the appellants argued that the Second Circuit's holding in *Naranjo*, prevented the District Court from hearing Chevron's RICO claims. The Court, however, held that since in *Naranjo* they only touched upon the scope of an injunction under the Recognition Act, it did not foreclose consideration of the validity of Chevron's claims under RICO and New York law.

1. The considerations of international comity

Finally, the appellants challenged the lower court's decision on considerations of international comity. In *Naranjo*, the Court of Appeals held that if the Recognition Act were interpreted to authorize an injunction against enforcement of a foreign judgment anywhere in the world, it would implicate principles of international comity. Therefore, concluding that the Recognition Act does not authorize a court to declare a foreign judgment null and void for *all purposes, in all countries*. Since the injunction

contained in the judgment issued by the District Court did not invalidate the Lago Agrio Judgment and only enjoined the defendants from taking actions toward the enforcement in courts of the United States *and not globally*, the judgment did not infringed the notions of international comity. Indeed, the District Court's judgment imposed limitations on the conduct of the defendants, rather than invalidating the judgment.

Comment

The Second Circuit's confirmation of Judge Kaplan's findings will certainly aid Chevron to consolidate its ongoing arbitration claim against Ecuador for denial of justice (*Chevron II*). On the other hand, it will impose a great barrier to the plaintiffs' efforts to enforce the judgment against Chevron outside of the United States. Even if the New York courts did not declare the Lago Agrio Judgment void –and therefore, it is valid unless reversed by the Ecuadorian competent courts- it will be very unlikely for a court to enforce a judgment where a court of law has determined it was obtained through fraud.

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