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EDITORS' NOTES

REBALANCING OIL CONTRACTS IN VENEZUELA

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I. INTRODUCTION

This Article is based on research of the regulatory framework for oil contracts in Venezuela, conducted during visits to Caracas in July and August 2009 and January 2010.[1] The study included reviewing Venezuelan legislation, petroleum contracts, and interviewing Venezuelan government officials, international oil companies (IOC) executives based in Venezuela and experts in the Venezuelan case.[2] Initially, the research concentrated on assessing the impact of the Carabobo tender on the contractual conditions for oil ventures in Venezuela. This was for two reasons: 1) The 2009–2010 auction of the Carabobo Project, located in the Orinoco Belt, was highly relevant to the pattern of Venezuelan oil contracts to exploit the vast reserves—estimated at 127.9 billion barrels—of heavy crude oil,[3] and 2) the reduction of the government's bargaining power when

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1. The research was carried out under the auspices of the Luis Castro Leiva Research Prize 2009, awarded by the Institute of Advanced Latin American Studies of the University Sorbonne-Nouvelle/Paris III, the French-Venezuelan Association in Social Sciences and Humanities "Jeannette Abouhamad", and the French Embassy in Venezuela. *See*, INSTITUT DES HAUTES ETUDES DE L'AMERIQUE LATINE http://www.iheal.univ-paris3.fr/spip.php?rubrique610.

2. Respecting interviewees' confidentiality requests, the author is not disclosing the identities of those interviewed.

3. Factbox, *Auction of Venezuela's Vast Carabobo Oil Fields*, REUTERS, Feb. 11, 2010.

oil prices collapsed in 2008, and foreign investment in new projects was vital to increase oil production.[4]

Based on the dates for the tender approved by the Venezuelan Ministry of the People's Power for Energy and Petroleum (MPPEP) in early 2009, the research was conducted first in Caracas during a period that permitted observation of the auction's outcome, scheduled for August 14, 2009.[5] Nevertheless, on July 28, 2009, the Minister of Energy and Petroleum and President of Petróleos de Venezuela S.A. (PDVSA), Rafael Ramirez, announced the halt of the bidding process "without providing new dates."[6]

The delayed auction thwarted the initial attempt to assess the overall consequences for the contractual regime, but it brought new elements to light: 1) the existing contractual imbalances, which have limited the presentation of bids,[7] 2) the instability of the fiscal regime with the introduction and reform of new taxes, 3) the simultaneous implementation of both competitive bidding and direct negotiation to award contracts,[8] and 4) the shift in the government's position towards approving economic incentives, providing greater substantive investment protection rights, and granting access to international arbitration to encourage the participation of foreign companies.[9]

To improve the understanding of Venezuela's current oil-sector investment framework, Part II of this Article reviews the major issues of the Venezuelan hydrocarbon legal regime. This review will demonstrate that during a period in which the government has increased its oil-sector control, the government's overbearing position has created contractual imbalances, which should be assessed in light of the investor's

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4. Sheila McNulty, *Oil-Rich Nations 'Seek Majors' Expertise*, FIN. TIMES (London), Mar. 10, 2009, at 24.

5. *Aplazan otra vez Licitación del Bloque Carabobo de la Faja* [*Carabobo Block Tender Delayed Again*], EL UNIVERSAL (Venez.), available at: http://www.eluniversal.com/2009/07/28/eco_art_aplazan-otra-vez-lic_1489236.shtml [hereinafter *Aplazan otra Vez*].

6. *Id.*

7. *See* Benedict Mander, *Chavez a Problem for Oil Groups Eyeing Vast Field*, Fin. Times (London), Aug. 31, 2009.

8. *See* Benedict Mander, *Help Needed to Make Orinoco Flow*, FIN. TIMES (London), Nov. 5, 2009, at 2 [hereinafter *Help Needed to Make Orinoco Flow*].

9. *Venezuela Softens Carabobo Oil Bid Terms*, REUTERS, Nov. 30, 2009.

rights under Bilateral Investment Treaties (BIT). Given the evolving negotiations between oil companies and the Venezuelan government, Part III of this Article will show how the heavy crude oil projects awarded after the February 2010 Carabobo Area tender, and the existing practice of directly assigning blocks in the Junín Area, also in the Orinoco belt, have led to a new balance in the contractual conditions which, if respected, might contribute in an influx of investment in the Venezuelan oil sector.

II. THE REGULATORY HYDROCARBON REGIME IN VENEZUELA AND ITS CURRENT MAJOR ISSUES

> *Les investisseurs doivent comprendre qu'un régime trop protecteur de leurs droits ne sert pas nécessairement leurs intérêts. Des clauses garantissant trop les seuls intérêts des investisseurs risquent de susciter des réactions brutales de la part des gouvernements futurs.*[10]

> *. . . l'équilibre est la règle d'or, et une nouvelle inégalité ne doit pas remplacer une ancienne.*[11]

The applicable legislation for oil contracts in Venezuela has undergone a constant and accelerated reform in the last decade.[12] One feature of the reform was its abrupt rupture with the previous regime, known as the *Apertura Petrolera* [Oil Opening], implemented throughout the 1990s.[13] The *Apertura* allowed foreign direct investment under attractive financial terms and provided a contractual protection

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10. Walid BEN HAMIDA, LA PRISE EN COMPTE DE L'INTERET GENERAL ET DES IMPERATIFS DE DEVELOPPEMENT DANS LE DROIT DES INVESTISSEMENTS 21 (2007) http://www.unctad.org/sections/
wcmu/docs/c2em21p11_fr.pdf.

11. *Id.*

12. *See* Luis E. Cuervo, The Uncertain Fate of Venezuela's Black Pearl: The Petrostate and its Ambiguous Oil and Gas Legislation, 32 HOUS. J. INT'L L. 637, 678 (2010).

13. Elisabeth Eljuri & Victorino J. Tejera Pérez, *21st Century Transformation of the Venezuelan Oil Industry*, 26 J. ENERGY NAT. RESOURCES L. 475, 484–85 (2008) [hereinafter *21st Century Transformation*].

regime that included fiscal stabilization clauses, choice of external law, and the government's consent to international arbitration.[14] This preferential treatment was seen as inconsistent with the aims the current administration and declared incompatible with its nationalization regime.[15]

The reversal of the *Apertura* led to a legal framework in which the Venezuelan government has sought to increase both the government's profit share and its control over the oil industry, which will be addressed in Section A. Further, a new model contract for Mixed Companies (incorporated joint ventures) was established to govern the participation of foreign investors in the oil sector.[16] Hence, Section B reviews the terms of the model and seeks to identify possible imbalances which will be reviewed in light of investment protection rights under BITs.

A. The Establishment of a Legal Framework Based on State Control

The current legal regime regulating hydrocarbons in Venezuela is based on a policy that sought to recover "full petroleum sovereignty."[17] The reform started with the 1999 approval of a new Constitution, which reaffirmed state ownership and control over hydrocarbons and PDVSA.[18] A new

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14. *See generally* Bernard Mommer, *Subversive Oil*, *in* VENEZUELAN POLITICS IN THE CHÁVEZ ERA: POLARIZATION AND SOCIAL CONFLICT Steve Ellner & Daniel Hellinger, eds., 2002).

15. See *21st Century Transformation*, supra note 13, at 475, 481.

16. Two model legal instruments govern the contractual conditions of the Mixed Company: 1) Acuerdo Mediante el cual se Aprueban los Términos y Condiciones para la Creación y Funcionamiento de las Empresas Mixtas [Resolution Approving the Terms and Conditions of the Creation and Operation of Mixed Companies] and 2) Proyecto de Acta Constitutiva y Estatutos Sociales de La Empresa Mixta [Model Mixed Company Bylaws], Gaceta Oficial de la República Bolivariana de Venezuela [G.O.] No. 38.410, 31 de marzo de 2006 (Venez.), *as amended by* G.O. No. 39.273, 28 de septiembre de 2009 (Venez.) [hereinafter MC Terms and Conditions, and MC Model Bylaws, respectively].

17. HILDEGARD RONDÓN DE SANSÓ, EL RÉGIMEN JURÍDICO DE LOS HIDROCARBUROS: EL IMPACTO DEL PETRÓLEO EN VENEZUELA 411–26 (2d ed. 2009); *see also* Rafael Ramírez Carreño, Venez. Minister of Energy and Petroleum, Full Sovereignty Over Oil, Speech at the Third OPEC International Seminar, (Sept. 2006), *transcript available at* http://www.pdvsa.com/index.php?tpl=interface.en/design/readsearch.tpl.html&newsid_obj_id=2990&newsid_temas=0.

18. *See* Constitución de la República Bolivariana Venezuela, G.O. No. 36.860, 30 de diciembre de 1999 (Venez.) [hereinafter 1999 Constitution] Articles 12, 156(12), 156(16),

Organic Hydrocarbons Law (OHL) was enacted in 2001[19] and partially reformed in 2006.[20] The OHL defined the government's operational control of the oil industry, increased its quota of fiscal income, and created the contractual framework for Mixed Companies (MCs).[21] Some analysts pointed out that such reform could be applied only to new investors or investments based on the two principles of non-retroactivity, under Article 24 of the Venezuelan Constitution and sanctity of contracts.[22] Nevertheless, various factors gave the Venezuelan government powerful incentives to impose the new regime on prior agreements. These factors included a contract design based on a low-price scenario, the obsolete bargain created at the conclusion of the private investment cycle of the oil opening and also a regressive oil tax framework, which did not include contingencies for oil price increases.[23]

1. *The Takeover of Upstream Operations and Windfall Profit Tax (2005–2008)*

During a period of increases in oil prices beginning in 2005, the Venezuelan government faced the opportunistic dilemma that the net economic benefit of reneging on its contracts was greater than the net benefit of complying with those contracts.[24] The government's initial steps were to unilaterally raise royalty rates and income taxes and create a new extraction tax,

302, 303.

19. Decreto con Fuerza de Ley Orgánica de Hidrocarburos No. 1510, 2 de noviembre de 2001, *reprinted in* G.O. No. 37.323, 13 de noviembre de 2001 (Venez.) [hereinafter OHL].

20. Ley de Reforma Parcial del Decreto No. 1510 con Fuerza de Ley Orgánica de Hidrocarburos, G.O. No. 38.443, 24 de mayo de 2006 (Venez.), *reprinted and corrected in* G.O. No. 38.493, 4 de agosto de 2006 (Venez.).

21. *See* Ramírez Carreño, *supra* note 17.

22. Bernard Mommer, *Venezuela: A New Legal and Institutional Framework in Oil,* 45(1) Middle East Economic Survey, (2002); *see also 21st Century Transformation*, *supra* note 13, at 481.

23. See Osmel Manzano & Francisco Monaldi, *The Political Economy of Oil Production in Latin America*, 9 ECONOMÍA 59, 77 (2008) [hereinafter *The Political Economy of Oil Production in Latin America*].

24. O. Manzano and F. Monaldi, *The Political Economy of Oil Contract Renegotiation in Venezuela*, in The Natural Resources Trap, Chapter 12, Massachussets Institute of Technology, 2010 (including a specialized financial analysis of the renegotiation process).

affecting the value of foreign investments.[25] Then, the government reneged on thirty-two operating agreements, two risk-exploration and profit-sharing agreements, and later forcibly renegotiated four association agreements for production of heavy crude oil operating in the Orinoco Belt.[26] The agreements were declared illegal, and the government insisted on adapting them to the new 2001 OHL.[27] In particular, on May 1, 2007, the government sent an ultimatum to IOCs involved in the association agreements.[28] The ultimatum stated that if the IOCs did not accept the new scheme, the authorities would take control of their operations and threatened to pay book value for expropriated assets.[29] Indeed, the execution of forced renegotiation compelled IOCs to agree to a re-allocation into a model of Joint Ventures with PDVSA as the majority shareholder.[30]

Notwithstanding the high risk of conflict, most companies accepted the new terms and decided to stay in Venezuela, partly in hopes of securing new opportunities.[31] However, ExxonMobil and ConocoPhillips resorted instead to international arbitration, seeking compensation for the expropriation of their assets.[32]

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25. See *Id.*

26. Leopoldo Olavarría Campagna, Historical Examples and Recent Latin American Experiences in Forced Contract Renegotiation in the Natural Resources Sector: Is Risk Mitigation Still Possible?, in Sixtieth Annual Institute on Oil and Gas Law § 14 (2009)*Id.* at 429–40.

27. *Id.* at 430.

28. *Id.* at 433–34.

29. *Id.* at 433–36. During negotiations with Exxon Mobil and Conoco Phillips, Venezuela insisted on paying book value for the expropriated assets. Emily A. Witten, *Arbitration of Venezuelan Oil Contracts: A Losing Strategy?*, 4 TEX. J. OIL, GAS & ENERGY L. 56, 58 (2008).

30. *See* Olavarría Campagna, *supra* note 264.

31. Witten, *supra* note 29, at 57; *see The Political Economy of Oil Production in Latin America*, *supra* note 23, at 61 (stating that even "if the government reneges on the contract after large investments have been sunk, the producers would still have incentives to continue operating as long as they can recover operational and non-sunk costs"); *see also* Press Release, PDVSA, Seven Multinational Companies Have Migrated to Joint Venture Companies (Jun. 26, 2007).

32. ConocoPhillips v. Venezuela, ICSID Case No. ARB/07/30 (registered Dec. 13, 2007); Mobil Corp. v. Venezuela, ICSID Case No. ARB/07/27 (registered Oct. 10, 2007). Both cases are waiting for a decision on the merits. *See also* Mobil Cerro Negro, Ltd. v. PDVSA and PDVSA Cerro Negro S.A. (ICC no. 15416/JRF) (2008). Other Companies such as ENI and TOTAL also resorted to arbitration, but they eventually settled with

a. *Windfall Profit Tax Introduction 2008*

Later, as a result of a further increase in oil prices that reached $147/barrel in July 2008, the Venezuelan government sought greater profits by approving the Law on the Special Contribution on Extraordinary Prices in the International Hydrocarbons Market.[33] This law established a new windfall profit tax called Special Contribution that should be added to the fiscal regime of royalties and taxes set forth in the OHL.[34] The Special Contribution tax reached 50% when oil prices reached $70/barrel, and up to 60% when the price exceeded $100/barrel in a given month.[35] The tax is paid by exporters of natural or upgraded liquid hydrocarbons and derivative products.[36]

After the implementation of these measures, one could expect the end of the reform process. The government, however, approved more interventions, which increased state control over the oil sector. The Venezuelan government continued acting based on its assumption that its huge onshore reserves of crude oil, the country's low geological risk, and the lack of opportunities for big upstream projects in other oil-rich countries, gave the government a strong bargaining position with foreign companies.[37]

2. *The Takeover of Service Companies and the Windfall Profit Tax Reform (2008–2011)*

The global financial crisis and the consequent economic recession had significant effects on the oil industry. Oil

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the Venezuelan government and decided to remain in the country

33. Ley de Contribución Especial Sobre Precios Extraordinarios Del Mercado Internacional de Hidrocarburos, G.O. No. 38.910, 15 de abril de 2008 (Venez.).

34. Elisabeth Eljuri, *The New Latin American Oil and Gas Scene: Taking the High Road or the Low Road?*, Who's Who Legal, Jan. 2009, *available at* http://www.whoswholegal.com/news/features/ article/12774/the-new-latin-american-oil-gas-scene-taking-high-road-low-road.

35. *Id.*

36. *Id.*

37. *See* Isobel Rea, Accessing *oil and gas reserves: Rethinking upstream offers by international oil companies*, ACCENTURE,http://www.accenture.com/ SiteCollectionDocuments/PDF/Accenture_ Resources_Accessing_oil_and_gas_reserves_Mar2009_LR_EiaB5_.pdf.

consumption fell, oil prices collapsed in late 2008, and access to credit for investment projects contracted.[38] Although the new circumstances stood to weaken the government's position subsequent actions did not seem to take into account the effects of the world economic crisis. Between September 2008 and late 2009, the government's moves further increased its absorption of private industry. The government, directly or indirectly, expropriated or forcibly bought a broad spectrum of investments, both foreign and domestic, including cement and steel companies and investments in the oil sector.[39] Three new laws were enacted giving the state control over certain activities and assets in the oil industry: 1) The Act on Reorganization of the Internal Market of Liquid Fuels,[40] 2) The Law Reserving State Rights to Petrochemical Activity, Basic and Intermediate,[41] and 3) The Organic Law Reserving State Property and Related Services to Primary Hydrocarbon Activities (RLSC).[42]

Interestingly, the RLSC was passed amid conflict between the government and a number of service companies, over PDVSA's outstanding invoices with these companies.[43] PDVSA sought discounts of 20% to 30% to reduce its substantial debt with services providers.[44] After

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38. See Jad Mouawad, Big Oil Projects Put in Jeopardy by Fall in Prices, N.Y. TIMES, Dec. 16, 2008, at A1.

39. Oscar Garibaldi, Is Your Company Adequately Protected From the Continuing Nationalization of Foreign Investments in Venezuela and Other Countries?, Feb. 17, 2010, Available at: http://www.cov.com/ogaribaldi/.

40. Ley Orgánica de Reordenamiento del Mercado Interno de los Combustibles Líquidos, G.O. No. 39.019, 18 de septiembre de 2008 (Venez.).

41. Ley Orgánica para el Desarrollo de las Actividades Petroquímicas, G.O. No. 39.203, 18 de junio de 2009 (Venez.).

42. Ley Orgánica Que Reserva Al Estado Bienes y Servicios Conexos a las Actividades Primarias de Hidrocarburos, G.O., No. 39.173, 7 de mayo de 2009 (Venez.) [hereinafter RLSC].

43. *See* Suhelis Tejero Puntes, *PDVSA exige a las contratistas reducir sus tarifas en 40%*, EL UNIVERSAL (Venez.), Feb. 27, 2009, http://www.eluniversal.com/2009/02/27/eco_art_pdvsa-exige-a-las-co_1283195.shtml.

44. Elizabeth Eljuri & Clovis Treviño, *Political Risk Management in Light of Venezuela's Partial Nationalization of the Oilfield Services Sector*, 28 NO. 3 J. ENERGY & NAT. RESOURCES L. 375, 381 (2010) [hereinafter *Political Risk Management*]; Owen L. Anderson, *Introduction*, 29 HOUS. J. INT'L L. 271, 275 (2007) ("The debt crisis in various regions of the developing world, especially South America, is one reason for the new

failing to reach an agreement with several service companies, the government enacted the RLSC and a series of MPPEP resolutions instructing PDVSA to take control of operations and immediate possession of the facilities and equipment owned by the service companies.[45]

Some observers worried about the government's tendency to use primarily legislative power to resolve situations of commercial conflict applying expropriation measures.[46] In this regard, Eljuri and Treviño have questioned whether the enactment of the RLSC was a short-sighted measure to address a serious cash-flow problem, or whether this nationalistic move might have a reasonable business justification.[47] With respect to the RLSC, Derman and Miskel stated that:

> Venezuela's legislature has declared that service firms be paid the book value of any expropriated assets, and that the Venezuelan government would have the option of paying for the assets with bonds instead of cash. In this attempt to avoid paying the full market value compensation required under international law, the legislature also sets forth that all controversies under the new law must be resolved by Venezuelan courts.[48]

According to Minister Ramírez, thirty-two service companies have acquiesced to agreements with the government about debt discounts and tariff reduction.[49] Some companies, however, have sought international arbitration in response to the seizure of

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wave of nationalism that has brought leaders such as Venezuela's Hugo Chávez to power.").

45. *Political Risk Management*, *supra* note 44, at 381 (explaining that the RLSC gives the national executive the authority to order expropriation of shares or assets of companies providing those services under the Expropriation Law for Public and Social Use, but also that the Reserve Law does not explicitly state when compensation is due for such a taking).

46. *Id.*

47. Elizabeth Eljuri & Clovis Treviño, *Venezuela: On the Path to Complete "Oil Sovereignty," or the Beginning of a New Era of Investment?*, 2 J. WORLD ENERGY L. & BUS. 259, 260 (2009) [hereinafter *"Oil Sovereignty" or Investment?*].

48. Andrew B Derman & Emily A. Miskel, *Venezuelan Oil Seizure: Not a License to Steal*, INDUSTRY TODAY, June 5, 2009 http://www.industrytoday.com/article_view.asp?ArticleID=we173.

49. Frank Jack Daniel, Venezuela Says Will Pay for Nationalized H&P Rigs, REUTERS, June 26, 2010.

their assets. For instance, the oil service company Tidewaters Inc. filed a request for arbitration with the International Centre for Settlement of Investment Disputes (ICSID) seeking compensation for eleven Tidewater ships seized by the Venezuelan authorities.[50] Likewise, Universal Compression International and the Williams Cos. Inc. also filed arbitration against Venezuela before the ICSID for the takeover of their facilities.[51]

b. Windfall Profit Tax Reform 2011

In April 2011 President Hugo Chavez repealed the 2008 Windfall Profit Tax Law.[52] Four tiers of taxes on oil prices emerged as a result: 1) The lowest tier is 20%, applicable to "extraordinary" oil prices between the price fixed by the Venezuelan budget for the relevant fiscal year ($40 per barrel for 2011) and $70 per barrel ($/b); 2) next, the tax reaches 80% on "exorbitant" oil prices more than $70/b but less than $90/b; 3) it expands to 90% when prices are more than $90/b but less than $100/b; and 4) it peaks at 95% when oil prices exceed $100/b.[53] Curiously, Article 14 of the reform caps the royalty and export tax set forth in the Hydrocarbons Organic Law at $70 per barrel. It is still far from clear whether the new law may suspend the application of a tax regime established in the Hydrocarbons Organic Law, which has a superior level in the hierarchy of Laws in Venezuela. The reform affects directly all the projects exporting oil or selling oil to PDVSA. However, articles 12 and 13 set forth a number of waivers which have to be considered on case by case basis by the MPPEP, for projects which increase oil production, or which has not recovered the investment, or projects in the framework of cooperation

50. Tidewaters v. Venezuela, ICSID Case No. ARB/10/5, (Barbaros-Venezuela BIT) Procedural Order No 1 on Production of Documents ¶ 2 (Mar. 29, 2011).

51. *See* The Williams Companies et al. v. Venezuela (ICSID Case No. ARB/11/10) (registred Apr. 20, 2011) and Universal Compression v. Venezuela, ICSID Case No. ARB/10/9 (registered Apr. 12, 2010).

52. Decreto con rango, valor y fuerza de Ley que crea contribución especial por precios extraordinarios y exorbitantes en el mercado internacional de hidrocarburos. No. 8.163 G.O. Ext. 6.022. 18 de abril 2011.

53. Idem.

agreements.[54] The new regulations turned in a complex tax model that requires harmonization through MPPEP's resolutions, still pending, increasing the uncertainty application of the fiscal regime since there is a lack of clarity on several issues.[55]

The number of reforms being enacted does not leave any shred of doubt about the Venezuelan government's determination to ensure that its objectives are given priority above those of the business ventures when these objectives conflict.[56]

The interviews in Caracas showed that the trend of instability in the legal framework is the main cause of concern for investors in the Venezuelan oil sector. On this point, the manager of an oil company operating in Venezuela commented that foreigners working in Venezuela "do not know what to expect. The government can enact a new law whenever it likes, changing the rules of the game."[57] Similarly, another manager stated:

> Many times we get notice of reforms through the press or the Official Gazette. We are required to continually adapt to new regulations, and on this you have two options: either to adapt or to leave. For many, leaving is not an option because we have placed investments in the country that are not so easy to withdraw. However,

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54. *Id.*

55. Preliminary analysis shows that by placing a cap on the royalty and export tax, the reform reduces the revenues paid to the Venezuelan Central Bank that should be transferred to the National Budget controlled by the Legislative. Instead, it increases payments to the National Development Fund (FONDEN), an off-budget spending vehicle under exclusive control of the Executive. Thus, the new redistribution seems to agree more with government strategy seeking cash flow for the presidential elections of 2012, rather than a new balance of revenues distribution between the Government and IOCs. These, so far, remain prudent in a wait-and-see approach. *See also*, *Harvest Natural Resources Announces 2011 First Quarter Results*, available at http://www.harvestnr.com.

56. *See, e.g.*, Rod Walton, *Venezuela Seizes Rigs Owned by Tulsa-based Helmerich & Payne*, TULSA WORLD, June 24. 2010. (Noting that after the RLSC was enacted, the service provider Helmerich & Payne kept 11 idle drilling rigs because PDVSA failed to pay for the services. Since no agreement was reached about discounted rates and tariffs after a year of negotiations, PDVSA opted to take the drills). Subsequently, the National Assembly declared the take over of the 11 drills in the public interest on June 30, 2010 through the Decree No. 7.532, G.O. No. 39.456, 30 de Junio de 2010.).

57. Personal interview, in Caracas, Venez. (Aug. 29, 2009).

> these circumstances increase the risk, and could cause underinvestment cycles.[58]

The full petroleum sovereignty policy was implemented at a time when oil prices allowed the government to significantly increase its revenues and, in many cases, allowed the authorities to settle with foreign investors after expropriation. However, it seems the negative effects of the global recession on the Venezuelan economy have reduced the government's financial leeway to reach agreements for the takeover of private assets, increasing the risk of litigation in the country. Thus, the policy could also be evaluated in terms of costs. First, the final result of litigation cases could require Venezuela to compensate foreign investors.[59] Second, the legal framework's lack of stability could adversely affect the level of investments in the country. The greater government control over the industry and the constant risk of legislation changes have potentially generated imbalances, raising the level of political risk and limiting foreign investors' capacity to invest as planned. As Eljuri and Treviño mentioned in 2009, the issues are whether "the recent nationalization cycles [will] lead to underinvestment" and whether "PDVSA's increasing control over the Venezuelan oil industry [will] lead to production inefficiencies and declining oil output."[60]

To further analyze this situation, the next Section will study the investment contract for Mixed Companies and will look for imbalances in a number of specific provisions that could affect the efficiency of the contractual framework to guarantee foreign investment.

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58. Personal interview, in Caracas, Venez. (Aug. 11, 2009).

59. *See* Interview by Ernesto Villegas with Bernard Mommer, former Vice Minister of Hydrocarbons for Energy and Petroleum and Director of PDVSA, in Caracas, Venez. (Feb. 12, 2008) *English transcript available at* http://www.pdvsa.com/index.php?tpl=interface.sp/design/readmenu.tpl.html&newsid_obj_id=5532&newsid_temas=80 [hereinafter Mommer Interview]. Regarding the expropriation of ExxonMobil, Bernard Mommer declared, "We cancelled that partnership, expropriated the assets and own them compensation." *Id. A summary of this interesting interview is available at: http://www.youtube.com/watch?v=kENv_qeA9zE.*

60. *"Oil Sovereignty" or Investment*, supra note 47, at 262.

B. Imbalances in the Contractual Framework for Mixed Companies

The Mixed Company contract is an investment contract drafted according to Articles 33 and 34 of the OLH.[61] The parties to this Joint Venture model are the state entity, *Corporación Venezolana de Petróleo* (CVP),[62] which is a wholly owned subsidiary of PDVSA for upstream activities, and the private foreign corporation. The MC contract model has been standardized and approved by the National Assembly and consists of several stages which comprise Executive and Legislative intervention:

1. CVP and the foreign company (IOC or NOC) sign a memorandum of understanding.
2. A draft of the MC contract is prepared according to the terms of the tender or via direct negotiation. At this point, the MPPEP exercises control over the contractual provisions (Executive Control). Additionally, the National Executive should approve a decree assigning the geographical area of activities and a decree granting the entity right to carry out primary activities.
3. The National Assembly approves the National Assembly Agreement for the Constitution of the MC with the framework conditions of the MC contract (Art. 33 OHL). According to Article 150 of the Venezuelan Constitution, contracts of public interest must be approved by the National Assembly (Legislative Control).
4. The MC contract is signed between CVP and the foreign investor following the general terms and conditions established in the OHL: a) rights and duties of each party, b) the term of the contract (25 years plus 15 years upon request 5 years before its expiration, c) area delimitation, d) conditions of use and later delivery to the MPPEP, e) decommissioning with the least environmental and economic damage, f) business Plan and budget

61. *See* OHL, *supra* note 19.

62. *21st Century Transformation*, *supra* note 13, at 480 (explaining that CVP is used as the corporate vehicle in Mixed Companies formed with foreign partners).

provisions for upstream activities, g) the obligation of oil sale of hydrocarbons to PDVSA, and h) provisions on dispute resolution and applicable law and jurisdiction.[63]

5. The MC Bylaws are also signed by CVP and the foreign company, thus establishing the decision-making provisions and dividends provisions.[64]

According to George Kahale, the new model grants the state power over three significant aspects of the contract: 1) economic: by increasing the government's profit share, 2) corporate governance: giving government control over the MC's operations, and 3) legal: by eliminating stabilization clauses and reducing access to arbitration.[65]

After the model had been in place for four years, the research underlying this article was undertaken to assess how effectively the MC contract was functioning. To this end, a series of interviews were conducted in Caracas with oil company executives and government officials. Two major operational and legal concerns were identified: 1) government control of oil management and sales and 2) limitations on contractual investor's protection rights.

Different measures have been taken to ensure the feasibility of the MC contract to different projects. MCs operating in the Orinoco Belt receive special treatment in some contractual provisions compared with MCs operating in other regions of the country. Since the Orinoco Belt operating companies work in the production of heavy oil, the contract is adapted to provide more operative and commercial control to foreign companies. Thus, these particular measures will be referred to as "Orinoco Belt exceptions."

1. Controls over Management and Oil Sales

The study of government control over the management and the commercialization of crude is organized in the following two

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63. MC Terms and Conditions, *supra* note 16.

64. *21st Century Transformation*, *supra* note 13, at 480.

65. George Kahale, Conference Paper, *Tendencias en Contratos Aguas Arriba en la Industria Petrolera Internacional* 2–10 (July 2009), *available at* http://www.pdvsa.com/interface.sp/database/ fichero/free/4998/637.PDF.

sections: (a) State Control over the Corporate Governance of the MC, and (b) Control on the Sale of Hydrocarbons and the Associated Cash Flow Constraints Imposed on Investors.

a. State Control over the Corporate Governance of Mixed Companies

Article 22 of the OHL establishes that CVP should be a majority shareholder of more than 50% of an MC that actually reaches a participation of 60% in all projects.[66] Because the MC is the operator of the project, the leadership of the company depends upon CVP.[67] Therefore, based on the composition of the shareholders' meeting (the highest governing body in the MC), CVP maintains control over the day-to-day management of the MC based upon decisions of a simple majority and approval of the annual work programs and budgets under Article 16 of the MC Bylaws.[68] This management model is considerably more restrictive than the systems of "golden shares," where the state holds the right to take certain decisions without necessarily assuming the role of operator.[69] But it is worth pointing out that the same article sets forth a number of limits upon the decision power of CVP for the protection of investor's interest.[70] For example, CVP must not act against the interests of the MC or put the execution of the contract at risk.

Given the high level of state control, the foreign company's co-participant risk is increased, and the effectiveness of the model relies on the optimal performance of PDVSA.[71] According

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66. OHL, *supra* note 19, art. 22.

67. Kahale, *supra* note 65, at 7.

68. MC Model Bylaws, *supra* note 16.

69. *See* MIGUEL A. GARCÍA-CESTONA & VICENTE SALAS, GOLDEN SHARES AND WELFARE: A THEORETICAL APPROACH 3 (2005) *available at* http://163.152.84.199/data/4th/session1/1B/ 03Miguel% 20Garcia%20Cestona.pdf (describing golden shares as "a tool that allows the Government to retain veto power over a certain set of future decisions in the privatized firm").

70. MC Model Bylaws, *supra* note 16. Article 16.I.c "(…) being understood that the simple majority shall not take decisions contrary to the interests of the Corporation, including, among others, any decision which would result in the revocation of the transfer Decree or of any permit, license or authorization of any kind required for the conduct of the Corporation's business, or in the early termination or breach of the Contract for the Purchase and Sale of Hydrocarbons (…)"

71. David Hults, *Petroleos de Venezuela, S.A.: The Right-Hand Man of the*

to some observers, this new role of National Oil Companies (NOCs)—competing for control with IOCs—is an example of how oil majors have apparently become mere suppliers of capital and technology, serving at the behest of NOCs.[72] One of the managers interviewed on this regard stated that "[t]he problem is not that the Mixed Company model cannot work correctly, the problem is that the current efficiency in the operability of PDVSA is undercutting performance and affecting the value of the investment."[73]

According to the interviewees, two interrelated causes have influenced the effectiveness of the corporate governance model: the highly politicized state companies and the lack of human resources in the domestic industry.

i. The Highly Politicized State Companies

Under the MC decision-making model, the interviewees emphasized the existence of high levels of political intervention of the Venezuelan government in PDVSA: One concluded that, "the Mixed Companies do not act independently as operators because substantial governmental control exists over the decisions that are taken in each of them."[74] Another remarked that any decision by state officials depends upon consultations at the highest levels of the Venezuelan government.[75] This situation may create a gap based on asymmetric information between PDVSA and the foreign investor, which could affect the feasibility of the model.

ii. The Lack of Human Resources in the Domestic Industry:

According to the officials interviewed, PDVSA has not recovered from the loss of half of its qualified workforce, fired after massive strikes in 2002 and 2003 in the oil

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Government, 6–21, (The Program on Energy and Sustainable Development, Working Paper No. 70, 2007), *available at* http://iis-db.stanford.edu/pubs/22067/Hults%2C_PdVSA_case_study%2C_WP_70.pdf/.

72. Jacqueline Lang Weaver, *The Traditional Petroleum-Based Economy: An "Eventful" Future*, 36 CUMB. L. REV. 505, 545 (2005–2006).

73. Personal interview, in Caracas, Venez. (Aug. 11, 2009).

74. Personal interview, in Caracas, Venez. (July. 29, 2009).

75. Personal interview, in Caracas, Venez. (Aug.. 11, 2009).

industry.[76] Additionally, the personnel dismissed from PDVSA and subsequently hired by IOCs based in Venezuela have not been allowed to work in the operations of the MCs.[77] "I have had to remove Venezuelan, ex-PDVSA workers, and to assign them to other operations abroad because they are not allowed to work in the MCs," commented one manager.[78]

Both problems can affect the operational capacity of the projects and, consequently, the levels of oil production.[79] The consequences are obscured by the public debate over Venezuela's oil production levels: Figures released by the Venezuelan government indicate oil production of more than 3 million barrels/day,[80] but the International Energy Agency (IEA) estimates oil production at around 2.6 million barrels/day.[81] Juan Carlos Boué, MPPEP's Senior Advisor, has argued that IEA figures are based on secondary sources that exclude the output of extra heavy crude from the Orinoco Belt, creating the 600,000 barrels/day gap.[82]

Adding to the perception that Venezuelan production is declining, Minister Ramírez asked MCs in late 2010 to increase their output and investment, and he threatened to "review the rights that were granted" to any companies that did not increase their productivity.[83] In sum, even the best scenario shows that the production capacity has remained at a standstill during the last decade and the government is now facing the need to increase production and revenues.

76. *See* U.S. Gov't Accountability Office (GAO), Energy Security: Issues Related to Potential Reductions in Venezuelan Oil Production, 6 (2006), *available at* http://lugar.senate.gov/energy/ venezuela/pdf/GAO_Report_Venezuela.pdf.

77. Human Rights Watch, A Decade under Chávez: Political Intolerance and Lost Opportunities for Advancing Human Rights in Venezuela 29 (2008).

78. Personal interview, in Caracas, Venez. (July. 29, 2009).

79. *See* U.S. GAO, *supra* note 76, at 6.

80. John Kingston, *The Numbers in Venezuela*, THE BARREL (July 13, 2007, 4:48 PM), http://www.platts.com/weblog/oilblog/.

81. Gregory Wilpert & Michael Fox, *International Energy Agency Increases Venezuela's Oil Production Estimates, Maybe*, VOITAIRENET.ORG, May 20, 2006, http://www.voitairenet.org/ article139141.html.

82. Juan Carlos Boue, *How Much Oil Has Venezuela Really Been Producing?*, MIDDLE EAST ECON. SURVEY, May 4, 2009.

83. Jose Orozco & Charlie Devereaux, *Venezuela Partners to Boost Oil Spending, Ramirez Says*, BLOOMBERG, Jan. 27, 2011.

Orinoco Belt Exception

The decision-management model can be found in the MC contract in two forms: 1) those from MCs operating in the Northeast or Northwest of the country or those based upon the nationalization of the thirty-two operating agreements where the Business Plan and the Annual Budget can be decided by simple majority under the sole discretion of CVP, and 2) the MCs operating in the Orinoco Belt, such as Petromonagas, Petropiar and Petrocedeño, where the approval of the Business Plan and the Annual Budget requires a qualified majority of the shareholders.[84] The latter model grants major decision-making power to the investing company as to the operation of the project and cost control. Furthermore, the investigation indicated that in cases where CVP/PDVSA were unable to lead the operation, it hired a private company to perform this role in coordination with the operator in order to obtain better levels of efficiency. Such a situation seems feasible, according to the OHL, as long as the PDVSA operator's function does not become denaturalized.[85]

b. The Controls on Oil Sale, The Risk of Nonpayment and Cash Flow Constraints

Articles 27, 56, and 57 of the OHL provide that the sale of hydrocarbons is controlled by the State.[86] The MC contract establishes the MC's obligation to sell oil to PDVSA or any other company the state selects for such purposes through a contract for sale and purchase of hydrocarbons.[87] Additionally, the sale price would be fixed by accounting methods included in the Annex A of the Contract of Sale or in Regulations approved by the MPPEP.[88]

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84. *See* Decree No. 5.664, PetroCedeño S.A., Decree No. 5.667, PetroMonagas S.A. and Decree No. 5.668, PetroPiar S.A. published in the G.O. No. 38.807 November 9, 2007.

85. OHL, *supra* note 19, arts. 25, 28.

86. *Id.* arts. 27, 56, & 57.

87. MC Terms and Conditions, Clause on Hydrocarbons Sales, *supra* note 16.

88. Contract to Sell and Purchase of Hydrocarbons. Calculation of Payments Provision: "The intention of the Parties is that the formulas contained in this Annex A should adequately reflect the long term export value to the relevant markets of the crude oil delivered, in the understanding that no request for adjustment may be based on

This situation embodies a further risk of nonpayment[89] by PDVSA, as was observed in the case of several service companies.[90] Recent experience has shown that PDVSA could suffer cash flow difficulties in honoring its obligations for two distinct reasons: 1) the abrupt reduction of revenues when oil prices dropped, as occurred in 2008 and 2009,[91] or 2) because of its role in implementing political aims of the Venezuelan government during electoral campaigns. A group of IOC employees operating in Venezuela reported having experienced this situation in late 2008: "[M]ore than one year passed before we received the first payment for oil sales. PDVSA delayed payment to those . . . it knew could financially resist."[92]

Concerning the risk of non-payment, it is worth noting that a *force majeure* provision is incorporated in Article 9 of the Contract of Sales of Hydrocarbons, establishing different events of non-liability for losses or damages resulting from interruptions, reductions or delays in the delivery or receipt of hydrocarbons.[93] However, it sets forth that "[n]o event of *force majeure* shall excuse the failure to pay any amount due in accordance with this Contract by either of the Parties," giving minimum protection to private investors.[94]

Private investors in the MC benefit via dividend distribution after the State has collected all taxes and make payments. Responding to this situation, Eulogio Del Pino, President of CVP, declared that PDVSA had to wait until the end of the fiscal

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disagreements regarding such value in the short term, or the use of Merey 16 as the reference crude oil."

89. Sebastien Manciaux, *The Notion of Investment: New Controversies*, 9 J. WORLD INVESTMENT & TRADE 453, 456 (2009).

90. *Political Risk Management*, *supra* note 44, at 5–6 (noting that in August 2007, PDVSA stopped paying a number of oil services companies and by May 2009 had accumulated about $12 billion in debt with these companies).

91. *See, e.g.*, J. Scott Childs, *Continental Cap-and-Trade: Canada, the United States, and Climate Change Partnership in North America*, 32 HOUS. J. INT'L L. 393, 444 (2010) (noting that, "the global recession of 2008 and 2009 caused oil prices to plummet").

92. Personal interview, in Houston, USA. (Sept. 2009).

93. Harvest Natural Resources, Inc., Quarterly Report (Form 10-Q), Contract for Sale and Purchase of Hydrocarbons, Annex K, art. 9 (2007).

94. *Id.*

year to pay dividends to foreign partners in the MC.[95] To reduce the risk of cash flow constraints to the IOCs, Del Pino also explained that in a scenario of high prices PDVSA requests from "the MC a budget of investment and expenditures" in order to "declare anticipated dividends," based on Article 32 of the MC Bylaws.[96]

Orinoco Belt Exception

Different arrangements have been approved on this matter for the projects in the Orinoco Belt. The government has given those MCs whose primary activity is producing heavy crude oil in the Orinoco Belt the right "to commercialize and to sell refined crude oil and any other resulting product of the improvement of petroleum," according to Article 3 of MC contract.[97] This distinction gives companies greater control over cash flow in projects involving greater investment and narrower profitability, offering a different balance for MC in the Orinoco Belt.

After the review of these operational and commercial issues, this study will examine the second element of concern, limits imposed on contractual investor's protection rights.

2. Contractual Restrictions of Investors' rights in Light of BITs

During the nationalistic reform the government has taken different actions to retain control over the MC Contract based on the Calvo Doctrine[98], such as: 1) excluding stabilization clauses from the MC contract, 2) restricting access to international arbitration, and 3) providing exclusive choice of Venezuelan law as governing law to the contract.[99] Nevertheless, these measures should be reviewed in light of international standards

95. Interview by Jeanne Liendo with Eulogio del Pino, Dir., PDVSA (Oct. 29, 2008) *transcript available at* http://www.revistamene.com/nuevo/index.php?option=com_content&task=view&id=90& Itemid=56.

96. MC Model Bylaws, Art. 32, supra note 16.

97. *See supra* note 82 and accompanying text.

98. Oscar Garibaldi, *Calvo Redivivus: The Rediscovery of the Calvo Doctrine In the Era of Investment Treaties*, The Proceedings of the 57th Annual Institute on Oil and Gas Law Procedures (2006).

99. *Id.*

incorporated into the Venezuelan network of BITs in order to assets their final effect.[100]

a. The Exclusion of Stabilization Clauses in the Mixed Company Contract

Facing the risk of harmful legislative interference, the international oil industry implemented the practice of stabilization clauses—freezing the tax legislation to the date when the contract is concluded—to reduce *ex post facto* opportunism of the host government.[101] Stabilization provisions entered into by states and foreign investors are considered binding upon the state under international law.[102] Although these provisions have not been interpreted as limiting the state's sovereign right to legislate or expropriate, they could justify the award of damages for breach of contract.[103] Nonetheless, when the equilibrium of a contract containing a stabilization clause is undermined, a sharp conflict may ensue to the detriment of both parties.[104] In particular, Professors Dolzer and Schreuer have pointed out that over the last decade, reliance on such clauses has decreased in practice, mainly in deference to the sovereignty of the host state.[105] For instance, Venezuela is one of these

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100. List of BITs signed by the Venezuelan Government available at: Comision Nacional de Promoción de Inversiones (CONAPRI) (Venez.).: http://www.conapri.org/articledetails.asp?articleid= 216437.

101. A. Z. El Chiati, *Protection of Investment in the Context of Petroleum Agreements*, 4 HAGUE ACADEMY COLLECTED COURSES 1, 114–15 (1987).

102. Nicolas David, *Les clauses de stabilité dans les contrats pétroliers, Questions d'un praticien*, 1 J. DU DROIT INT'L 79 (1986) ; *see also* Texaco Overseas Petroleum Co. v. Libya, 53 I.L.R 389, 478–79 (1978) (stating that "nationalization cannot prevail over an internationalized contract containing stabilization clauses").

103. *Pierre Mayer,* La neutralisation du pouvoir *normatif de l'Etat en matière de contrats d'Etat*, 113 J.D.I. 5, 50–51 (1986); *see also* Liamco v. Libya, 20 I.L.M. 1 (1997).

104. Anne van Aaken, Commitment and Flexibility: The Fragile Stability of the International Investment Protection Regime, 1 (Univ. of St. Gallen Law Sch., Working Paper No. 2008-23, 2008), *available at* http://ssrn.com/abstract=1269416 (explaining that "[i]f substantive rules or review mechanisms place too much of a constraint on sovereignty without allowing for flexibility, that might precipitate a backlash by states").

105. RUDOLF DOLZER & CHRISTOPH SCHREUER, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW 75 (2008). Critics of stabilization clauses that freeze the host state legislation are not scarce, and some have proposed adaptation clauses allowing equitable adjustments and good faith negotiation following civil law principles. *Id.* As pointed out by Prof. A. El Chiati, "the Host Countries do not dispute the fact that the contract is the

cases. The government has refused to accept limitations upon its legislative power and similarly refused to compensate oil companies for legislative reforms affecting oil contracts.[106] This adverse reaction reduces the investors' predictability on long-term agreements and increases their exposure to unilateral amendments. Likewise, Article 33 OHL sets forth the government's right to unilaterally amend the MC's terms and conditions issued through the "National Assembly Agreement," which governs the MC contract, comprising, among others issues, tax provisions.[107] Facing this situation, foreign investors might move to different contractual provisions and BIT's substantive international standards for stability.

i. Additional Sources of Contract Stability

Articles 17 and 18 of the Venezuelan Investment Law allow for "legal stability agreements" between the state and the foreign investor to freeze the tax legislation for periods up to ten years,[108]however, these agreements have so far not been implemented.

Other approaches suggests that given that the MC contracts have been delegated to CVP as a state enterprise, a question

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law of the parties and as such should not be altered or amended except by their mutual agreement. They do, however, contend that long-term contracts are founded on good faith and co-operation. Accordingly, they should be permitted to evolve with changes in circumstances which could not be predicted at the time of contracting. In their view, the clause rebus sic stantibus is implied in all contracts." Chiati, *supra* note 101. However, Professors Dolzer & Schreuer assert that the "practicability and usefulness [of the adaptation and renegotiation provisions] remain to be tested in practice" since "a duty to renegotiate relies on the continued good will of both parties," which may not be useful in a dispute. "Thus, it is far from clear whether a duty to renegotiate will serve the practical needs of a long-term investment." DOLZER & SCHREUER, *supra* note 105.

106. *See Political Risk Management*, *supra* note 44, at 13 (explaining that contracts in the 1990s provided an indemnification clause in which PDVSA would directly compensate aggrieved companies "for adverse economic situations resulting from adoption of governmental decisions or changes in the legislation which causes a discriminatory treatment of the AA or PDVSA´s partner."

107. OHL, *supra* note 19, art. 33 ("Any subsequent amendment of such conditions shall also be approved by the National Assembly with the prior favorable report of the Ministry of Energy and Petroleum and the Permanent Commission of Energy and Mines.").

108. Ley de Promoción y Protección de Inversiones arts. 17, 18, G.O. No. 5390, 22 de octubre de 1999 (Venez.) [hereinafter Venezuela Investment Law].

arises on the observance of such contract obligations in the interface between CVP, the foreign investor and the regulatory authority of the Venezuelan government. In this regard, Professor Thomas Wälde asserted that if a state enterprise has entered into a contract with a private party, and if this contract or a state entity action can be attributed to the state, then the state has entered into a commitment and is obliged to respect it.[109] For instance, Article 8 of the MC Contract extends the consent requirement of the foreign investor commonly found in intangibility clauses,[110] and provides that the contract cannot "be amended without the prior written consent of the Parties."[111] Thus, any CVP action that attempts to alter the terms of the agreement must be done in good faith and with the written consent of the foreign investor, providing a source of contract stability. Additionally, a question arises on whether Article 8 might be attributed to the government as a negation of *clauses exorbitantes du droit commun*, commonly found in state contracts,[112] and therefore, converting this clause to a duty of the state as a party on the agreement.[113]

ii. The Umbrella Clause as a BIT source of Contract Stability

In cases involving a breach of contract, the parties to the MC may invoke the "Applicable Law and Jurisdiction" clause, which provides for the exclusive resort of local courts. However, foreign investors may be unwilling to submit their disputes before

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109. T. W. Wälde, *Arbitration in the Oil, Gas and Energy Field: Emerging Energy Charter Treaty Practice*, OGEL, Sept. 2003 at 21–22; *see also* Noble v. Romania, ICSID Case No. ARB/01/11, Award (Oct. 12, 2005). *But see* Impregilo S.p.A. v. Pakistan, ICSID Case No. ARB/03/3, Decision on Jurisdiction ¶ 316(b) (Apr. 22, 2005) (stating the tribunal had no jurisdiction over claims stemming from any alleged contract breach by public entities).

110. *See* Prosper Weil, *Les Clauses de Stabilisation ou d'Intangibilité Insérées dans les Accords de Développement Economique*, *in* MELANGES OFFERTS A CHARLES ROUSSEAU 307–08 (A. Pedone ed., 1974) (stating that intangibility clauses attempt to circumvent the state's exercise of its public authority in contracts).

111. Contract for Conversion to a Mixed Company between CVP, Harvest Vinccler and H.N.R. Finance B.V., September 11, 2007, Article 8 Amendments and Waivers. Harvest Natural Resources (Form-10-Q U.S. SEC) [hereafter MC Contract CVP-Harvest-Vinccler].

112. Ahmed El Kosheri, *International Arbitration and Petroleum Contracts*. Encyclopedia of Hydrocarbons. Vol. IV, 2007 pp. 884-885.

113. Wälde, *supra* note 109, at 22.

Venezuelan tribunals.[114] If a foreign investor has the protection of a BIT, a question arises as to whether an "umbrella clause" elevates any breach of contract by a state or a state entity to the level of a breach of the treaty.[115] A negative answer may argue that an umbrella clause only applies to contractual obligations entered by the state, and not by its instrumentalities. Thus, the investor should demand the State-owned entity in local courts, and State responsibility before the Arbitral Tribunal. However, this conclusion would simply allow governments to avoid responsibility by creating and delegating its power to private companies.[116]

In contrast, a positive answer to the question requires the analysis of different elements. In cases where the state instrumentality is a party to the contract, the investor's contract claim before a BIT Arbitral Tribunal will require proving: 1) the action of the state entity can be attributed to the state as if the government had undertaken them, or 2) that a BIT provision provides the "liability" of state actions as well as actions of its instrumentalities, as occurs in the 2006 French BIT model and the 2004 U.S. BIT model.[117] The latter case does not seem applicable to the Venezuelan context because Venezuelan BITs

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114. Paul Santoyo, Comment, *Bananas of Wrath: How Nicaragua May Have Dealt Forum Non Conveniens a Fatal Blow Removing the Doctrine as an Obstacle to Achieving Corporate Accountability*, 27 HOUS. J. INT'L L. 703, 715 n.90 (2005) ("Although countries such as Nicaragua, Colombia, Ecuador, Guatemala, Honduras, and Venezuela have been deemed adequate forums by various U.S. courts, the U.S. State Department reports that fair trials and due process are often unavailable in those forums.").

115. Iona Tudor, *The Fair and Equitable Treatment Standard in the International Law of Foreign Investment* 195 (2008). The umbrella clause requires "compliance with investment contracts, or other undertakings of the host State to the BIT's substantive standards. In this way, a violation of such a contract becomes a violation of the BIT." *Id.* For example, some Venezuelan BITs have incorporated the umbrella clause from BITs with Spain, Belarus, Russia, Barbados, The United Kingdom, and Argentina. The typical version used is: "Each Contracting Party shall observe *any* obligation it may have entered into with regard to the treatment of investments of nationals or companies of the other Contracting Party." The term "any" in this Article involves treaty and contract obligations entered into by the State. *Id.*

116. Michael Feit, *Responsibility of the State Under International Law for the Breach of Contract Committed by a State-Owned Entity*, 28 *BERKELEY* J. INT'L L. 142, 163 (2010).

117. *See Id.* at 152; *see also* Draft Agreement for the Reciprocal Promotion and Protection of Investments, France (2006); Draft Agreement Concerning the Encouragement and Reciprocal Protection of Investment, United States (2004).

lack liability provisions for the actions of a state entity. However, the former case requires that 1) the state entity and its relevant conduct can be extended to the state, and 2) the breach of contract must constitute a violation of an international obligation.[118] Attributing the state owned entity's conduct to the state could be attempted in two ways. The first method is through piercing of the corporate veil, allowed if the tribunal determines the state entity's conduct constitutes an abuse of legal personality.[119] Second, commentators and arbitrators agree that the "Draft Articles on Responsibility of States for International Wrongful Acts" of the International Law Commission (ILC) currently represents the most authoritative statement of the law of state responsibility and that "there is no reason not to apply the rules therein to investment arbitration."[120] In particular, Articles 4, 5, and 8 of the ILC provide elements to identify the liability of the State and its instrumentalities that might be invoked through an umbrella clause.[121]

Additionally, some argue that a mere breach of contract does not constitute a violation of international law.[122] Thus, in order to deem a contract claim as an umbrella clause violation, the conduct must involve the exercise of sovereign power and be inconsistent with one of the state's international obligations.[123] For example, if a state entity breaches its contractual obligation by using methods unavailable to a regular contracting party, or if the nonobservance of a contractual obligation constitutes a violation of the obligation to provide fair and equitable

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118. Feit, *supra* note 116, at 152–53.

119. *Id.* at 151.

120. Sébastien Manciaux, The Relationship Between States and Their Instrumentalities in Investment Arbitration, in STATE ENTITIES IN INTERNATIONAL ARBITRATION 195, 210–11 (Emmanuel Gaillard ed., 2008).The ILC articles have been applied by Arbitral Tribunals *see. e.g.* Noble v. Romania, Eureko v. Poland, and Mazeffini v. Spain.

121. *See* Feit, *supra* note 116, at 151("the basic difference between the principle of 'piercing the corporate veil' and the rules of attribution as reflected in the ILC Articles, is that under the former, the contract itself is attributed to the state, while under the latter, only the act which constitutes the breach of international law is attributed for the purpose of state responsibility.").

122. *See* Feit, *supra* note 116, at 156.

123. *Id.*

treatment of foreign investments, or whether it breaches its duty in exercise of its governmental authority.[124] According to this approach, the arbitral tribunal in Pan Am. v. Argentina ruled that contract claims based on commitments made by the state as a sovereign give rise to a treaty claim.[125] However, a different standard has also been applied by other Tribunals which have rejected the sovereign power requirement. In Burlington v. Ecuador, in a contract claim on the execution of an indemnity clause over tax changes, the Tribunal ruled that umbrella clauses may apply when a breach of contract is made and even if no exercise of sovereign power is involved.[126]

Therefore, while attributing conduct to states is applied very broadly in international law, the interpretation of the umbrella clause has resulted in a number of contradictory awards.[127] Nevertheless, its implementation has been recognized in one way or another.[128] This provision in itself may serve as a deterrent to unilateral changes in investment contracts, and even if it does not offer a panacea for contractual instability[129] it is, however, a powerful agent for seeking enhanced compensation.

iii. Fiscal Stability through State Obligation of Treatment and Protection in BIT Standards

As we could observe during the contract renegotiation period and by the imposition of the windfall profit tax since 2008, IOCs

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124. *Id.* at 161.

125. Pan Am. Energy v. Argentina, Preliminary Objections, ICSID Case No. ARB/03/13 (July 27, 2006).

126. Burlington Resources v. Ecuador, ICSID Case No. ARB/08/5, Decision on Jurisdiction, June 02, 2010 ¶190, quoting *Duke Energy v. Ecuador*, ICSID Case No. ARB/04/19, Award, Aug. 18, 2008, ¶ 320–21.

127. These clauses have been interpreted broadly, *see, e.g.*, Noble v. Romania, *supra* note 106; and narrowly, *see, e.g.*, SGS. v. Pakistan, ICSID Case No. ARB/01/03, Decision on Objections to Jurisdiction, ¶ 170 (Aug. 6, 2003). Some tribunals have held that contractual breaches where the state acted as a sovereign will fall under the protection of the umbrella clause. see, *e.g.*, El Paso v. Argentina, ICSID Case No. ARB/03/15, Decision on Jurisdiction, ¶ 81 (Apr. 27, 2006).

128. *See, e.g.*, Duke v. Ecuador. Award,¶ 320, *supra* note 122.

129. Nkiru Okobi, The Umbrella Clause: A Panacea for Contractual Instability? A Look at Production Sharing Contracts, CENTER FOR PETROLEUM AND MINERAL LAW POLICY 15 (2009).

have accepted tax increases in Venezuela when they are granted a profit margin. However, IOCs may be reluctant to accept any fiscal increase that would upset the economic balance of the investment and that may not be considered a mere amendment, but rather a state breach of the investment contract.[130] In the absence of a stabilization clause in the MC contract, BIT provisions may provide oil companies some minimum standards according to the scope of the dispute resolution provision, the arbitrability of tax matters, and the alleged state breach of one of its commitments under a BIT. Two BIT commitments are then likely to be violated by changes in the fiscal regime: 1) the obligation to treat investors from the other state party by BIT standards, and 2) the obligation to protect, which includes the obligation not to expropriate their investments without compensation. In the first case, the investor should argue that a change in the fiscal legislation is contrary to the state obligation under the Most Favorable Nation Treatment (MFN) or the National Treatment (NT) provisions, when discriminatory, or by proving that a fiscal reform constituted tax harassment to the foreign investor violating fair and equitable treatment (FET) standards and rendering it uncompetitive relative to other investors.[131] In *Occidental v. Ecuador*, a case concerning the contractual interpretation of valued-added tax (VAT) refunds, the arbitral tribunal ruled that "the Ecuadorian authorities wrongly interpreted the contract" and "the tax law was changed without providing any clarity about its meaning and extent, and the practice and regulations were also inconsistent with such changes."[132] Thus, the tribunal concluded that Ecuador breached its obligation to accord FET and NT treatment to the

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130. Sébastien Manciaux, Changement de législation fiscale et arbitrage international, in Revue de l'Arbitrage 311, 337 (2001).

131. *Id.* However, Professor Manciaux explained that this argument would be limited by the scope of the BITs, which in some cases excludes tax matters. *Id.* Moreover, any case involving MFN standard treatment will require a case-by-case study on the recognition of the host state's right to policy space and the analysis of "like circumstances." *Parkerings v. Lithuania*, ICSID Case No. ARB/05/8, Award at ¶ 369 (Sept. 11, 2007).

132. Occidental v. Ecuador, LCIA Case No. UN 3467, Final Award ¶ 184 (U.S.-Ecuador BIT) (July 1, 2004).

investor in violation of the US- Ecuador BIT and Occidental was entitled of reimbursement.[133]

Concerning the BIT commitment of protection, the investor should prove expropriation by way of a tax measure. The expropriation through taxation would involve an abuse of right with a confiscatory character.[134] This requires that the tax measure deprive the investor of any return on investment or rendered the expectation of profits to a long-term time frame, undermining the economic function of its investment.[135] The Arbitral Tribunal in *EnCana v. Ecuador*, also concerning the interpretation of VAT refunds, declined its jurisdiction on the ground that the Canada-Ecuador BIT did not provide protection over tax claims unless they constituted an expropriation.[136] Thus, the Tribunal placed taxation in a special category for purposes of a claim of expropriation, i.e., "only if a tax law is extraordinary, punitive in amount or arbitrary in its incidence would issues of indirect expropriation be raised."[137] Despite this interpretation open the possibility of an expropriation test, close attention must be given to the scope of BIT exceptions on tax matters.[138] In *Burlington v. Ecuador*, in a claim involving the expropriation of contract rights and the application of a windfall

133. *Id.* at ¶ 200.

134. Manciaux, *Id.*

135. *Id.*

136. EnCana v. Ecuador, LCIA Case No. UN 3481, Award ¶ 149 (Feb. 3, 2006), 45 I.L.M. 901, 928 (2006).

137. Id. at ¶ 177, 45 I.L.M. 901, 923. In a Dissenting opinion on this case the Arbitrator Horacio A. Griega Naón asserted that: "A measure or series of measures do not need to totally eliminate returns to be expropriatory. A substantial or significant deprivation of returns suffices. (…) because requiring the total or quasi-total suppression of returns for an expropriation of returns to exist would be tantamount to requiring the existence of a de facto expropriation of the underlying investment, enjoying independent protection under the Treaty." The argument was also used in CJSC Companies v. Mongolia, in a case involving the implementation of a Windfall Profit Tax against a gold mining investor. The Arbitral Tribunal concluded that "the expert evidence submitted by the Claimants does not support their thesis that the WPT constituted an expropriation measure or a measure tantamount to expropriation." CJC Co. v. Mongolia, Award on Jurisdiction and Liability, April 28, 2011, at ¶ 11.

138. Mark Friedman, et al., *International Arbitration*, 41 INT'L LAW. 251, 272 (2007) ("Several BITs exclude taxation measures from the scope of the BIT, but they often provide for exceptions when the tax measures amount to violations of certain BIT protections.").

profit tax, the Tribunal affirmed its jurisdiction over expropriation claims but declined jurisdiction over non-expropriation claims relating to "matters of taxation", on the ground that they were outside the scope of the US-Ecuador BIT.[139] Hence, BIT provisions are currently being interpreted on their effectiveness to cover tax matters issues, producing an evolution of sources of stability in investment contracts, even more relevant when stability clauses have been excluded from the contract.

b. The Restrictions on Access to International Arbitration and the Governing Law

Removing investors' access to international arbitration was a non-negotiable condition imposed by the Venezuelan government during the contract renegotiation between 2005 and 2007.[140] At that time IOCs assigned a greater value to future investment opportunities than to ensuring "neutral fairness" through the resort to international arbitration.[141] The Venezuelan government argued oil contracts are matters of public utility and social interest that shall be submitted to Venezuelan law and Venezuelan tribunals,[142] and imposes the following clause to all the contractors:

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139. Burlington v. Ecuador, *supra* note 126.

140. Mommer Interview, *supra* note 59. "From the first day of negotiations we stated this [arbitration clause] right here will disappear.' We did not discuss the issue. In other words, we began negotiating with well[-]defined political positions. Sovereignty will not be discussed or negotiated here. Numbers will." *Id.*

141. Witten, *supra* note 29, at 58.

142. According to Article 9 of the OHL, the state assumed control over primary activities such as exploration, extraction, gathering, initial transportation and storage of hydrocarbons and the government defined agreements on these activities as contracts of public interest, which should remain under the exclusive jurisdiction of the Venezuelan courts. This policy is supported by Article 4 OHL and Article 151 of the Venezuelan Constitution (the Calvo clause), which sets forth that disputes relating to public interest contracts shall be decided by the competent courts of the Republic. Nevertheless, the same Article provides an exception to the submission of a dispute to national jurisdiction when it is provided for by the terms of a contract. Concerning the exception, Eljuri and Tejera Pérez stated that they "interpret this to mean that the clause would not apply to a contract of a commercial nature." *21st Century Transformation*, *supra* note 13, at 493. Thus, in their views, the exception should apply to oil contracts "since most of these contracts are commercial and are entered into by PDVSA when conducting commercial activities." *Id.* at 492. However, they also pointed out the restrictive views of the

> Applicable law and jurisdiction
>
> This Contract shall be governed by and interpreted in accordance with the laws of the Republic and any dispute or controversy that may arise in connection with this Contract which cannot be resolved amicably by the Parties shall be submitted exclusively to the courts of the Republic having jurisdiction. Before initiating any litigation, the Parties shall in good faith and within the framework of the Organic Hydrocarbons Law explore the possibility of utilizing mechanisms to amicably resolve controversies of any nature that may arise, including for technical matters, the possible request of opinions of independent experts appointed by mutual agreement. It is understood that any important dispute, including, for example, disputes relating to the Business Plan, work programs, development plans and related budgets, shall be referred to the chief executives of the parties involved in the dispute, who shall meet to endeavor to resolve the differences. In case such dispute is not resolved within sixty (60) days following the meeting held for such purpose by the Parties, they shall inform the Minister of the relevant details of the dispute.[143]

i. Limitations to Contractual Arbitration

The Article states that Venezuelan domestic courts retain jurisdiction over disputes concerning the MC contract. The provision includes a multi-tier dispute resolution mechanism comprising negotiation periods and expert adjudication. However, contrary to oil industry standard practice, this Article eliminates the investor's resort to international arbitration.[144] By implementing this measure, the government sought to reduce CVP (or PDVSA) exposure to international arbitration and to avoid the duplication of international procedures, as

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Venezuelan Supreme Court has in the PDVSA v. Intesa decision, which indicates that "the activities of PDVSA are of vital importance to the economic development of the country and that they are directly related to guaranteeing the quality of life of all Venezuelans." *Id.* at 493.

143. *See* MC Terms and Conditions, Applicable Law and Jurisdiction clause, *supra* note 16.

144. *See* Tozzini Freire Advogados and Bain & Company, Relatório I – Regimes Jurídico-Regulatórios E Contratuais de E&P de petróleo (2009).

occurred in the case of ExxonMobil.[145] Moreover, it seems that the government takes advantage of the narrow interpretation and dichotomy between contract claims and treaty claims in investment arbitration decisions, in the assumption that contract claims should fall in the jurisdiction of national courts, narrowing the resort to arbitration only to investment treaty claims.[146] This has been confirmed by government officials. As pointed out by Bernard Mommer, even if the government has blocked access to contractual arbitration, more arbitration cases against Venezuela could arise based on BITs, "since they rely on a complex network of international treaties and laws."[147] Thus, the government has also taken measures to reduce access to investment arbitration but some exceptions still remain.

ii. Limitations to International Investment Arbitration but BIT Planning Allowed

The Venezuelan government has criticized ICSID arbitration and issued various threats of denunciation of the ICSID Convention,[148] or the creation of an alternative dispute resolution center,[149] but so far, none have been implemented. On

145. Mommer Interview, *supra* note 59. The Venezuelan government sought to avoid the exposure of PDVSA to a final award or temporary injunctive relief, as occurred with the Mareva injunction against PDVSA in the ExxonMobil case, which affected a PDVSA-Cerro Negro bank account in early 2008 (the Mareva Injunction was revoked in March 2008). *See Id.* "What you cannot do is bring a lawsuit against PDVSA because the State did this or that. The State responds on its own. That means that what ExxonMobil is doing today won't happen again." *Id.* Mommer explained that, "by engaging in arbitration against PDVSA, which is a state-owned company, they are trying to seize the assets the company has in the United States and that belong to Venezuela, such as bank accounts or assets. That was precisely what the old PDVSA d*Id.* It put itself in a deliberate position to be susceptible to damages in case lawsuits arose." *Id.* He refers to the internationalization strategy implemented in the 1980s, when PDVSA transferred money and assets overseas by buying refineries in Germany, Curacao, and CITGO in the United States, which could be seized in the execution of an arbitral award. *Id.*

146. *See* Vivendi v. Argentina, ICSID Case No. ARB/97/3, Decision on Annulment, ¶ 114 (July 3, 2002).

147. Bernard Mommer, Vice Minister of Hydrocarbons, Plena Soberanía Petrolera, Conference Presentation at El otro lado del arbitraje internacional de inversiones in Caracas (July 9–10, 2009).

148. Acuerdo sobre la Campaña de la Transnacional Exxon Mobil contra Petróleos de Venezuela, S.A., Asamblea Nacional de Venezuela, G.O. No. 38.869, 13 de febrero 2008.

149. Declaración de la VI Cumbre Extraordinaria del ALBA-TCP, 24 de junio de

the contrary, PDVSA has acknowledged as favorable some recent arbitral decisions in claims against Venezuela before the ICSID.[150]

However, a series of events have occurred limiting access to international investment arbitration. On April 30, 2008, the Venezuelan government gave official notice of its intention to terminate the BIT between Venezuela and the Netherlands (Dutch BIT),[151] because IOCs—notably ExxonMobil—had been abusing the Dutch BIT to obtain ICSID jurisdiction.[152] Later, on October 28, 2008, the Venezuelan Supreme Court issued a landmark decision that developed a narrow interpretation of Article 22 of Venezuela's Investment Law, pointing out that the Article does not contain state consent to ICSID arbitration.[153] Government officials likely filed the request to weaken the position foreign investors pursuing ICSID arbitration against Venezuela using the Investment Law as a vehicle to obtain jurisdiction.

However, on June 2010, a decision on jurisdiction from the contract renegotiation arbitration cases was realized providing relevant information on BIT protection. The ICSID Arbitral Tribunal in *Mobil Corporation v. Venezuela* ruled that: 1) rejected the claimant's request to invoke ICSID jurisdiction under Article 22 of the Venezuelan Investment Law on the ground that the "ambiguous" text cannot contain an advanced consent to arbitration, and 2) concluded that claims arising prior to the establishment of Exxon Mobil as a Dutch corporation in

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2009, Maracay, Venezuela, *available at* http://www.alba-tcp.org/contenido/declaracion-conjunta-vi-cumbre.

150. *See* Press Release, PDVSA, Report on the Claim by Cemex Against the Bolivarian Republic of Venezuela on the Provisional Measures. (Apr. 14, 2010) *available at http://www.pdvsa. com/index.php?tpl=interface.en/design/readmenuprinc.tpl.html &newsid_temas=54*.

151. Venezuela gives notice to terminate Netherlands' BIT. IA Reporter, available at: http://www.practicallaw.com/9-381-7749?q=&qp=&qo=&qe=. By its own terms, however, the treaty remains in force for fifteen years after termination. Art. 14, Neth.-Venez., BIT Oct. 22, 1991.

152. According to Minister Ramirez, Exxon Mobil registered its assets in the Netherlands in 2006, seeking for BIT protection and brought its case against Venezuela before the ICSID in October 2007. Reuters, *Venezuela says preliminary Exxon ruling favorable*. June 11, 2010.

153. Decisión Nº 1541 of the Sala Constitucional del Tribunal Supremo de Justicia, 17 de Octubre 2008.

2006 are not admissible.[154] Hence, the tribunal ruled it had jurisdiction over future claims, following the incorporation of Exxon Mobil as a Dutch corporation and based on alleged breaches of the Dutch BIT as far as they relate to the dispute concerning the nationalization measures taken by the Venezuelan government, narrowing the scope of the case.[155] The Arbitral Tribunal stated that the aim of restructuring the investment to reach the protection of a BIT was "*perfectly legitimate as far as it concerned future disputes".*[156] Thus, the tribunal developed a *ratione temporis* test for deciding whether treaty-shopping strategies are legitimate according to principles of international investment law, which involves the observation of good faith and the rejection of any attempt of abuse of right.[157]

Concerning the recognition of forum-shopping practice in Venezuela, the above mentioned Venezuelan Supreme Court Decision of October 2008 has deemed this practice to be "perfectly lawful and legitimate as long as it is not used to undermine the principle of the parties' good faith in order to achieve a benefit or advantage not protected by the applicable legislation, at the expense of the rights and interests of the other party, such as those undertaken ex post behavior to legal business or in connection with the emergence of the dispute or controversy"[158]

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154. Mobil Corp. v., ICSID Case No. ARB/07/27, Decision on Jurisdiction, ¶ 206 (June 10, 2010).

155. *Id.* at ¶ 209.

156. *Id.* at ¶ 204

157. Mobil Decision is also based quoting the Phoenix Action on the standard of abuse of right, (Phoenix Action v. Rep Czech ICSID case No. ARB/06/5, Decision of Jurisdiction (2009)) and Aucoven v. Venezuela (ICSID Case No.ARB/00/5, Decision on Jurisdiction (2001) concerning the duty of notification of restructuring and good faith. The test is currently been tested in the case Tidewaters v. Venezuela (Procedural Order No. 1), *supra* note 50, and further attention shall be paid to the questions of the notion of investors and investment in BIT, in order to proceed with this practice. *See* also, Paul Michael Blyschak, Access and advantage expanded: Mobil Corporation v Venezuela and other recent arbitration awards on treaty shopping. J World Energy Law Bus 2011 4: 32–39.

158. MACLEOD DIXON, VENEZUELAN SUPREME TRIBUNAL ISSUES FUNDAMENTAL DECISION ON ARBITRATION (2008), http://www.macleoddixon.com/documents/Bulletin__TSJ_issues_ fundamental_decision_on_arbitration__Oct__23_2008.pdf.

The research found that the Venezuelan authorities have followed this standard and investors have proceeded to treaty and forum shopping strategies at the onset of the project in subsequent MC contracts. For instance, Chevron and ENI have signed agreements as corporations incorporated in The Netherlands and have obtained protection under the Dutch BIT, which also provides access to ICSID arbitration.[159] Similarly, Petrobras has entered in a MC Contract through an Argentinian subsidiary eligible for protection under the Venezuelan-Argentina BIT which includes an ICSID arbitration clause.[160] Thus, the events confirm that Venezuela does not wish to depart from the investment arbitration forum. Further, the Venezuelan government recently signed three new BITs with the governments of Belarus, Russia, and Vietnam between 2008 and 2009.[161] These three BITs were executed in the framework of negotiations for new investments in the oil and gas industry.[162] The BITs contain provisions for ad hoc arbitration under U.N. Commission on International Trade Law (UNCITRAL) rules and arbitration before the Stockholm Chamber of Commerce.[163] Thus, arbitration remains an

159. *See*, e.g., MC Petropiar (CVP-Chevron) and MC Petrosucre (CVP-ENI) Official Gazette No. 38.844, January 7, 2008.

160. *See*, e.g., Petrowayú, (CVP-Petrobras-Williams Int.), G.O. No. 38.518, September 8, 2006. It is interesting to observe how Petrobras is taking advantages of the practice of BIT treaty shopping which provide substantives investment protection rights, while the Brazilian Government refuse to ratify BITs entered with other countries to provide same treatment to foreign investors.

161. Alfredo de Jesús O., *Overview of Recent Developments in Investment Arbitration and the Oil and Gas Industry in Venezuela*, IBA ARB. NEWS (Int'l Bar Ass'n, London), Sept. 2010, at 103–04; *see also* Ley Aprobatoria del Acuerdo Entre el Gobierno de la República Bolivariana de Venezuela y el Gobierno de la Federación de Rusia sobre la Promoción y Protección Recíproca de Inversiones, G.O. No. 39.191, 2 de junio de 2009 (Venez.) [hereinafter Venezuela-Russia BIT]; Ley Aprobatoria del Acuerdo Entre el Gobierno de la República Bolivariana de Venezuela y el Gobierno de la Rebpúlica Socialista de Vietnam para la Promoción y Protección de las Inversiones, , G.O. No. 39.170, 4 de mayo de 2009 (Venez.) [hereinafter Venezuela-Vietnam BIT]; Ley Aprobatoria del Acuerdo Entre el Gobierno de la República Bolivariana de Venezuela y el Gobierno de la Rebpúlica Belarús sobre Promoción y Protección Recíproca de Inversiones, G.O. No. 38.894, 24 de marzo de 2008 (Venez.) [hereinafter Venezuela-Belarus BIT].

162. *Id.*, at 104.

163. *Id.* These new agreements show that ICSID arbitration has been removed from the Venezuelan BIT practice. *See Id.* For example, even though Venezuela and

alternative method of dispute resolution in the oil sector in Venezuela, through BIT protection, which under certain conditions allows investors to employ treaty-planning strategies.

iii. Governing Law

Large oil-producing countries like Venezuela insist on applying their national law to international petroleum agreements. The Applicable Law and Jurisdiction clause of the MC Contract states that the contract itself is "governed by and interpreted in accordance with the laws of the Republic."[164] Additionally, Article 1.9 of the MC Contract establishes that "the applicable laws shall prevail over petroleum industry practices."[165] This approach allows the government to regulate an investment in accordance with its national policy priorities, thereby increasing the legal risk of unilateral intervention.[166]

Having proved that access to international arbitration has continued to be a practice in Venezuela, the role of international law remains essential.[167] Dr. Yas Banifatemi explains that this role in no way undermines that of the law of the host State where it would be the proper law.[168] The two systems of law may be applied depending on each distinct issue to be determined on the merits.[169] Dr. Banifatemi finds support for this principle in three places: the second sentence of Article 42(1) of the ICSID Convention,[170] Article 33(1) of the UNCITRAL Arbitration

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Belarus are both parties to the ICSID Convention, but the Venezuela-Belarus BIT does not provide for ICSID arbitration. *Id.*; *see* Venezuela-Belarus BIT, *supra* note 161, art. 8 (providing for UNCITRAL arbitration).

164. *See* MC Terms and Conditions, *supra* note 16, art. 7.

165. *Id.* art 1.9.

166. Lauren Grau, Comment, *Cutting Off the Building Blocks to Methamphetamine Production: A Global Solution to Methamphetamine Abuse*, 30 HOUS. J. INT'L L. 157, 186 & n.184 (2007) (describing the difficulties of implementing U.S. anti-drug policies in Venezuela and North Korea and attributing those difficulties, in part, to "Venezuela's thwarting of other U.S. policy goals in the region").

167. Yas Banifatemi, *The Law Applicable in Investment Treaty Arbitration*, in ARBITRATION UNDER INTERNATIONAL INVESTMENT AGREEMENTS 191, (K. Yannaca-Small ed., 2010) [hereinafter *The Law Applicable to Investment Treaty Arbitration*].

168. *Id.*

169. *Id.* at 204.

170. ICSID Convention, at art. 42(1).

Rules[171] and Article 22(1) of the Arbitration Rules of the Stockholm Chamber of Commerce,[172] which enable arbitral tribunals, in the exercise of their discretion and pursuant to a choice of law inquiry, to decide what rule of law (international or domestic) is the most appropriate to the determination of each specific question.[173]

For instance, Article 42(1) of the ICSID Convention provides that "[t]he Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such an agreement, the tribunal shall apply the law of the contracting state party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable."[174] A first reading of the Article may lead one to believe that international law has a subsidiary role in ICSID disputes.[175] However, modern practice in arbitration provides that national law may be supplemented by international practice and international law principles to ensure international law customs apply when they conflict with the applicable domestic law.[176] Hence, foreign investors covered by a BIT could have protection in aspects such as the state's bona fide commitments and legitimate expectations through alternatives sources in addition to the Venezuelan Law, under the general principles of international law or the *lex mercatoria*.[177]

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171. UNCITRAL Rules 12–May 7, 1976. See also, art. 35 of the UNCITRAL Rules, 15, August, 2010.

172. Arbitration Inst., Stockholm Chamber of Commerce, Arbitration Rules art. 22(1) (2010)

173. *The Law Applicable to Investment Treaty Arbitration*, supra note 167 at 200–01.

174. ICSID Convention, at art. 42(1).

175. Tudor, *supra* note 114, at 11.

176. See Emmanuel Gaillard & Yas Banifatemi, The Meaning of "and" in Article 42(1), Second Sentence, of the Washington Convention: The Role of International Law in the ICSID Choice of Law Process, 18 *ICSID REV.* 375, 407 (2003) (quoting Amco Asia Corp. v. Indonesia, ICSID Case No. ARB/81/1, Ad hoc Committee Decision on the Application for Annulment, ¶ 20 (May 16, 1986).

177. See Laura Henry, *Investment Agreement Claims under the 2004 Model U.S. BIT: A Challenge for State Police Powers?*, 31 U. Pa. J. Int'l L. 935, 975 (2010). See also Carmen Otero, *Consideraciones sobre la Ley applicable a los Contratos Petrolíferos Internacionales,* Rivisa di Diritto Internazionale Privado e Processuale, Anno XLV-N.2, Aprile-Giunio 2009, pp. 351–386.

The Calvo doctrine measures implemented in Venezuela have reduced investors' rights toward contractual disputes, also affecting the predictability of investments in the oil sector.[178] However, BITs contradict the two keys tenets of the Calvo doctrine: 1) the exclusive application of the state's law and 2) the exclusive jurisdiction of the state's courts.[179] Despite that, the Venezuelan government has become more sophisticated by using national law and coercive state power to the detriment of foreign private investors,[180] pragmatic decisions have been made providing different sources of protection to foreign investors. Identifying these pragmatic decisions contributes to the understanding on how the current legal framework was accepted by IOCs after the contract renegotiation over existing operations. However, imposing this nationalistic regime on new projects represents a great challenge for the Venezuelan government.[181]. Therefore, the government should assess the flexibility of the legal regime to make the necessary adjustments.

III. METHODS OF AWARDING CONTRACTS AS A SOURCE OF BALANCE IN THE VENEZUELAN'S PETROLEUM CONTRACT REGIME FOR ORINOCO BELT PROJECTS

> *[L]e réquilibrage du droit des investissements ne doit pas affaiblir la protection légitime des droits des investisseurs. Tout investisseur privé qui réalise des investissements à l'étranger a des aspirations légitimes à la justice et à l'égalité.*[182]

Oil prices dramatically fell at the end of 2008, gradually affecting the Venezuelan economy.[183] As a result, the Venezuelan government lacked the resources to undertake the $119 billion investment plan needed to boost oil production to more than 5 million barrels a day, according to the "*Siembra*

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178. *Calvo Redivivus*, *supra* note 98.
179. *Id.*
180. *Political Risk Management*, *supra* note 44, at 28.
181. Tozzini Freire Advogados and Bain & Company, *supra* note 144, at 444.
182. BEN HAMIDA, *supra* note 10, at 21.
183. Venezuela Oil: Another Asset Grab, THE ECONOMIST, May 12, 2009.

Petrolera" Plan 2009–2013.[184] The new scenario has led the government to move from a decade of reforms reaffirming its sovereignty over hydrocarbons into a new era of negotiation in which foreign investors are seeking better conditions to secure their investments.

The simultaneous implementation of different methods of awarding contracts has led the Venezuelan government to seek a balanced approach by creating incentives adapted to the current scenario. Article 37 of the OHL establishes two methods of awarding contracts for an MC. First, the licensing round method is defined in the first part of the Article, where "[t]he competent public body shall promote the existence of various offers for the selection of the operators."[185] In February 2010, the auction of blocks of the Carabobo Area in the Orinoco Belt awarded two out of three projects to international consortiums associated with CVP after a long and complex process characterized by delays and changing contractual conditions.[186] Second, the same article establishes that "[f]or reasons of public interest or for special circumstances related to the activities, the operators may be directly selected, with the prior approval of the Council of Ministers."[187] Thus, the Venezuelan petro-diplomacy has led to direct negotiations that awarded oil blocks to political partners.[188]

In a study on the recognition of State and foreign investor's interest under international investment law, Dr. Walid Ben Hamida has noted two distinct sources that shape and protect these interests.[189] The first source is contractual in nature: BITs and investment contracts enumerate and describe in detail the interests held by both parties.[190] The second source is the precedent set by international arbitration decisions, which provides nuanced solutions to investment disputes and

184. CONAPRI, BUSINESS OPPORTUNITIES: PETROLEUM, http://www.conapri.org/English/MainCategory.asp?categoryid=.

185. *See* OHL, *supra* note 19, art. 37.

186. Venezuela Awards 2 Blocks in Massive Oil Region, LATIN AM. HERALD TRIB., Feb. 11, 2010.

187. *See* OHL, *supra* note 19, art. 37.

188. See *Help Needed to Make Orinoco Flow*, *supra* note 8.

189. *See* BEN HAMIDA, *supra* note 10, at 2–3.

190. See *Id.*

interpretations of relevant contractual and legal provisions.[191] The international oil sector has produced relevant decisions on expropriation, stabilization provisions, access to arbitration, and the recognition of state responsibility to foreign investors.[192] These approaches are currently being tested by the recent increase of international litigation resulting from the resurgence of nationalization in oil-producing countries.[193] Events in the next few years will determine whether these approaches must be adapted to new situations.[194]

Meanwhile, the following Section evaluates the recent international agreements entered into by the Venezuelan government with oil producing companies in the adjudication of two main Areas of the Orinoco Belt: the Carabobo Area and the Junín Area.

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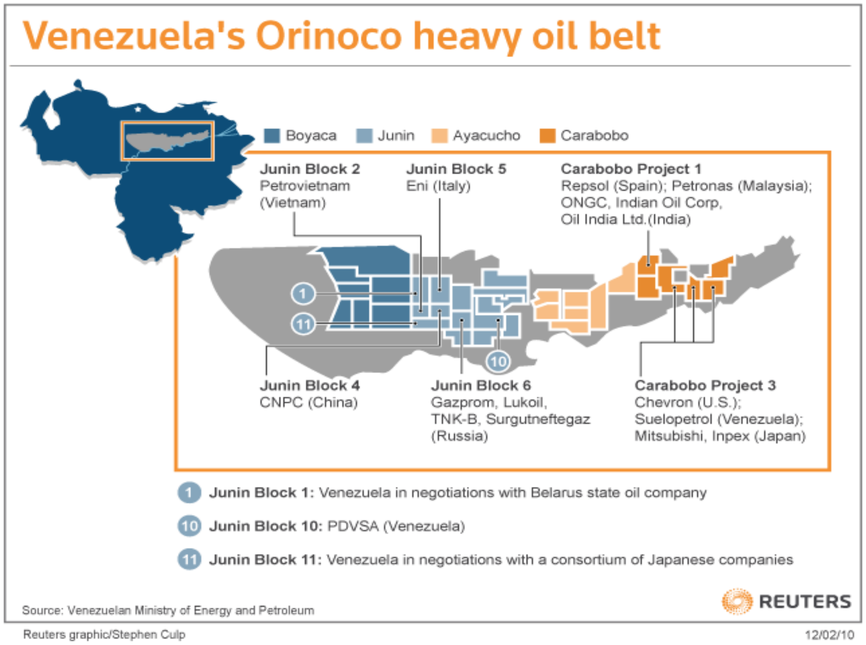
191. *Id.* at 7.

192. See generally R.D. BISHOP, INTERNATIONAL ARBITRATION OF PETROLEUM DISPUTES: THE DEVELOPMENT OF A LEX PETROLEA (1998).

193. Kevin T. Jacobs & Matthew G. Paulson, The Convergence of Renewed Nationalization, Rising Commodities, and "Americanization" in International Arbitration and the Need for More Rigorous Legal and Procedural Defenses, 43 TEX. INT'L L.J. 359, 376, 381–82 (2008).

194. *Id.*

A. The Tender of the Carabobo Area



One year after implementing the nationalization process, the Venezuelan government launched the tender for the Carabobo project in October 2008.[195] Carabobo is one of the most important hydrocarbon projects in the Western hemisphere. The amount of oil reserves auctioned reached 127.6 billion barrels of heavy oil, a potential production of 1.2 million barrels/day and a required investment between \$10–\$20 billion dollars per project, which includes construction of heavy oil upgraders.[196] Nineteen oil-producing companies participated in the tender and sought to enter or increase their investment in the Venezuelan oil sector.[197] The selection of the winning bidders was based on a

195. See https://fajadelorinoco.com/.

196. Factbox, *Venezuela Development Plan for Orinoco Oil Belt*, REUTERS, Apr. 2, 2010. The 7 blocks were auctioned in three groups. *Id.*

197. The participant companies were BP, Chevron, CNPC, Ecopetrol, ENI, Galp Energía, Inpex Corporation, Japan Oil Gas Metals, Mitsubishi Corporation, Ongc Videsh Limited, Petrobras, Petronas, Repsol, Shell, Sinopec, StatoilHydro, Suelopetrol, Total, and a National Consortium of Russian Companies. Only Ecopetrol cancelled its participation due to the ongoing diplomatic conflict between Venezuela and Colombia caused by the establishment of U.S. military bases in Colombia in 2009. A \$2 million

formula combining the amount of the signing bonus, a marketing proposal for the heavy crude oil produced, and a funding proposal to reduce the financial burden of PDVSA. As oil prices recovered in 2009, PDVSA took an aggressive position, seeking a minimum of $2.5 billion signing bonus and $3 billion of loan guarantees for the PDVSA investment.[198]

Nevertheless, in addition to the difficulties posed by the global economic crisis in 2009, the Venezuelan authorities also suffered from the inflexibility of the bidding conditions, which delayed the allocation process.[199] Although three models of conditions were presented during 2009, the first two models were tacitly rejected by the participants in the tender when no offers were made.[200] Consequently, the government approved a third model, which included a number of incentives to attract the participation of foreign investors.[201] An overview of the tender conditions is presented in the following chart:

<table>
<tr><td>Terms</td><td>First Proposal (Nov. 2008) Four Blocks</td><td>Second Proposal (May 2009) Seven Blocks</td><td>Third Proposal (Nov. 2009) Seven Blocks</td></tr>
<tr><td>Common Conditions for selection of the winners</td><td colspan="3">1. Bonus Amount payable to the Bolivarian Republic of Venezuela.
Project Carabobo 1: $1 Billion
Project Carabobo 2: $1 Billion
Project Carabobo 3: $500 millions
2. Funding proposal for the Joint Venture which could reduce the financial burden of PDVSA in the projects.
3. Marketing proposal for the entire Crude oil processed by the Joint Venture.</td></tr>
</table>

bonus for the data room of the Carabobo project was required. *Id.*

198. *Aplazan otra Vez*, *supra* note 5.

199. *Id.*

200. *See infra* Part III.A.1.

201. *See infra* Part III.A.2.

	4. Recovery factor of 20%.		
Blocks Offered	The first proposal offers 2 projects each with two blocks and requires the construction of 2 oil upgraders.	The second proposal expanded its offer to 3 projects, two of two blocks and a third of 3 blocks, requiring the construction of 3 oil upgraders.	Same
Governing Law and Jurisdiction	Venezuelan Law and the jurisdiction of the Venezuelan courts.	Venezuelan Law and the jurisdiction of the Venezuelan courts. The government agreed to accept an arbitration clause on claims relating to their financial burden. Annex 1 to the Loan Agreement includes an ICC arbitration clause in New York.	Same
Economic Conditions	-50% Income Tax. -Special Contribution Tax on Extraordinary Price of Oil (deductible in calculating Income Tax) -33.33% Of Royalty (30% royalty of 3.33% more special advantages).	-50% Income Tax. -Special Contribution Tax on Extraordinary Price of Oil (deductible in calculating Income Tax) -33.33% Of Royalty (30% royalty over 3.33% of special benefits)	Offers fiscal incentives to Oil companies that accept the construction of refineries in the country. Reduction of the Royalty from 30% to 20% according to article 44 of the OHL.

Operator	PDVSA as the operator of the Project.	Offers to give the role of Operator to the IOC for the construction period of the upgraders, then to grants the role of Operator to PDVSA at the beginning of oil production.	

1. *The Inflexibility of the Original Contractual Conditions*

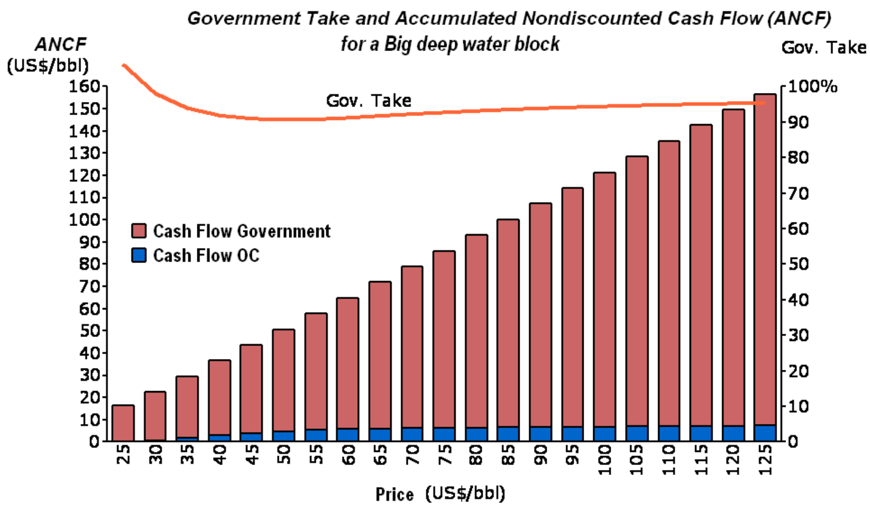
The Venezuelan government argued that the auction delays occurred because "the companies have asked for more time to form their consortiums."[202] Some experts indicated that "a project of such magnitude was impossible to negotiate in the schedules that the government had issued." For others, "the economic conditions and the exclusion of arbitration within the contract limited the presentation of bids." Finally, the research found that investors unanimously agreed that "[t]he numbers do not add up." The research identified the following four elements of inflexibility in the tender package: 1) fiscal regime, 2) technical factors, 3) operating factors, and 4) the exclusion of arbitration clauses in contracts for primary activities.

a. *Fiscal Regime*

PDVSA demanded a substantial amount of financial investment from foreign companies. This demand was a major stumbling block in the negotiations for the Carabobo Project, since companies were required to secure financing not just for their own stakes (40%), but also to reduce PDVSA's financial burden.[203] In practice, this condition required companies to undertake 100% of project financing. According to an economic study on the Venezuelan hydrocarbons fiscal regime by Tozzini Freire Advogados and Bain & Company, the combined fiscal burden of a 50% tax rate on profits, 33.33% on royalties, 1% tax for social programs, the "shadow tax," and the

202. *Aplazan otra vez*, *supra* note 4.
203. *Id.*

Law of Special Contribution, could reach a to 90% of government's take, as is illustrated in the following figure.[204]



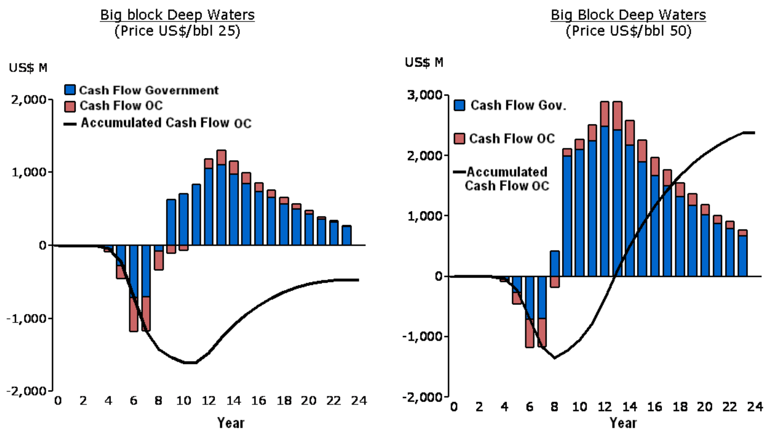
The same study examined the exploitation of large project using different pricing scenarios for the MC model under the Venezuelan tax system. The study concluded that the internal rate of return for private investors will not be positive in a scenario of $25/barrel. The recovery period would be twelve years when oil was at $50/barrel. Thus, the long-term recovery period is detrimental to international oil companies and could discourage private investment in Venezuela.[205] In fact, during the first quarter of 2009, the average price for the Venezuelan crude basket was $47.33 per barrel.[206] However, if oil prices reach the range of $60 to $80, investment in the Orinoco oil

204. Tozzini Freire Advogados and Bain & Company, *supra* note 144, at 439. The shadow tax is triggered in case the fiscal take does not reach at least 50% of gross profits after applying royalties, taxes and other levies. Thus, the MC must pay the difference between this threshold and the fiscal take. *Id.*

205. *Id.* at 438–446.

206. *See* U.S. ENERGY INFORMATION ADMINISTRATION, WEEKLY VENEZUELA TIA JUANA LIGHT SPOT PRICE FOB, http://www.eia.doe.gov/dnav/pet/hist/LeafHandler.ashx?n=PET&s= WEPCVETIA&f=W (last visited Nov. 21, 2010).

could significantly reduce the period of investment recovery, as illustrate the following figure:[207]



b. Technical factors

The government has demanded a rate of recovery factor of 20% through thermal recovery techniques.[208] According to one manager interviewed, "the rate of recovery of 20% has been imposed by the Venezuelan government without adhering to the current reality of crude oil produced on the Orinoco Belt, whose recuperation rates are around 8%, and between 12% and 14%, under gas injection."[209] This requirement demands a higher level of investment, which increases the project's costs. However Del Pino, supporting the PDVSA position, declared in November 2009 that PDVSA estimates "20% as a conservative figure" due to the development of more efficient oil recovery technologies in the future.[210]

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207. Tozzini Freire Advogados and Bain & Company, *supra* note 144, at 438–46. It is worth noting that the graphics based on offshore scenarios through two ranges of prices have been developed as equivalent to onshore projects in the Orinoco Belt. The study shows the cash flow behavior in cases of high level of investment such as the production of heavy crude oil or offshore deep waters oil wells. *Id.*

208. Miguel Romero, Intevep Busca Producir Technología que Permita Mayor Factor de Recobro, CORREO DEL ORINOCO, Nov. 6, 2009, at 9.

209. Personal interview, in Caracas, Venez. (July. 29, 2009).

210. *Id.*

c. Operating Factors

Despite undertaking heavy financing costs, the international companies will not have operational control over their investments. While delivering the second package of conditions, the government made a significant proposal. This proposal indicated that while the upgraders were being constructed, the international companies would retain operational control over the project. This could be achieved through the incorporation of an additional company dedicated exclusively to infrastructure building where the foreign investors could have control of the project. This proposal would require, however, that the international companies perform all the initial infrastructure work, only to hand over control of the project to CVP in the capital recovery phase.

d. The Exclusion of Arbitration in Contracts of Primary Activities

The Carabobo Project requires investments between $10–$20 billion dollars per project, including at least $6 billion for the construction of upgrading facilities of 400,000 barrels of heavy crude per project.[211] Thus, given the significant amounts of investments in infrastructure, access to international arbitration became a critical aspect of the negotiations. Although the risk of expropriation tends to decrease when new investments are required, the state's previous nationalization of private industries contributes to uncertainty about the risk of expropriation.

The Position of IOCs

Representatives of the IOCs indicated that they sought to include arbitration protection in the contract.[212] Nevertheless, the request was publicly rejected in early 2009 by Minister Ramirez and Deputy Ángel Rodríguez, former President of the Parliament Commission of Energy.[213] Those who have found

211. *Auction of Venezuela's Vast Carabobo Oil Fields*, *supra* note 3.

212. Venezuela Not to Accept Arbitration in Carabobo Block of Orinoco Belt, EL UNIVERSAL (Venez.), Apr. 28, 2009.

213. *Id.*

protection in BITs declared that BITs represent an alternative method to gain access to international arbitration.[214]

The Position of NOCs

The recent BITs approved by Venezuela with the governments of Belarus, Vietnam, and Russia, show that even political partners sought to grant international arbitration and substantive investment protection rights to their NOCs, acting as any other IOCs in the international oil market on this issue.

2. The Incentives Granted and the Auction Results

Was the approval of incentives a predictable outcome? The answer is probably yes. The different oil shocks exposed the pendulum swing between protectionism and liberalization in the energy sector, giving investors a better understanding of investment cycles.[215] But before announcing the shift in the government's position, the Venezuelan authorities allowed a lengthy process marked by auction delays.[216] In August 2009, during an interview with a CVP manager, a question was raised about the possibility that negotiations could be halted because of the conditions imposed by the Venezuelan government; the laconic answer was that, "the authorities will take the necessary measures."[217]

On October 1, 2009, Minister Ramírez announced that the Venezuelan government was reviewing the fiscal conditions for the winners of the Carabobo tender, in order to stimulate the companies to invest in Venezuela despite the

214. Jean Carlos Manzano, *Francia y Venezuela acuerdan términos para explotar la Faja*, EL MUNDO, ECONOMÍA & NEGOCIOS (Venez.), Sept. 10, 2009, at 14. Pierre-Franck Chevet, Director General of the French Ministry of Ecology, Energy, Sustained Development and the Sea addressed arbitration concerns by noting that, "[t]here is a bilateral investment treaty signed in 2004 between both states, for us this is enough, considering that it was signed by the president Chávez." *Id.*

215. Thomas Friedman, *The First Law of Petropolitics*, FOREIGN POLICY, May/June 2006.

216. Deisy Butrago, *Prevalecerá Esquema Fiscal en la Faja Pese a la* Crisis, EL UNIVERSAL, Apr. 20, 2009.

217. Personal interview, in Caracas, Venez. (July. 30, 2009).

global recession.[218] According to an official press release issued by the MPPEP, the Minister announced the possibility of "applying mechanisms of the OHL to reduce taxes and royalties to grant the economic feasibility of the project."[219] Also, Minister Ramírez indicated the possibility of two types of fiscal regimes: the traditional one that taxes company profits at 50% and a special one that lowers the tax rate to 34% if the company built the refinery.[220] These announcements were in accord with Articles 44 and 48 of the OHL and would allow a new economic balance in future ventures in the Orinoco Belt.[221] In this way, Article 44 of the OHL sets out the possibility of reducing the royalty income from 30% to 20% to ensure the economic viability of the projects.[222] Similarly, Article 48.4 of the OHL offers the possibility of reducing the extraction tax from 1/3% to 20%, and Article 48.5 OHL offers the possibility of partially or totally eliminating the so-called general consumption tax.[223] Moreover, November 12, 2009 was set as the deadline to deliver the final conditions package, January 28, 2010 as the deadline for the receipt of bids, and February 8, 2010 as the date for announcing the winners. [224]

On January 28, 2010, two consortia presented offers for two of the three auctioned projects. One consortium, led by Repsol and including Malasya's Pretronas and India's ONCC, placed a bid for the Carabobo 1 Project.[225] A second consortium led by

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218. Venezuela studies for the first time from 1999 to reduce oil taxes, AFP, Oct. 1, 2009.

219. Press Release, Ministry for Energy and Petroleum, *Acuerdan Cronograma para la Selección de Socios en el Area Carabobo* (Oct. 1, 2009) *available at* http://www.mem.gov.ve/portal menpet/noticias.php?option=view&idNot=1453 [hereinafter "Petroleum Ministry Press Release"].

220. *Venezuela Ofrece Incentivos Fiscales a Petroleras que Construyan Refinerías*, EFE, Sept. 22, 2009, *available at* http://informe21.com/venezuala/venezuela-ofrece-incentivios-fiscales-petroleras-construyan-refinerias.

221. Petroleum Ministry Press Release, *supra* note 219.

222. *Id.*

223. *See* OHL, *supra* note 19, art. 48.

224. Petroleum Ministry Press Release, *supra* note 219.

225. *See Venezuela Awards Two Carabobo Licenses*, OILVOICE, Feb. 15, 2010, http://www.oilvoice.com/n/Venezuela_Awards_Two_Carabobo_Licenses/2f74b785f.aspx.

Chevron and including Mitsubishi, JOGMEC, Inpex, and Suelopetrol, placed a bid for the Carabobo 3 Project.[226] Surprisingly, no offer was received for Carabobo 2. Companies such as Shell, Statoil, Total, CNPC, and a consortium of Russian Companies declined to participate despite their prior announcements in 2009.[227]

a. The Carabobo Auction Results

On February 10, 2010, the Venezuelan government awarded two projects: Carabobo 1 to Repsol and Carabobo 3 to Chevron.[228] The final incentives were announced for the MC participating in projects in the Orinoco Belt as follows:

b. Economic Incentives

1) The payment of the signature bonus will be divided into two or three payments: $1 billion signature bonus for Carabobo 1 and $500 million signature bonus for Carabobo 3.[229] 2) Reduced rates of royalties and taxes according to Articles 44 and 48 of the OHL, which will enable companies to recover their investments in a period equal to or shorter than seven years from the start of commercial production of upgraded crude oil.[230] 3) Early production of non-upgraded crude in the third year of the project in order to allow companies to have access to cash flow for the construction of the upgraders.[231] These three major changes approved by the government are the first economic incentives offered to foreign investors in the Venezuelan oil

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226. See *Id.*

227. Total, CNPC to Bid on Venezuela Oil Blocks, REUTERS, July 4, 2009.

228. Steven Bodzin, Daniel Cancel, and Jose Orozco, *Chevron, Repson Win $30 Billion Venezuela Oil Auction (Update 2)*, BLOOMBERG, Feb. 11, 2010, http://www.bloomberg.com/apps/ news?pid=newsarchive&sid=aTJwEEbT9BI0.

229. Carlos Bellorin, *The Petroleum Royalty Reduction in Venezuela*, THE ENERGY LAW ADVISOR, *available at* http://www.cailaw.org/iel_advisor/industry_news/petroy_venezuela.html.

230. *Id.*

231. ***Id.*** Moreover, the provision establishes that in case the Ministry chooses to reduce the royalty rate and the extraction tax, the "shadow tax" will be subject to an "*adjustment in order to ensure that it does not neutralize, in whole or in part, such reductions."* Id.

industry since Hugo Chávez began his tenure in government. [232] However, their implementation shall be reviewed in light of the new regulations and waivers of the 2011 windfall profit tax reform.

c. International Arbitration

Concerning access to international arbitration, both Repsol and Chevron have found BIT protection and access to international arbitration. Repsol, under the Venezuelan-Spain BIT and Chevron through a subsidiary incorporated in Denmark, based on the Venezuela-Denmark BIT.[233] Both BITs provide state consent to ICSID arbitration or ad hoc arbitration under UNCITRAL rules. Thus, in the case of Chevron, it is worth concluding that the Venezuelan government confirms its consent to the treaty-planning strategy by foreign investors in the onset of the project. This also demonstrates the government's pragmatic decisions toward international investment protection rights granted to foreign investors, including international arbitration to ensure the required investments in the country.

The government's shifting position regarding the fiscal regime has permitted the participation of a diverse range of foreign investors in two mega projects. The Carabobo auction allowed competition between oil companies to emerge when their adaptability to the current conditions was challenged.[234] It also shows the new strategy to organize consortia between NOCs and IOCs. In these consortia, the NOCs provide political cover and capital, and the IOCs offer technical expertise, creating a scenario of cooperation and a new pattern of behavior for international oil companies. Although, potential partners to the Carabobo 2 Project declined to participate, the Ministry of Energy announced that three new offers were made in April

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232. *Id.*

233. *See* Carabobo Bid Results published at the Gaceta Oficial No. 39.421, May 11, 2010, at 376 .440. See also, Agreement for the Reciprocal Promotion and Protection of Investments, Denmark-Venez., Nov. 28, 1994.

234. See, U.S. Embassy in Caracas Cable 10CARACAS193. Chevron "Wins" A Carabobo Project. Feb. 10, 2010. Available at: http://wikileaks.ch/cable/2010/02/10CARACAS193.html

2010 for this project; however, so far no new announcement has been made.[235]

B. The Practice of Direct Negotiation of the Junín Area Blocks

According to an official press release of the MPPEP on October 1, 2009, Minister Ramírez guaranteed that the conditions of the project of the Carabobo block "will be compared with those established in the agreement signed with Russia" in the Junín block 6 and similar projects with China and Vietnam.[236] What is the scope of this declaration? The Venezuelan government started negotiations with different companies from countries with whom it maintains strategic alliances, such as Russia, China, Spain, France, Vietnam, and India.

These agreements concern the adjudication of five Junín Area zones with great potential of reserves in the Orinoco belt such as: Junín 2 North (Petrovietnam), Junín 4 (CNPC), Junín 5 (ENI), Junín 7 (Repsol YPF), and Junín 10 (TOTAL and StatoilHydro), where the total investments announced have ranged between $16 billion and $25 billion each.[237]

Project	**Partners**	**Estimated Production**	**Estimated Reserves**	**Bonus**
JUNIN BLOCK 2	PDVSA 60% Petrovietnam 40%	200,000 bbl/day	49 Billion barrels	$500 Million
JUNIN BLOCK 4	PDVSA 60% China's CNPC 40%	400,000 bbl/day	36 Billion barrels	$900 Million
JUNIN BLOCK 5	PDVSA 60% ENI 40%.	240,000 bbl/day (Early production for 75,000	35 Billion barrels	$646 Million

235. Venezuela Receives Three Bids for Carabobo 2 Oil Block, EL UNIVERSAL, Apr. 21, 2010.

236. Petroleum Ministry Press Release, *supra* note 219.

237. *Venezuela Development Plan For Orinoco Oil Belt*, *supra* note 195.

		bbl/day)		
JUNIN BLOCK 6	PDVSA 60% Russian Consortium 40%	450,000 bbl/day	31 Billion barrels	$1 Billion

Source: Reuters, Upstream online, and PDVSA.

The projects operated by PDVSA are ambitiously designed to begin producing by 2013 and contain a total investment of $80 billion.[238] Several upgrades to transform heavy oil into lighter synthetic oil will become operational several years later.[239] Nevertheless, despite the grandiose initial announcements, several of these proposed assignments remain uncertain and further negotiations are needed to define the founding terms of MCs. For instance, according to statements by Minister Ramírez, relating to the block Junín 10, "[t]he proposals presented by the companies Statoil and Total did not meet the required conditions", suspending negotiations on this project.[240]

The practice of directly negotiating with NOCs from geopolitical allies has created new international instruments that have been more effective in the design of incentive mechanisms. The close political and military ties between the governments of Venezuela and Russia,[241] and the strategic political alliance between Venezuela and Vietnam,[242] have provided the backdrop for the approval of incentives for the development of the Junín 6 Block by a Russian National Petroleum Consortium (NPC)[243] and the Junín 2 block by Petrovietnam.

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238. *Id.*

239. *Id.*

240. Descartan Participación De Total Y Statoil En Bloque Petrolero De Junín 10, EL UNIVERSAL, Jan. 21, 2010.

241. Alexander Benard & Paul J. Leaf, *Modern Threats to the United Nations Security Council: No Time for Complacency (A Response to Professor Allen Weiner)*, 62 STAN. L. REV. 1395, 1405 (2010) ("Russia is Venezuela's principal arms dealer.").

242. News Release, Vietnamese Embassy in Myanmar, Viet Nam, Venezuela Forge Friendship and Cooperation (Mar. 16, 2006).

243. *Russia, Venezuela Set Up Junín 6 Oil Venture*, REUTERS, Feb. 2, 2010. The consortium consists of Rosneft, Gazprom, LUKOIL, Surgutneftegaz, TNK-BP.

1. Incentive Mechanisms Granted through Direct Negotiation

Negotiations with the Russian and Vietnamese governments produced several bilateral agreements and investment packages[244] with interesting provisions to govern different areas of the contractual relation.

a. Corporate Governance

Corporate governance in the Venezuela-Russia Energy Cooperation Treaty is similar to that granted to investors in other Orinoco Belt projects.

> Article 3: (. . .) The decisions of the shareholders that involve significant changes to the Mixed Company with respect to the structure and/or effectiveness of the business, including, among others, the Business Plan and budget will be taken by qualified majority voting and other decisions are taken by simple majority of its members.[245]

The article gives the foreign investor greater control over the approval of the project's Business Plan and Annual Budget through the vote of qualified majority. This provision was later incorporated into the Bylaws of the Mixed Company Petromiranda (CVP-NPC) created for the development of the block Junín 6.[246]

b. Fiscal Adjusting Mechanism

One of the most innovative pieces of the agreement is found in Article 4 of Annex 1 of the Venezuela-Russia Cooperation Agreement for the Development of Specific Projects (Block Junín 6). [247] It incorporates an economic-balancing clause that will

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244. Important examples are: The Venezuela-Russia Energy Cooperation Agreement, G.O. No. 39.312, 23 de noviembre 2009 (Venez.) [hereinafter Venezuela-Russia Energy Cooperation Agreement] and the Venezuela-Russia Cooperation Agreement for the Development of Specific Projects G.O. No. 39.312, 23 de noviembre de 2009 [hereinafter Venezuela-Russia Agreement on Specific Projects].

245. Venezuela-Russia Energy Cooperation Agreement, *supra* note 244, art. 3.

246. Art. 16. II. MC Petromiranda Bylaws. G.O. No. 39.455, 29 de Junio de 2010.

247. Venez. Russia Agreement on Specific Projects, at annex 1, art. 4, *supra* note 244.

serve as a pendulum whenever the estimated cost shows that the investment cannot be recovered within seven years after the start of commercial production of upgraded crude oil. In that situation, the Venezuelan government shall approve fiscal incentives to guarantee the project's financial feasibility.[248] In its entirety, Article 4, titled Basic Investment Terms and Conditions, provides:

> The project economy calculated on the basis of Class 5 estimated cost so far indicates that the proposed extra-heavy oil exploitation of the Block Junín 6 in the Orinoco Oil belt, may require to be economically exploitable, the granting of tax incentives, hence, the Parties agree to instruct to their respective companies, CNP, by the Russian side and CVP, by the Venezuela side, to enter into a Memorandum of Understanding for the incorporation of a Mixed Company based on the following economic consideration:
>
> > a) The activities of the Mixed Company will aim to achieve an Internal Rate of Return equal to or greater than 19% which would allow an investment recovery timeframe equal to or less than 7 years counted from the start of the commercial production of upgraded crude oil. "Investment" means the total capital invested since the formation of the Mixed Company until production of the first barrel of upgraded crude oil.
> >
> > b) The Ministry for Energy and Petroleum will grant to the Mixed Company the possibility to produce oil for a period of up to 36 months from the date of commencement of production.
> >
> > c) The Mixed Company will review the economy of the project model once completed the project basic enginery to produce upgraded crude oil, according to estimated cost Class 3, in order to quantify with greater definition the scheme to be selected and make the final decision on the investment.

248. *Id.*

> d) On the basis of the economic studies reviewed under previous paragraph, if the project did not accomplish with the timeframe for the investment recovery provided under paragraph a) the National Executive, through the Ministry of Popular Power for Energy and Petroleum shall grant to the Mixed Company, the reduction of the royalty and taxes, under Articles 44 and 48 of the Organic Hydrocarbon Law and likewise shall request to the other national authorities to grant other tax incentives that may be necessary to make the project financially feasible.

> As established in the Organic Hydrocarbons Law, these benefits are of temporary nature and as such will be applied for the period of time that the Mixed Company to recover the entire investment, at which time both the royalty and tax reduction shall be restored to original levels.[249]

The Article imposes a duty on the Venezuelan government to grant 1) economic viability conditions for the investment recovery based upon fiscal incentives, 2) an Internal Rate of Return (IRR) of 19%, and 3) the possibility of early production. First, the proposed mechanism is calculated based on economic studies submitted by the MC to the Ministry of Energy to seek a final decision about the reduction of royalties and taxes. The possible reduction of the royalty rate from 30% to 20% is based on Article 44 of the OHL, and the reduction of the tax rate from 1/3 to 20% is based on Article 48 of the OHL. According to the study of Tozzini Freire and Bain & Company, "the effects of these two changes generate, at the most, a tax reduction equivalent to 10% of gross revenues."[250] This might be insufficient for the development of projects. Thus, the clause sets forth that the national executive "shall request the other national authorities to grant other tax incentives that may be necessary to make the project financially feasible," which seems

249. *Id.*
250. Tozzini Freire Advogados and Bain & Company, *supra* note 144, at 446.

to be a wide fiscal promise to grant the economic feasibility of the project.

The royalty and tax rate mechanism shall be revised annually and shall revert to their original levels when the MC recovers its entire investment. Thus, no provision for negotiation between parties has been incorporated into this scenario, as occurred in other adaptation or economic balancing clauses affecting the oil industry. In this case, the government maintains its discretionary power to approve these fiscal incentives. The clause entails, however, an obligation under international law since the mechanism was approved under an international bilateral treaty in favor of Russian investors and it might be also contractualized as an obligation of the Venezuelan government by repeating its terms in the MC contract.[251]

c. Internal Rate of Return and the Legitimate Expectation of the Investor

The fiscal adjusting mechanism is based on the compromise to achieve an IRR equal to or greater than 19%. It sets out an investment recovery time frame equal to or less than seven years starting from the commercial production of upgraded crude oil that seeks to grant economic feasibility of the project.

The relevance of the IRR is that it creates a substantive legitimate expectation for Russian investors and is probably a key element in the final determination of the investment. The investors' legitimate expectations were recognized by the tribunal in *Saluka v. Czech Republic* as the dominant element of the standard of fair and equitable treatment.[252] In *International Thunderbird Gaming Corporation v. Mexico*, the concept of the investor's legitimate expectations has been suggested as a "self-standing subcategory and independent basis for a claim under the 'fair and equitable standard."[253] Furthermore, according to *Parkerings-Compagniet v. Republic of Lithuania*,

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251. MC Terms and Conditions between CVP and the Russian NPC G.O. No. 39.382, 9 de marzo de 2010 (Venez.) art. 5.

252. See A.F.M. Maniruzzaman, The Pursuit of Stability in International Energy Investment Contracts: A Critical Appraisal of the Emerging Trends, 1 J. WORLD ENERGY L. & BUS. 121, 150 (2008).

253. *Id.*

"[t]he expectation is legitimate if the investor received an explicit promise or guaranty from the host-State, or if implicitly, the host-State made assurances or representation that the investor took into account in making the investment. . . . In order to determine the legitimate expectation of an investor, it is also necessary to analyze the conduct of the State at the time of the investment."[254]

However, no legitimate expectation was created for the investor if he misunderstood the basis of his decision to invest or relied on the false assumption of his right.[255] The tribunal in *MTD Equity v. Chile* concluded that the BITs are not an insurance against business risk and the Tribunal considers that the Claimants should bear the consequences of their own actions as experienced businessmen.[256] Some questions arise on the enforceability of the fiscal mechanism. The provision was included in to the MC Terms and Conditions for the creation of a MC between CVP and NPC. The incorporation makes these obligations enforceable by either resorting to national courts or seeking international arbitration by invoking the protection of a BIT. Furthermore, another question arises about scenarios of price volatility that could render the 19% IRR impossible for the parties and the eventual applicability of force majeure or hardship clauses, if any.

The model should be tested in order to determine whether it is progressive enough to increase the government's take while overall rent grows. In designing a fiscal package, the government has attempted to offer a profit margin on both a pre-tax and post-tax basis. The question is whether this increase in the government's profit share can be implemented without excessively burdening the investor in the risky areas or during lower oil price periods.[257] Thus, it seems necessary to wait for the evolution in the implementation of this provision to reach further conclusions.

254. *Id.*

255. *Id.* at 151.

256. *Id.*

257. Duval, LeLeuch, Pertuzio and Weaver., *International petroleum exploration and exploitation agreements: Legal, economic, and policy aspects, Barrows Press* (2009).

d. Early Production

The government grants an additional incentive by authorizing early production for three years before the production of upgraded crude oil, as established by the Annex 1 of the Russian-Venezuela Agreement on Strategic Projects. Article 4.b provides that "[t]he MPPEP shall grant to the Mixed Company the authorization to produce crude oil under the scheme of mixture for a period up to 36 months from the date of commencement of production."[258] The provision was incorporated in the Venezuelan National Assembly Agreement for the Constitution of a MC between CVP and the Russian NPC,[259] which sets out in Article 1: "The Mixed Company shall sell to PDVSA Petroleo, S.A. . . . the unrefined heavy or extra-heavy oil it produces for a period of thirty-six months (36 months)."

The aim of this provision is to increase the cash flow in the project's initial phase, while the upgrader is being completed and investments for infrastructure are needed.

e. Two Different Tax Regimes for Primary Activities and Refining

Different incentives were adopted in Annex 1 of the Russian-Venezuelan Agreement on Specific Projects, such as two types of fiscal regimes depending on the type of activity involved.[260]

> 3. Business Model: The Mixed Company will develop oil production activities and upgrading, as well as the commercialization of upgraded crude oil in international markets as well as to PDVSA according to the cases i) from the upgrading process and ii) from the oil mixture mentioned in the preceding paragraph with extra-heavy crude, all of this as one integrated business subject to the oil taxation regime. However, to improve the economy of the project, the Parties may assess the

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258. *Venez.-Russia, Agreement on Specific Projects Agreement,* at annex 1 art. 4.

259. MC Terms and Conditions *supra* note 16.

260. Venezuela-Russia, Agreement on Specific Projects Agreement at annex I, art. 2.

> suitability of a disintegrated business model by forming a Mixed Company of production of extra heavy crude and a Mixed Company of refining and marketing of products. In the case of the Mixed Company of production of extra heavy crude, it is subject to the oil taxation regime, while the refining Mixed Company will be at ordinary tax rules.[261]

Thus, in a government's attempt to increase refinery capacity, those projects that construct refineries instead of upgraders will have an income tax of 34%, instead of 50%, which applies in the regime of extraction of crude.

f. Arbitration and Expropriation on the Recent BITs

On February 29, 2009, the Venezuelan government signed a BIT with Vietnam in the framework of the adjudication of the Junín 2 Block.[262] The BIT contains an arbitration clause which provides for ad hoc UNCITRAL arbitration.[263] Article 8 Paragraph 3 sets forth the state's consent to submit disputes directly arising from an investment to international arbitration.[264] The provision also establishes a fork-in-the-road provision that sets forth that the selection of any of the Article procedures will be final. The alliance between PDVSA and Petrovietnam is playing a key role in the emergence of oil production in the Orinoco Belt in the block *Junín* 2. Thus, the government chose to give Vietnamese investors the right to resort to arbitration in order to attract their investment in Venezuela.

Second, the Venezuela-Russia BIT contains significant provisions for expropriation and arbitration.[265] Article 5 states that the compensation for expropriation must correspond "to the market value of the expropriated investment."[266] This approach runs counter to "the standard book value" advocated by the

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261. *Id.*

262. Nguyen Pham Muoi, Vietnam, Venezuela to Jointly Develop Junin-2 Block, RIGZONE, June 30, 2010.

263. Venezuela-Vietnam BIT, *supra* note 161.

264. *Id.*

265. *Id.*

266. *Id.*

Venezuelan government in the cases of ExxonMobil and ConocoPhillips.[267] Further this provision also contradicts the recently-enacted Venezuelan law nationalizing services companies.[268] Article 6 of the RLSC states, in reference to compensation for expropriations, that "[t]o calculate the fair value of the above mentioned goods, at no time should lost profits of consequential damages be taken into account, and the valuation of property shall apply the criterion of book value deducting the labor and environmental liabilities determined by the competent authorities, if applicable."[269]

Moreover, Article 9 of the Russian/Venezuela BIT sets forth a broad scope provision to access to arbitration comprising "but not limited" matters of expropriation, compensation for damages and funds transfers.[270] The Arbitration clause includes the possibilities of ad hoc UNCITRAL arbitration and arbitration before the Stockholm Chamber of Commerce Arbitration Institute. Undoubtedly, the friendly strategic relations between Venezuela and Russia have enabled the Russian negotiators to obtain such significant concessions.

2. *Most Favored Nation (MFN) Clause towards Orinoco Belt Projects*

The simultaneous implementation of licensing and direct negotiations has ended different arrangements for NOCs and IOCs to operate in the Orinoco Belt. The incentives granted in the Venezuela-Russia Cooperative Energy Agreement, the Venezuela-Russia Agreement for the Development of Specific Projects and the BITs Venezuela recently entered into with Russia and Vietnam give rise to the question of whether other investors might claim the same conditions based upon the MFN clause of their BITs. Arbitration practice has accepted that MFN clauses incorporate more favorable substantive investment protection granted to third countries.[271] Likewise, arbitration

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267. *See* Witten, *supra* note 29, at 58.
268. *See* RLSC, *supra* note 42, art. 6.
269. *Id.*
270. *Id.*
271. Stephan W. Schill, *Multilateralizing Investment Treaties Through Most-*

jurisprudence has, with one exception, declined to apply MFN clauses as a basis of jurisdiction for investment tribunals.[272]

a. Substantive Rights

Will the incentives granted to Russian investors such as a fiscal adjusting mechanism, IRR, early production and decision-making power be extended to other investors in projects in the Orinoco Belt? In an initial attempt to address this question, Minister Ramírez declared that participants in the Carabobo Project will receive similar treatment as Russian investors.[273] Indeed, the National Assembly Agreements for the Incorporation of MCs in the Carabobo Project awarded Chevron and Repsol included provisions on fiscal adjusting mechanisms for royalty and tax reduction, early production of crude oil, and decision-making power.[274] But no considerations have been approved comparable to the IRR terms accorded to Russian investors. This substantive element might be associated with the legitimate expectations in new projects in the Orinoco Belt in similar conditions. Thus, the underlying question is whether foreign investors could request similar treatment.

Incentives such as royalty and extractive tax reduction will be granted through the adjustment mechanism, which remains at the Venezuelan government's discretion. Likewise, decision over all tax waivers established in articles 12 and 13 of the 2011 Windfall Profit Tax Reform, are under the control of the

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Favored-Nation Clauses, 27 BERKELEY J. INT'L L. 2, 496, 566 (2009) [hereinafter *Multilateralizing Investment Treaties*].

272. *Id.*

273. Petroleum Ministry Press Release, *supra* note 219.

274. *See* Bellorin, *supra* note 229. "For Income Tax effects: 1) the MC investments in assets for the development of hydrocarbons primary activities will be entirely deducted in the fiscal year they are incurred, while the upgrading investments incurred will be deducted during a 10 year period using the straight-line method; and 2) the net operative losses incurred by the MC in any fiscal year could be carried forward to be deducted in anyone of the 10 subsequent fiscal year from the fiscal year in which they had been incurred" The quote refers to Article 5 of the MC Terms and Conditions for the Carabobo 3 Project awarded to Chevron. G.O. No. 39.404, 15 de abril de 2010 (Venez.). The article develops a system of tax deduction during a ten-year period but also repeat the seven-year period for investment recovery that appeared in the Annex 1 of the Venezuela-Russia Energy Cooperation Agreement.

government. Thus, investors might search diligently among bilateral arrangements as well as special taxes or regulatory incentives accorded to one or more investors of another state, to seek the standard treatment for new oil ventures in the Orinoco Belt. Consequently, provisions of MFN treatment and also FET in BITs might play a key role in the future relations between the government and foreign investors which might look for equal treatment in "like circumstances," compare to government's concessions to NOCs from political allies in a privileged position to negotiate.

However, Venezuelan BITs contain exceptions to the application of the MFN clause.[275] The broadest and most common exception is the denial of preferential treatment that results from the host state's membership in customs or economic unions, common markets and free trade areas that grant preferential tax treatment.[276] For instance, the MFN clause in the BIT between France and Venezuela includes a limitation on tax treatment, stating that the article does not apply to tax matters.[277] Moreover, the BIT signed between Belgium and Luxemburg excludes measures related to public order.[278] Thus, in some cases the Venezuelan government could attempt to avoid giving incentives to third country investors on the grounds that the limited scope of the MFN clause excludes related tax measures or public order, and thereby reducing the bargaining position of foreign investors.

Facing the restrictions in the scope of a MFN clause, Dr. Stephan W. Schill proposes a model called the "Circumvention of Exceptions to MFN Clauses by Double-Derivation."[279] Under this model, a MFN clause in the basic treaty could incorporate the benefits of another MFN clause in a third country BIT that does not contain a comparable exception to avoid the limits of

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275. J. Albites-Bedoya, *A Closer Look at the National Treatment Standard: Stocktaking of Venezuelan BITs and Review of Arbitral Practice*, OGEL 2, 2008, at 8.

276. *Id.*

277. Art. 4, BIT Venezuela – France, G.O. No. 37.896, 11 de marzo de 2004.

278. Albites-Bedoya, *supra* note 275, at 8.

279. *Multilateralizing Investment Treaties*, supra note 271, at 566.

the scope of its own BIT.[280] This broad approach to the MFN would enable investors to attempt to circumvent the limits of the MFN in the basic treaty and seek better treatment through a secondary MFN clause. However, this method might be rejected by the Venezuelan authorities because BITs contain malleable terms that could be interpreted to the detriment of state sovereignty. [281] The government might argue that a liberal interpretation of the BIT could extend protection to foreign investors beyond the initial terms that the respective state accepted at the onset of the BIT.

b. Jurisdictional Rights

Relating jurisdictional issues, arbitral tribunals have uniformly accepted that MFN clauses allow investors to circumvent restrictions on access to investor-state arbitration.[282] Specifically, they have given less favorable waiting periods if third country BITs offer more favorable conditions. However, two recent cases involving the German-Argentina BIT, *Siemens v Argentina* and *Wintershall v Argentina*, ruled in contradictory conclusions.[283] The *Wintershall* tribunal found that MFN treatment did not encompass dispute settlement and it was not accompanied by a provision extending to all matters covered in the BIT. In contrast, the *Siemens* tribunal held that access to international arbitration was part of the treatment agreed to in the BITs and thus meant to be covered by the MFN clause.

The recently signed Venezuelan BITs with Belarus, Vietnam, and Russia offer the state's consent to international arbitration with a common provision to arbitrate disputes before ad hoc tribunals under UNCITRAL rules (and the Russian BIT

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280. *Id.* (asserting that a practical example relates to benefits granted in relation to investments in Germany to investors from other EU Member States based on the EC Treaty and that some of these benefits are extended to U.S. investors based on the MFN clause in the Treaty of Friendship, Commerce and Navigation between Germany and the United States).

281. Kahale, *supra* note 65, at 8.

282. *Multilateralizing Investment Treaties*, *supra* note 271, at 566.

283. Wintershall v. Argentina, ICSID Case. No. ARB/04/14, Award, Dec. 8, 2008, ¶ 198; and Siemens A.G. v. Argentina, ICSID case No. ARB/02/8, Award, 6 February2007.

also before the Stockholm Chamber of Commerce). Given the diversity of arbitration provisions, Schill asserts that

> there is no reasons why an investor should not be able to invoke the consent to ICSID arbitration under one of the host State's third-party treaties, even though the basic treaty provides for arbitration under UNCITRAL rules, or conversely, invoke the consent to UNCITRAL arbitration, even though the basic treaty only provides for ICSID arbitration. Depending on the circumstances of the case, ICSID or UNCITRAL arbitration may be more favorable for an investor in initiating investment treaty arbitration. While ICSID arbitration, for example, is more favorable than UNCITRAL arbitration regarding recognition and enforcement, UNCITRAL arbitration can be more favorable than ICSID arbitration as the former does not require that the jurisdictional requirements of Article Twenty-Five ICSID Convention are met, which excludes, for example, claims by dual nationals and may have a stricter scope ratione materiae as regards the notion of investment than some investment treaties.[284]

Thus, the current BIT network in Venezuela sparks interesting questions about future relations between international investors and the host state. The MFN clause could play a key role in balancing the interests of the contracting parties. No single answer exists to these questions, and future practice and jurisprudence will provide new elements for their solution. Undoubtedly, the Venezuelan government's view does not seem to agree with a broad approach on these issues, especially since the BITs practice contain explicit limitations on national sovereignty. However, its need for further investments to develop infrastructure projects and to increase oil production is leading the Venezuelan government to shift its policies in order to create the necessary conditions to ensure foreign investment.

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284. *Id.* at 565.

IV. CONCLUSION

This Article demonstrates the ongoing rebalancing situation of the legal framework and contractual conditions of oil contracts in Venezuela. Specifically, it analyzes the current MC contractual conditions, which will be used for the development of the Orinoco Belt area, where one of the world's largest reserves of heavy crude oil is located.

After a decade of increasing state control, the Venezuelan government is seeking to guarantee foreign investment by exploring flexibility in the hydrocarbons fiscal regime. The economic incentives approved may result in an effective decision if some stability is granted to foreign investors. Nevertheless, the enactment of the Windfall Profit Tax Reform, in April 2011, revealed that the opportunistic behavior remains in government's decisions. These decisions might cause disruptions on the implementation of the economic incentives and in the investors' strategic to invest as planned.

The new Venezuelan BIT network and Energy Cooperation Agreements are providing additional protection for NOCs and IOCs operating in Venezuela, which demonstrates the increasing reliance for protection on these treaties by oil companies. Further, despite the Venezuelan government's hostile attitude toward international arbitration, it has been demonstrated that international arbitration is available to foreign investors through BIT protection and even through legitimate corporate treaty planning.

Current negotiations in Venezuela are not a simple task. Investors have to adapt continuously rebalancing the interests of the Venezuelan government and the production companies. The developments are far from offering perfect solutions because both parties are not on an even playing field in international law or in the oil industry market. In fact, new agreements provide what could be defined as an unstable equilibrium. For instance, special attention should be paid to the implementation of the Windfall Profit Tax Reform and its consequences over the entire fiscal regime of hydrocarbons. Further, the implementation of the adjusting fiscal mechanism approved for the Junín blocks and the Carabobo Project would raise new questions.

So far, IOCs and NOCs remain interested despite tough contractual conditions where huge onshore reserves are located and geological risk is low. The agreements signed for projects in the Carabobo and Junín areas are close to reaching the figure of $80 billion for new investments in the country.[285] However, further conditions remain to be agreed upon, and observers continue to be concerned about three main aspects: 1) political risk, 2) the performance of new players, and 3) the effectiveness of the new terms facing the volatility of the oil prices and the global economic scenarios.

285. Elio Ohep, U.S.$ 80 billion Venezuela's Orinoco Belt Carabobo Projects Starts, PETROLEUM WORLD, May 17, 2010.