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ICSID RULE AGAINST ECUADOR IN OIL DISPUTE

Burlington Resources Inc. v. Republic of Ecuador (ICSID Case No. ARB/08/5)

Introduction

In a decision dated 14 December 2012, an ICSID Tribunal found in favour of ConocoPhillips' wholly owned subsidiary, Burlington Resources Inc., in its arbitration against Ecuador.

Background

The dispute centred on two production sharing contracts ("PSCs") for Blocks 7 and 21, entered into between Burlington and Ecuador in September 2001.

In 2002, oil prices began to rise and by 2005, the price of a barrel of oil had more than doubled. Ecuador considered that this price increase destroyed the economic stability of the PSCs and that the allocation of oil production (which gave the majority to the contractor) was unfair on the grounds that the State owning the oil should benefit the most. On 19 April 2006, the Ecuadorian Congress enacted Law 42 which provided for an additional participation for the State of "at least 50%" on so-called extraordinary profits, i.e. profits resulting from oil prices in excess of the price of oil as it stood when the PSCs were executed.

In 2008, Burlington commenced arbitration against Ecuador alleging that the Ecuadorian government's decision to reform the country's Hydrocarbons law and regulate profits generated by rising oil prices was illegal. The revised law required companies to pay the Government 50% of their windfall profits arising from high oil prices on international markets.

Burlington alleged that this represented a unilateral change of contract, violated the principle of legal certainty, and constituted an expropriation of Blocks 7 and 21. It also halted production at those two blocks, which it jointly controlled with French company, Perenco.

Ecuador denied that it expropriated Burlington's investments, and stated that it had only intervened in Blocks 7 and 21 after Burlington unilaterally opted to suspend operations at those sites. Ecuador argued that the revised hydrocarbons law was necessary and appropriate given the unforeseen rise in oil prices, and did not breach or modify the PSCs entered into between Burlington and Ecuador, which dealt only with oil volumes and not the price of oil.

Judgment

The Tribunal ruled that Ecuador unlawfully expropriated the company's significant oil investments in Blocks 7 and 21, in violation of the US-Ecuador bilateral investment treaty. The Tribunal also found that Burlington's investment included the contractual right to be indemnified for the effects of Law 42.

The Tribunal has not yet issued a decision on damages. An additional arbitration phase will take place to determine the amount of compensation owed to Burlington for Ecuador's actions.

Update on Occidental and Perenco

The decision in this arbitration comes only two months after ICSID awarded Occidental damages of US$1.77 billion against Ecuador (reported in our alert of 23 October 2012). Ecuador has filed an application to have that decision annulled, and the ICSID tribunal in that matter was constituted on 18 January 2013. A decision in Perenco v Ecuador (registered in 2008) is still pending.

28th January 2013