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Oxy vs Ecuador: Chronicle of a Death Foretold

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In the middle of a short holiday, the Ecuadorian Government anxiously expected the Decision on Annulment issued by the Ad-hoc Committee regarding the investment arbitration initiated by Oxy. On November 2nd, 2015, the ICSID published on its web site the Decision and this event provoked a major debate in Ecuador. The influence of leftist President Rafael Correa over the defence of the case was really criticized due to the refusal to appoint an arbitrator on the early stage of the proceedings. The aftermath is the obligation to pay more than US $1bn, which will have an outrageous effect in the Ecuadorian economy that has suffered a severe downturn due to low oil prices, an incipient FDI and a desperate need of financial aid. Ecuador is today confronted with a very costly defeat and it seems it is only the beginning.

Background

In 1985, Occidental Petroleum Company (Oxy) and the former Corporación Estatal Petrolera (CEPE), later known as Petroecuador, entered into a Services Contract for the exploration and exploitation of hydrocarbons in Bloque 15 in the Ecuadorian Amazon region. On May 21st, 1999, Oxy and Petroecuador entered into a new contract which amended and converted the 1985 Services Contract to one of Participation. In this Participation Contract (hereinafter “Contract”), as in the Hydrocarbons Law (hereinafter “HCL”), there was a stipulation which prohibited Oxy to transfer or assign its rights and obligations to a third party without the prior authorization of the former Ministry of Energy and Mines. Likewise, it was also prohibited to participate in or create a consortium without authorization.

In 2000, Oxy and Alberta Energy Company (AEC), latter Encana, entered into an Farmout agreement whereby Oxy assigned to AEC its 40% of “economic interest” of the Contract, thus breaching the Ecuadorian HCL and the Contract itself. On May 15th, 2006, former Minister of Energy and Mines, Iván Rodríguez, under fierce political pressure declared the *caducidad* of the Contract and thus Petroecuador had taken control of the operations of Bloque 15.

Arbitral proceedings

The arbitral tribunal’s Award of October 5th, 2012, declared Ecuador’s international responsibility for breaching its international obligation to respect the standard of fair and equitable treatment by expropriation and for breaching customary international law and Ecuadorian law (principle of proportionality) due to the declaration of *caducidad*. ¶ 876. This was contradictory since the

declaration of *caducidad* was issued due to the unauthorized assignment of an "economic interest" by Oxy.

In her Dissenting Opinion, professor Brigitte Stern considered the majority of the tribunal ignored that Oxy had breached the Contract, Ecuadorian legislation and the importance of foreign companies to fulfil the legal system of Ecuador. ¶ 4.

The method the tribunal used to calculate damages had also drawn attention, when considering only a 25% discount on damages, whereas it could have had considered a 50% discount due to contributory fault. The first percentage on calculation of damages was confirmed in the Decision of Annulment. ¶ 419-420.

Annulment process

On October 9th, 2012, Ecuador filed a request of annulment of the award pursuant article 52 (1) (b) (excess of powers), (d) (departure from a fundamental rule of procedure), and (e) (failure to state the reasons of the award) of ICSID Convention. In my opinion the following are the most relevant and interesting grounds for annulment:

Oxy failed to comply with the six-month waiting period since the dispute arose. –

Ecuador stated that Oxy had failed to comply with the six-month waiting period for negotiations since the dispute arose (article VI.3 of the USA-ECU BIT) due to Oxy filed the request for arbitration 2 days after the Decree of *Caducidad* was issued. See, Decision on Jurisdiction, ¶ 57-58. Conversely, Oxy argued that the dispute had arisen 18 months before the decree's issuance, when they were in permanent "negotiations" to preclude the dispute. ¶ 60-61. On this particular issue the tribunal pointed out that the process of *caducidad* had commenced in 2004, therefore the decree's issuance cannot be considered as the initiation of the negotiations due to this would have been futile. The tribunal dismissed this objection to jurisdiction invoked by Ecuador. ¶ 94-97.

The tribunal deviated from previous decisions of other arbitral tribunals that decided they had no jurisdiction over the dispute since the the six-month waiting period had not been fulfilled. For instance see *Burlington v. Ecuador* (ICSID Case No ARB/08/05) and *Murphy v. Ecuador* (ICSID Case No. 08-ARB-4). The fact that Ecuador breached the USA-ECU BIT before the decree's issuance is not completely understood. The Decree of *Caducidad* was supposed to have caused damages to Oxy and therefore constituted the initiation of the investment dispute. Before the declaration of *caducidad* Oxy was fully in control of Bloque 15, thus no harm could have been caused on its investment.

The Committee upheld the tribunal's argument that the six-month waiting period for negotiations was futile and in that sense Oxy was not required to fulfil that procedural requirement. ¶ 130-135. In my opinion, the tribunal and lastly the Committee conducted an extensive interpretation on the initiation of the process of *caducidad* and its effects over Oxy's investment.

Principle of Proportionality. –

Ecuador stated that the declaration of *caducidad* was proportional and in accordance with international and Ecuadorian law. See, *Award*, ¶ 410. Conversely, the tribunal noted that the *caducidad* was declared only by virtue of the HCL and not for breaching the Contract. ¶ 418.

The latter is incorrect due to the decree of *caducidad* itself established that Oxy had breached HCL's article 74 and the Contract's clauses 21.1.1 and 21.1.2. In addition, the tribunal stated that Ecuador had different options than the declaration of *caducidad*. However, neither the Contract nor the HCL stipulated other options. ¶ 434-436. Finally, the tribunal stated that the declaration of *caducidad* had been a measure tantamount to an expropriation. ¶ 455.

On this particular issue, the Committee stated that there were two possible consequences for the unauthorized assignment of rights over Bloque 15. ¶ 334. Firstly, there was a sanction of contractual nature: termination of the Contract declared by Petroecuador. Secondly, there was an administrative sanction which involved the termination of the Contract and that Oxy was required to turn over, without any compensation, all assets used in operations of the Bloque 15 to the Government. The latter was deemed as disproportionate by the Committee. ¶ 335-40.

Effectiveness of the Farmout Agreement. –

The tribunal considered the assignment of rights of the Farmout agreement as null and void without considering that the tribunal had no jurisdiction over the interests or investments of Andes. Thus, the nullity should have been declared by a judge from Ecuador or New York. ¶ 650. Moreover, it is contradictory that the tribunal deemed that the Farmout did exist whereas the assignment of rights was null and void disregarding that the principal purpose of the Farmout was the assignment of rights of Bloque 15. Accordingly, the tribunal should have not ignored that Oxy, through a Letter Agreement, agreed that it should compensate Andes with 40% of the rights of the net amount received by a monetary award as a result of the declaration of *caducidad* of the Contract and therefore had no right to 100% of the compensation. ¶ 651. Nevertheless, Andes' right to receive compensation from Oxy would remain in effect. ¶ 654.

On this issue, the Committee said that the tribunal committed a manifest excess of powers due to the tribunal shouldn't have decided or exercised jurisdiction over Andes' investments whose protection was not contained in the USA-ECU BIT. Consequently, the Committee declared partially null the award on this point. ¶ 269-270. In this regard, the Committee also overturned the quantum of damages previously and set only a 40% of damages (US $ 1.061.775.000). ¶ 301.

Commentaries

The Ecuadorian Government has sought to take advantage of the outcome of this case. In an official communiqué, the Attorney General's Office has stated that the Decision on Annulment was a legal victory for Ecuador and its defence had achieved a much less costly award than intended by Oxy.

Despite the damages awarded, the Government of Ecuador had profited from the Declaration of *Caducidad*. Former Minister of Energy and Mines, Iván Rodríguez, noted that Ecuador had received more than US $ 20bn since Oxy left operations in Bloque 15, almost 20 times more than the quantum of damages payable to Oxy.

The President of Ecuador announced, he would seek a "friendly settlement" with Oxy for the payment of the award. This statement has been widely criticized by different sectors since this controversy could have been settled before. On November 20th, 2015, the President announced that an agreement with Oxy had been reached and the payment would be imminent. However, Committee's decision provoked lots of concerns and legal uncertainty with regard to Andes' prerogative to file a request for arbitration against Ecuador seeking compensation for the remaining

40% of damages.

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