

**Chevron's Misrepresentations in Public Filings Regarding
its \$18.1 Billion Environmental Liability in Ecuador**

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by Graham Erion, Lawyer for the Rainforest Communities*

Summary

Below is a memo that presents evidence and analysis that Chevron's management is publishing false or materially misleading information regarding its \$18.1 billion adverse judgment in Ecuador for causing environmental damage. Chevron has an obligation to immediately acknowledge the reality of this loss contingency to the company's investors so informed decisions can be made about the material financial risks Chevron faces. This memo relies heavily on legal and factual information available to Chevron and to the lawyers who represent the rainforest communities who won the judgment. However, this material has not been readily available to the investing public, which relies on Chevron for honest and complete disclosure of all the material information related to the company. Investors likely have not reviewed the 188-page trial court decision in Ecuador, the 220,000-page trial record, or the various appellate decisions affirming the judgment or the decisions from the Second Circuit Court of Appeals in the United States rebuking Chevron for the manner in which it sought to block enforcement of the judgment.¹

It must also be noted that Chevron's management team and Board of Directors appear to suffer from conflicts of interest regarding the Ecuador litigation. All are compensated to some degree or another by the company's short-term financial performance and thus have an interest putting off the Ecuador liability to another day. Further, Chevron CEO John Watson played a vital role in the Chevron-Texaco merger in 2001. It now appears that at the time of the merger Chevron did not adequately vet Texaco for its enormous Ecuador environmental liability and thus overpaid significantly for the company.

Legal Obligations Under the Securities Act

To prevent fraud and to protect the investing public, securities regulators in numerous countries require publicly-listed companies to provide regular disclosure of key information about their operations to enable investors to make informed investment

* Graham Erion has an LL.M. (*Kent Scholar*) from Columbia University in New York and a LL.B. from Osgoode Hall Law School in Toronto, Canada. Prior to advising the rainforest communities in Ecuador, he practiced corporate and securities law at Torys LLP and Norton Rose Canada LLP. He has published multiple articles on securities law and corporate disclosure including a June 2009 feature piece on securities-related climate change litigation in the *Review of European Community and International Environmental Law* (18 R.E.C.I.E.L 164). He is licensed to practice law in Ontario and New York.

¹ See, e.g., "Summary of Overwhelming Evidence Against Chevron in Ecuador Trial," Amazon Defense Front (Jan. 2012), at <http://chevrontoxico.com/assets/docs/2012-01-evidence-summary.pdf> ("Ev. Summ."); Plaintiffs' Final Legal Argument, at <http://chevrontoxico.com/news-and-multimedia/2011/0406-key-documents-and-court-filings-from-aguinda-legal-team.html> ("Alegato"); and *Chevron v. Naranjo, et. al.* Docket: 11-1150-cv(L) (2nd Cir., 2012) at: http://www.ca2.uscourts.gov/decisions/isysquery/a0846430-540a-47a9-ae4c-dbbdd880e356/1/doc/11-1150_op.pdf

decisions. In the United States, these obligations are rooted in the Securities Acts of 1933 and 1934 and the regulations prescribed thereunder. These include the obligation of public companies to provide a prospectus to investors when first listing on a public exchange, and a continuous disclosure obligation thereafter of financial and material information regarding their business, including material legal proceedings.² Public companies, including Chevron, who misrepresent or fail to disclose such material information can be criminally or civilly sanctioned by the Securities and Exchange Commission or the Department of Justice and face potential individual, class, or derivative civil litigation by private investors.

Background

Chevron is the defendant in an 18-year litigation brought by 30,000 rainforest residents over environmental contamination in Ecuador. The case, *Aguinda v. ChevronTexaco*, (hereafter, “Ecuador litigation”) originally was filed in the Southern District of New York in 1993 but was transferred to Ecuador at Chevron’s request. On February 14, 2011, the Superior Court of Nueva Loja in Ecuador released its final decision ordering the company to pay \$8.646 billion in actual damages to be used solely for costs associated with remediating the extensive environmental contamination and damages caused by Chevron; an additional USD \$8.646 billion in punitive damages; and an additional amount equal to ten percent (10%) of the actual damages (\$864.6 million) to be paid to the Claimants’ representative group, for a total of \$18.1 billion.³ Both parties appealed the decision to the relevant provincial appeals court in Ecuador. On January 3, 2012, the appeals court confirmed the lower court ruling and upheld the entirety of the judgment.⁴

Because Chevron refused to post a modest bond to suspend enforcement of the judgment as required by Ecuadorian law, the judgment is now immediately enforceable against Chevron assets on a worldwide basis.⁵ Representatives of the affected communities have stated their intention to commence recognition and enforcement actions in the near term in multiple countries, some of which have mutual enforcement treaties with Ecuador. Despite this looming threat, Chevron continues to mislead investors in public filings and on conference calls with analysts about the impact of enforcement, the potential loss the company faces, the extent of the various legal rulings against Chevron, and even as regards the merits of the case. Several examples follow.

² See Item 103, Regulation S-K (17 CFR § 229)

³ A summary of the judgment is available here: <http://chevrontoxico.com/assets/docs/2011-02-14-summary-of-judgment-Aguinda-v-ChevronTexaco.pdf>. The court found actual damages to include \$5.4 billion for remediation of soil, \$600 million for addressing groundwater contamination, \$200 million for restoration of native flora and fauna, \$150 million for delivery of potable water, \$1.4 billion to augment the healthcare system to respond to health issues (excluding cancer), \$800 million to address past and future excess cancer deaths in the affected area and \$100 million to address cultural impacts of the indigenous groups.

⁴ An English translation of the judgment is available here: <http://chevrontoxico.com/assets/docs/2012-01-03-appeal-decision-english.pdf>

⁵ The three-judge appellate panel ruling in Ecuador found that Chevron’s request for a special bond waiver had no basis in Ecuadorian law, thereby paving the way for the commencement of enforcement actions. See: <http://chevrontoxico.com/assets/docs/2012-02-17-notification.pdf>

1. Refusal to Disclose Material Impact of Enforcement Actions Against Chevron Assets In Multiple Countries

In its recent 2011 10-K, Chevron discloses that it expects the Ecuadorian plaintiff communities to seek to enforce the judgment outside of Ecuador but does not disclose what impact this might have. However, Chevron fails to disclose the most critical material fact – that the company's own internal assessment is that such enforcement actions could cause irreparable harm to its operations. In the context of a related case Chevron filed in 2011 in New York federal court, Chevron Deputy Comptroller Rex Mitchell stated the following in a sworn affidavit:

The seizure of Chevron assets, such as oil tankers, wells, or pipelines, in any one of these countries, would disrupt Chevron's supply chain and operations; and seizures in multiple jurisdictions would be more disruptive...[The] Defendants' campaign to seek seizures anywhere around the world and generate maximum publicity for such acts *would cause significant, irreparable damage to Chevron*. Unless it is stopped, Defendants' announced plan to cause disruption to Chevron's supply chain is likely to cause *irreparable injury to Chevron's business reputation and business relationships that would not be remediable by money damages*.⁶

The assessment in the Mitchell affidavit appears on its face to meet the materiality test as defined by the U.S. Supreme Court. Information is “material” if investors would regard it as altering the “total mix” of information required to make an informed investment decision.⁷ Chevron’s decision to withhold this information and assessment, in addition to the misrepresentations detailed below, appears to be a prima facie violation of Chevron’s disclosure obligations and thus creates a liability for misleading statements under the U.S. *Securities Acts* of 1934.⁸

2. Chevron's Refusal to Disclose Possible Loss or Range of Loss in Financial Statements, Despite Specificity of \$18.1 Billion Judgment

In addition to withholding material assessments of risks, Chevron also appears to be breaching securities regulations through the company’s ongoing refusal to disclose a possible loss or range of loss from the Ecuador judgment. In its public filings for each of the past four years, Chevron has maintained

⁶ *Chevron Corp. v. Steven Donziger, et al*, (S.D.N.Y., Case No. 11-CV-0691), *Declaration of Rex J. Mitchell in Support of Chevron Corporation’s Motion for a Preliminary Injunction*, filed 5 Feb 2011 at paragraphs 7; 10. (emphasis added) Available at: <http://chevrontoxico.com/assets/docs/2011-02-15-mitchell-declaration.pdf>

⁷ *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 96 S.Ct. 2126, 48 L.Ed. 2d 757 (1976); *Basic Incorporated v. Levinson*, 485 U.S. 224, 108 S.Ct. 978, 99 L.Ed. 2d. 194 (1988).

⁸ See, e.g., 15 U.S.C. § 78r (“Any person who shall make or cause to be made any statement in any application, report or document filed pursuant to this title...which statement at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, shall be liable to any person...who in reliance upon such statement, shall have purchased or sold a security at a price which was affected by such statement...”)

“Management does not believe an estimate of a reasonably possible loss (or a range of loss) can be made in this case...the highly uncertain legal environment surrounding the case provides no basis for management to estimate a reasonably possible loss (or a range of loss).”

Chevron continues to draw this conclusion despite the \$18.1 judgment rendered against it, which has been affirmed on appeal. Chevron dismisses the judgment as a basis for such an estimate based on its claimed “defects”. But the “defects” cited by the company have been rejected by Ecuador's trial and appellate courts.⁹

Loss contingency disclosure in the United States is governed by the Financial Accounting Standards Board's 1975 Standard No. 5 – “Accounting for Contingencies”. This standard requires an estimated loss from a loss contingency (which includes litigation) if it is probable that an asset has been impaired or a liability has been incurred at the date of the financial statements *and* the amount of loss can be reasonably estimated.¹⁰ It should also be noted from the FASB standard that the term “reasonably possible” refers to the chance of the future event occurring is more than remote but less than likely.

It is clear from the FASB standard that the requirements for disclosure of Chevron's loss contingency in Ecuador have been met. The judgment was affirmed on appeal and is enforceable. While the exact timing of enforcement of the judgment has some uncertainty, the enforcement of the judgment is certainly more than a remote possibility – especially given that Chevron has substantial assets in dozens of countries, many of which have reciprocity enforcement agreements with Ecuador. Even in recent court filings, Chevron has provided an estimate of their loss in the case, albeit an absurdly low \$200 million.¹¹ This at least proves the company is able to engage in such calculations when it suits it to do so.

Investors deserve a more honest calculation that takes into account the size of the \$18 billion judgment, the likelihood of successful recognition and enforcement actions around the world, and how such actions could encumber Chevron assets and put the company at a disadvantage relative to its competitors when seeking new business.

⁹ Chevron cites defects associated with the Ecuadorian judgment, the 2008 Cabrera report on alleged damages and the September 2010 plaintiffs' submission on alleged damages. In short, the Ecuador court relied for its findings on 106 technical reports presented by both parties and by independent experts that proved legal violations at 100% of the Chevron well sites inspected. This is simply indisputable. Further the evidence shows clearly there were no improprieties with either the Cabrera reports or the plaintiff's own damages assessment. Cabrera himself signed on to a report that was empirically valid based on the evidence cited above, including Chevron's own evidence. However, given the fake controversy ginned up by Chevron as part of its litigation strategy, the court chose to disregard the Cabrera report in reaching its conclusions.

¹⁰ FAS 5 – Accounting For Contingencies at paragraph 8.

¹¹ The absurdity of this figure can be contrasted with the \$20 billion trust that BP pledged to pay for damages from the Deepwater Horizon disaster, with the company's total liability estimated at roughly \$60 billion. The BP spill notably discharged far fewer gallons of oil toxins into the Gulf of Mexico than Chevron's operations discharged in the streams, rivers and soil of Ecuador's rainforest. See, e.g., <http://chevrontoxico.com/news-and-multimedia/2012/0301-bp-talks-settlement-in-gulf-while-chevron-pouts.html> and <http://www.bp.com/genericarticle.do?categoryId=2012968&contentId=7073667>

3. Selective Disclosure of Court Rulings

While much of Chevron's 2011 10-K disclosure on Ecuador provides an update of recent judicial rulings, the company fails to properly disclose adverse developments that seriously weaken the its legal position. In the first example, Chevron disclosed the decision of a private investment arbitration panel that issued an interim award mandating that the government of Ecuador take all measures necessary to suspend the enforcement and recognition of the judgment against Chevron.¹²

However, Chevron failed to disclose that the rainforest communities are not bound by the arbitration ruling as they are not a party to the arbitration proceeding; that the government of Ecuador has concluded it will not suspend enforcement of the judgment, as there is no valid basis to do so under Ecuadorian and international law; and that the Second Circuit Court of Appeals in New York has ruled that the investor arbitration has no bearing on the ability of the rainforest communities to enforce their judgment anywhere in the world.¹³ This latter finding was cited by the appellate court in Ecuador in rejecting the Interim Award of the investor arbitration panel on February 20, 2012 (three days before the 10-K was filed). These facts are obviously material to investors: they show that Ecuadorian courts (and potentially other enforcement jurisdictions) will continue to recognize the judgment against the company, regardless of any decision by the private investment arbitration panel.¹⁴

In another misleading statement, Chevron's disclosure of a civil RICO lawsuit in New York states that the company "is seeking relief that includes...a declaration that any judgment against Chevron in the Lago Agrio litigation is the result of fraud and other unlawful conduct and is therefore unenforceable." While the company later admits that the Court of Appeals for the Second Circuit dismissed Chevron's claim for declaratory relief, the use of the present tense of "seeking" in Chevron's disclosure creates the impression that such efforts are still underway and such an award is still possible. Since neither is true, Chevron's disclosure again creates a false impression.

¹² For further background on Chevron's illegitimate use of the BIT process in this instance, see letter from Andean Commission of Jurists to United Nations Secretary General Ban Ki-moon expressing alarm at Chevron's tactics, available here: <http://chevrontoxico.com/assets/docs/2012-02-10-caj-letter-to-un.pdf>

¹³ See, e.g., *Chevron Corporation v. Naranjo*, Docket Nos. 11-1150-cv (L) 11-1264 (Con), (2d Cir. Jan. 26, 2012), at 27: "The [Lago Agrio Plaintiffs] hold a judgment from an Ecuadorian court. They may seek to enforce that judgment in any country in the world where Chevron has assets"; and *Republic of Ecuador v. Chevron Corporation*, Docket Nos. 10-1020-cv (L) 10-1026 (Con), (2d Cir. March 17, 2011): "Plaintiffs are not parties to the [Bilateral Investment Treaty], and that treaty has no application to their claims, their dispute with Chevron therefore cannot be settled through BIT arbitration."

¹⁴ Chevron investors might also be interested to know that Ecuador's government is on solid legal ground in rejecting interference by the arbitration panel in its sovereign judicial system. Its position on the matter is exactly the same as that taken by the United States government, which rejects orders from international bodies that require it to violate the separation of powers doctrine and interfere in its judiciary. See, e.g., *Medellin v. Texas*, 552 U.S. 491 (2008) (order of the International Court of Justice does not require President, or give him authority, to act beyond traditional separation of powers bounds; *Loewen Group v. United States*, ICSID Case No. ARB(AF)/98/3 (Jan. 5, 2001) (noting U.S. position that "the claim is not arbitrable because the judgments of domestic courts in purely private disputes are not . . . within the scope of [international arbitration]").

4. Repeated Misrepresentations as to Legal and Factual Merit

Since 2008, the year Chevron first disclosed its liability in Ecuador in its 10-K filing (annual report), the company has repeated the exact same paragraph each year on why it believes the lawsuit lacks legal merit:

As to matters of law, the company believes first, that the court lacks jurisdiction over Chevron; second, that the law under which plaintiffs bring the action, enacted in 1999, cannot be applied retroactively; third, that the claims are barred by the statute of limitations in Ecuador; and, fourth, that the lawsuit is also barred by the releases from liability previously given to Texpet by the Republic of Ecuador and Petroecuador and by the pertinent provincial and municipal governments.

Evidence that these assertions advanced by Chevron in its public filings are either demonstrably false or misleading is provided below.

a) The Ecuadorian court lacks jurisdiction over Chevron

This argument is demonstrably false as evidenced by Chevron's own consent to the jurisdiction of Ecuadorian courts. On June 21, 2001, United States District Judge Jed S. Rakoff had counsel for both Chevron and the affected communities sign a stipulation order that proves Chevron voluntarily subjected itself to jurisdiction in Ecuador's courts for the *Aguinda* matter as a condition precedent for the removal of the case from the U.S. The Stipulation Order was issued after Chevron asserted in multiple pleadings filed with the U.S. court that the company would submit to jurisdiction in Ecuador, and be bound by Ecuador's courts, as a condition of removal of the *Aguinda* matter. The Second Circuit Court of Appeals, which specifically conditioned the dismissal on the defendants' agreement to submit to the jurisdiction of Ecuador's courts, affirmed this ruling.¹⁵ This Court again confirmed Ecuador's jurisdiction over Chevron in a March 2011 ruling involving the Bilateral Investment Treaty dispute between Chevron and the Government of Ecuador. The Second Circuit again noted that in arguing to remove the case from U.S. District Court in the 1990s, "Texaco assured the district court that it would recognize the binding nature of any judgment issued in Ecuador." The judgment then concluded,

As a result, that promise, along with Texaco's more general promises to submit to Ecuadorian jurisdiction, is enforceable against Chevron in this action and any future proceedings between the parties, including enforcement actions, contempt proceedings, and attempts to confirm arbitral awards.¹⁶

Chevron's continued assertion in its public filings that the Ecuadorian courts do not have jurisdiction over the company after *three* rulings to the contrary in U.S. courts is misleading.

¹⁵ *Aguinda v. Texaco*, 303 F.3d 470 (2d Cir. 2002) at 478-478.

¹⁶ *Republic of Ecuador v. Chevron Corporation*, supra note 12 at p. 6.

b) The 1999 law cannot be applied retroactively against Chevron

Like the jurisdictional argument, this assertion is also demonstrably false and has been dismissed by any court that has heard it argued. The key misrepresentation by Chevron is its failure to disclose that the *Aguinda* plaintiffs are using the referenced law, the 1999 Law of Environmental Management (“Ley de Gestion Ambiental”), for its *procedural provisions only*, rendering the retroactivity question moot. As a general matter of law in Ecuador (and the U.S.), a statute used for procedural purposes does not raise concerns regarding retroactivity except in rare circumstances inapplicable here. In Ecuador, that country’s highest court has ruled in the *Delfina Torres* decision that the 1999 law can be applied retroactively - a decision Chevron fails to disclose, even though it was cited in the judgment against the company where its argument was specifically considered and rejected.

c) Claims barred by the Statute of Limitations

Chevron’s assertion that the *Aguinda* claims are barred by the statute of limitations is also demonstrably false, as the company waived statute of limitations defenses in the same Stipulation and Order in which it agreed to submit to jurisdiction in Ecuador as a condition of the removal of the case from U.S. federal court.¹⁷ It is well-settled law that a statute of limitations defense, once waived, cannot be reasserted without the consent of the opposing party.¹⁸ As such, the company’s assertion that the *Aguinda* claims are barred by the statute of limitations is demonstrably false and was also rejected by the Ecuadorian courts, much as it would be by any court looking to enforce the judgment.

d) The lawsuit is barred by a release of liability given Texaco by the government of Ecuador and PetroEcuador, the state-owned oil company.

Chevron’s assertion is grossly misleading, as proven by the fact the legal release from Ecuador’s government expressly carves out the type of private claims that were litigated in the *Aguinda* lawsuit (which was pending in U.S. Federal Court at the time the release was negotiated in 1994). The plain language of the Memorandum of Understanding between Texaco and the Republic of Ecuador incorporates this express “carve out” language:

“The provisions of this [MOU] shall apply without prejudice to the rights possibly held by third parties for the impact caused as a consequence of the operations of the former Petroecuador-Texaco consortium.”

Even Texaco’s principal attorney who negotiated the agreement, Rodrigo Perez Pallares, acknowledged in sworn deposition testimony in the U.S. that the release carves out third party claims of the type being litigated in the Ecuador lawsuit. The plaintiffs in *Aguinda*

¹⁷ *Aguinda*, 303 F.3d 470,475.

¹⁸ 56 Am.Jur., Waiver, s 24; *Gilbert v. Globe & Rutgers Fire Ins. Co.*, 91 Or. 59, 174 P. 1161, 178 P. 359, 3 A.L.R. 205 (holding that where a party intentionally relinquishes a known right by waiver, he cannot, without consent of his adversary, reclaim it)

were not a party to the release, and the Ecuadorian Constitution bars the government from releasing the claims of private parties. No court in either Ecuador or the U.S. has ever accepted Chevron's claim that the release bars the *Aguinda* lawsuit and thus Chevron clearly misrepresents the scope of the release in its filings.

e) "Texpet, a subsidiary of Texaco Inc., was a minority member of this consortium with Petroecuador, the Ecuadorian state-owned oil company, as the majority partner"

While this statement is technically correct, this characterization of the relationship between Texpet and Petroecuador is materially misleading to investors as Chevron has refused to disclose that Texpet was actually the "operator" of the consortium. This is an undisputed fact and a key legal distinction for assigning liability as the Ecuadorian court found when it ruled that Chevron, as the operator of the concession and designer of all production infrastructure, can be held liable for 100% of the damage, not the 37.5% that Chevron claims (Texaco's ownership share in the consortium).

f) Misrepresentations as to the so-called "remediation"

In addition to its misrepresentations as to the legal merits of the case, Chevron has continued to distort the evidentiary record -- in particular, by hiding the fraudulent "remediation" the company performed to secure its release from the Government of Ecuador:

With regard to the facts, the company believes that the evidence confirms that Texpet's remediation was properly conducted and that the remaining environmental damage reflects Petroecuador's failure to timely fulfill its legal obligations and Petroecuador's further conduct since assuming full control over the operations.¹⁹

Chevron's claim that the remediation was "properly conducted" is factually untrue according to the evidence at the trial. The Ecuadorian court's judgment considered the remediation issue at length and concluded "the environmental conditions are similar in all sites even though in these the aforementioned remediation labors have taken place."²⁰

5. Mischaracterizations of the Lawsuit as a Fraud

Another misrepresentation is Chevron's repeated characterization of the case as a product of "fraud" or misconduct by the plaintiffs. This claim is made in Chevron's annual and quarterly reports and also conveyed directly to investors. On January 27, 2012, during the company's quarterly earnings calls with analysts, Chevron CEO John Watson stated:

Now, when it comes to Ecuador, that has been in the news as well...And I think it's generally acknowledged that this case is a product of fraud. Most of us know

¹⁹ Chevron Corporation, 2010 Annual Report at page 24

²⁰ Ruling of Presiding Judge Nicolas Zambrano Lozada, Provincial Court of Sucumbios, 14 February 2011, p.34 and p.104-106.

that. *This is a collaboration between corrupt plaintiff's lawyers in the U.S. and a corrupt judiciary in Ecuador.*²¹

During the same conference call, Watson referred to the case as “an elaborate fraud” and a “collusion.” The audacity of these statements in light of the actual facts is telling. Watson has clearly signaled to Chevron’s investors by the above statements that the lawsuit in Ecuador does not have merit, despite the overwhelming evidence of Chevron’s liability (now upheld on appeal) and not a single final verdict to support his charges.²² Watson's statements are conveyed as facts, not opinions, and thus could mislead Chevron’s investors as to the level of risk the company faces. We also remind the reader that Watson himself suffers from a personal conflict of interest on the Ecuador matter, given his central role in merging the company with Texaco and failing at the time to properly vet the Ecuador environmental liability.

Conclusion

As Chevron faces an \$18.1 billion liability for its pollution in Ecuador, the company has a legal obligation to investors to disclose accurate and reliable information about the case and the potential loss the company faces. Rather than provide such information, Chevron appears to be presenting false and/or misleading information to the investing public to downplay and obfuscate the risk facing the company.

²¹ Chevron Q4 2011 Earnings Conference Call Transcript, Jan. 27, 2012. (emphasis added.)

²² Even though Chevron did its best to manipulate the evidence to pretend that there was no contamination and threat of harm left at its old oil fields, *see* A. Maest, M. Quarles, W. Powers, “How Chevron's Sampling and Analysis Methods Minimizes Evidence Of Contamination,” Mar. 8, 2006, *available at* <http://chevrontoxico.com/assets/docs/e-tech-sampling-annex-final.pdf> (describing how Chevron’s field work was “designed specifically to avoid finding contamination that would otherwise be obvious to any neutral technical expert”), the Ecuadorian trial court judgment ended up relying largely on *the company’s own evidence* to establish liability. Indeed, 79% of Chevron’s own soil and water samples showed illegal levels of contamination. *See* Ev. Summ. at 3-4, Alegato at 42-44. Additionally, two environmental audits commissioned by Chevron itself in the 1990s provided devastating evidence of the company’s horrendous environmental practices, such as the fact that billions of gallons of toxic “produced water” were “discharged to creeks and streams,” that “no spill prevention methods were in place,” that waste pits were never properly lined and routinely overflowed, and worse. Alegato at 42-44. Overall, illegal levels of contamination were found at every single site—illegal even under Ecuador’s extraordinarily lax environmental standards which tolerate levels of total petroleum hydrocarbons (TPH) ten and twenty times over levels found in the United States. *See* Alegato at 25-42 (listing individually the contaminants found at each individual site).