Chevron vs. Ecuador: Harmony of Environmental Protection and Economic Development from the Legal Perspective

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Introduction

Despite being a mean to ensure energy security and sustain economic growth,\(^1\) oil and gas development could significantly contribute to environmental degradation.\(^2\) As a result of oil and gas development in Ecuador’s Amazon, a series of disputes between Chevron and the Ecuadorian government clearly illustrates potential clashes between economic development and environmental protection. In 2011, Ecuadorian court found Chevron to be guilty for pollution it caused thus issued an $8 billion fine along with an addition of $8 billion if Chevron did not promptly issue an apology (also referred to as the ‘Lago Agrio Litigation’\(^3\)). As of the time of writing, the plaintiffs are still trying their best to enforce this judgment in the United States and Canada. Apart from battles in courtrooms, Chevron initiated an arbitration proceeding under the UNCITRAL Arbitration Rules against Ecuador in September 2009 by relying on investment protection.\(^4\)

This paper analyses that legal principles such as the polluter-pays-principle (or commonly referred to as the ‘PPP’), sustainable development and fair and equitable treatment are capable of reconciling economic development and environmental protection. Its first section addresses the possible synergy between environmental protection and economic development through the lens of sustainable development. Furthermore, given the existence of international foreign investment protection in Ecuadorian’s oil industry, the second section critically assesses the competence of investment protection standards in mutually ensuring investor’s interests and environment protection. In particular, this paper attempts to investigate the ambiguous relationship between fair and equitable treatment and principles of environmental regulation.

I. Environmental Protection and Economic Development

The Lago Agrio Litigation has revealed that oil and gas exploration and production might be carried out at the expense of the environment and the local people. Granted a petroleum concession to extract oil and gas in Ecuador’s Amazon region by the Ecuadorian government, Texaco Petroleum Company (TexPet), an American oil company which was bought and wholly-owned by Chevron in 2001, had carried out operational in 1964 and ceased its operation in 1992. It drilled and operated 356 oil wells and opened at least 1,000 pools in the rain forest. While facilitating Ecuadorian’s economic growth, TexPet’s operations constituted widespread and long-lasting environmental and social impacts, including severe pollution from both accidental spill and routine. For harmonising the potentially conflict

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5 The consortium led by Texaco extracted nearly 1.5 billion barrels of Amazon crude over a period of twenty-eight years (1964 – 1992). During its tenure as operator, Texaco drilled 339 wells and built 18 central production stations, in an area that now spans more than a million acres of Orellana and Sucumbios. See Kimerling (n3), 449 – 450.

6 Ibid, 657.
between economic development and environmental protection, sustainable development is applicable.\(^7\)

Apart from sustaining the needs of present without jeopardising the ability of future generations to meet their own needs,\(^8\) the core elements of sustainable development comprise economic development, social development and environmental protection\(^9\). Interestingly, the principle of sustainable development postulates that economic growth and environmental protection need not be considered contradictory.\(^10\) For this reason, there is neither absolute protection of economic nor environment, but reconciliation.

Reflecting the above scholarly comments, the need for reconciliation is affirmed by the ICJ in *Gabčíkovo-Nagymaros*, the case concerning the construction and operation of the Gabčíkovo-Nagymaros System of Locks between the Hungarian People's Republic and the Czechoslovak People's Republic.\(^11\) The ICJ recognised the need to reconcile economic development with protection of the environment\(^12\) by ruling that:


text quote

\(^{10}\) Holder (n 7), 218.
\(^{12}\) Ibid, para 140.
generations of pursuit of such interventions at an unconsidered and unabated pace, new norms and standards have been developed, set forth in a great number of instruments during the last two decades. Such new norms have to be taken into consideration, and such new standards given proper weight, not only when States contemplate new activities but also when continuing with activities begun in the past.

This need to reconcile economic development with protection of the environment is aptly expressed in the concept of sustainable development.”¹³

In relation to the oil industry, the African Commission on Human and People’s Rights in the Ogoniland case¹⁴ acknowledged Nigeria’s right to produce oil and, simultaneously, imposed state’s responsibility to take reasonable measure to prevent ecological degradation and to secure an ecologically sustainable development.¹⁵ Therefore, through the sustainable development’s lens, the Ecuadorian government with the cooperation of Chevron and TexPet is allowed to exploit its hydrocarbon resource and therefore sustain its economic growth. Concurrently, it assumes responsibilities to protect the environment.

Given the responsibility to protect the environment, the Ecuadorian government and its local court shall be capable of regulating the environment by penalising the polluter. Nevertheless, a further analysis on the relevant principles of environmental regulations should be performed to justify the considerable environmental compensation imposed in the Lago Agrio judgment.

¹³ Ibid, para 141. (emphasis added).
¹⁵ Ibid, para 52 and 54.
Imposing environmental liability upon Chevron and TexPet is justifiable on the ground of the polluter-pays-principle (‘PPP’). The Lago Agrio Litigation judgment awarded the plaintiffs a total of more than US$18 billion for the environmental damage and health problems resulting from the operation. According to the redistributive function of the PPP, it is imperative to return the profits accruing to Chevron and TexPet as the results of its activities to the public authorities responsible for inspecting, monitoring, and controlling the pollution these activities produce. On the other hand, the judgment allows the suffering people to be compensated. Additionally, penalising multinational corporations and building instruments for international environmental accountability under the current free trade regime are apparently significant. The use of rule of law to promote and impose oil developments without controlling or remedying the injuries caused is fundamentally unfair and reveals gross inequities in law and governance.

Importantly, it should be noted that the principle of sustainable development does not put limits on economic growth but requests the less-damaging development and as such reveals the cooperation between economic development and environmental protection. Interestingly, the PPP justifies ability of Ecuador to regulate the environment and simultaneously benefit the

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16 ‘Justifiable’ in this context implies the ability of the host state to protect the environment by applying the PPP and imposing environmental liability. This conclusion does not rule out controversial issues such as ‘appropriate amount’ of the compensation and effectiveness of the trial. For instance, on March 11, 2011 Chevron has appealed the judgment on the ground of fraud by the plaintiffs’ lawyers, supporters and others that has corrupted the trial, as well as the numerous legal and factual defects in the judgment. See Carly Gillis, ‘Ecuador vs Chevron Texaco brief history’ (Counterspill, 27 April 2011) <http://counterspill.com/article/ecuador-vs-chevron-texaco-brief-history> accessed 14 April 2012.

17 Alongside the environmental protection, preventing distortion of international trade is the economic function of the PPP. For instance, the Recommendations of the OECD and the EC referred to the PPP as an instrument of harmonisation intended to ensure the smooth functioning of the common market. See Sanford E. Gaines, ‘The Polluter Pays Principle: From Economic Equity to Environmental Ethos’ (1991) Vol. 26 Texas International Law Journal 463, 489.; Nicholas De Sadeleer, Environmental Principle: From Political Slogans to Legal Rules (Oxford University Press 2002), 33.

18 Hinton (n3).

19 Sadeleer (n17), 3.

20 Kimerling (n3), 660.

21 Ibid, 663.
free trade regime. Hence, this mutually supportive relationship displays the synergy between principles of environmental regulation and principle economic law.

Notwithstanding, it is too superficial to acknowledge the foregoing compatibility without mentioning investment protection standards and the involvement of investment arbitration tribunal. This is because the *Lago Argio* judgment has been suspended by the investment arbitration tribunal. For this reason, it is necessary to investigate whether or not the existing investment dispute would undermine the importance of environment protection and therefore vitiate the abovementioned mutually supportive relationship.

II. Environmental Protection and Investment Protection

Like other Latin American nations, Ecuadorian government chose to sustain economic growth through their own natural resource by attracting foreign investments. Foreign oil companies (‘FOC’), however, always seek for reasonable level of legal protection. Apart from the relationship between the host state and the oil investor, the host state and the home state of the oil investor may enter into a bilateral investment treaty (‘BIT’), such as the Ecuador-United States BIT. This BIT is deemed as one of various available investment protection

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24 Oksan Bayulgen, *Foreign Investment and Political Regimes: The Oil Sector in Azerbaijan, Russia and Norway* (Cambridge University Press 2010), 33.

tools. Theoretically speaking, BITs generally seek to protect foreign investors against expropriation and discriminatory treatment and guarantee them fair and equitable treatment.

Soon after the *Lago Agrio* judgment, Chevron submitted the claimant’s notice of arbitration alleging that Ecuador has breached its investment agreements and its Treaty obligation. The aforesaid breach includes undermining and nullifying the Remediation Contract. Among other allegations, Chevron has alleged that Ecuador has breached its obligation to provide Chevron’s and TexPet’s investment fair and equitable treatment, full protection and security, and treatment no less than that required by international law. Later, the *Lago Agrio* judgment was suspended by the arbitration tribunal in February 2012. Pending the final award, the concern is that the tribunal may exclusively protect Chevron and TexPet and as such deteriorate ability of Ecuador to regulate its environment. As one of the core arguments invoked by Chevron and TexPet, essence and function of fair and equitable treatment will be discussed in turn.

Fair and equitable treatment is considered the most promising standard of protection from the investor’s perspective. Despite having a vague definition, the sub-principles of fair and equitable treatment includes: the respect for the legitimate expectations of investors,

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26 Loncle (n1), 269.
28 Claimants’ Notice of Arbitration (n4), 15.
29 Chevron has alleged that Ecuador has refused to notify the *Lago Agrio* court that TexPet and its affiliated companies have been fully released from liability for environmental impact resulting from the former Consortium’s operations. In addition, Ecuador has refused to indemnify and protect and defend the rights of Claimant in connection with the *Lago Agrio* Litigation. Besides, Ecuador has supported the *Lago Agrio* plaintiffs in various ways, including openly campaigning for a decision against Chevron and by initiating baseless criminal proceedings against two Chevron attorneys. See Claimants’ Notice of Arbitration (n4), 15.
30 Ibid, 16.
31 The Second Interim Award on Interim Measures (n22), para 3.
stability and predictability of the legal framework, protection against arbitrariness and discrimination, and procedural propriety and due process. One challenging task of fair and equitable treatment is its capability to balance the competing interests and integrate environment protection in the investment protection regime. With respect to Lago Agrio Litigation, it is reasonable to determine whether or not the arbitration tribunal is going to consider the investors’ environmentally-malpractice, such as improperly disposing of severe toxics or concluding a dubious Remediation Contract as the relevant factors.

Alongside governing arguments pertaining to international investment laws, fair and equitable treatment aims to integrate and reconcile competing objectives. It requires a comprehensive balancing of all the relevant factors and interests. Importantly, the maxim of equity postulates that ‘one who seeks equity must do equity’. Therefore, it is logical to conclude that beyond the act of the host state, the conduct of the particular investor may also be a relevant factor. This implies that the particular conduct of the TexPet and Chevron may also be the relevant factor.

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34 Kimerling (n3), 657.
37 Ibid, 204.
39 Kläger (n36), 204.
Among other duties,\textsuperscript{40} Muchlinski suggested that investors owe a duty to conduct business in a reasonable manner.\textsuperscript{41} According to Muchlinski, Chevron and TexPet have to act in the best interest of Ecuador and its economic development.\textsuperscript{42} Nevertheless, by causing severe social and environmental impacts, it might be considered that the companies failed to act in the best interest of Ecuador. For illustration, at the outset of the operation, TexPet set its own environmental standard but did not appropriately include environmental protection and monitoring.\textsuperscript{43} Moreover, it caused widespread and long-lasting environmental and social impacts such as deliberate discharges and emissions.\textsuperscript{44}

In 1995, the company signed Remediation Action Plan which might be labeled ‘cosmetic’. Under the plan, TexPet agreed to clean only 264 pools of the 1,000 pools which were opened up by the company.\textsuperscript{45} However, it was reported that 162 pools were not effectively cleaned.\textsuperscript{46} Furthermore, it was claimed that TexPet concealed hundreds of toxic waste pools covering them with topsoil and leaving them in the same pollutant state.\textsuperscript{47} Due to these reported actions, the Remediation Action Plan has been heavily criticized on the ground that it was concluded without meaningful participation by affected communities, transparency or other democratic safeguards.

\textsuperscript{40} Muchlinski suggested that the duty includes: a duty to manage well lies in the need for management to be fully aware of the regulatory environmental in which they operate, and to foresee any regulatory changes that is likely as a result of the manner in which that regulatory environment operates; a duty of reasonable management is the requirement to follow any applicable regulatory requirement; an obligation to take relevant professional advice See \textit{Ibid}, 550 – 553.
\textsuperscript{41} Ibid, 547.
\textsuperscript{42} Ibid, 549.
\textsuperscript{43} Kimerling (n3), 655.
\textsuperscript{44} Ibid, 657.
\textsuperscript{46} Ibid.
\textsuperscript{47} Ibid.
By dishonoring the duty to conduct business in a reasonable manner, the investment tribunal, in the light of the *ELSI* case coupled with *Noble Ventures Inc v Romania*, may not protect Chevron and TexPet under the ambit of fair and equitable treatment. The ICJ in the *ELSI* case refused to protect the investor on the ground of management conduct. The ICJ emphasised the socially damaging effects of the investor’s conduct and suggested that wider stakeholder interests may be relevant in determining how management is conducted. Correspondingly, the Tribunal in *Noble Ventures Inc v Romania* refused to apply the fair and equitable treatment for protecting Noble Ventures by referencing to the investor’s conduct.

Notwithstanding, the aforesaid conceptually parallel of investment protection standard and environmental protection is questionable, *inter alia*, on the grounds of incomplete case-law and arbitration biased toward investor protection. As claimed by Muchlinski, to date the case-law supporting a duty of investors to conduct business in a reasonable manner is still far from complete. On the other hand, arbitrators are appointed by the parties on a case-by-case basis and therefore depend on the preferences of parties. Coupled with the very broad and making no explicitly reference to sustainable development, investment tribunals tend to focus on the protection of investors rather than protecting host state polices. In relation to the Ecuador–United States BIT, the foregoing concern is not dramatic. The BIT does not refer to

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50 Muchlinski (n38), 549.

51 The *ELSI* case (n48) para 101; *Ibid*, 549.

52 The *Noble Ventures* case (n49) para 103-113; *Ibid*, 550.


sustainable development. This means that its preamble, which is a very important interpretation instrument of the BIT, also makes no apparent reference to sustainable development.

Hence, there is a possibility that the arbitrators would exclusively focus on the protection of investor. Nonetheless, it must be highlighted that this dilemma is a concern pertaining to impartialness of the investment arbitration tribunal not the one directly stems from the contradiction between fair and equitable treatment and principles of environmental protection. Thus, it does not truly represent the incompatibility between investment protection standard and principles of environmental regulation.

Although surrounding by the abovementioned concerns, it appears the ability of fair and equitable treatment to balance investors’ and the host state’s interest. In the light of equity, it integrates environmental consideration in the investment protection regime by, potentially, not protecting the investor who severely degraded the environment and caused social impacts. When the investor and the environment are simultaneously protected, it is more or less correct to say that fair and equitable treatment is conceptually compatible with sustainable development. For this reason, fair and equitable treatment, as a kind of economic laws, does not oppose the function of principles of environmental regulation.

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56 Without expressly mentioning sustainable development, the BIT’s preamble recognises the greater economic cooperation, the flow of private capital and the economic development, stable framework for investment and maxim effective utilisation of economic resources and the development of economic business. See the preamble of The Treaty between the United States of America and the Republic of Ecuador Concerning the Encouragement and Reciprocal Protection of Investment.

Conclusion

With respect to the concept of sustainable development, as acknowledged and explained by the Gabčíkovo-Nagymaros case and the Ogoniland case, sustaining economic development through revenue accruing from the oil industry does not absolutely rule out the environment protection. Key stakeholders especially, the host state is responsible to carefully monitor and mitigate impacts of any economic development on the environment. Importantly, imposing environmental liability upon Chevron and TexPet – the polluter – is beneficial for environmental protection and the current free trade regime. This relationship exhibits the synergy between principles of environmental regulation and economic laws.

On the other hand, the foregoing supportiveness remains unchanged in the context of fair and equitable treatment. In the light of the ELSI case and the Noble Ventures Inc v Romania case, there is a possibility that the investment arbitration tribunal may refuse to protect the polluting investor on the ground of dishonoring the duty to conduct business in a reasonable manner. As a result, environmental protection is being balanced and integrated in the investment protection regime. Hence, it addresses the conceptual compatibility between fair and equitable treatment and sustainable development. This cooperation exposes that economic laws does not protect investors who arbitrarily pollute and as such does not obstruct the principles of environmental regulation. Regarding the mutually supportive relationship in both domestic and international level, it is logical to conclude that, potentially, economic laws and principles of environmental regulation do not perform their functions at the expense of one another.