

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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: **Electronically Filed**
THE REPUBLIC OF ECUADOR AND PETROECUADOR, :
:
: 04 Civ. 8378 (LBS)
Plaintiffs, Counterclaim Defendants, :
:
-against- :
:
CHEVRONTEXACO CORPORATION AND TEXACO PETROLEUM :
COMPANY, :
:
Defendants, Counterclaim Plaintiffs. :
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**PLAINTIFFS' MEMORANDUM OF LAW IN SUPPORT OF THEIR
MOTION TO AMEND THEIR REPLY TO DEFENDANTS' COUNTERCLAIMS
IN ORDER TO ASSERT ONE ADDITIONAL AFFIRMATIVE DEFENSE**

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Pursuant to Rule 15(a) of the Federal Rules of Civil Procedure, Plaintiffs, the Republic of Ecuador (the “Republic”) and Petroecuador, by their counsel, respectfully move this Court (the "Motion") to grant them leave to amend their Reply to the counterclaims of Defendants ChevronTexaco Corporation and Texaco Petroleum Company (“Counterclaims”). The proposed Amended Reply, which is identical in all respects to the original except that for the addition of a single affirmative defense, is attached to this Motion as Exhibit 1.

BACKGROUND

On January 10, 2005 Defendants filed their Answer to the Republic’s Amended Complaint and Counterclaims. (Docket #30.) Defendants allege in their Counterclaims that, pursuant to the 1995 Settlement and 1998 Release Agreements (sometimes collectively referred to herein as the “Agreements”), Plaintiffs released Defendants from any claims arising from the operation of the Napo Concession. In their Counterclaims, Defendants seek damages, declaratory relief and mandatory injunctive relief requiring Plaintiffs to indemnify them for any fees, costs and expenses, including any judgment against them, arising out of the Lago Agrio litigation currently proceeding against them in Ecuador (the “Ecuador Action”). Defendants’ requested declaratory judgment would declare that: (1) Plaintiffs breached their obligations to Defendants under the Agreements; and (2) Plaintiffs are obligated to (a) inform the Ecuadorian Court of the 1998 Release, (b) intervene in the Ecuador Action and (c) indemnify Defendants for all fees, costs and judgments incurred or awarded against them in the Ecuador Action.

Plaintiffs filed their Reply to Defendants’ Counterclaims (“Reply”) on July 15, 2005.¹ The Reply denies that Defendants are entitled to any relief whatsoever, asserts that the

¹ See *Plaintiffs The Republic of Ecuador and Petroecuador’s Reply to ChevronTexaco Corporation’s and Texaco Petroleum Company’s Counterclaims* (entered in ECF as “Answer to Counterclaim”), filed by the Republic of Ecuador and Petroecuador on 07/15/2005 (Docket #69).

Defendants' Counterclaims should be dismissed and judgment entered for the Republic, and sets forth a number of affirmative defenses. Plaintiffs hereby seek leave to amend their Reply to Defendants' Counterclaims to add as an affirmative defense that Defendants, through intentional or negligent material misrepresentations of fact, fraudulently or negligently induced Plaintiffs to sign the Agreements.² As Plaintiffs' proposed Amended Reply (attached hereto as Ex. 1) states, Defendants, *inter alia*, presented to Plaintiffs false and misleading information that defendants had a duty to disclose, but failed to do so. Defendants did so for the purpose of inducing Plaintiffs to execute the Agreements, and Plaintiffs reasonably relied to their detriment on this misleading information.

ARGUMENT

I. Under Applicable Rules and Law, and in the Proper Exercise of its Discretion, the Court Should Permit Plaintiffs to Amend Their Reply to Defendants' Counterclaims.

Federal Rule of Civil Procedure 15(a) provides, in pertinent part, as follows:

A party may amend the party's pleading once as a matter of course at any time before a responsive pleading is served or, if the pleading is one to which no responsive pleading is permitted and the action has not been placed upon the trial calendar, the party may so amend it at any time within 20 days after it is served. Otherwise a party may amend the party's pleading only by leave of court or by written consent of the adverse party; *and leave shall be freely given when justice so requires.*

(Emphasis added).

The United States Supreme Court, this Circuit and this District have uniformly and routinely invoked Rule 15(a)'s liberal standard in granting requests to amend, especially, as here,

² Rule 15(a) applies to amendments to "pleadings". Rule 7(a) defines "pleadings" to include "a reply to a counterclaim denominated as such." Hence, the instant motion is properly filed under Rule 15(a) as the document Plaintiffs seek leave to amend is a "pleading" as defined by Rule 7(a).

when made before commencement of meaningful discovery. As the Supreme Court observed, the language of Rule 15(a) that “leave shall be freely given when justice so requires” reflects a liberal policy favoring amendment. *Foman v. Davis*, 371 U.S. 178, 182 (1962). The Supreme Court found that leave may be denied only for an “apparent or declared reason . . . such as undue delay, bad faith or dilatory motive on the part of the movant, repeated failure to cure deficiencies by amendments previously allowed, undue prejudice to the opposing party by virtue of allowance of the amendment, futility of amendment, etc. . . .” *Id.* This Circuit, of course, has repeatedly invoked the same liberal standard in affirming the grant of Rule 15(a) motions. *AIU Insurance Co. v. Mitsui O.S.K. Lines, Ltd.*, 897 F.Supp 724, 726 (S.D.N.Y. 1995) (citing *State Teachers Retirement Bd. v. Fluor Corp.*, 654 F. 2d 843, 856 (2d Cir. 1984)) (“Leave to amend a pleading should be ‘freely given,’ Rule 15(a), F.R.Civ.P., and leave should be denied only where amendment would be futile, where it is sought in bad faith, or where it would prejudice the opposing party.”).

Given the liberal standard governing pleading amendments, the burden is ordinarily on the party *opposing* the amendment to demonstrate why the amendment should *not* be allowed. *See Foman v. Davis*, 371 U.S. 178 (1962); *Laurie v. Alabama Court of Criminal Appeals*, 256 F. 3d 1266, 1274 (11th Cir. 2001) (“There must be a substantial reason to deny a motion to amend.”); *Firestone v. Firestone*, 76 F.3d 1205, 1209 (D.C. Cir. 1996) (per curiam) (criticizing district court’s “complete failure” to explain grounds for denying leave to amend).

As shown below, the Republic’s proposed addition of a single affirmative defense is *not* futile, sought in bad faith or otherwise unduly prejudicial to Defendants.

A. The proposed amendment is integral to this case and is not futile.

Plaintiffs' proposed amendment offers an alternative dispositive ground on which this Court may reject Defendants' contention that Plaintiffs fully and finally released them from any and all liability whatsoever flowing from their operation of the Napo Concession. The amendment is predicated substantially on facts apparently being developed by the plaintiffs and the defendants in the Ecuador Action, the transcript of which the undersigned counsel have recently begun reviewing.

As this Court knows, Defendants contend that the parties' 1995 Settlement and a 1998 Release discharged and released Defendants, not only from any environmental claims belonging to Plaintiffs, but from all Napo Concession-related environmental claims belonging to anyone. In making this contention, Defendants have distorted the reach of the 1999 Environmental Management Law and misconstrued the state of Ecuadorian environmental law prior to 1999. But while Plaintiffs intend to address these *legal* issues at a later and more appropriate time, they need to amend their Reply to Defendant's Counterclaims so that at trial (should those Counterclaims survive summary judgment) Plaintiffs may prove that the 1995 Settlement and 1998 Release are voidable and may be rescinded as having been procured by a series of material misrepresentations or omissions that Defendants knew were false and misleading and would be reasonably relied upon by Plaintiffs.

As part of the negotiations leading up to the execution of the 1995 Settlement and 1998 Release, Defendants, as sole operator under the 1965 Joint Operating Agreement until 1991, affirmatively misrepresented the environmental status of the producing and shut down oil fields and wells that they had been operating. Plaintiffs consequently agreed to a remediation plan proposed by Defendants that was hopelessly insufficient, in that it failed to disclose numerous

unremediated toxic sites. While Defendants identified 137 unlined toxic pits for which it promised remediation, it failed to disclose more than 100 others—and instead took affirmative steps to conceal their very existence from Plaintiffs. Evidence before the court in the Ecuador Action discloses that Defendants covered the surface of the unlined toxic “pits” with thousands of pounds of soil or “fill,” thereby concealing their existence. To this day, these disguised pits are continuing sources of pollution; recent toxicity tests just beneath the surface confirm that no remediation has been performed on them; and the pools of hazardous substances just beneath the surface continuously release into the ground, leak into groundwater and seep into nearby vegetation and surficial waterways.

With the benefit of both sides’ expert evaluations and judicial inspection of many of the sites, the plaintiffs in the Ecuador Action have introduced powerful evidence of this (literal) coverup, stating in a judicial proceeding at one such site:

[W]e have stopped at the surface of Sacha pit 114, but before we drill at Sacha pit 114, on this site, on this surface stood one of the first pools that was constructed by the Texaco company. I want to ask you to observe the aerial photograph, certified by IGM, taken in the year 1976. I refer precisely to this site; here is the large pool [of sludge], in this place. It is a pool of more than 2200 square meters. This pool was also plugged [filled with soil] during the years 1976 and 1985. Why do I say this, Your Honor? Here is the aerial photograph of IGM taken in the year 1986. In this photograph, this pool no longer appears; we see the change. . . . That pool no longer exists, there was already another one in 1986. But why the surprise? Hypothetically, before the pool was plugged, it should have been remediated. But what did the Texaco company do? Possibly it limited itself to covering the pool with a layer of dirt, perhaps one and one-half or two meters of dirt, and today the experts, following your order, have proceeded to take soil samples, to drill holes, and as you can see, Your Honor, these samples have stains from hydrocarbons, from petroleum. Here is the evidence.

Transcript of Superior Court of Nueva Loja, No. 002-2003-P-CSJNL at 31 (original and certified translation attached as Ex. 2).

Texaco concealed the contamination, covering it with earth and leaving contaminating substances inside that now constitute a fatal trap, a sort of mine field waiting for some unsuspecting farmer, indigenous person or colonist to arrive and build his house, plant crops, breed livestock and/or dig a well for water. Unknowingly, those living in this area could consume contaminated products or water, placing themselves and their families and those who purchase their products at high risk of contracting fatal illnesses such as cancer. What is even more serious is that in the majority of cases, Texaco discharged the formation water and the drilling muds and wastes into the environment with no treatment whatsoever.

* * * *

Due to the immense quantity and the high concentration of polycyclic aromatic hydrocarbon molecules that have the capacity to penetrate the lower layers of the soil and sometimes to migrate through the groundwater, the damage has extended over time, to the present. These wastes continue to produce ecological, environmental, property and personal damage. The only way to prevent this situation from continuing is to perform an adequate repair.

See Ex. 3 (Transcript of Superior Court of Nueva Loja, No. 002-2003-P-CSJNL at 46) (original and certified translation attached).

In sum, while it is not part of movant's burden on a motion to amend a pleading, Plaintiffs can offer substantial evidence supporting its proposed additional affirmative defense. By no stretch of the imagination could this proposed amendment be deemed futile as lacking a good faith evidentiary basis.

This Circuit and this Court have long favored amendments to pleadings in circumstances such as these involving important new information regarding core issues of the case. *See, e.g., Golden Trade v. Jordache*, 143 F.R.D. 504 (S.D.N.Y. 1992). Plaintiffs do not need to prove their proposed additional affirmative defense at this time, only to put Defendants on notice of all of their defenses so that the parties may explore the subject in discovery. In light of the legal and factual import of the issues raised by the proposed affirmative defense, public policy and justice

require that Plaintiffs be granted leave to amend their Reply and to take discovery on their proposed affirmative defense.

B. Plaintiffs do not seek the amendment in bad faith.

Plaintiffs do not seek this amendment in bad faith, but rather to ensure that this Court has the full range of facts and arguments before it so that it may fairly and justly adjudicate this action on the merits.

C. Defendants will not be prejudiced by this amendment.

Finally, Defendants will suffer no prejudice by this proposed amendment. The parties have not yet exchanged any documents or taken any depositions, with the date of document production still five weeks away. This Court's scheduling order does not require the submission of expert reports for another four months. Trial is still nearly 10 months away.

Perhaps most fundamentally though, Defendants cannot claim that they are unaware of or unfamiliar with the substance of Plaintiffs' proposed amended claims. Plaintiffs are relying, in significant part, on evidence already submitted in the Ecuador Action being actively litigated by Defendants since 2003, and in which litigation Defendants have already offered expert testimony. *See Popp Telecom v. American Sharecom, Inc.*, 210 F. 3d 928, 943 (8th Cir. 2000) ("The inclusion of a claim based on facts already known or available to both sides does not prejudice the non-moving party.").

RELIEF REQUESTED

For the reasons stated herein, Plaintiffs respectfully request that this Court grant the Motion and allow them to amend their Reply in the manner sought.

