ARBITRATION OF VENEZUELAN OIL CONTRACTS:
A LOSING STRATEGY?

EMILY A. WITTEN

I. INTRODUCTION ........................................................................................................... 56
II. TIMELINE LEADING TO THE ARBITRATION BETWEEN EXXON AND VENEZUELA ........................................................................................................... 56
III. LEGAL ISSUES ............................................................................................................. 60
A. Customary International Law .................................................................................. 60
   1. State Sovereignty and the Doctrine of *Pacta Sunt Servanda* ......................... 60
   2. Sovereign Immunity and the Calvo Doctrine ................................................. 62
   3. Compensation for Expropriation ................................................................. 62
B. Modification of Customary International Law by Contract and Treaty ................. 64
   1. Bilateral Investment Treaties ........................................................................ 65
   2. ICSID Arbitration ......................................................................................... 66
   3. ICC Arbitration ............................................................................................. 69
   4. Exxon Mobil’s Separate Arbitrations ......................................................... 71
C. Venezuela’s National or Public Interest .................................................................. 72
   1. Petroleum Activities are Reserved to the State ......................................... 72
   2. Whether Arbitration is Unconstitutional for Contracts in the Public Interest ...... 73
   3. Effect of Domestic Law on Arbitration ....................................................... 75
D. Enforcement of an Award .................................................................................... 77
IV. BUSINESS ISSUES .................................................................................................... 80
A. Exxon’s Corporate Reputation ........................................................................... 80
B. Jeopardizing Further Opportunities in Venezuela ........................................... 81
C. Relative Risk ........................................................................................................ 83
V. NEW DEVELOPMENTS—MEDELLIN AND SOVEREIGN IMMUNITY ... 85
VI. CONCLUSION ........................................................................................................... 87

* Emily Witten is a graduate of Harvard Law School and practices at Thompson & Knight in Dallas, Texas. She is a licensed Professional Engineer in California with a degree in Mechanical Engineering from Stanford University. Before she practiced law, she worked in the oil and gas industry for clients including ChevronTexaco, Valero, Kinder Morgan, and Oxy. The author would like to thank Robert Kimball, a partner at Vinson & Elkins in Dallas, for his help with her research.
I. INTRODUCTION

Arbitration can be a useful tool in private international law. An arbitration clause in a contract allows an investor to fund a large infrastructure project in a foreign country while limiting the risk that the host government will change the laws in ways that affect the investment. Arbitration provides a feeling of certainty or predictability that may not be quite as secure in reality as the investor might hope. Under domestic law, parties can bargain in the shadow of a system that has the final power to mandate a resolution. In international law, contract terms sometimes can be only as good as the other party’s willingness to observe them. Arbitration is fundamentally based on consent, and it works best when the parties continue to support it as a solution. Absent an ultimate authority with the power to exercise force in support of the rules, it is uncertain whether there can be a dispute resolution regime that provides the certainty investors would like.

In contracts where one party is a sovereign state, any contract law may actually be subordinate to the interaction between a country’s sovereign powers and the parties’ relative bargaining positions. For example, when petroleum prices are low, countries entice multi-national oil companies to invest, and when prices and profits are high, they squeeze. Sometimes the company has the power to extract concessions, and sometimes the country can force renegotiation. In this sense, an agreement to arbitrate may still be critical, but better used as a bargaining chip than as an actual solution. Sovereign power and business interests can be much more important than even the most well-drafted contract.

II. TIMELINE LEADING TO THE ARBITRATION BETWEEN EXXON AND VENEZUELA

In the 1990s, Venezuela encouraged multi-national oil companies to invest in the Orinoco belt by offering generous terms, including royalties of 1%; a minority stake for the state oil company, Petroleos de Venezuela S.A. (“PDVSA”); income tax of 34%; and contracts which allowed disputes to be arbitrated in New York. Exxon Mobil, ConocoPhillips, Chevron, Total, BP, and Statoil invested more than $16 billion in the Orinoco belt, which produced 600,000 barrels per day of heavy crude. 1 After Hugo Chavez was elected president in 1998, he began a series of reforms to undo the “Apertura,” or opening of Venezuela’s oil resources to foreign investment. 2 In 2001, the Chavez regime enacted a new hydrocarbons law that raised royalty rates, promised PDVSA majority control of all new projects, and required joint ventures for foreign

---

1. Jim Landers, Driving a Hard Bargain, DALLAS MORNING NEWS, Aug. 2, 2006, at 1D.
investment. In 2004, the government raised royalty rates from 1% to 16.6% on Orinoco heavy crude. The government also reinterpreted tax rates from Apertura-era deals and assessed foreign investors $4 billion in back taxes. Chavez said that foreign oil companies had to pay the taxes or leave. In April 2005, Venezuela’s energy minister, Rafael Ramirez, declared that thirty-two operating agreements for privately-run oil fields were illegal when signed and must be brought into compliance with the 2001 hydrocarbons law. He announced that the existing agreements would have to be converted into joint ventures, with PDVSA owning a minimum of 51%, and would owe a new royalty of 30%. When faced with the Hobson’s choice of accepting the new terms or abandoning their investments, “twenty-six companies decided to go to the new system,” said Bernardo Alvarez, Venezuela’s ambassador to the United States and a former deputy energy minister, “it was 100 percent legal.” When Total and Eni balked, Chavez sent the national guard to seize their fields. Exxon Mobil sold its stake in those fields to Repsol to avoid accepting the unfavorable terms. After Exxon’s refusal to accept contract changes, Ramirez said, “the doors are closed to that company here.” In early 2006, Venezuela removed Exxon Mobil from a multi-billion dollar petrochemicals project. Exxon’s chief executive officer, Rex Tillerson, said the company would avoid making further major investments in the country. In May 2006, Venezuela’s National Assembly, made up entirely of Chavez loyalists, enacted a new 33.33% extraction tax and raised income taxes to 50% (from 34%). Ramirez said a 1945 hydrocarbons law permitted the government to raise royalties when the price of oil increased.

In September 2006, the Venezuelan government demanded that PDVSA’s ownership share of the Orinoco projects be increased, from an average of 40% to a minimum of 51%, and that PDVSA take over

3. Id.
5. Investing in Venezuela, supra note 2.
8. Id.
10. Id.
11. Editorial, Exxon Mobil Pays Price For Balking, HOUSTON CHRON., Feb. 8, 2006, at Business 4. (Note: those fields are unrelated to the current dispute.)
12. Id.
13. Id.
15. Landers, supra note 1.
16. Juan Forero, As Prices Soar, the Orinoco Belt Becomes an Economic Battleground, N.Y. TIMES, June 1, 2006, at C1.
operational control of the fields. 17 Chavez set a deadline of May 1, 2007 for PDVSA to take operational control and June 26, 2007 for companies to sign new agreements. 18 A lawyer familiar with the negotiations said that the companies—ConocoPhillips, Exxon Mobil, Chevron, BP, Total, and Statoil—were offered essentially the same deal: PDVSA gave them veto power over investment decisions but said they would not have the right to seek international arbitration over future disputes. 19 However, another attorney familiar with the dispute says that even offering veto powers would be contrary to all of the government’s and PDVSA’s public statements. 20 On June 26, 2007, Chevron, Statoil, BP, and Total signed deals giving PDVSA 60–83% interests in their ventures and preserving their presence in the Orinoco oil field projects. 21 ConocoPhillips and Exxon Mobil refused to accept new working terms for their Venezuelan operations and walked away from their investments. PDVSA absorbed their stakes, and the companies began to negotiate compensation for the value of their investments. 22 The Orinoco fields contained 5% of Conoco’s crude production and 10% of its total reserves. 23 Exxon’s share of crude oil produced by its Venezuelan operations represented only about 1% of the company’s production, and its Venezuelan reserves were less than 2% of its total reserves. 24 Exxon Mobil and ConocoPhillips sought compensation in cash for the market value of the projects; however, Venezuela insisted on paying book value in crude or reserves. Exxon’s stake had a book value of $750 million and a market value in excess of $2 billion while Conoco’s assets had a book value of $4.5 billion and a market value of about $7 billion. 25 However, a lawyer familiar with Exxon’s dispute has said that the $2 billion reference is misleading and the as-yet-unstated market value will likely far exceed that amount, 26 while Venezuela insists that Exxon’s assets are worth less than $1 billion. 27 U.S. State Department spokesman Tom Casey said, “The

20. E-mail from Charles Beach, Coordinator, Corporate Litg. Law Dep’t, Exxon Mobil Corp., to Emily A. Witten, Author (May 12, 2008, 21:04 CDT) (on file with author).
24. Id.
government of Venezuela, like any other government, has the right to make these kinds of decisions to change ownership rules. We want to see them meet their international commitments in terms of providing fair and just compensation.”

In September 2007, Exxon filed a request for arbitration with the International Centre for Settlement of Investment Disputes (“ICSID”) in regard to compensation from the Venezuelan government for seized oil-production assets. Exxon is seeking market value for the assets, but Venezuela maintains that it will only pay book value. In February 2008, Exxon Mobil obtained court orders in Britain, the Netherlands, and the Netherlands Antilles, freezing up to $12 billion of PDVSA’s worldwide assets, as well as a court order in the United States attaching $300 million in cash belonging to an Exxon/PDVSA joint venture. “We fully support the efforts of Exxon Mobil to get a just and fair compensation package for their assets, according to the standards of international law,” State Department spokesman Sean McCormack said.

Chavez suspended crude sales to Exxon on February 12, citing its “judicial-economic aggression.” However, Chavez’s government declared that the boycott does not apply to high-sulfur oil that can only be refined at a facility that Venezuela and Exxon Mobil jointly operate in Chalmette, Louisiana. In March 2008, the British court injunction was overturned because, as was stated in a summary of the judge’s comments, “in the absence of any exceptional feature such as fraud, and in the absence of substantial assets of [PDVSA] located here, the fact that the seat of the arbitration is not here makes it inappropriate to grant an order.” Venezuela is still bound by similar asset freezes put in place by the courts in the Netherlands and Dutch Antilles. According to lawyers acting on the case, arbitration proceedings are set to take place in late 2008 at the earliest.

As of February 2008, ConocoPhillips said it was continuing to discuss a resolution over the expropriated assets. Venezuelan Energy and Oil Minister Rafael Ramirez also said in February that negotiations with

35. Megan Murphy, Chavez Buoyed by Exxon Court Ruling, FIN. TIMES (LONDON), Mar. 19, 2008, at Companies Int’l 17.
36. Id.
ConocoPhillips were continuing and that he expected to reach a settlement soon.\textsuperscript{38} However, the ICSID website shows a pending arbitration registered in December of 2007.\textsuperscript{39}

Exxon has a high likelihood of success on its legal arguments, but there are many hurdles standing between them and full compensation for their expropriated investment—even with an arbitration clause.

III. LEGAL ISSUES

A private corporation seeking to resolve an investment dispute against a foreign state has several options, including: domestic remedies, political risk insurance, arbitration under a bilateral investment treaty, and international arbitration as provided for in the contract. Although parties can choose a governing law in the contract, background principles of international law will apply in arbitrations where one party is a foreign country.

A. Customary International Law

Many elements of customary international law that are implicated by breach of foreign investment agreements reflect a tension between respect for private property rights and a sovereign’s power to act for the public interest. Each doctrine seems to be a two-steps-forward-one-step-back dance, at first providing new protections for investors, while also providing a state with defenses to liability.

1. State Sovereignty and the Doctrine of \textit{Pacta Sunt Servanda}

A bedrock principle of international law is that states are absolutely sovereign within their own borders. Many countries have recognized that the state may not contract away its police power or duty to act for the public good. For example, the U.S. Supreme Court held that, “[t]he taking of private property for public use upon just compensation is so often necessary for the proper performance of governmental functions that the power is deemed essential to the life of the State. It cannot be surrendered, and, if attempted to be contracted away, it may be resumed at will.”\textsuperscript{40} In British law, “Where the Crown acts in an executive capacity to vary or terminate a contract, its action is deemed to be lawful, and no breach of contract. . . . [A] government cannot fetter its duty to act for the public good. It cannot bind itself—by an implication in the contract—

\begin{footnotesize}
\begin{enumerate}
\item International Centre for Settlement of Investment Disputes, World Bank, List of Pending Cases, \url{http://icsid.worldbank.org/} (follow “Cases”; then “List of Cases”; then “Pending Cases” hyperlinks) (last visited Sept. 14, 2008).
\item Georgia v. City of Chattanooga, 264 U.S. 472, 480 (1924).
\end{enumerate}
\end{footnotesize}
not to perform its public duties." This principle can be important where a government considers the substance of a contract to be an issue of the public interest, as with petroleum contracts in Venezuela. Venezuela can argue that a private contract with a foreign investor cannot restrict the government from fulfilling its public duties.

The doctrine of sovereign equality, that no state could be expected to submit to the laws of another, leads to the concept of sovereign immunity: no state can exercise jurisdiction over another. Sovereign immunity, before the twentieth century, was seen as absolute, and no state would be subjected to another state’s courts for any private dispute. As states began to participate in commercial activities and other functions outside of their roles as governments, nations began to recognize a doctrine of restrictive sovereign immunity: states retain immunity for their sovereign or public acts, but not their private acts. This has led to expanded international liability for governments participating in the commercial sphere. There are two approaches that can be taken to determine whether an act is within a state’s public capacity: the nature test and the purpose test. The nature test evaluates whether the act is one that only a sovereign may perform. The purpose test analyzes whether the act furthers a sovereign interest or the state’s private and mercantile concerns. Many nations that follow the restrictive sovereign immunity concept apply the nature test, but there is little agreement as to which acts are by nature public.

However, states would like to reap the benefits of foreign capital by entering into private contracts. It has been held that entering into a binding agreement can be an exercise of a state’s sovereignty, rather than a limitation on it. When a state enters into an enforceable contract, its actions are governed by the fundamental principle of *pacta sunt servanda*, constantly cited by international courts, which means that contract obligations must be respected. While a state’s sovereignty allows it to breach obligations at will, the traditional rule of *pacta sunt servanda* may provide for consequences, especially if a state is acting in its private and mercantile capacity.

---

43. NOAH RUBINS & N. STEPHAN KINSELLA, INTERNATIONAL INVESTMENT, POLITICAL RISK AND DISPUTE RESOLUTION 141 (Oceana Pub. 2005).
2. Sovereign Immunity and the Calvo Doctrine

Not all states have accepted restrictive sovereign immunity. Latin American nations, including Venezuela, have been known to favor the Calvo doctrine, which limits foreign interference in a country’s affairs. The doctrine provides that foreign investors may be treated no better than domestic investors, and the only means of dispute resolution is through domestic courts.\(^{47}\) The doctrine was popular through the 1970s and was incorporated into many countries’ national laws and constitutions.\(^{48}\) Latin American countries would formalize the doctrine by inserting a “Calvo clause” into investment contracts, explicitly stating that whenever there is any dispute relating to this investment, the investor will treat themselves in all respects as a citizen of the host government, under penalty of forfeiture of its interest, and it agree to be bound by the host government’s laws and may not seek redress in its home country. To encourage foreign investment in the 1990s, many developing Latin American countries ratified bilateral investment treaties and the ICSID Convention, which provide a private right of action for foreign investors through arbitration. The Calvo doctrine was thought to be falling out of favor through the 1990s as Latin American countries embraced privatization. However, now that political and economic conditions are changing, some Latin American countries have been reinvoking Calvo’s arguments to avoid liability for nationalizing foreign investments.\(^{49}\)

3. Compensation for Expropriation

Prior to World War II, the standard of full compensation for expropriation was almost unquestioned in customary international law. In one study of sixty international claims tribunals ruling on damages to foreign investors from 1840-1940, none of the arbitral panels held that the appropriate measure of compensation was less than the full value of the property taken, and many specifically affirmed the rule of full compensation.\(^{50}\) The United States expressly adopted this formula when Secretary of State Cordell Hull announced in 1938 that expropriation of foreign-owned property must be accompanied by “prompt, adequate, and effective” compensation.\(^{51}\) This “Hull formula” has been interpreted to

\(^{47}\) Bernardo M Cremades, Disputes Arising out of Foreign Direct Investment in Latin America, 59 DISP. RESOL. J., 78, 80 (May—July 2004).
\(^{48}\) See id. at 80-81 (stating the prevalence of the Calvo doctrine in international agreements from that region).
\(^{49}\) Id. at 81-83.
\(^{50}\) RUBINS & KINSELLA, supra note 43, at 157.
\(^{51}\) Id. at 158.
No. 1] Arbitration of Venezuelan Oil Contracts

require compensation in the amount of the full market value of an investment as a going concern.\textsuperscript{52}

As early as the nineteenth century, Latin America began to dispute this principle of customary international law. The Calvo doctrine itself dates back to 1868.\textsuperscript{53} Latin American states argued that foreign nationals should be entitled to no better treatment than the state gave to its own nationals, which might be no compensation at all. They insisted that states had absolute sovereignty and were not obligated to recognize any international claims for expropriation. This view reflected Latin America’s general hostility to foreign investment at that time, as evidenced by several state constitutions that prohibited ownership of real property by foreigners.\textsuperscript{54}

 Throughout the twentieth century, many states nationalized property during radical socialist or communist revolutions. The most familiar example for Americans is Cuba’s 1959 nationalization of over $2 billion of U.S. company property and refusal to pay any compensation.\textsuperscript{55} Former Spanish colonies that became newly independent through the middle of the century argued that they should not have to honor contracts entered into by former colonial authorities that deprived them of essential control over their national resources.\textsuperscript{56} A common argument by developing countries was that the right to economic self-determination was inalienable and that the requirement of full compensation for expropriation should be inapplicable because it would make economic restructuring impossible.\textsuperscript{57} Several U.N. General Assembly Resolutions, passed over the objection of first-world, capital-exporting countries, embraced the possibility of paying less than full compensation in cases of social reform.\textsuperscript{58} The Calvo Doctrine and the actions of the former colonies demonstrate how governments try to avoid being fettered by their previous contract obligations when pursuing social change.

Despite the considerable disagreement between capital-exporting (developed) states and capital-importing (developing) states over the appropriate standard for compensation, there is a clear precedent in arbitral decisions. Key early arbitration decisions from the 1950s, including \textit{ARAMCO}, \textit{Sapphire}, \textit{Qatar}, and \textit{Lighthouse}, awarded full compensation for the expropriation of oil concessions.\textsuperscript{59} However, a few

\textsuperscript{52} \textit{Id.}
\textsuperscript{54} See \textit{RUBINS \\& KINSELLA, supra} note 43, at 159.
\textsuperscript{55} \textit{Id.} at 161.
\textsuperscript{56} \textit{Id.} at 161-62.
\textsuperscript{57} \textit{Id.} at 162.
\textsuperscript{58} \textit{Id.} at 162-66.
\textsuperscript{59} \textit{Id.} at 166-67.
important arbitrations arising out of expropriations in the 1970s provided for less than the Hull standard of compensation. The *LIAMCO* decision concerning Libya’s nationalization of its oil industry relied upon an equitable compensation standard and awarded the reasonable value of the property taken.\(^{60}\) In the *AMINOIL* case, Kuwait sought to pay book value for an expropriated oil concession. The tribunal used a standard of appropriate compensation and awarded the depreciated replacement value of the fixed assets and the going concern.\(^{61}\) Despite these exceptions, one commentator has written that “every recent arbitral tribunal that has considered the issue has affirmed that customary international law requires a state expropriating the property of a foreign national to pay the full value of that property, measured, where possible, by the market price.”\(^{62}\)

Countries may use their other governmental powers to influence the recovery the company can eventually receive. For example, Venezuela may be using its tax policy strategically to lower the market value of the expropriated assets. In 2006, before the increase in taxes, ConocoPhillips earned about $21 a barrel on oil it produced in Venezuela; in the first quarter of 2007, it earned about $3.75 a barrel.\(^{63}\) The increase in taxes could be intended to strengthen Venezuela’s position if it goes to international arbitration to determine the value of the Conoco and Exxon operations, allowing Chavez to skew the value of those assets.\(^{64}\)

In expropriation cases that proceed all the way to an arbitral decision, companies are likely to receive full compensation. However, even when an arbitration clause exists, there still remain many uncertainties involved with trying to enforce it.

**B. Modification of Customary International Law by Contract and Treaty**

Although a state may participate in the commercial sphere and enter into contracts, a state is not automatically liable under international law for the breach of a private contract. International remedies will only be available if the state has consented to international scrutiny, thus “internationalizing” the contract. A state can do this in several ways: by enacting a bilateral investment treaty with a trading partner state, by ratifying an arbitration treaty, or by explicitly agreeing in a contract that it will be subject to international law.

---

64. *Id.*
1. Bilateral Investment Treaties

A bilateral investment treaty (“BIT”) is a treaty concluded between two states in which each agrees to offer certain protections to investors of the other state. The agreements are designed to encourage the flow of foreign direct investment from capital-exporting states to capital-importing states by presenting the host state as an attractive venue for investment. Most bilateral investment treaties provide that expropriation should be non-discriminatory and for a public purpose and that full compensation should be paid. For example, the bilateral investment treaty between Venezuela and Iran provides:

1. The Investments of the investors of either of the Contracting Parties shall not be nationalized, confiscated, expropriated or subjected to similar measures by the other Contracting Party, unless such measures are taken because of public interest and in conformity with due process of law, without discrimination and upon prompt and adequate compensation.

2. The amount of the compensation shall be equivalent to the market price of the investment, immediately before the measures of nationalization, confiscation or expropriation are made publicly known.

Venezuela’s BIT with France similarly declares:

The contracting Parties shall not take steps of expropriation, nationalization, or any other measures where the effect is to dispossess, directly or indirectly, the other Party’s nationals or companies of their investments within the territory or maritime zone, unless such measures are taken for the public good without discrimination and are not contrary to a particular commitment.

All steps of expropriation that may occur must be compensated by the payment of prompt and adequate compensation of the amount equal to the fair market value of the affected investment, which should be established based on the normal economic situation prevailing before the threat of expropriation became known publicly. This compensation, the amounts, and the conditions of payment shall be established no later than the date of expropriation. This compensation shall be payable in cash, without delay and freely

65. RUBINS & KINSELLA, supra note 43, at 191.
66. Id. at 192.
67. Id. at 171.
68. Agreement on the Reciprocal Promotion and Protection of Investments Between the Gov’t of the Bolivarian Republic of Venezuela and the Gov’t of the Islamic Republic of Iran art. 6, Iran-Venez., Mar. 11, 2005.
transferable. The compensation shall bear interest until the date of payment calculated at the appropriate market rate of interest. 69

The existence of a treaty commitment to full compensation reduces some of the uncertainty in a panel’s interpretation of international law. That is why, as a primary strategy, companies would like to find a way to make a BIT apply. Venezuela does not have a BIT in effect with the United States, so Exxon would not be able to rely on such a treaty to govern arbitration of this particular dispute. However, sometimes a company will structure an individual project to take advantage of beneficial treaties, through a process known as project finance. For example, a company could set up its Venezuelan investment as a Netherlands corporation, and since the Netherlands has a BIT in effect with Venezuela, the investment would be able to benefit from those terms. (An Exxon attorney has confirmed that Exxon’s investment had a Dutch parent corporation.) 70 Countries have objected to this “treaty-shopping,” but it has been found valid in some cases, depending on the language of the particular BIT. 71

2. ICSID Arbitration

The International Centre for Settlement of Investment Disputes (“ICSID”) was created by the World Bank and implemented through a multilateral treaty to be an impartial international forum providing for the resolution of legal disputes. 72 ICSID provides a self-contained system of administrative and procedural rules to decide disputes independently of national courts.

In order to arbitrate a dispute through ICSID both parties must be from Contracting States and must consent to ICSID jurisdiction. The ICSID Convention provides that:

The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State...and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre.


70. Beach, supra note 20.


When the parties have given their consent, no party may withdraw its consent unilaterally.\textsuperscript{73}

A bilateral investment treaty will usually provide consent to ICSID jurisdiction. Without a BIT, parties can provide for ICSID jurisdiction by express consent in the contract. Additionally, a most favored treatment contract clause, providing that the parties will extend to this contract the most favorable treatment given to any other contract, can provide indirect access to the consent to ICSID arbitration in another country’s BIT. Without express written consent, however, ICSID arbitration is unavailable, even if both parties belong to ICSID Contracting States. Another important consequence of consent to ICSID jurisdiction is that the treaty provides that “[c]onsent of the parties to arbitration under this Convention shall, unless otherwise stated, be deemed consent to such arbitration to the exclusion of any other remedy.”\textsuperscript{74} The purpose of ICSID is to provide an impartial international forum, and this provision emphasizes that ICSID remedies displace other means of dispute settlement, including domestic courts. In general, it can take from thirty days to six months for ICSID to register an arbitration request, and then hearings typically last between three and four years.\textsuperscript{75} ICSID General Counsel Uche Onwuamaebu said in September 2007 that the group would not make any details public unless it decides that Exxon’s complaint is within its jurisdiction, something he said could take weeks or months.\textsuperscript{76} Although the relative certainty of the ICSID arbitration process is preferred by investors, whether ICSID has jurisdiction over any particular suit can be a source of uncertainty.

The substantive law governing an ICSID arbitration may be selected by the parties in the contract. The Convention states:

The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such 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.\textsuperscript{77}

Undoubtedly the contracts at issue contained clauses specifying a governing law. Even if a contract did not specify a choice of law, the


\textsuperscript{74} \textit{Id.} at art. 26.


\textsuperscript{77} ICSID Convention, \textit{supra} note 73, at art. 42(1).
Tribunal would apply Venezuelan law together with relevant international law. This clause in the Convention describes the modern practice in arbitration where national law is supplemented by international practice and international law principles. The customary international law regarding sovereign power will always exert a pull on arbitrations.

A key reason ICSID arbitration is so desirable is the limited means for appealing, questioning, or re-opening an arbitral decision. The Convention states that “[t]he award shall be binding on the parties and shall not be subject to any appeal or to any other remedy except those provided for in this Convention.” The grounds provided in the Convention are narrower than those allowed under the New York or Panama Conventions (see discussion in Section 3, infra). Under ICSID rules:

Either party may request annulment of the award by an application . . . on one or more of the following grounds:

(a) that the Tribunal was not properly constituted;
(b) that the Tribunal has manifestly exceeded its powers;
(c) that there was corruption on the part of a member of the Tribunal;
(d) that there has been a serious departure from a fundamental rule of procedure; or
(e) that the award has failed to state the reasons on which it is based.

The provisions do not include any grounds for appealing an award based on its constitutionality under the parties’ domestic laws. Aside from objections under those limited grounds, a tribunal’s award becomes immediately enforceable in any ICSID member state. The convention says, “[e]ach Contracting State shall recognize an award rendered pursuant to this Convention as binding and enforce the pecuniary obligations imposed by that award within its territories as if it were a final judgment of a court in that state.” The only national law that is implicated is the law of the country where the prevailing party seeks to enforce the judgment. The ICSID Convention states that “[e]xecution of the award shall be governed by the laws concerning the execution of judgments in force in the State in whose territories such execution is sought,” and that “[n]othing in [the article on enforcement of the award] shall be construed as derogating from the law in force in any Contracting

---

78. See, e.g., ARAMCO, supra note 45; AMINOIL, supra note 61.
79. ICSID Convention, supra note 73, at art. 53(1).
80. Id. at art. 52(1).
81. Id. at art. 54(1).
State relating to immunity of that State or any foreign State from execution.\textsuperscript{82} Once an ICSID award is presented to the enforcing country and recognized by its courts, that country’s domestic law governs how judgments may be executed: for example, whether and how assets may be attached. It is at this point that a country’s laws regarding sovereign immunity may affect the execution of an arbitral award.

Venezuela has signaled that it does not view ICSID as a viable choice for settling disputes. In May, Chavez threatened to pull out of the World Bank and International Monetary Fund, although Venezuela has not yet acted on the threat.\textsuperscript{83} Such a step would deny future investors access to ICSID arbitration, but cases opened before Venezuela’s withdrawal would still be valid.\textsuperscript{84} However, since Venezuela’s constitution and national laws contain anti-arbitration provisions, Venezuela may challenge the jurisdiction of an ICSID arbitral tribunal or claim immunity from the execution of awards as against public policy. While the apparent certainty of the ICSID process and awards would seem to allay investor concerns, it is important to remember that the sovereign power of the host government is always lurking.

3. ICC Arbitration

The International Chamber of Commerce ("ICC") provides for an institutional arbitration framework that allows parties to choose, through their contracts, the place and language of arbitration, substantive and procedural rules to be applied, and the arbiters.\textsuperscript{85} ICC awards may be enforced through the U.N. Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention), to which both the United States and Venezuela are parties. The New York Convention provides that a foreign arbitral award may be enforced in any state that is a party to the convention,\textsuperscript{86} and 142 countries are parties.\textsuperscript{87} However, a country may make a reservation that it will not apply the Convention in matters not considered commercial under its national law.

\textsuperscript{82} Id. at art. 54(3), art. 55.

\textsuperscript{83} Camacho, supra note 76.

\textsuperscript{84} Exxon Keeps Options Open in Orinoco Row, PETROLEUM INTELLIGENCE WEEKLY, Oct. 1, 2007, feature story.


\textsuperscript{87} See id.
Venezuela has made this reservation to the Convention and may argue that petroleum disputes are not commercial.  

Although a country may withdraw, the Convention provides that denunciation will take effect one year after the state announces its withdrawal, and the Convention will continue to be applicable to arbitral awards where enforcement proceedings were instituted before the denunciation took effect.

Venezuelan officials have made statements about Venezuela’s withdrawal from such institutions, but that should not affect the current proceedings.

Venezuela and the United States are also signatories to the Inter-American Convention on International Commercial Arbitration (known as the Panama Convention). This convention also provides for the enforcement of foreign arbitral awards in any member state, including 19 Latin American countries. Article 1 of the convention says it applies to “an agreement in which the parties undertake to submit to arbitral decision any differences that may arise or have arisen between them with respect to a commercial transaction…” The Chavez government insists that petroleum agreements are not commercial. The exception for non-commercial transactions is critical in the current disputes.

The New York and Panama Conventions also have more generous grounds for challenging an arbitral award than does ICSID, including that the agreement is invalid under applicable law or that it has been annulled or suspended by a competent authority of the state where the award was made.

This means that an arbitral award can be challenged by courts in the country specified by the choice of law clause in addition to courts in the seat of arbitration. The conventions also allow the state asked to enforce the award to decline to recognize it if the subject of the dispute cannot be settled by arbitration in that state or if recognition would be contrary to its public policy. These several options for questioning the validity of an arbitral award in domestic courts are why investors tend to prefer ICSID arbitration.

88. Id. at art. I(3).
90. New York Convention, supra note 86, at art. XIII.
93. New York Convention, supra note 86, at art. V(1)(a); Panama Convention, supra note 92, at art. 5(1)(a).
94. New York Convention, supra note 86, at art. V(2); Panama Convention, supra note 92, at art. 5(2).
4. Exxon Mobil’s Separate Arbitrations

Although news sources have focused on Exxon’s filing an arbitration request with ICSID, one source reported that the contract at issue allegedly requires that arbitration must be before the ICC International Court of Arbitration in Paris. The news source reported that it had obtained a copy of the sections of the contract dealing with arbitration:

It appears to stipulate in one section that any arbitration claim arising from the project is to be decided exclusively and definitively by “the rules of conciliation and arbitrage of the International Chamber of Commerce.”

However, the following section, titled, the “Alternative Mechanism for the Solution of Controversies” allows for ICSID involvement in case if [sic] the ICC decision “is declared void or cannot be executed in Venezuela for whatever reason.”

A Venezuelan government source told the news service that PDVSA’s lawyers will ask ICSID to ignore Exxon’s petition to open an arbitration case in favor of their interpretation of the contract. The source, also identified as a PDVSA source, said that the lawyers would “approach ICSID with a petition. We are just trying to get Exxon to honor the conflict-solving provisions in the Cerro Negro contract. . . . The contract says ICC should issue a decision first; only if that decision cannot be implemented can one of the parties ask for ICSID arbitration.”

The Exxon attorney described the above uncertainty as having to do with the media’s and Venezuela’s initial confusion over the fact that Exxon has filed two separate arbitration actions related to the events in Venezuela. The parties, the claims, and the forum of each arbitration are different.

The first arbitration is an ICSID arbitration filed on September 6, 2007. This suit is by Exxon and its affiliates against the Venezuelan government. The Exxon attorney said that ICSID’s jurisdiction arises
out of Venezuela’s national Investment Law and the Netherlands-Venezuela BIT.\textsuperscript{103}

The second arbitration is an ICC arbitration filed on January 25, 2008.\textsuperscript{104} This suit is by Exxon’s affiliate against PDVSA.\textsuperscript{105} The Exxon attorney said that the ICC jurisdiction arises out of the Association Agreement with PDVSA, whereby PDVSA agreed to indemnify the Exxon affiliate in the event of an expropriation by the Venezuelan government.\textsuperscript{106} The contractual indemnity provision required that Exxon pursue its rights against the government as a condition for seeking indemnity by PDVSA, so Exxon had to bring the ICSID claim before it could bring the ICC arbitration.\textsuperscript{107}

C. Venezuela’s National or Public Interest

If Exxon can get to arbitration, it has a high likelihood of success. However, Venezuela will try to block the dispute from being submitted to arbitration at all. Venezuela will no doubt raise issues of sovereign immunity and argue that the Venezuelan Constitution and national laws make petroleum disputes an issue of public interest not subject to foreign arbitration.

1. Petroleum Activities are Reserved to the State

Venezuela’s Constitution and national laws, including the nationalization law and the commercial arbitration law, all contain language that Venezuela can cite in an attempt to block arbitration of petroleum disputes or expropriations. Article 12 of the Venezuelan Constitution, enacted in 1999, has a clause addressing ownership of hydrocarbons:

[F]ields of minerals and hydrocarbons existing in the national territory, in the territorial sea, in the exclusive economic zone, and on the continental shelf belong to the republic, are under the regime of public ownership, and hence give rise to inalienable and imprescriptible national rights.\textsuperscript{108}

Article 302 of the constitution reserves petroleum activity, together with “goods of public interest and strategic character,” to the state.\textsuperscript{109} There is

\begin{footnotesize}
\begin{itemize}
\item 103. Id.
\item 104. Id.
\item 105. Id.
\item 106. Id.
\item 107. Id.
\item 109. 1999 Constitution, supra note 108, art. 302.
\end{itemize}
\end{footnotesize}
debate over whether that means such activities may only be carried out by the state. Venezuela’s older nationalization law (known by its Spanish acronym LOREICH) provided that petroleum activities, including exploration, production, transportation, storage, processing, refining, and the internal and external petroleum markets, must be carried out exclusively by PDVSA and its affiliates and that the affiliates must be exclusively state-owned.110 Both LOREICH and the 1999 Constitution state that Venezuela must own all shares of PDVSA, but they differ to the extent that PDVSA affiliates must be state-owned.111 LOREICH is still in effect, but, to the extent that there is a direct conflict with the new constitution, some provisions may have been overruled. However, Venezuela would likely want the extent of any conflicts to be a matter decided by Venezuelan courts.

Venezuela’s commercial arbitration law excludes from arbitration those disputes “directly concerning the jurisdictional powers or functions of the State or of persons or entities of public law.”112 Since petroleum activities can only be carried out through the powers and the functions of the state, this is more evidence that Venezuela did not or could not consent to arbitration of petroleum contracts. A company may feel confident that it has an airtight arbitration clause, but without the consent of the state, there can be no arbitration, and the only remedy may be through local courts.

2. Whether Arbitration is Unconstitutional for Contracts in the Public Interest

In 1995 a group of Venezuelan citizens challenged the arbitrability of disputes regarding oil exploration contracts under Article 127 of the 1961 Venezuelan Constitution, which seemed to make arbitration unavailable for contracts involving the public interest:

In contracts of public interest, even when not expressly stated, there is considered to be incorporated, if not against the nature of the contract, a clause pursuant to which any doubt or dispute that may arise in connection with such contracts and which cannot be amicably resolved by the parties, shall be decided by the competent courts of the Republic, in accordance with its laws, and may not give cause or reason to foreign claims.113

110. Id.
111. Id.
The Venezuelan Supreme Court ruled in 1999 that the exploration agreements were “contracts of public interest,” but also held that the arbitration clause in these agreements was not unconstitutional through the exception in Article 127. This exception specifies that local court remedies would not apply if against the nature of the contract, and the court held that this exception allowed the government, subject to congressional approval, to decide on a case-by-case basis whether to include an arbitration clause in a contract of public interest. The court reasoned that, in cases over the exploration agreements, an eventual arbitral tribunal would not be confronted with issues concerning the “national interest.”

The Venezuelan government reacted immediately to the court’s decision, stating that the court’s decision was not final and advocating that contracts of public interest were subject to jurisdictional immunity and would require litigation in Venezuelan courts.

Only months after this decision, Venezuela approved the new constitution which retained the same Calvo-inspired anti-arbitration language, word for word—this time as Article 151. Commentators suggested that the precedential value of the case may be in jeopardy. The 1999 Supreme Court decision held that the particular exploration agreements at issue were of a commercial or mercantile nature and thus subject to the exception. That decision came right at the turning point of Venezuela’s politics from the Apertura era of promoting international investment to the Chavez era of nationalization. A future Supreme Court might distinguish the nature of the contracts or interpret the exception in Article 151 more narrowly than the earlier decision. In fact, in April 2006, the Venezuelan Supreme Court of Justice set aside an arbitral award because it did not conform to the country’s commercial arbitration law. The court held that when it comes to agreements having (1) a public interest; (2) a direct impact on national development; and (3) a direct impact on the Venezuelan wealth, the controversy cannot be subject to arbitration.

---

115. Id.
116. Id.
118. 1999 Constitution, supra note 108, art. 151; Cremades, supra note 47, at 83.
119. Cremades, supra note 47, at 83.
120. Exploratory Round Decision, supra note 114; Hughes, supra note 117.
Alfredo Morales-Hernandez, who published a notable treatise on the Venezuelan Constitution, has long argued that “contratos de interés público,” are subject to exclusive local jurisdiction.\footnote{Hughes, supra note 117.} Other writers support this assertion, arguing that the exceptions should be construed narrowly and that contracts involving such sectors of national importance as hydrocarbons remain subject to the exclusively-Venezuelan jurisdiction provisions.\footnote{Id.}

3. Effect of Domestic Law on Arbitration

Although domestic law would seem to be irrelevant if the parties consented to international arbitration, Venezuela can assert several arguments to block enforcement of an award or even avoid arbitration altogether: (a) the state was acting in its public capacity and retains full sovereign immunity; (b) since arbitration for petroleum disputes was unconstitutional and against national law when the contracts were signed, consent was an \textit{ultra vires} act, and therefore void; and (c) the dispute is not in regards to a commercial matter, so the tribunal has no jurisdiction.

In regards to (a), under Venezuelan law, petroleum activities have been reserved to the state, and, under customary international law, this is an argument that the “nature” of the government activities in this arena are within its public role, and so it retains complete sovereignty. The New York and Panama Conventions provide up to three different courts in which to challenge the award by claiming lack of arbitral jurisdiction under this theory: the state of the governing law, the state of the seat of arbitration, and the state where enforcement of the judgment is sought.\footnote{See discussion supra Part III.B.3.}

Even if the courts eventually determined that the nature of the contract should be determined by the international, rather than the domestic, definition of commercial, there could still be lengthy and costly delays. Determinations of sovereign immunity can also affect ICSID enforcement. If a state that is asked to recognize an arbitral award finds that, under its law, Venezuela has sovereign immunity, it can refuse to attach assets to enforce the judgment.\footnote{See discussion supra Part III.B.2.}

As for argument (b), arbitration is fundamentally based on consent. An arbitral tribunal has no jurisdiction without the actual consent of the parties. The ICSID Convention explicitly speaks of consent: “The jurisdiction of the Centre shall extend to any legal dispute . . . which the parties to the dispute consent in writing to submit to the Centre.”\footnote{ICSID Convention, supra note 73, at art. 25 para. 1.} The ICC Rules state that “any decision as to the jurisdiction of the Arbitral
Tribunal shall be taken by the Arbitral Tribunal itself. If the Court is not so satisfied, the parties shall be notified that the arbitration cannot proceed. In such a case, any party retains the right to ask any court having jurisdiction whether or not there is a binding arbitration agreement.”

The New York Convention provides that “[e]ach Contracting State shall recognize an agreement in writing under which the parties undertake to submit to arbitration all or any differences . . . concerning a subject matter capable of settlement by arbitration,” and that “[t]he Court of a Contracting State . . . [shall] refer the parties to arbitration, unless it finds that the said agreement is null and void, inoperative or incapable of being performed.”

The Panama Convention refers to “[a]n agreement in which the parties undertake to submit to arbitral decision any differences that may arise . . . .” While this language is less clear, “undertake to submit” likely embodies consent. If the arbitral panel finds that consent was invalid, there is no jurisdiction to proceed with the arbitration, so Venezuela is likely to use all evidence of its Constitution, national laws, and latest Supreme Court holdings to show a lack of consent.

Finally, as to (c), the third way to avoid liability is to argue that the Conventions require the dispute to be of a commercial nature and that, under Venezuelan law, petroleum disputes are not commercial, but rather in the public interest. The issue of whether the contract was commercial, under the New York and Panama Conventions, affects the enforceability of the award. Under ICSID, the issue of whether the subject of the dispute is an investment is jurisdictional and absolute—if it is not an investment, there is no authority to conduct an arbitration. The New York Convention allows countries to make a reservation that it will only apply to “legal relationships . . . which are considered as commercial under the national law of the State making such declaration,” which Venezuela has done. If Venezuela can successfully argue that the disputed contracts cover a non-commercial matter, then the award of an arbitral tribunal may not be enforced under this Convention. Likewise, the Panama Convention applies to “differences that may arise . . . with respect to a commercial transaction,” and so would have a similar vulnerability. The ICSID Convention is the strongest in this area, since it applies to “any legal dispute arising directly out of an investment.”

129. New York Convention, supra note 86, at art. II, para. 1, 3 (emphasis added).
130. Panama Convention, supra note 92, at art. 1 (emphasis added).
131. New York Convention, supra note 86, at art. I, para. 3.
132. Panama Convention, supra note 92, at art. 1.
133. ICSID Convention, supra note 73, at art. 25 para. 1.
Although the term “investment” is not defined in the Convention, and although ICSID tribunals have evaluated the limitation on a case-by-case basis, investment is a broad term that would most likely apply even where the New York and Panama Conventions do not. ICSID tribunals have repeatedly accepted concessions for the exploitation of minerals and hydrocarbons as within ICSID subject matter jurisdiction. This is likely another reason the companies filed an ICSID arbitration as their first choice.

D. Enforcement of an Award

Even if a favorable arbitral decision is rendered, an award can be difficult to collect, and the process can take years. Argentina has been found liable in dozens of arbitration cases since its financial crisis in 2001-2002 when the country forcibly changed contracts from dollars into pesos and froze utility prices. Foreign companies have won a string of rulings against Argentina at ICSID, awarding them hundreds of millions of dollars in compensation for lost earnings. Argentina has so far declined to pay any of the awards.

Venezuela has considerable international assets to attach, including refineries and tankers full of crude oil landing in United States ports. PDVSA still has stakes in fourteen refineries in the U.S., Europe, and the Caribbean worth about $15 billion. If the companies prevail, says James Loftis, chairman of the international dispute-resolution practice at Vinson & Elkins, “these awards will be enforceable because Venezuela will have to export goods in order to survive. . . . Sovereign immunity will make it more difficult to collect, but I don’t think given the reality of their economy, it will make it impossible.”

State-owned PDVSA is the sole owner of Citgo, which operates refineries and gasoline retailers in the U.S. Citgo, the eighth-largest oil refiner in the United States, is Venezuela’s most valuable overseas asset. Citgo has five refineries in the U.S. that experts say could be targeted for seizure to pay a judgment obtained through international arbitration. “The government of Venezuela owns significant assets in

---

137. Mander & McNulty, supra note 37.
140. Hays & Otis, supra note 19.
the United States through Citgo, as well as significant resources that move through the U.S. financial system,” said Jose Valera, a partner with King & Spalding in Houston. “These are assets that could conceivably be subject to an arbitration award.”

Exxon’s chief executive officer Tillerson said that the Chalmette refinery Venezuela owns with Exxon in Louisiana is one of the assets Venezuela could make available as part of a settlement. However, Exxon recently said that U.S. law made it too difficult to go after Citgo assets.

Chavez’s government has been taking actions to limit its exposure in the United States. These actions could be for the purpose of avoiding judgments or as part of Chavez’s general policy of decreasing trade with the United States in favor of doing business with countries like China, Russia, and Iran. In February 2005, Chavez signaled that his government was interested in selling its American oil-refining operations, which include as many as eight U.S. refineries. The move surprised energy executives because the profitability of the refineries was growing. In August 2006, PDVSA sold Citgo’s share of one Houston refinery for $1.3 billion. Citgo then paid off all of its debt and stopped reporting data to Moody’s financial service, thus ending all outside scrutiny of the company’s books. As Chavez seized control of the Orinoco belt oil projects on May 1, 2007, he also announced that Venezuela would end its affiliation with the International Monetary Fund and the World Bank. Venezuela had recently paid off its loans from those organizations.

A perpetual source of uncertainty for investors considering arbitration is the ability to collect an award. News reports cite PDVSA’s shaky

141. Id.
143. Ellsworth, supra note 139. Although no legal theories were mentioned in the quotation, perhaps the representative meant that it was too difficult under U.S. law to get a pre-judgment attachment of Citgo’s assets, because although PDVSA is the sole shareholder, either there is a corporate veil that cannot be pierced or U.S. law limits the extent that Venezuela’s state actions can be imputed against an affiliated company.
145. Simon Romero et al., Citgo’s Status is Giving Houston the Jitters, N.Y. TIMES, Mar. 5, 2005, at C1.
147. Collier, supra note 17.
financial condition as an obstacle to a negotiated solution and question whether the state oil company would have the resources to pay a settlement given the obligations it has to finance the government’s social programs. Investors are increasingly concerned about the financial health of PDVSA amid reports that its debt is ballooning as its output declines. PDVSA’s debt jumped from $3 billion to $16 billion last year amid concerns that it was suffering a cash shortage because of Chavez’s use of its financial resources for political ends. Chavez has tapped into the revenue of the state oil company to finance domestic food and fuel subsidies, social programs, the Fund for National Development, and a $1.7 billion aid program for Cuba and other countries in the Caribbean and Latin America.

Although there are concerns about PDVSA’s finances, there will undoubtedly be sufficient resources to satisfy an award. Money could always be obtained from Venezuela’s sizable crude reserves. It is not unheard of for companies to seize crude oil in payment of judgments. BP won an arbitration case against Libya in the 1970s after the North African nation nationalized investments and BP seized tankers of Libyan crude as payment. Within the past year, western companies that purchased debt for unpaid construction work in the Congo have tried to seize tankers of Congolese oil to satisfy arbitration awards.

With 1.1 million barrels in daily exports to the U.S., Venezuela is the fourth-largest foreign energy supplier behind Canada, Saudi Arabia, and Mexico. The United States is Venezuela’s biggest market, and Venezuelan crude oil is of such low quality that few of the world’s refineries outside the United States can use it. China does not have a refinery capable of handling the heavy crude. New refineries will be able to refine the heavy oil, but the capacity does not currently exist. Under the best of circumstances, China’s retooling of its refineries to handle Venezuela’s sour, or high-sulfur, crude could take five to seven years. This is one reason why it is unlikely that Chavez would carry out his threat to cut off oil sales to the U.S. in retaliation for Exxon’s court orders. Venezuela, lately beleaguered by food shortages, depends

152. Mander & McNulty, supra note 37.
156. Mufson, supra note 153.
heavily on oil exports for about 90% of its export earnings and about half of government revenue. The United States is its main market. Fadel Gheit, an oil analyst at Oppenheimer & Sons, said, “You just cannot go unilaterally and confiscate assets at will like that especially when your largest customer is the government of the company you’re seizing assets from.” Venezuela will also have trouble sidestepping the asset-freeze orders because big commercial transactions mostly go through New York or London banks. “It’s going to be very difficult to move that large a stream of oil outside the U.S. stream of commerce,” said Joseph Profaizer, a lawyer and arbitration expert at Paul Hastings. In light of all of these factors, Venezuela is likely to remain a close trading partner with the United States. Actually finding assets to enforce an arbitral award will not be the most difficult step for the companies.

IV. BUSINESS ISSUES

Although the legal issues can be interesting and complex, business concerns may be much more critical than legal remedies in a company’s assessment of political risk and its decision to arbitrate. In order to arbitrate, ConocoPhillips and Exxon Mobil had to completely walk away from their investments and pin their hopes on a lengthy arbitration process. Other companies may decide that the continued income from their investments and the access to future opportunities in a country are worth accepting reduced profits.

A. Exxon’s Corporate Reputation

Exxon stands out because of its signature method of dealing with governments in countries where it operates. Exxon is famous for heavy litigation in disputes. The company usually takes a hard line with any government that tries to change contract terms, whether it’s Venezuela or the U.S. Congress, which now wants to roll back royalty relief for offshore drilling that was enacted when prices were low. In 2005, Exxon Mobil filed arbitration proceedings at the International Chamber of Commerce in Paris against the government of Yemen for expropriating an oil-producing block with output worth more than $1 billion a year. Exxon Mobil has built a powerful reputation for being a

---

159. *Id*.
company that sticks to contracts and expects its partners to do the same. “Exxon believes that they cannot win in an environment in which there’s essentially no respect for the law,” said Alex Gorbansky, managing director of the Frontier Strategy Group. “If you look at their track record, you can argue that that’s fundamentally a very good practice.”

Exxon executives warn that if oil companies fail to take a stand against unlawful changes in contract rules, they risk sending themselves and the industry down a slippery slope with oil-rich countries demanding more and more concessions. “Exxon has been the most aggressive in fighting the Venezuelan government,” said Michael Shifter, a senior analyst at the Inter-American Dialogue. “[P]eople are going to be watching this decision by the court to see what the parameters are and how far governments can push the companies.” With delicate negotiations over its Sakhalin-1 project in Russia under way, Exxon would not want to be seen as compromising in Venezuela.

Amy Myers Jaffe, an oil analyst with the James A. Baker III Institute for Public Policy at Rice University said that “what happens in Venezuela is something the Russians will look at, and may have bearing on places like Iran, Nigeria, and other countries.” Analysts say that Exxon Mobil’s refusal to renegotiate its Orinoco river basin project likely means that it will sacrifice operations in Venezuela to focus on protecting operations in other countries with energy under government control, notably Russia. Patrick Esteruelas, an analyst with political risk consulting firm Eurasia Group said, “the costs of caving in to government pressure, and the precedent it sets for other sovereign nations where [Exxon Mobil is] currently much more prolific, far outweigh the benefits of staying put.” It is not surprising that Exxon has pursued arbitration, since its corporate style is to litigate heavily and it has relatively little at stake in Venezuela. Other companies compromised after deciding that sacrificing their investments was not worth a potential legal victory.

B. Jeopardizing Further Opportunities in Venezuela

Another reason most companies chose to give up their contractual rights was to maintain a presence in Venezuela. Venezuela’s proven reserves of 79.7 billion barrels ranks seventh in the world. Considered

165. Lesova, supra note 75.
171. Landers, supra note 1.
the largest energy reserve in the Western Hemisphere, the Orinoco Belt may hold up to 260 billion barrels of extractable crude. If that is certified, Venezuela will surpass Saudi Arabia as number one in proven petroleum reserves. The daily output from the Orinoco fields is 483,000 barrels per day. The old contracts enabled today’s so-called “windfall profits,” and companies could give back some of the upside potential of the contracts and still earn good returns.

Gersan Zurita, an oil-industry analyst with credit evaluator Fitch Ratings, said the companies fear being black-listed by Chavez and losing out on future oil deals. “It’s a very delicate situation. It involves more than just these contracts . . . . The biggest incentive is to preserve access for the future. These are enormous reserves.” Companies must consider that a country may not allow them to return once they’ve launched an arbitration, said Ray Whitman, a partner with Baker Hostetler in Houston. “They are long, drawn-out fights,” he said, “and then you have to worry about whether you ever have to do business in that country again.” For example, Chevron accepted Chavez’s new contract terms, in part because it was also negotiating access to a large natural gas project in Venezuela.

For the most part, Western oil companies have accepted the new terms. StatoilHydro, a division of Norway’s national oil company, signed a deal with Venezuela in January 2008 to step up operations in the Orinoco belt. Thore Kristiansen, who runs Statoil’s Venezuelan operations said, “We see enormous reserves potential in Venezuela.” Eni, the Italian oil and gas group, has recently agreed to invest $4 billion to develop in the Orinoco Belt. The project conforms to the new contract terms imposed by Chavez and gives PDVSA 60% of the joint venture. The investment exposes Eni to the risk of further expropriation, but gives it increased access to Venezuela’s huge reserves ahead of its European and U.S. competitors. Eni’s agreement comes two weeks after it agreed to drop arbitration over Venezuela’s expropriation of an oil field, highlighting the political nature of the deal. Total and Royal Dutch Shell have also recently signed preliminary investment agreements with

173. Id.
175. Collier, supra note 17.
176. Hays & Otis, supra note 19.
177. Id.
Chavez’s government has been eager to sign deals with other Western oil companies in an attempt to show that Exxon and ConocoPhillips are isolated in the industry. “There’s an overriding issue here,” said Pedro Burelli, a former member of PDVSA’s board who lives in the U.S. “Has resource nationalism made Venezuela irrelevant despite 300 billion barrels of reserves? Are you such a bad partner that you’re irrelevant?” Asked whether the Orinoco was too big to walk away from, Exxon chief executive officer Tillerson responded, “Well, nothing’s too big to walk away from us.”

Analysts say the other companies that have stayed hope to ride out the nationalistic trend and end up with more favorable terms in coming years. Tim Cejka, president of Exxon’s exploration business, acknowledged that access to oil fields was becoming increasingly challenging, but he said that the global oil industry has been through similar periods of restricted access. “Access comes in cycles,” Mr. Cejka said, “and I have got to admit, it’s tough right now.” Companies whose Venezuelan assets were nationalized in the 1970s and made available again in the 1990s know the pitfalls of operating there and assume that Chavez will not be around forever. As long as companies are able to make some profit, they are willing to give up their contract rights in return for the opportunity to be considered for future investments.

C. Relative Risk

The Venezuelan nationalizations reflect a trend in some resource-rich countries, such as Bolivia, Russia, and Kazakhstan, toward renegotiating contracts with foreign oil companies now that prices are high. “The present oil price climate can put tremendous political pressure on more populist governments with regard to foreign investors,” said James Loftis. When oil prices are high and citizens see record wealth leaving their country, they put pressure on their government to take a bigger share. Oil-rich nations, such as Russia and Nigeria, will be influenced by the results of Venezuela’s demands. “How this case is handled is going to be a signal about whether countries have free rein to renegotiate contracts when the underlying circumstances change,” said David Victor,
director of an energy and sustainable development program at Stanford University. Producing countries, he said, assume that oil firms are without bargaining power once they have sunk capital into a venture. With oil prices soaring and new oil fields hard to come by, Chavez has the better bargaining position. Jeroen van der Veer, chief executive officer of Royal Dutch Shell, has warned that the increasingly nationalistic position of oil-rich countries and their redrawing of contracts is a new reality that international energy companies have to accept. Mr. van der Veer said, “The higher the oil and gas price is, the more national thinking you get. This is a new reality. In the end, governments are always the boss.” He said that using lawsuits to fight the loss of control and profit share that comes when countries such as Venezuela change contract terms was “counterproductive . . . good luck!” In Venezuela, Conoco decided to walk away from investments, choosing instead negotiation on compensation that is likely to be prolonged and uncertain, and which could end up in arbitration. In the United States, on the other hand, it agreed to give into demands for higher royalties from the Gulf of Mexico. Many in the industry see the two moves as part of the same global problem confronting the industry: the attempt by governments to cash in on record profits.

One reason most companies have declined to fight the various measures squeezing their operations is that Venezuela remains a relatively friendly place to do business. Oil and gas experts compare Venezuela to other countries, such as Nigeria, where militant attacks hinder production, and Southeast Asia, where insurgents can interrupt business. While Venezuela’s politics might be risky, its geology is not, with its oil easy to find. Luis Giusti, president of PDVSA from 1994 to 1999, said that many companies have little choice but to look to Venezuela because their reserves elsewhere are dwindling and their access to the Middle East is limited by those nation’s government monopolies. “There’s a low risk in Venezuela for discovering oil, and these companies know that,” said Alejandra Leon, an oil analyst in Mexico City with Cambridge Energy Research Associates. “They are able to pay higher royalties in exchange for more access because it’s getting harder and harder to gain access to oil reserves.” Roger Tissot,

190. Mufson, supra note 153.
191. Landers, supra note 1.
192. Catan et al., supra note 166.
193. Id.
194. McNulty, supra note 185.
197. Collier, supra note 17.
198. Landers, supra note 1.
director of countries and markets at PFC Energy, a consultant group based in Washington, said that oil production in “business-friendly” countries is quickly declining, meaning that companies will have to work under increasingly changeable conditions. “Nothing upsets an oil executive quite as much as having a contract changed,” Mr. Tissot said, "but the problem that private oil companies face is there just aren’t that many production areas available for them.”

During the last several decades, control of global oil reserves has steadily passed from private companies to national oil companies. According to a Rice University study, 77% of the world’s 1.148 trillion barrels of proven reserves is in the hands of national companies, and fourteen of the top twenty oil-producing companies are state-controlled.

A more recent estimate claims that Western majors, which once dominated the global energy business, now control only about 6% of the world’s oil reserves. Last year, PetroChina overtook Exxon as the world’s largest publicly-traded oil company.

Rodolfo Guzman, a director in Arthur D. Little’s Global Energy Practice, favors staying the course. “Countries with prospectivity like Venezuela are rare, and those that allow for investment can be counted on your fingers,” he says. Companies may look at the business implications of renegotiating contracts or arbitrating and decide to concede to government demands rather than lose still valuable opportunities.

V. NEW DEVELOPMENTS—MEDELLIN AND SOVEREIGN IMMUNITY

A country that has already agreed, in treaties or contracts, to arbitrate disputes may not like how the obligation conflicts with domestic social or economic policy choices. This is a universal complaint, even heard recently in the U.S., when presidential hopeful Hillary Clinton said, “[W]e will have a very clear view of how we’re going to review NAFTA. We’re going to take out the ability of foreign companies to sue us because of what we do to protect our workers.”

When a state receives an unfavorable decision from an arbitral tribunal, the host government will always look for an opportunity to reexamine the decision in local courts or to avoid paying the award as contrary to public policy. Arbitration organizations have attempted to make enforcement of awards as automatic as possible by limiting the ways that they can be reopened for scrutiny. However, a recent U.S.
Supreme Court decision has the potential to be used by foreign countries in an effort to avoid payment of judgments. The recently-released opinion in Medellin v. Texas interprets a treaty and finds that the parties consented to the jurisdiction of the tribunal but did not expressly consent to the enforceability of the judgment:

The most natural reading of the treaty at issue is as a bare grant of jurisdiction. It provides only that “disputes arising out of the interpretation or application of the [treaty] shall lie within the compulsory jurisdiction of the [tribunal]” and “may accordingly be brought before the [tribunal] by any party to the dispute. . . .” The treaty says nothing about the effect of [a decision by the tribunal] and does not itself commit signatories to comply with [a] judgment. The treaty is similarly silent as to any enforcement mechanism.205

The Court emphasizes that “submitting to jurisdiction and agreeing to be bound are two different things. A party could, for example, agree to compulsory nonbinding arbitration. Such an agreement would require the party to appear before the arbitral tribunal without obligating the party to treat the tribunal’s decision as binding.”206 Chief Justice Roberts is explicit about using a textual approach and defends it against criticism from the dissent.207 The extent to which a state waives its sovereign immunity and consents to arbitration depends on the explicit language of the contract term.

Under the logic of the case, a country which was the object of an arbitral award could argue that it consented to the jurisdiction of the arbitral panel, but did not waive its sovereign immunity with respect to payment of the award. For example, a contract clause providing that disputes shall be submitted to arbitration under ICC jurisdiction may not be held to be an explicit textual waiver of sovereign immunity with respect to payment of the judgment. This issue has been known in contract drafting for some time, and practical guides to arbitration clauses recommend that the contract include an explicit waiver of sovereign immunity from service of process, jurisdiction of the tribunal, and post-judgment execution of the judgment, in addition to language that provides the arbitral award is final and binding.208

The majority opinion tries to avoid any effect on investment disputes by stating that the “holding does not call into question the ordinary enforcement of foreign judgments or international arbitral

---

206. Id.
207. Id. at 1361-62.
agreements;”\textsuperscript{209} however, this is undercut by language immediately following: “as a general matter, ‘an agreement to abide by the result’ of an international adjudication—. . . an agreement to give the result of such adjudication domestic legal effect—can be a treaty obligation like any other, so long as the agreement is \emph{consistent} with the Constitution.”\textsuperscript{210} Private investors who rely on international arbitration do not want judgments to be reopened by local courts to determine the extent to which they are consistent with the nation’s constitution. For example, Venezuela’s constitution and national laws seem to make such awards unconstitutional. If Venezuela were to have a domestic court reopen the judgment, it would be able to use \textit{Medellin} as evidence that, even under United States law, it would not be obligated to pay a judgment inconsistent with national law. The majority glosses over this issue by stating that “[t]he judgments of a number of international tribunals enjoy a different [i.e., enforceable] status because of implementing legislation enacted by Congress.”\textsuperscript{211} The concurring opinion also tries to reassure that foreign arbitral awards, specifically ICSID awards, are not affected, but Justice Stevens does this by pointing to implementation by the U.S. Congress, suggesting that the enforceability of contractually agreed-to arbitral awards depends on domestic legislation.\textsuperscript{212} Investors would respond to both of these attempts to comfort them by pointing out that they do not want the enforceability of their award and judgment to be conditioned upon domestic legislation of the host country.

Finally, the Court makes a distinction between a commercial dispute and a political one: “\textit{Medellin} does not ask us to enforce a foreign-court judgment settling a typical commercial or property dispute . . . . Rather, \textit{Medellin} argues that the . . . judgment has the effect of enjoining the operation of state law.”\textsuperscript{213} However, host countries often have state laws addressing petroleum. They could argue that since a petroleum dispute is an issue of national or public interest, addressed by domestic law, the foreign judgment is not a mere commercial dispute and should not be given effect.

VI. CONCLUSION

Although the availability and desirability of international arbitration for foreign investments has grown significantly, the arbitration process cannot be viewed in a vacuum. There are many challenges even in enforcing the arbitration clause to gain access to a tribunal, much less

\footnotesize{\textsuperscript{209} See \textit{Medellin}, 128 S. Ct. at 1365.  \\
\textsuperscript{210} Id. (emphasis added).  \\
\textsuperscript{211} See \textit{id.} at 1366.  \\
\textsuperscript{212} See \textit{id.} at 1373 (Stevens, J. concurrance ).  \\
\textsuperscript{213} Id. at 1366.}
eventually collecting an award. Countries retain significant sovereign powers and wide latitude to exact concessions from investors, who may value future investment opportunities more highly than ensuring the sanctity of contract rights. While an arbitration clause is properly viewed as a necessary part of an agreement, an investor should be aware of the uncertainty involved in relying on it.