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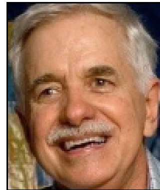

From Gunboats to Arbitration by J.E. Anzola

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FROM GUNBOATS TO ARBITRATION

J. Eloy Anzola*

The arrogant foot of a foreigner has profaned the sacred soil of our country
Cipriano Castro, President of Venezuela
in 1902 after German ships had sunk
three Venezuelan small boats, shelled
and blocked Venezuelan ports

Someday, I fear we shall have to spank Venezuela
Theodore Roosevelt, President of the
United States of America, in 1905

We will not send a drop of oil to the US
Hugo Chávez, President of the
Bolivarian Republic of Venezuela, in 2008

German gunboats blocked and shelled Venezuelan ports in 1902 to collect debts. Exxon-Mobil in 2008 claims that Venezuela must pay appropriate compensation for the expropriation of its investments in the Orinoco Oil Belt and an English Court issues a *Freezing Injunction* for 12 Billion Dollars over PDVSA's[1] assets with worldwide effects.

The exchange between foreign investors and Venezuela has been long and eventful. There have been times of cooperation, times of strain and times of contention as proven by these two events separated by a 100 years.

Shortly after Venezuela became a sovereign country in 1830, the United States claimed that US merchants had some imported goods confiscated at the port of Puerto Cabello and asked for compensation. The Venezuelan Government responded that such takings had been carried out in 1835 by rebel forces that intended to overthrow the legitimate administration of President José María Vargas and that they had in fact been able to hold the helm of power for a few days. The

[1] PDVSA is the acronym for Petróleos de Venezuela, S.A., the wholly owned government company that serves as holding company and as the operating arm of all oil and gas activities in Venezuela and abroad.

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legitimate Government, back in power asserted that compensation for such actions could be claimed only against the perpetrators of such crimes before Venezuelan Courts. The Government added that the authorities had attached property owned by the insurgents and therefore US nationals should direct their actions against such real estate or goods. Venezuela refused to indemnify these US citizens.[2]

This was going to be one of many claims of such kind. In fact, around 1845 Spain made a claim against Venezuela for the properties lost by Spanish subjects during the war of independence in that had ended in 1821. In this case Venezuela agreed to return property that it had confiscated if the Government was still holding it. It also agreed to pay compensation with Government-issued bonds for the property it had sold to a third party. A treaty was signed in 1846 to cover these matters. In this treaty Spain also recognized the independence of Venezuela.[3]

In the 1850s Spain would again claim compensation for its subjects that had suffered losses during the many civil wars of those times. A second treaty was signed in the Spanish city of Santander in 1861 where Venezuela agreed to pay compensation only in cases where it could be proven that the legitimate authorities had been *negligent*.[4]

Claims of this type, of unpaid debt and ill-treated investors piled up at the end of the XIX century and trying times would come in 1902.

THE GUNBOATS OF 1902

The Imperial German fleet captured and sunk small Venezuelan vessels and bombarded and blocked Venezuelan ports at the end of 1902. The specific cause for dispute this time was the unpaid foreign debt underwritten by the German bank Berliner Disconto Gesellshaft and also the mistreatment of German, British and

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2 José Gil Fortoul, *Historia Constitucional de Venezuela*, Editorial Las Novedades, Caracas, 1942, Vol II, p. 129.
3 José Gil Fortoul, *Op. cit.*, Vol II, p. 132.
4 Luis Eloy Anzola, *Le Venezuela et les Grandes Puissances*, *Thèse présenté à l'Ecole des Sciences Politiques*, Imprimerie Les Presses Modernes, Paris, 1938, p. 117.

Italian subjects and their properties prior to and during the *revolution* that had brought Cipriano Castro to power in 1899. Although Castro had allowed the creation of a Commission to review the claims of foreign proprietors, the matters had remained unsolved and the debt unpaid. President Castro's response to the German attack was a nationalistic speech that began: *The arrogant foot of a foreigner has profaned the sacred soil of our country …*

Theodore Roosevelt, then President of the United States, sided with Venezuela not because he opposed the forceful collection of the debts – in fact his Secretary of State John Hay had approved military action[5] – but because he feared that the Germans would eventually seize and keep new territories for themselves in the Western Hemisphere. This action would have contradicted the US Monroe Doctrine that disallowed forced territorial gains by European powers in the Hemisphere. *America for Americans* was the basic principle stated by President Monroe. Matters developed to a point where the US Admiral Dewey – a hero during the Spanish-American war of 1898 – was instructed to prepare his fleet to face the European ships[6].

The controversy lost intensity when Germany made clear that it did not intend territorial gains as Chancellor von Bülow confirmed before the *Reichstag* on March of 1903. He stated that the *Reich's* actions were a *warning for the future* to those who would dare to play with the *honor and prestige of our flag.*[7] The pressure finally ceased when it was agreed by Venezuela and the Europeans countries to bring the disputes to arbitral proceedings.

The European powers, including Germany, asked President Roosevelt to be the arbitrator, and Venezuela acquiesced, but after much thought Roosevelt finally refused to act in such capacity and the disputes were referred to a Court of

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5 See Memorandum of John Hay to the German Ambassador in the US, signed in Washington on December 16, 1901, in Manuel Rodríguez Campos, *Venezuela 1902: La Crisis fiscal y el Bloqueo*, Universidad Central de Venezuela, Caracas 2003, page 373.

6 See Edmund Morris, *Theodore Rex*, Random House 2001, Chapter 12, p. 170.

7 See Holger R. Herwig, *Sueños alemanes de un imperio en Venezuela,* Monte Ávila Editores, Caracas 1991, page 124.

Arbitration under the Protocols signed in Washington between February and May of 1903.[8]

The US represented Venezuela in the signings of the Protocols in the subsequent proceedings. In its ruling of February 22, 1904, the Arbitration Court sitting in The Hague said that the blocking powers – Germany, Great Britain and Italy – could collect before other creditors from thirty percent (30%) of the customs revenues collected at the Venezuelan ports of La Guaira and Puerto Cabello.[9] Venezuela had agreed to such takings. The customs revenues were to be revised and audited by Belgians nationals.

With regard to the other debts – held by individuals or corporations from the US, France, Spain, the Netherlands, Mexico, Sweden and Norway and Belgium – it was agreed that mixed commissions would determine the amount of compensation to be paid to the claimants from additional proceeds of custom revenues[10].

The commissions heard over a thousand cases and awarded to various claimants over eight million dollars, which represented only about fifteen percent of the total amount claimed[11].

These disputes, particularly the initial German armed attack, created bitterness in Venezuela[12] and in some countries in Latin America, especially in Argentina. In its 1891 Constitution, Venezuela had already adopted the so called *Calvo Clause* that referred all contractual disputes between foreigners and the

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[8] Manuel Rodríguez-Campos, *op. cit*, page 407.

[9] *Ibidem*, page 435.

[10] In addition to Venezuelan sources such as Manuel Rodríguez-Campos, op.cit.; Ramon J. Velasquez, *La Caida del Liberalismo Amarillo*, Grupo Editorial Norma, Caracas 2005; Simón Alberto Consalvi, in *Venezuela y Estados Unidos a Través de 2 Siglos*, Cámara Venezolano-Americana de Comercio e Industria, Caracas 2000, I found very useful the article written by Kevin M. Anderson, *The Venezuelan Claims Controversy at the Hague, 1903*, The Historian, Vol. 57, 1995.

[11] Kevin M. Anderson, *Op. cit.* There seems to be some discrepancies with regard to these figures, Rodriguez-Campos, op.cit., page 348, places the total amount claimed by foreign creditors at Venezuelan Bolivares 186,558,150 and the amount awarded by the mixed commissions totaled VB 40,379, 225, that is, around 22% of the claims.

[12] See Herwig, *Op. cit.* According to Herwig, Georg Blohm, head of a German-Venezuelan family with business interests in both countries insisted with German authorities and commercial associations that the blockade would be detrimental to German interests in Venezuela. His pleas would not be heard and he decided to resign his position at the Hamburg Chamber of Commerce (P. 114). The Blohm family continues to live and work in Venezuela.

Venezuelan Government to Venezuelan Courts and provided that Venezuelan law would govern. This Constitutional provision followed the ideas of the Argentinean professor Carlos Calvo who had stated that foreign investors had recourse only to local courts and were bound by the local laws of the country where the investment was located. Calvo was responding to the British blockade of Argentinean ports in 1848. These principles – needless to say – were not agreed or accepted by the European powers.

At the time of the German blockade of Venezuelan ports in 1902, Luis M. Drago, then Argentinean Minister of Foreign Affairs, issued a statement – since then known as the *Drago Doctrine* – stating in stringent terms that the collection of debts owed by a country could not be obtained via warlike means. Only peaceful means were allowed for carrying out such an endeavor[13]. Of course, his thoughts were more wishes than reality.

During the Castro regime, which ended in 1908, the US had several additional claims for mistreatment of its nationals and US corporations in Venezuela. There were controversies regarding an asphalt concession in the Eastern part of the country that was held by the *New York and Bermudez Company*[14] and its rival the *Warner-Quinlan Group*. There was a sizeable dispute between the Americans Fitzgerald and Turnbull over the control of a mining concession held by the *Manoa Company Limited* (succeeded by the *Orinoco Company Limited)* and also over the limitations imposed upon the concession by the Venezuelan Government. There were also disputes over the extent of the shipping concession granted to the *Orinoco Shipping & Trading Company* to sail on the Orinoco. The fourth of these disputes was related to another asphalt concession given in the western part of the

[13] See Horacio Grigera-Naón, *Arbitration and Latin America: Progress and Setbacks*, 2004, Freshfields Lecture, in Arbitration International, Volume 21 Number 2, Kluwer Law International, London 2005, page 127 and also in Manuel Rodriguez Campos, *Op. cit.*, page 389.

[14] This matter was not only a conflict with the Venezuelan Government. An intense dispute arose between the *Bermudez Company* and other US investors that also held an asphalt concession on grounds where the *Bermudez Company* considered that it had exclusive rights. Some US diplomats took sides and were suspected of defending their own private interests. To add insult to injury the *Bermudez Company* gave support to Manuel Antonio Matos and his *Revolución Libertadora* intending to overthrow Castro but failed! The details of these disputes are very well developed by Nikita Harwich Vallenilla, in *Asfalto y Revolución: La New York and Bermudez Company*, Monte Avila Editores, Caracas, 1991.

country to the *United States & Venezuela Company*.[15] This company also claimed that it was being prejudiced by adverse actions of the Venezuelan Government. Efforts were made by the US Government to solve these conflicts through arbitration between the investors and the Venezuelan Government. But the Castro Government refused, alleging that all these disputes had to be resolved by Venezuelan Courts. It was at this time when Theodore Roosevelt remembered his *Big Stick* and, exasperated, predicted the spanking of Venezuela! It was not to be.

Castro had to take a trip, ironically to Germany, to undergo surgery[16]. Soon after he left in 1908 he was overthrown by his Vice-President, Juan Vicente Gómez, who would control Venezuela until his death in December 1935. Gomez took a very different approach to foreign investors and in 1909 agreed to settle the US disputes either through direct negotiations and agreements or through arbitration. These claims were finally resolved in ways favorable to Venezuela. Although the companies in some cases kept their concessions (such as in the case of the New York & Bermudez Company after payment of certain indemnities to Venezuela), the compensation to be paid by Venezuela turned out to be minimal. In addition, the jurisdiction of Venezuelan Courts was reaffirmed in many cases.

GOMEZ IN POWER

During the Gómez regime (1908-1935) Venezuela became an important player in the oil business. Gómez granted large territorial concessions to members of his family and political allies, including – in disguised manners – to members of his own government. These cronies in turn sold these concessions for cash and on occasions for cash and a royalty, to major international oil companies (Shell, Standard Oil, Gulf, and others). Some Venezuelan individuals were very fortunate when these companies found important quantities of oil and paid their vendors the agreed percentage of royalties.

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15 These were not the only conflicts then existing between Venezuela and other nations. Investors from France, the Netherlands, the United Kingdom and Italy had also claims. Some of these conflicts were harsh. The Netherlands, in addition to the US, had severed diplomatic relations with Venezuela.

16 Castro never returned to Venezuela. He died in exile in Puerto Rico in 1925.

Some frictions erupted when the Venezuelan Government – specifically the stubborn and incorruptible Minister of Development, Gumersindo Torres – tried to impose conditions on the companies requiring them to explore and bring into production the vast territories granted to them and to transfer to Venezuela a bigger share of the oil revenues. But these matters never became bitter international disputes[17].

In Gómez times the oil companies carried out very profitable activities in the country. By 1935, Venezuela had become the second largest oil producer in the world, the first place then held by the United Sates. During World War II Venezuela was the major non-US supplier of oil to the Allied Forces that carried out the war against Italy, Japan and Germany.

Just after the war, when Juan Pablo Pérez Alfonzo[18] was the Minister in charge of oil, Venezuela amended its income tax laws increasing rates on oil activities to get a 50% share of the oil income. In general terms, however, the oil companies and investors in other sectors enjoyed a welcoming atmosphere in Venezuela and total freedom to remit capital, dividends and profits abroad.

Matters changed drastically in the 1970's. Many Latin American countries became distrustful of foreign investors.

MISTRUST OF FOREIGN INVESTORS

In the case of Venezuela two factors came into play. First, in 1974 Venezuela became a full fledged member of the Cartagena Agreement (the Andean Pact) that under the terms of Decision 24 imposed several restrictions on foreign investors:

[17] See B.S. McBeth, *Juan Vicente Gómez and the Oil Companies in Venezuela, 1908-1935*, Cambridge University Press, 2002. This book has abundant information on the names of individuals that participated in such deals and the terms of such transactions.

[18] He was the ideologue of the Venezuelan oil policy during 30 years. He, together with Sheik Abdullah Tariki of Saudi Arabia, promoted in the early 1960s the creation of OPEC, the association of oil exporting countries.

many sectors were allocated exclusively to national investors; foreign investment had to be authorized in advance by national authorities; foreign capital investment had to be registered; dividends to be sent abroad were limited to 14% of the registered capital; companies that were owned by foreign investors had to agree to gradually transform themselves into mixed (more than 51% owned by national investors) or national companies (more than 80.1% owned by national investors); transfer of technology agreements had to include mandatory provisions; loans obtained from foreign sources had to be authorized and registered; and all agreements related to foreign investments were to be governed by local laws and disputes would be settled in local courts.

The second important factor was the nationalization of iron ore and oil activities in the country carried out in 1975-76. Previously, these activities were held mainly by foreign investors. The oil concessions would expire in 1983, so in fact the termination and the transfer of assets was advanced a few years. Oil companies' assets were expropriated, and the oil companies were offered compensation that took into account only the non-depreciated or amortized value of such assets. No goodwill or going concern value was added. Although some claims were filed with Venezuelan Courts, all procedures were terminated and finally agreed through negotiations between the investors and the Venezuelan Government[19].

Venezuela was then in a position of force. Few years before – October 1973 – the Arab Oil Embargo[20] had shown oil consumers the devastating effect that oil scarcity could have for the economy and for life in general in the Western World. Venezuela and the major former oil operators in the country through a series of

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[19] As examples, see Venezuelan Official Gazettes: No. 1784 Extraordinary of December 18, 1975 and No. 3919 of October 9, 1986.

[20] On October 6, 1973, the Jewish holy day of Yom Kippur, Egyptian forces attacked Israel from across the Suez Canal, while at the same time Syrian troops were flooding the Golan Heights in a surprise offensive. After early losses, Israeli counterattacks quickly pushed into Syrian territory in the north, as troops outflanked the Egyptian army in the south. Israel, with help from the U.S., succeeded in reversing the Arab gains and a cease-fire was concluded in November. But on October 17, the Arab members of OPEC – Venezuela did not participate – struck back against the West by imposing an oil embargo on the U.S., while increasing prices by 70% to America's Western European allies. Overnight, the price of a barrel of oil to these nations rose from $3 to $5.11. By January 1974, they had reached $11.65. See: http://www.buyandhold.com/bh/en/education/history/2002/arab.html

agreements assured that oil would be delivered as usual with no interruption. Assured production and delivery of oil was then the major concern for consumers.

In the 1990s the atmosphere changed again.

FOREIGN INVESTORS: WELCOME BACK!

The restrictions on foreign investments were gradually lifted. Decision 24 of the Andean Pact was abrogated and under Decision 291, adopted on March 1991, and internal Venezuelan legislation, many of the then-existing limitations almost completely disappeared. Only a few sectors remained reserved for national investors; limits for the payment of dividends or repatriation of capital (excepting exchange control regulations) were lifted; parties in contractual affairs were freed to choose foreign laws or to have disputes settled by foreign courts or through domestic or international arbitration. These were times of privatization and of substantial foreign investments in key sectors such as telecommunications, steel plants and energy.

In the oil sector Venezuela established a program – the *Apertura Petrolera* (Oil Opening) – where foreign oil companies were invited to come back into the country, and these companies did return entering into agreements of different nature with PDVSA or its subsidiaries or affiliates.

The contractual schemes used during the Oil Opening period were divided into three categories. The first was the Operating Agreements, a type of service contract. In the second category are the Strategic Associations, in the form of joint venture agreements between the State and private companies to exploit extra-heavy deposits in the Orinoco belt. And in the third category are the Profit Sharing Agreements, a type of joint venture, used for conventional fields.

The activities carried out under these agreements came to represent by 2006 1/3 (about 800,000 barrels per day) of total Venezuelan crude oil production (about 2.5 million barrels per day)[21]. In all these programs US, European and Asian concerns participated together with fledging Venezuelan groups.

The life of these agreements was short. A new era was born at the inception of the XXI Century.

THE XXI CENTURY

Since the year 2000, the Venezuelan Government, after amending the hydrocarbon laws and raising taxes, has imposed the amendment of the Operating Agreements (first category) and of the joint ventures (second and third categories). All these operations had to migrate to joint ventures where Venezuela, through PDVSA or its affiliates and subsidiaries, is to hold a shareholders' majority.

The changes requested, or imposed, by the Chávez Government in taxes and contractual conditions in past agreements have moved oil investors to bring claims against Venezuela on grounds that their original contracts have been breached and property rights affected.

In addition, the acquisition of an additional stake to have PDVSA hold a majority of shares in the joint ventures has been a point of disagreement. The oil companies – or some of them – have claimed that they should be paid the market value of the stake transferred to PDVSA while the Venezuelan Government and PDVSA maintain that the transfer price should be based on the depreciated value of the assets.

[21] This figure for September 2006 was provided by www.oilmarketreport.org, a publication of the International Agency Energy. In http://www.opec.org/home/Monthly%20Oil%20Market%20Reports/2008/pdf/MR032008.pdf, OPEC reports that as of February 2008, Venezuelan oil production is 2,392 million barrels per day.

At the beginning of 2006, the Venezuelan Government forced Verizon to sell its controlling interest in the local telephone company, *CANTV*. Likewise, AES had to sell the Caracas power company, *Electricidad de Caracas.* In both cases, the investors and the Venezuelan Government agreed on a purchase price.

In other sectors such as land reform, properties owned by local and foreign investors have been taken with no compensation. These actions have prompted owners to take actions against the Venezuelan administration[22].

Investors and owners, particularly foreigners, are not without legal tools to take such actions. We want to review the options that they may exercise based on domestic legislation or international treaties.

PROTECTION BASED ON VENEZUELAN DOMESTIC LAWS

At present, the laws of the Republic of Venezuela provide considerable protections for foreign investors. At the Constitutional level, the Venezuelan state guarantees the right to private property and allows expropriation only for reasons of public purpose with payment of prompt and just compensation,[23] confiscation is prohibited,[24] and access to justice and due process of law are assured.[25] Constitutional injunctions (*amparo*) through an expedited judicial process are provided in cases of violations of fundamental rights[26]. Arbitration is allowed for settling disputes in contractual matters[27] and is considered to be part of the *system of justice*[28].

These are not only theoretical rights written in the Constitution with no practical relevance. Although it may be claimed that the Venezuelan Courts are

22 Vestey Group Ltd v. Bolivarian Republic of Venezuela (ICSID Case No. ARB/06/4). Vestey, an English family group, claimed that the Venezuelan Government had not paid compensation for farms taken. The case has settled or is in the process of settlement.
23 Article 115 of the Venezuelan Constitution of 2000.
24 Article 116, idem.
25 Article 26, idem.
26 Article 27, idem.
27 Article 258, idem.
28 Article 253, idem.

under the influence of the incumbent Venezuelan Government and its political project – the *Revolución Bolivariana* or *XXI Century Socialism* – at least one recent decision of the Venezuelan Supreme Tribunal may be cited to prove that these rights are not just ink and paper.

The Governor of the State of Barinas, Hugo de los Reyes Chávez, father of President Chávez, initiated expropriation proceedings of a commercial facility owned by *Refinadora de Maiz Venezolana, C.A. (REMAVENCA)*, an affiliate of *Empresas Polar* one of the most important Venezuelan private groups. *REMAVENCA* claimed that due process was not being followed and the Governor had no right to take preliminary possession of the plant before completing the procedures and paying the compensation due to the company as legitimate owner. *REMAVENCA* started legal action to annul the expropriation procedures and to get an injunction from the Constitutional Chamber of the Venezuelan Supreme Tribunal to suspend them. The Tribunal on November 15, 2005, granted such injunction as a precautionary measure:

> *An **a priori** analysis of the contents of the actioned Legislative Accord and the Expropriation Decree and of the constitutional violations alleged by Plaintiff with regard to such acts, specially those related to the violation of property rights ... proves that **fumus boni iuris** has been established …. In addition, it is evident that the implementation of the actioned acts will bring juridical consequences that if this legal action is found with merit at the end, will cause damages impossible to repair such as the reversion to the present holder of its property rights …. [therefore] in accordance with the decision number 256 of March 16, 2005, this Chamber grants the suspension of such acts …. and orders the authorities of Barinas State to refrain from carrying them out … prior to the final decision that will be rendered in this nullity process ….*[29]

It is true that this decision is only a provisory measure granted at the start of these legal proceedings and that at the end the final decision may not give satisfaction to *REMAVENCA*. But it shows at least that the Court is looking to scrutinize very carefully any action taken at the national or local level by

[29] Decision No. 05-2077, of November 15, 2005, *Refinadora de Maíz Venezolana, C.A. (Remavenca)*.

governmental authorities that may affect basic rights such as property. One may note also that this was a unanimous decision with no dissenting opinions.

Furthermore, contracts entered into at the national, state, or municipal levels, as well as contracts entered into by government-owned entities or corporations with foreign investors, must be complied as they have been agreed by the parties. The principle of *pacta sunt servanda*, that is, that contracts are binding and enforceable in accordance with their own terms is a well established principle in Venezuelan Law[30]. This principle exists for contracts entered into by private parties and also if the parties are, on the one part, a private entity and on the other hand, a public entity, the so called *administrative contracts*. If, for example, a Government entity or a government owned corporation wishes to terminate a contract prematurely when there is no breach from the other party, it must be ready to compensate the other party for the damages this early termination causes[31].

CONTRACTUAL ARBITRATION

Another important protection is the possibility for foreign investors to ask for an arbitration clause to be inserted in any agreement or contract signed with a Venezuelan Government entity.

Arbitration is allowed, protected and must be promoted according to Articles 253 and 258 of the Venezuelan Constitution of 1999. Venezuela is a signatory of the New York Convention[32] and of the Inter-American Convention on Arbitration and of the Inter-American Convention on the Extra-Territorial Effect of Foreign Court Decisions and Foreign Arbitral Awards[33]. Additionally, a Commercial Arbitration Law (CAL) was adopted in Venezuela in 1998[34].

[30] Article 1159 of the Venezuelan Civil Code applicable to all contracts provides: Contracts have the effect of Law between the parties. They may not be revoked but by mutual consent or by causes indicated in the Law.

[31] See Allan R. Brewer Carias, *Nuevas Consideraciones sobre el Régimen Jurídico de los Contratos de Estado en Venezuela*, unpublished paper presented at the VIII Jornadas Internacionales de Derecho Administrativo Allan Randolph Brewer Carías, Fundación de Estudios de Derecho Administrativo, Caracas, November 2005.

[32] Venezuelan Official Gazette, No. Extraordinary 4832, December 29, 1994.

[33] Both Conventions were published in Venezuelan Official Gazette, No. 33170, February 22, 1985.

[34] Venezuelan Official Gazette No. 36430 of April 7, 1998.

A year latter, in 1999 prior to the enactment of a new Venezuelan Constitution promoted by President Chávez, a decision by the then existing Supreme Court[35] validated arbitration agreements contained in certain petroleum contracts[36] approved and granted by the State. This Supreme Court decision[37] was consistent with the legislation covering the subject matter and which had allowed the state oil company PDVSA to partner with private parties for the exploration and production of petroleum after the nationalization of 1976[38].

This Supreme Court decision revisited the scope of article 127 of the Constitution of 1961 – again a *Calvo* clause provision – that provided (similarly to article 151 of the current Constitution) the following:

> *(…) In contracts of public interest, unless against the nature of the contract, it should be considered inserted, even if not expressly formulated, a clause whereby all doubts and controversies arising from such contracts which are not resolved amicably by the contracting parties shall be decided by the competent courts and in accordance with the laws of the Republic of Venezuela, without giving rise to any foreign claims (…)*

After analyzing the content of the provision and the nature of the contract – understood as one of public interest – the decision concluded that Venezuela had adopted a restricted concept of sovereign immunity:

> *(…) It appears obvious to this Court that the wording of the norm [the Constitutional Article] leaves no doubt as to the intention of the legislator that when incorporating to public interest contracts the exception "unless against the nature of the contract" it chose to adopt the criteria of relative sovereign immunity, which already had been assumed in the Constitution of 1947. This criterion is also one adopted by most developed countries which*

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35 The Supreme Court under the Chávez Constitution approved on December 1999 was converted into the Supreme Tribunal of Justice.

36 These contracts were given the name of "Association agreements for the exploration of new areas under risk and the production of hydrocarbons under a profit sharing scheme". As described before, they are joint ventures to explore and develop fields with conventional oil.

37 Supreme Court of Justice, decision of August 17, 1999.

38 This was the Organic Law that reserves to the State the Industry and Commercialization of Hydrocarbons of August 29, 1975 (O.G. No. 1779 Extraordinary of same date) which served to nationalize all foreign interests relating to petroleum in Venezuela.

> *permanently (…) submit their controversies internationally to arbitrators chosen by both states, in order to avoid that one's jurisdiction might prevail over the other (…)*

The petroleum agreements under review subjected to arbitration only some aspects of the contracts. The decision expressed the following with relation to this matter:

> *(…) With regard to the arbitration clause authorized by the congressional accord … it is worth mentioning that in conformity with clause seventeenth, article second of the very accord, it appears expressed that: the [petroleum] agreement shall be ruled and interpreted in conformity with the laws of the Republic of Venezuela and also that matters appertaining to the operating committee [the main decision-making body of the Joint Venture between PDVSA and the private company] shall not be subject to arbitration. And it is this operating committee (whose effective control rests –by majority representation- in the hands of PDVSA) which shall know of the fundamental national interest decisions concerning the execution of the petroleum agreement, which permits this court to deduct that those matters which will be eventually decided by arbitration will not be fundamental to national interests (...)*
>
> *(...) In lieu of the aforementioned, this court deems that, in the case of the petroleum agreements authorized by the congressional accord of June 4th 1995, as their nature is not only commercial but also of significant importance to the achievement of the economic measures adopted by the administration and validated by Congress, it falls neatly within the cited constitutional norm without infringing it, therefore the claim of unconstitutionality shall be rejected (...)*

In essence this decision of the Venezuelan Supreme Court blessed the adoption of arbitration as a method of dispute resolution in these petroleum agreements entered into during the 1990s.

There was, however, one dissenting opinion. One magistrate – one out of 15 – was adamantly opposed to accept arbitration in these agreements. She said: *the supreme welfare of the country cannot be left to rules …. of commercial arbitration… It is incongruous that contracts of public interest be subject to commercial arbitration …. Only a "revolution" willing to risk the prestige of the*

Republic and its own stability will be capable to repel such an agreement ….[39] Her ideas seem to have pervaded the current Chávez administration that through the Minister of Petroleum and Energy has expressed its resistance to arbitration or has accepted it with constraints, although the Constitutional and legal framework laid out, in our view, a solid base for arbitration in past oil and gas contracts or licenses as we will discuss shortly.

Some Venezuelan Courts in turn have shown some resistance towards arbitration. Specifically, the Political-Administrative Chamber of the new Venezuelan Supreme Tribunal – created in accordance with the 1999 Constitution – has voided arbitration clauses for being unclear; because of lack of representation issues, such as to the lack of powers of the individuals who represent a company in the signing of an arbitration clause; or because one of the parties has tacitly waived his right to request arbitration.

In a decision taken on April 5, 2006, the Political-Administrative Chamber of the Venezuelan Supreme Tribunal [40] has ruled against arbitration in contracts entered by the Venezuelan Government or by Venezuelan Government owned entities or companies. This decision – issued in the field of public television services – seems a setback or a change of attitude towards arbitration in contracts where public interest is involved, and oil and gas contracts may fall in this category.

This position taken by the Political-Administrative Chamber reflects well the political atmosphere created by the current Venezuelan Administration. The Chávez administration rejects arbitration in contracts of public interest and wants to have local State Courts rule on all matters and contracts where the Government is involved. The ruling of the Court was issued in very broad terms:

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[39] The Magistrate was Hildegard Rondón de Sansó, and her dissenting opinion read in Spanish in the parts that we have cited and translated: *Los altos intereses del país no pueden ser dejados a reglas … de un arbitraje comercial…Pareciera un contrasentido [calificarlo] de interés nacional [y permitir] que las controversias … sean objeto de arbitraje comercial … Sólo una "revolución" capaz de jugarse el prestigio de la República y su estabilidad misma, sería capaz de echar por tierra el acuerdo como tal…*

[40] In the case of *Elettronica Industriale S.P.A. contra Compañía Anónima Venezolana de Televisión (C.A.V.T.V.)*. The Court nullified an award issued by a panel formed under the ICC rules.

> *This contract has a public purpose, to improve the quality of the public television service and because it has a very direct impact on the national development and it gravely affects the assets of the Venezuelan State …. the controversy is not subject to arbitration ….*

This decision is certainly surprising because it is contrary to criteria that have emerged from legal norms which might also aid in the interpretation of article 151 of the current Constitution of 1999. This Article 151 provides that *all doubts and controversies which cannot be resolved amicably by contracting parties shall be resolved by the competent courts of the Republic, in conformity with its laws*. It is unclear, reading the provision, whether arbitration can be considered included in the reference made to the term *amicable*; as one might more readily associate institutions such as negotiation, mediation or conciliation as *amicable*. The matter is not without controversy.

The Constitutional Chamber of the same Supreme Justice Tribunal has a much more favorable position to arbitration be it domestic or international. It has a clear view that arbitration is protected and must be promoted as indicated by the current Venezuelan Constitution and is a valid and appropriate tool to resolve disputes[41]. It has, however, repeatedly affirmed that in addition to nullity actions against arbitral awards, Constitutional injunctions (*amparos*) may be exercised against foreign and domestic awards[42].

At the same time, the Constitutional Chamber in its decision of August 7, 2001, in the case of *Fermin Toro-Jimenez* and *Luis Britto-Garcia* – two Venezuelan University professors who had acted to void the US-Venezuelan Tax Treaty[43] alleging violations of the Venezuelan Constitution and were rejected –

[41] In a decision rendered recently validating arbitration with certain safeguards in consumer contracts, the Chamber has again stressed the significance of arbitration in the Venezuelan legal system. See decision No. 192 of February 28, 2008, File 04-1134.

[42] See J. Eloy Anzola and F. Zumbiehl, *El Tribunal Supremo de Venezuela Riñe con el Arbitraje* (The Supreme Tribunal of Venezuela Quarrels with Arbitration), published by the Venezuelan Law and Economics Association (VELEA) in a book dedicated to Alternative Dispute Resolution, *Resolución de Conflictos*, Caracas, 2005.

[43] The Treaty and its Additional Protocol were published in the Official Gazette of the Bolivarian Republic of Venezuela on January 5, 2000, Number 5427 Extraordinary.

examining this Article 151 said that the term *amicably* refers only to *conciliation* (or *mediation*) but not to others alternative means of dispute resolution. This would exclude arbitration from being *amicable* and could not be a valid choice to resolve disputes in contracts that fall under the spell of this Constitutional provision.

Nonetheless, two laws enacted during the Chávez administration *do* in fact mention what could be understood as *amicable* forms of resolution, and they expressly include arbitration.

Article 24 of the Organic Law of Gaseous Hydrocarbons (OLGH) states:

> *(…) any doubts and controversies of any nature that may arise regarding a [Natural Gas] license which cannot be resolved amicably by the contracting parties, including arbitration, shall be decided by the competent courts of the Republic [of Venezuela] , in accordance with its laws, without giving rise to any foreign reclamation (...)*[44] (Underlining added)

In much the same manner, and also in relation to hydrocarbons – although this time *oil (petroleum)* – the Organic Law of Hydrocarbons (OLH) sets up a similar rule in Article 34:

> *(…) any doubts and controversies of any nature that may arise regarding the realization of [Petroleum] activities which cannot be resolved amicably by the contracting parties, including arbitration in the cases permitted by the law, shall be decided by the competent courts of the Republic, in accordance with its laws, without giving rise to any foreign reclamation (...)*[45] (Underlining added)

We believe that, at least with respect to gas and oil, the Venezuelan legislature has validated arbitration as a method of dispute resolution; even

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[44] Free translation of article 24(6)(b) of the Organic Law of Gaseous Hydrocarbons, published in O.G No. 36793, on September 23, 1999. Note that this Law was enacted before the *Fermin Toro-Jimenez* decision of August 7, 2001. It is important to point out that the decision did not examine this legal provision.

[45] Free translation of article 34(3)(b) of the Organic Law of Hydrocarbons, published in the O.G. No. 37323, on November 13, 2001. Note that this Law was enacted a few months after the *Fermin Toro-Jimenez* decision of August 7, 2001. Obviously, the decision did not examine this legal provision. This provision was untouched when the Law was reformed in 2006.

considering the fact that these contracts deal with what is considered to be a matter of *public interest*.

Our view that arbitration is permitted in natural gas agreements and licenses is confirmed by Article 19 of the Regulations of the OLGH which establishes that the parties may agree to submit disputes associated with a license or permit to *final and binding arbitration*. In addition to arbitration, this provision clears the way for the licensee and the Venezuelan entity entering into the contract to seek the use of independent experts in order to resolve their differences and disputes. Furthermore, it provides that the award issued, whether by the arbitration tribunal or the independent expert, shall be binding in accordance with what has been established in the corresponding clause agreed by the parties, whether final, having the traits of *res judicata*, or making use of the remedies specified by common agreement between the parties.

In addition to these points and although one has to take into account the cases that we have mentioned above, it is important to note that the use of arbitration in Venezuela in *administrative contracts*, that is those entered into by the National, State or Municipal Government, or Government owned institutions or corporations with individuals or companies of the private sector, in matters of public welfare, has been validated by reputed scholars, the courts and the laws of the country including those enacted during the Chávez administration. [46]

As we have seen, the constraints imposed by the *Calvo* provision of the Venezuelan Constitution are limited, the parties to a contract of *public interest* can choose *amicable* modes to solve of their disputes or they can avoid Venezuelan Courts when this is required by the *nature of the contract*. It is clear then that Venezuela has elected a limited application of the sovereign immunity principle and therefore providing for arbitration in *administrative* contracts or contracts of

[46] Rafael Badell-Madrid, *Medios Alternativos de Solución de Conflictos en el Derecho Administrativo Venezolano, Especial Referencia al Arbitraje en los Contratos Administrativos*, Separata del Libro del Congreso Internacional de Derecho Administrativo en Homenaje al Profesor Luis Henrique Faría Mata, Caracas, 2006, studies this matter in detail and makes a recollection of opinions and court decisions validating this point.

public interest, after all required authorizations are obtained[47], is a valid choice. Obviously there are matters of public policy or *jus imperii* of the State that are never subject to arbitration.

One vivid example of the admission of arbitration in *administrative* contracts is the provision contained in article 61 of the Organic Law for the Promotion of Private Investment Under Concession Agreements[48]. Under this provision national, state, and municipal authorities are allowed to include final and binding arbitration clauses in all types of concession agreements (airports, public parking, garbage collection and disposal of waste, water distribution, etc).

In the mid-1990s – as we have already referred to – in the process of *Opening* to private investment of the then nationalized oil industry, the petroleum agreements entered into by the Venezuelan state oil company PDVSA or one of its subsidiaries or affiliates, included arbitration clauses, selecting the city of New York and the rules of the International Chamber of Commerce (ICC). Others selected Caracas as the place of arbitration under the ICC Rules or Venezuelan laws. In our view all these clauses are valid and binding. As we have seen, the then existing Venezuelan Supreme Court in its decision of August 17, 1999, with only one dissenting opinion had approved such arbitration clauses and the new legal framework – the newly enacted oil (OLH) and gas (OLGH)statutes – have followed the same trend.

Paradoxically, in spite of this legal framework, but based in a political position, some the recently granted licenses provide differently. Although still permitting recourse to arbitration, they confine arbitration to the procedures established by the Venezuelan Code of Civil Procedure and the Venezuelan

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[47] Such as that required by Article 12 of the Organic Law of the Solicitor General (*Procuradoría General*) of the Bolivarian Republic of Venezuela: this public officer must be consulted when an arbitration clause is inserted in an agreement to be executed by the Republic; or Article 4 of the Commercial Arbitration Law: prior approval of the arbitration clause must be given by the governing Ministry and the governing body of government owned institutions and corporations; or article 33 of the Hydrocarbons Organic Law that provides for the prior approval of the activities of mixed companies (joint ventures of government and privates investors) by the Legislative Assembly (Congress).

[48] *Decreto con Rango y Fuerza de Ley sobre Promoción de la Inversión Privada bajo el Régimen de Concesiones*, O.G. No. 5394 Extraordinary, October 25, 1999.

Commercial Arbitration Law currently in place in Venezuela. Arbitration is to be held in Caracas.

Finally, with regard to the most recent models being drafted for natural gas licenses, it appears that arbitration might in fact *not* be included at all as a method for the resolving of disputes, even though as we have seen the currently oil and gas laws *do* allow such an alternative.

OPERATING AGREEMENTS CONVERTED INTO *MIXED* COMPANIES

There has been an additional important adjustment where arbitration had been agreed and has now been discarded or its scope limited. During the Opening of the 1990s, 32 fields were offered to oil operators that were engaged by PDVSA's affiliates through operating agreements. These were service contracts – not associations – where the operator was paid a fee but did not acquire the oil it produced. The oil went directly to PDVSA's affiliates that in turn would commercialize it. The fee paid to the operator was determined through a complex formula that took into account, among other factors, the price of oil.

As soon as the price of oil increased in 2004, and the fee paid to the operators sky-rocketed, the Venezuelan Government decided to re-negotiate the terms of these contracts alleging that these agreements were a disguised form of association agreement. The Venezuelan Government, with all the power it has being an important world oil producer and holding important reserves, was successful in imposing new conditions to the oil operators with few exceptions.[49] The new scheme consists of joint-venture associations, *compañías mixtas* or *mixed* companies, where a PDVSA affiliate holds a majority. Among other

[49] Of the more of twenty-five companies that had entered into these operating agreements, only Total-Fina-Elf, the French-Belgian outfit and the Italian ENI, did not follow through. ENI started arbitral proceedings at ICSID but recently settled and got new oil licenses from he Venezuela Government. Total-Fina-Elf did not participate in the new mixed companies that were formed with the old contractors of the operating agreements, but agreed to do so in the new mixed companies for the Orinoco Belt and settled its claim concerning the operating agreements. Exxon-Mobil had an operating agreement but, in this specific case, sold its participation prior to the transformation into mixed companies.

amendments arbitration has been put on hold through some incongruous provisions.

The terms and conditions of the new joint venture agreements have been approved by the Venezuelan National Assembly and Section 12 of the basic terms reads:

> *The differences and controversies derived from the non-fulfillment of the conditions, terms, procedures and actions that are the object of this document or that derive from it shall solved in accordance with ... Venezuelan Law and before its jurisdictional courts.* [50]

But the in the same document, the Model Contract was approved and a convoluted provision for dispute resolution was included. It reads:

> *Governing Law and Jurisdiction*
> *This Contract shall be governed and interpreted in accordance with laws of the Republic, and any dispute or controversy that may arise related to it and that may not be solved amicably by the Parties, shall be exclusively submitted to the decisions of the competent tribunals of the Republic. Before initiating any litigious proceedings, the Parties shall seek, in good faith, and within the frame of the Organic Law of Hydrocarbons, to use means to amicably resolve the controversies of any nature that may arise ...* [51](Emphasis added)

If one reads this provision quickly it appears that controversies may be solved only before Venezuelan Courts. However, one immediately notes that the word amicably appears twice. Also, that the parties are invited to review the possibility of avoiding litigation in courts and to find ways to settle their disputes within the frame of the Organic Law of Hydrocarbons. We have seen that such law includes arbitration in the amicable ways to settle disputes; therefore, it is not absurd to think that if a controversy arises the parties may then agree to go into arbitration. However, arbitration may not be chosen from the outset - at the time of the signing of the agreement - making uncertain if it will be agreed once a dispute starts.

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[50] Free translation of the Terms and Conditions for the Creation and Functioning of Mixed Enterprises, Venezuelan Official Gazette No. 38410, March 31, 2006. In addition, the National Assembly passed the Law to Rule the Involvement of Private Participants in Primary Activities provided for in Decree No. 1510 containing the Organic Law of Hydrocarbons, published in Official Gazette No. 38419 on April 18, 2006.

[51] *Ibidem*.

NEW MIXED COMPANIES FOR THE ORINOCO BELT AND PROFIT SHARING AGREEMENTS

On February 2007[52] President Chávez issued Decree Law N° 5200 to rule the *migration* process of the Orinoco Oil Belt and of the exploration at risk and profit sharing agreements of the joint ventures or association agreements into mixed companies. According to this Law, the activities carried out by private sector companies had to *migrate* to *mixed* companies where the Government through PDVSA or its affiliates or subsidiaries, will hold a minimum of sixty percent of the capital stock of the new companies.

Article 13 of this Decree provides that *all facts and activities linked to this Decree-Law shall be governed by National Law, and the controversies that derive therefrom shall be subject to Venezuelan jurisdiction, in the manner provided in the Constitution of the Bolivarian Republic of Venezuela*. The Government's determination is to exclude arbitration in the new agreements that are being signed at this time with the partners of the Orinoco Belt. If the *migrated* and now minority partners are willing to accept these conditions in case of contractual disputes they will appear before Venezuelan Courts to make their claims.

In case the operators and investors in oil activities do not have arbitration clauses to solve their contractual disputes, in our view – if they are of foreign origin – they have not waived their right to file investment claims against the Republic of Venezuela for violations of a Bilateral Investment Treaty (if one does exist with the State of the investor) or in accordance with the Law on the Promotion and Protection of Investments. Under this scenario, these claims could very well go the jurisdiction of an ICSID arbitral tribunal or any other arbitral institution chosen in the corresponding treaty.

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[52] The Decree was published in Official Gazette N° 38.632 of February 26, 2007. See comments by Elizabeth Eljuri and Daniela Jaimes, in *The 2007 Nationalization of the Venezuelan Orinoco Oil Belt*, in www.gasandoil.com/ogel/, Issue: Vol. 5 - issue 4; published on November 2007.

THE LAW FOR THE PROMOTION AND PROTECTION OF INVESTMENT AND BILATERAL INVESTMENT TREATIES

Protections reserved by most countries for bilateral investment treaties are granted unreservedly to all investments made in Venezuela by the Law for the Promotion and Protection of Investment ("LPPI").[53] Amongst such principles are: the non-discrimination of investors;[54] national treatment;[55] open entry to investments;[56] expropriation only by public cause or social interest; adherence to the standards of prompt, just and adequate compensation in line with the Hull formula;[57] unrestricted repatriation of profits and proceeds of investments,[58] and others.

Venezuela, in addition, has subscribed and ratified no less than 25 treaties for the promotion and protection of investments made by foreigners in the country.[59] In these treaties, in matters concerning dispute resolution amongst parties, certain standard provisions are usually established, similar to these in the Bilateral Investment Treaty signed with Sweden[60]:

Article 7.- Controversies between an Investor and the Host Contracting Party
(1) Any dispute between one Contracting Party and an investor of the other Contracting Party, relating to an obligation by the former under this

53 Official Gazette Extraordinary, No. 5390, Oct. 22, 1999.
54 Article 6, 8 & 15 paragraph 1 of the LPPI.
55 Article 7 & 9 of the LPPI.
56 Article 7, 2nd paragraph of the LPPI.
57 Article 11 of the LPPI. The Hull formula is based on the contents of British treaties and is used to describe the valuation standard of compensation in accordance to a clause that reads as follows: "Such compensation shall include market value of the investment expropriated immediately before the expropriation became public knowledge, shall include interest at a normal commercial rate until the date of payment, shall be made without delay, be effectively realisable and be transferable". See M. Sornarajah. The International Law on Foreign Investment (Cambridge University Press).
58 Article 12 of the LPPI. Temporary limitation of this right might ensue do to financial constraints.
59 With Germany, O.G. 35.383 of 01/28/98; with Argentina, O.G. Extr. 4.801 of 11/01/94; with Barbados, O.G. Extr. 4.853 of 02-08-95, with Belgium–Luxembourg O.G. 37.357 of 01-04-02; with Brazil O.G. 36.268 of 08-13-97, although this Treaty has not been ratified by Brazil; with Chile O.G. Extr. 4.830 of 12-29-94; with Canada O.G. Extr. 5.207 of 01-20-98; with Costa Rica O.G. 36.383 of 01-28-98; with Cuba O.G.. 37.913 of 05-05-04; with Denmark O.G. Extr. 5.080 of 07-23-96; with Ecuador O.G. Extr. 4.802 of 11-02-94; with Spain O.G. 36.281 of 09-01-97; with France O.G. 37.896 of 03-11-04; with Great Britain O.G. 36.010 of 07-30-96; with Iran, O.G. 38.389, 2-03-2006; with Lithuania O.G Extr. 5.080 of 07-23-96; with the Netherlands O.G. 35.269 of 08-06-94; with Paraguay O.G. 36.301 of 09-29-97; with Peru O.G. 36.266 of 08-11-97; with Portugal O.G. Extr. 4.846 of 01-26-95; with Czech Republic O.G. 36.002 del 07-17-96; with Switzerland O.G. Extr. 4.801 of 11-01-94; with Sweden O.G. Extr. 5.192 of 12-18-97; with Uruguay O.G. 36.519 of 08-20-98. There are also protection to investments in the commercial treaty subscribed with Colombia and México (named "Grupo de los Tres"), see O.G. Extr. 4.833 of 12-29-94, although Venezuela has announced (May 2006) its separation from this Treaty. On 02-14-01 a treaty with Italy was subscribed but at the time these notes were written it still has not been approved by the corresponding internal law.
60 Free translations of the text of the treaty.

agreement regarding an investment made by the latter, will be submitted to the International Centre for the Settlement of Investment Disputes ("ICSID") for the settlement by means of arbitration or conciliation in conformity with the Convention on the settlement of differences (….)

Article 8.- Controversies amongst contracting parties

(1) Any controversy between contracting parties with respect to the interpretation or application of this agreement will be resolved, where possible, between the governments of both contracting parties.

(2) If the controversy cannot be settled in the sixty days following the date negotiation was required by one of the contracting parties, the dispute will be submitted to an arbitral tribunal (…).

In addition to these treaties, the LPPI establishes similar provisions encompassing all investments made in Venezuela, regardless the nationality of the investor.[61] In fact article 21 of this legislation provides the following regarding controversies arising between Venezuela and the Government of another country regarding an investment by one of its nationals:

Any controversy arising from the interpretation and application of this law [the LPPI], between the Venezuelan State and the country of origin of the international investor where no investment treaty exists will be resolved diplomatically. If no settlement has been reached in the twelve months following the beginning of the controversy, the Venezuelan State shall propose the submitting of such controversy to an arbitral tribunal whose composition, designation mechanisms, procedures and costs regime will be accorded with the counterparty State. The decisions of this tribunal will be definitive and of obligatory compliance.

Also, in case there arises any controversies between a foreign investor and the Venezuelan State, arbitration is foreseen as the possible method for the solution of such disputes. Article 22 of the LPPI provides as follows:

The controversies arising between a foreign investor whose country of origin has an investment treaty signed with Venezuela, or those other controversies where the provisions of the Multilateral Investment Guarantee Agency or the International Convention on the Settlement of Investment Disputes are applicable, will be submitted to international arbitration, in accordance with the respective terms and provisions of such treaties, if so established, without

[61] The LPPI was published in the O.G. No. 5.390 of October 22, 1999. .

prejudice to the possibility of making use of the contentious options contemplated in the Venezuelan legislation, if and when applicable.[62]

Concerning this article of the LPPI, the Supreme Tribunal touched on the legality of such provision in a case proposing its annulment (case *Fermin Toro Jimenez et al.*, February 14, 2001) and the decision reiterated its validity in the following terms:

> *(...) In this case it is observed that the Decree Law [the LPPI] promoted and developed the existing constitutional mandate establishing arbitration as an integral part of the mechanisms for the resolution of disputes arising from a foreign investment (...)*
>
> *(...) This court deems that the provision of the LPPI establishing arbitration in the terms contained, does not violate the sovereignty of the national courts with regards to the administration of justice (...)*
>
> *(...) Therefore, from the reading of the constitutional provisions under examination it appears evident that arbitration is admitted under our [the Venezuelan] legislation as integral part of the justice system. For the reasons stated, the arbitral solution of controversies provided in articles 22 and 23 [of the LPPI] do not collide in any way with the constitutional text (...)*

The Convention on the Settlement of Investment Disputes between States and Nationals of Other States created the International Centre for Settlement of Investment Disputes (ICSID). This convention came into force on October 14th 1966, when it was ratified by 20 countries. As of May 2005 this number had reached to 142 states. Venezuela did so in 1994[63].

ICSID provides services for the conciliation and arbitration of differences in matters concerning investments between contracting states and between contracting states and private foreign investors. Venezuela has already been engaged in ICSID arbitration in at least three occasions and has received two adverse awards: *Fedax N.V.* v. *Republic of Venezuela* (Case No. ARB/96/3) and *Autopista Concesionada de Venezuela, C.A.* v. *Bolivarian Republic of Venezuela*

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[62] Free translation of the legal text.

[63] See http://www.worldbank.org/icsid/constate/c-states-en.htm

(Case No. ARB/00/5)[64]. In both cases, Venezuela has complied with the awards rendered by the arbitral tribunals.

There is, however, one caveat to the language used by Article 22 of the LPPI. Under such provision it is clear that arbitration will be the dispute resolution system of choice in those cases where Venezuela has signed a bilateral investment treaty (or a covenant under MIGA) and this has been effectively established. However, when there exists no such agreement and only the ICSID treaty becomes available, then the language used by Article 22 of the LPPI appears less conclusive. The provision states that in case the ICSID treaty is the one being invoked by the foreign investor as basis to go to arbitration the corresponding claim *will be subject to international arbitration according to the terms of the corresponding treaty or agreement.*

As it happens, the preamble to the ICSID treaty establishes *that no Contracting State shall by the mere fact of its ratification, acceptance or approval of this Convention and without its consent be deemed to be under any obligation to submit any particular dispute to conciliation or arbitration.* Therefore, it appears evident that a contracting State *cannot* be forced to arbitration if it has not given its consent. Obviously, consent has been granted when such State has signed and ratified a bilateral investment treaty, although that is not necessarily the case when there is no such treaty.

For important practitioners[65], Article 22 of the investment law embodies state consent and can be invoked by an aggrieved investor to institute ICSID proceedings against the state. They argue that the wording of Article 22 points to

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[64] See http://www.worldbank.org/icsid/cases/conclude.htm. In the ICSID award rendered in the case *Autopistas Concesionadas de Venezuela, C.A. (AUCOVEN)* the Venezuelan national Government terminated the concession agreement entered into with Aucoven to maintain and improve the highway that connects the Caracas with its airport and Vargas State (a major leisure place for the city with beaches, hotels, restaurants, etc.). In this case the Venezuelan Government was condemned in the ICSID award to pay AUCOVEN, a consortium dominated by Mexican investors, a portion of the damages it had requested. Venezuela on its own accord paid such damages.

[65] Guillaume Lemenez de Kerdelleau, in *State Consent to ICSID Arbitration: Article 22 of the Venezuelan Investment Law*, OGEL, Vol. 4, Issue 3, June 2007; Andrés Mezgravis, in *Las Inversiones Petroleras en Venezuela y el Arbitraje ante el CIADI*, Arbitraje Comercial Interno e Internacional, Reflexiones Teóricas y Prácticas, Academia de Ciencias Políticas y Sociales, Serie Eventos 18, Caracas, 2006.

ICSID arbitration. The reference to ICSID arbitration in this legal provision is as clear as the references to ICSID arbitration in the investment laws of Egypt and Albania. It happens that two different ICSID tribunals[66] asserted their competence in actions brought by investors against these two countries that had raised as first defence the lack of jurisdiction for lack of consent.

This is the current state of affairs with the United States of America and Venezuela. There is no bilateral treaty signed between Venezuela and the US. American investors have an interrogation mark as to whether Venezuela may raise a defense for lack of jurisdiction when they file an investment claims before an ICSID arbitral tribunal. Based on the Egyptian and Albanian cases just mentioned it would seem that Venezuela's chances for success with this defense are slim.

THE NEW CONTROVERSIES

The *migration* process to *mixed companies* with PDVSA being the majority shareholder imposed by the Venezuelan Government on February of 2007 to operators of the Orinoco Belt has become a major source of controversy. Two of the participants, companies affiliated to Conoco-Philips[67] and to Exxon-Mobil[68], have started separate ICSID proceedings against the Bolivarian Republic of Venezuela. The specific claims have not been made public but its is known that the substance of the claims refers to disagreements on the price to be paid for the taking or expropriation of the investments that these companies made in joint ventures for the extraction and improvement of heavy oil in the Orinoco Belt. Both ICSID proceedings are at a very early stage.

The companies claim that the compensation for their share should take into account the market value or going concern value of their investment. Venezuela

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[66] Southern Pacific Properties Limited v. Arab Republic of Egypt (Case no. ARB/84/3), Decision on Jurisdiction, November 27, 1985, in ICSID Rep. vol. 3, 1995; Tradex Hellas S.A. v. Republic of Albania, (ICSID Case No. ARB/94/2), Decision on Jurisdiction of December 24, 1996, available at http://www.worldbank.org/icsid/cases/awards.htm#awardARB0415

[67] ConocoPhillips Company and others v. Bolivarian Republic of Venezuela (ICSID Case No. ARB/07/30). In http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=ListPending.

[68] Mobil Corporation and others v. Bolivarian Republic of Venezuela (ICSID Case No. ARB/07/27). In http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=ListPending

has offered to pay the depreciated book value of the assets. The use of one or the other method of valuation results in major differences.

Other participants in the Orinoco Belt operations – such as Fina-Total-Elf – acquiesced to the Venezuelan Government requirements, agreed to reduce their percentage of shares and remain as minority shareholders. Others – such as Chevron-Texaco, Veba Oil – that were already minority shareholders have also agreed to form part of the new *mixed companies* and continue with their presence in the Orinoco belt.

The Exxon Mobil group has additionally initiated a commercial arbitration, governed by the Rules of Arbitration of the International Court of Arbitration of the International Chamber of Commerce (ICC), against PDVSA Cerro Negro, S.A., and also its sole shareholder, PDVSA. The place of arbitration is the city of New York. The actual claims are not known, they have not been made public, although information has transcended in the court proceedings that we mention below. They are contractual claims and PDVSA has been brought as guarantor of the obligations undertaken by PDVSA Cerro Negro, S.A. in the contracts of association or joint venture signed in the 1990s.

In aid of this arbitration, and as permitted by Article 23.2 of the Rules of Arbitration of the ICC, the Claimant, Mobil Cerro Negro, S.A., requested the District State Court for the Southern district of New York to issue orders for the attachment of property owned by PDVSA and located in New York. On December 27, 2007, the Court issued an Order of Attachment US$ 300 million that PDVSA has deposited with the Bank of New York Mellon Corporation. On January 8, 2008, a Supplemental Order of Attachment was issued for an additional US$ 15 million deposited by the PDVSA with the same Bank. PDVSA opposed the attachment orders but the same Court confirmed the Order on February 20, 2008[69].

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[69] The Court decisions and the briefs presented by the parties are in http://www.transnational-dispute-management.com/

Also related to the ICC arbitration, the same Mobil Cerro Limited requested and was granted a *Freezing Injunction* or *Manreva Injunction,* ordered by the High Court of Justice, Queens Bench Division, Commercial Court, sitting in London, on January 24, 2008. The *Freezing Injunction* ordered PDVSA not to: *(1) remove from England and Wales any of its assets which are in England and Wales up to the value of US$ 12,000,000,000 ("US$ 12 Billion"); or (2) in any way dispose of, deal or diminish the value of any of its assets whether they are in or outside England and Wales of the same value.* The amount and extent of this Order are certainly exceptional.

The order was subsequently revoked on March 18, 2008, by the same Court. In these hearings Counsel for PDVSA were able to convince Judge Walker that England was not the proper forum and that PDVSA remained a financially solvent company that could comply with the award resulting from the ICC arbitration[70]. The Venezuelan Government has reacted triumphantly to this revocation.

There are also attachment orders issued by Courts in the Netherlands but as of this time the have not been made public.

All these attachment orders have made news in the media. These controversies are at a very early stage and will be a subject of discussion in the future.

CONCLUSIONS

The review made in these notes permit to say that foreign investors that are ill-treated in Venezuela are entitled to exercise all the remedies granted by Venezuelan Constitutional and legal rules before Venezuelan Courts. In addition, foreign investors are entitled to access ICSID arbitration in case their rights as investors – investment claims – are affected under the terms of a bilateral

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investment treaty. There have been rumors that Venezuela would denounce and separate form the ICSID Convention and bilateral treaties, but no formalization of this pretense has materialized.

If they come from a country that has yet not concluded a bilateral investment treaty, then they may base their investments claims on the Venezuelan Law for the Promotion and Protection of Investments and file them with ICSID. In this case, the Venezuelan Government could eventually raise the objection that in order to submit to ICSID arbitration it needs first to give its consent to the specific arbitration proceedings. The outcome of this discussion tends to be in favor of the investor if one looks into the ICSID decisions that have been rendered in prior cases.

Commercial arbitration under the Rules of the ICC, or any other international arbitration center, has sufficient Constitutional and legal support to say it was validly adopted in all types of oil and gas agreements and granting documents in Venezuela that were entered into before 2000. Taking into account the principles of *pacta sunt servanda* and good faith that protect these agreements in the international arena, in addition to the provisions of Venezuelan Law and the treaties ratified by Venezuela, the Venezuelan Government would not have valid grounds to dislodge the arbitral clauses that were included in those agreements.

An exception must be made for the recently created *mixed companies* or joint-ventures that substitute the Operating Agreements. The Venezuelan Government has taken an anti-arbitration position and the terms submitted to and approved by the National Assembly indicate that arbitration clauses cannot be inserted into the new agreements at the time of the signing of the agreement. However, those rules do not discard arbitration completely. It would seem that arbitration may be agreed later when the dispute arises.

A more clear exception has been made for agreements related to the new *mixed companies* dedicated to the production and improvement of oil in the

Orinoco Belt and other joint ventures for conventional oil, signed after February 2007. Venezuela will not agree on arbitration, the February 2007 Decree-Law does not allow the Government to accept it.

With regard to the rest of oil agreements and licenses, or any other granting documents, or contracts with the Government or Government owned entities, the Venezuelan Government may require by way of choice, that contractual controversies be solved by Venezuelan courts. That is of course a valid alternative from a legal standpoint if accepted by the investors who would be part to those agreements and/or are the grantees of the corresponding titles.

A nationalistic and self-defined socialist Government, such as the current Venezuelan administration, may not want to appear before arbitral tribunals created under the auspices of institutions keen to the *capitalistic* world and brought there by *disgusting imperial multinational companies*. It would be much happier before a Venezuelan Court. This second alternative, however, may not guarantee a fair level of independence and impartiality to foreign investors and may become a deterrent to investment in general.

PDVSA, on the other side, is an important player in the oil word with substantial investments in several countries. In case of discrimination, lack of fair and equitable treatment, lack of full protection and security, expropriation by a recipient country, wouldn't PDVSA prefer to make its claims before an impartial international arbitration panel? International arbitration has many limitations, but it may assure better an independent and impartial forum to assure the rights that all investors should have.

It is not by chance that in the last bilateral investment treaty to promote and protect investments signed by Venezuela, the treaty signed with the Islamic

Republic of Iran[71], arbitration was selected to resolve disputes between investors and the recipient country.

Arbitration is preferable to gunboats. It is also a better option than a long international dispute with no solution in sight.

March 2008

[71] O.G. No. 38.389 of March 2, 2006. According to Article 11 of this BIT, the harmed investor may choose between: (a) Ad-Hoc arbitration, under UNCITRAL Rules; (b) ICC arbitration; or (c) ICSID arbitration if both parties are signatories of the ICSID Convention. Iran is not at this time a party to the ICSID Convention.