Case Comments

Proportionality Analysis and Disproportionate Damages: Occidental Petroleum Corporation and Occidental Exploration and Production Company v The Republic of Ecuador
ICSID Case No. ARB/06/11, Award, 5 October 2012 (L. Yves Fortier, David A.R. Williams, Brigitte Stern) and Dissenting Opinion, 20 September 2012 (Brigitte Stern)

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Keywords


In Occidental v. Ecuador, an ICSID tribunal held that Ecuador had breached Articles II(3)(a) and III(1) of the United States-Ecuador bilateral investment treaty (BIT), and ordered Ecuador to pay USD 1,769,625,000 in damages to the Claimants. The Tribunal held that Ecuador had breached the BIT by terminating a Participation Contract under which Occidental Exploration and

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Production Company (OEPC) had acquired the right to explore and exploit oil in Ecuadorian territory. Despite the fact that OEPC transferred part of its rights under this contract to a third party (by means of a so-called Farmout Agreement) in violation of the terms of the contract and Ecuadorian law, the Tribunal unanimously decided that the termination of the contract was a disproportionate response to the wrongdoing of the Claimant, which violated the fair and equitable treatment standard and the obligation not to take measures equivalent to an expropriation.

However, the members of the Tribunal were not in accord in relation to the quantum of damages. The majority decided that Ecuador had to pay the full market value of the investment reduced by a factor of 25% in order to take into account the illegal conduct of the Claimants, who had contributed to the damage suffered. The dissent would have applied a 50–50 apportionment of damages (Dissent, para. 7). More importantly, the majority vote did not take into consideration in awarding OEPC 100% damages the fact that OEPC had transferred 40% of its rights under the contract to a third party (para. 650). The legal basis for disregarding the transfer of rights that had been effected prior to the termination of the Participation Contract was that in the Tribunal’s view the Farmout Agreement was ‘inexistent’ under the applicable law (para. 650). Brigitte Stern was of a different opinion, concluding that in declaring the inexistence of the Farmout Agreement the Tribunal manifestly exceeded its powers (Dissent, paras. 117–132). As of October 2014, an application for an annulment of the award is pending.

This decision is important in relation to the issue of the use of proportionality analysis as a method of review in investment arbitration. It reveals the difficulties in the application of proportionality analysis to administrative sanctions imposed by State authorities, where the outcome might be that the decision of a tribunal leaves a violation of domestic law by the investor unpunished. The case also reveals the need for arbitrators to have some training in the field of comparative administrative law, as the treatment of domestic law in this case was deficient.

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Facts

In 2006, Ecuador terminated by decree a 1999 Participation Contract between OEPC and the State-owned company PetroEcuador. The contract granted OEPC the exclusive right to explore and exploit hydrocarbons in a sector of the Ecuadorian Amazon region, identified as Block 15. PetroEcuador (through its