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**ENFORCING *PACTA SUNT SERVANDA*? CONOCO-PHILLIPS AND EXXON-MOBIL
VERSUS THE BOLIVARIAN REPUBLIC OF VENEZUELA AND PETRÓLEOS DE
VENEZUELA**

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ABSTRACT : In 2007, the government of Venezuela decided to re-structure certain oil projects, known as Associations, so as to bring them in line with the 2001 Hydrocarbons Law. In response, ExxonMobil and ConocoPhillips decided to exit Venezuela. Supposedly motivated by a commitment to uphold the principle of sanctity of contract, the companies subsequently initiated a series of arbitrations involving some of the largest claims ever put before international tribunals. However, the bargains that the companies insist they are defending are not reflected in the agreements that they had actually signed. Thus, these arbitrations amount to an attempt on the part of these companies to use international arbitral tribunals to re-draft on their behalf the contracts they had negotiated, so as to secure a windfall (which they had never bargained for) upon their exit from Venezuela.

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'But Socrates' said Hippias, 'how can anyone take laws seriously or believe in them, when often the same people who established them repeal and change them?'

(Xenophon, *Memorabilia*, 4.4.14.1-4)

Die Lüge wird zur Weltordnung gemacht

(The world-order is based upon a lie).

Franz Kafka, *Vor dem Gesetz* (*Before the Law*)

In 1968, in a review of books dealing with oil concessions of the Middle East, Prof. Arghyrios A. Fatouros wrote that a colleague of his was finding it quite difficult to pursue his study of the international legal problems surrounding foreign investment "without being almost constantly distracted by petroleum fumes". Fatouros added that "problems of oil investments abroad ... dominated to an extraordinary extent the legal debate and literature" in the area of "treatment and protection of private foreign investment in developing countries".¹ Fast forward by more than half a century, and the whiff of petroleum is still pervasive – at times, indeed, overpowering – in the (mine)field of dispute resolution between international investors and nation states. Admittedly, with the proliferation of bilateral and multilateral investment treaties ("BITs" and "MITs", hereafter), and the development of "an entirely new body of international law" centred upon "the interpretation of investment treaties embodying ambiguous and malleable concepts such as 'fair and equitable treatment'", the number of disputes submitted to international arbitration soared in the years after Fatouros penned his review.² Thus, it is certainly no longer the case that "most of the few postwar arbitrations worthy of being cited in discussions of private foreign investment problems ... relate to petroleum".³ That being said, petroleum-related arbitrations continue to be in a class of their own in terms of both the magnitude of the sums at stake and the complexity of the legal

questions at issue, to say nothing of the political explosiveness of the disputes themselves.

An excellent case in point are the four arbitrations – two ongoing, and two concluded, as of the time of writing – that affiliates of either ConocoPhillips (“COP”) or ExxonMobil (“XOM”) have brought against the Republic of Venezuela or Petróleos de Venezuela S.A. (“PDVSA”, the country’s national oil company), before the International Centre for Settlement of Investment Disputes (“ICSID”) and the International Chamber of Commerce (“ICC”), respectively. The legal disputes at the core of these arbitrations arose from the decision on the part of the Venezuelan government – embodied in Decree-Law 5.200, promulgated by the late President Hugo Chávez on February 26, 2007 – to re-structure certain oil projects, known as Associations, so as to make them compliant with the legal requirements applicable to all other companies with oil activities in Venezuela, as set out in the 2001 Hydrocarbons Law.⁴ This essentially required that such Associations – in which PDVSA affiliates had not been permitted to hold a majority stake – be transformed into mixed companies in which PDVSA affiliates were to have a minimum 60 per cent shareholding.

This process of transformation from the association form to the mixed company form – referred to as “migration” in official Venezuelan parlance – neither expelled foreign oil companies nor banned private participation in the country’s oil industry. Naturally, in order to ensure the continuity of the operations, provisions had to be made whereby the PDVSA affiliates involved in the projects would take over the activities and assets of any company that did not reach basic agreement regarding the migration of its interests within the initial four-month period set out in Decree-Law 5.200 (companies that did come to such an agreement had an additional two months to finalise the terms of their migration and then submit the resulting mixed enterprise projects to the approval of the Venezuelan National Assembly). In the event, these provisions had to be invoked when two companies, COP and XOM, declined to participate in the migration of their interests. Thus, on the 27th of June 2007, all COP and XOM assets dedicated to oil exploration and production in Venezuela had to be duly taken over by PDVSA.⁵

This decision on the part of these two American companies has been presented as the calamitous culmination of a process whereby, through a mixture of bullying and unilateral measures, the Chávez administration sought to impose extortionate new terms on oil exploration and production activities in Venezuela, which rode roughshod over the vested rights of investors. Chávez's actions, so this story goes, not only led to suspension of the transfer of managerial know-how and technology from which Venezuela had benefited so handsomely throughout the 1993-2006 period (and without which the gigantic resources of the Orinoco Oil Belt would not have been developed) but, ultimately, paved the way for the involuntary exodus of foreign oil companies from the country and the expropriation without compensation of their assets. That being the case, so this version goes, the aggrieved companies involved were left with no alternative but to initiate legal proceedings against a rogue government and its state oil company and affiliates.

The picture presented in the paragraph above is drawn in strokes so broad and crude that it reduces the conduct and outcomes of Venezuelan oil policy from 1999 onwards to the level of a mere caricature. Nevertheless, the broadcast and print media have had no qualms about echoing and amplifying it, while a number of OECD governments – most especially, that of the USA – have seemed equally at ease to use it as a premise for taking foreign policy decisions with regard to Venezuela. That such credence should be vouchsafed to unproven allegations raised in the context of acrimonious litigation is hardly unprecedented in the annals of US foreign relations. Unfortunately, as on many a previous occasion, this facile stance contributes nothing towards understanding the real issues underlying, and arising from, a state's exercise of its sovereign powers to the apparent detriment of the rights (real or alleged) of foreign investors.

At first glance, one would think that anybody seeking to shed some light on the confusion surrounding the re-structuring of oil contracts in Venezuela would be well advised not to waste time investigating any of the arbitrations mentioned above. After all, arbitration is meant to be a process that is highly refractory to outside scrutiny (indeed, that is one of its main attractions, compared to litigation in an ordinary court of

law), and detailed information on ICSID and ICC arbitrations is not easy to come by. The Venezuelan oil arbitrations mentioned above, however, are an exception to this particular rule. Due to the litigation strategies adopted by the various parties (but especially XOM), there is plenty of information available in the public domain on both these legal proceedings and the disputes underlying them. The key sources of such information are as follows:

- Documents associated with the court proceedings whereby XOM sought (successfully, as it turned out) to obtain an *ex parte* attachment of funds (i.e. without prior notification to the affected party) of PDVSA affiliate PDVSA Cerro Negro in New York (27 December 2007).⁶
- Documents associated with XOM's – eventually unsuccessful – attempt to obtain in the High Court in London, also on an *ex parte* basis, a “Worldwide Freezing Order ... [of] up to US \$12 billion ... in support of ICC Arbitration proceedings ... seeking compensation for losses arising from the expropriation without compensation, of the Claimant's interests in the Cerro Negro area of the Orinoco belt” (January 24, 2008; discharged March 18, 2008).⁷
- The partial decision on jurisdictional matters of the arbitral tribunal hearing regarding XOM's claims against the Republic of Venezuela, published June 10, 2010. (Due to the complexity of this case, the members of this tribunal decided to bifurcate the proceedings and hold separate hearings on questions of jurisdiction, firstly, and questions relating to the legal merits and quantum of damages, subsequently.)⁸
- The award of the ICC tribunal in the case *Mobil Cerro Negro Ltd. v. Petróleos de Venezuela S.A. et al.*⁹
- The award of the ICC tribunal in the case *Phillips Petroleum Company Venezuela Ltd. and Conoco Phillips Petrozuata B.V. v. Petróleos de Venezuela*.¹⁰
- Offering memoranda for bonds to finance projects, and other miscellaneous materials (notably leaked diplomatic cables from personnel at the US embassies in Venezuela and elsewhere).

And last, but by no means least,

- Official Venezuelan documents produced in connection with the procedures for Congressional approval of all associations between PDVSA affiliates and private companies, pursuant to the 1975 Venezuelan Oil Nationalisation Law.¹¹

A propos of these official documents, the 1975 Law barred private capital from participating in the essential activities of the oil industry¹², subject to two exceptions, one being that:

in special cases and if convenient for the public interest, the National Executive ... may, in the exercise of any of the indicated activities, enter into association agreements with private entities, with a participation that guarantees control on the part of the State and with a specified duration. The execution of such agreements shall require the prior authorisation of the [Congressional] Chambers in joint session, within the conditions that they establish, once they have been duly informed by the National Executive of all the pertinent circumstances.¹³

These requirements for approval and information were expressly established out of a “concern that such exceptional cases be covered with great legal certainty and extreme control”.¹⁴ And precisely on account of such concern, the association projects between PDVSA and its foreign partners gave rise to a paper trail of documents (produced in fulfillment of the stringent regulatory requirements mentioned above), which include reports by the Venezuelan Executive to the Bi-Cameral Congressional Commission on the pertinent circumstances for each proposed project, reports to the Venezuelan Congress by this same Commission, the Congressional authorisations of the Framework of Conditions for specific projects (published in Venezuela's *Official Gazette*), not to mention the Association Agreements themselves (which also had to be made available to the Venezuelan Congress, even though there continues to be a widespread misperception that their contents were always strictly confidential).

Such is the level of detail in this material that it is no exaggeration to say that a competent specialist in the field of international law would probably not find it difficult to reproduce the arguments submitted by the parties to the relevant tribunals (in a manner

akin to that by which William of Baskerville was able to visualise much of the second book of the *Poetics* of Aristotle, without ever having had to read or even touch any of the poison-laced pages of the sole surviving exemplar of that work).¹⁵ An ambitious exercise in textual reconstruction along such lines lies well beyond the scope of this article, not to mention the capabilities of its author. Nevertheless, it is still quite possible – and not especially difficult – for a researcher with a modicum of familiarity with international law to paint a thorough picture of these cases, provided of course that the right questions are asked.¹⁶

Brief Overview of the Projects

But before such questions can be posed, some background information on the five projects at issue in the arbitrations is essential. Known as Petrozuata, Hamaca (or Ameriven), Corocoro, Cerro Negro and La Ceiba (the first three involved COP affiliates, while the latter two involved XOM affiliates), these projects fall into two separate categories. Petrozuata, Hamaca and Cerro Negro were large integrated projects dedicated to the production, transportation and upgrading (i.e. partial refining) of extra-heavy ("XH") crude oil (very dense and viscous crude oil, heavier than water) from the Orinoco Oil Belt, and to the marketing of the resulting upgraded (i.e. synthetic) crude oil ("UCO") and associated by-products (intermediate feedstocks, sulphur, petroleum coke). La Ceiba and Corocoro, in contrast, were projects focused on conventional oil and gas exploration and production activities, undertaken pursuant to so-called Profit Sharing association contracts, which were authorised by the Congress of Venezuela in 1995 to allow private investors "to explore for oil with no participation by a State owned entity".¹⁷ Key milestones and statistics for each one of these projects are summarised below.

- Petrozuata: Association Agreement (henceforth "AA") signed in 1995 (50.1 per cent COP, 49.9 per cent PDVSA).¹⁸ Total investment: MMUSD 2,500 (COP investment: MMUSD 1,250). Congressional approval: 1993. Commercial startup: 2002. Initial capacity: approximately 100 MBD of low gravity (\approx 22° API) UCO, obtained from processing 120 MBD of XH crude.

- Hamaca (Ameriven): AA signed in 1997 (39.9 per cent COP, 30.1 per cent Chevron, 30 per cent PDVSA).¹⁹ Total investment: MMUSD 4,000 (COP investment: 1,600 MMUSD). Congressional approval: 1997. Commercial startup: 2005. Initial capacity: approximately 150 MBD of medium gravity ($\approx 26^\circ$ API) UCO, obtained from processing 197 MBD of XH crude.
- Corocoro: Profit Sharing Agreement signed in 1995 (32.5 per cent COP, 26 per cent Agip, 6.5 per cent Opic Karimun, 35 per cent Corporación Venezolana del Petróleo, “CVP”, a PDVSA affiliate). COP outlays: 230 MMUSD. No production at the time of PDVSA takeover.²⁰
- Cerro Negro: AA signed in 1997 (41 2/3 per cent XOM, 41 2/3 per cent PDVSA, 16 2/3 per cent BP).²¹ Total investment: 1,600 MMUSD (XOM investment: 667 MMUSD). Congressional approval: 1997 Commercial startup: 2002 Initial capacity: approximately 100 MBD of very heavy (16° API) UCO, obtained from processing 120 MBD of XH crude.
- La Ceiba: Profit Sharing Agreement signed in 1996 (XOM 50 per cent, PetroCanada 50 per cent). XOM outlays: 180 MMUSD. No development undertaken at the time of PDVSA takeover.

The production and investment figures cited above are very relevant in terms of any discussion of the damages being claimed by both COP and XOM (also, because neither the Corocoro nor La Ceiba projects were in production at the time COP and XOM exited Venezuela, it should be borne in mind that these two projects make a negligible contribution to the respective damages claims of these companies). Furthermore, it is useful to bear in mind that, to migrate their interests in the upgrading projects pursuant to Decree-Law 5.200, COP and XOM would have had to reduce their stakes in Petrozuata and Hamaca, on the one hand, and Cerro Negro, on the other, by 10.1 and 11.1 percentage points, and 13 percentage points, respectively.

There is one more aspect of the associations that needs to be highlighted at this point, given its prominence in all of the arbitration proceedings. This is the fiscal conditions

that the upgrading projects enjoyed at the time they were undertaken. Even before any concrete deals had been negotiated, let alone signed, PDVSA had mounted an intense lobbying effort to convince the Venezuelan government that unprecedentedly generous fiscal conditions (i.e. negligible royalties, no special petroleum taxes), would have to be applied to all associations if they were to be made sufficiently attractive for private investors. Thus, the various reports directed to Congress by any of PDVSA, the executive or the aforementioned Bi-Cameral Congressional Commission, as well as the Congressional authorisations for each one of the associations, all contain language to the effect that the projects would benefit greatly from – and hence, should apply to receive – preferential royalty treatment from the Venezuelan government.²² Crucially, though, none of these documents made any representations whatsoever that this preferential treatment would, in fact, be granted. Moreover, when PDVSA and its foreign partners decided to go ahead with these ventures, the Republic of Venezuela was not a party to any of their agreements.

As things turned out, a royalty reduction did eventually materialise in the form of a Royalty Agreement subscribed in May 1998 between PDVSA and the Ministry of Petroleum, and which the Petrozuata, Hamaca, Cerro Negro and Sincor upgrading associations all subsequently adhered to.²³ Thus, despite the supposedly intimate connection between the viability of the upgrading projects and a royalty remission, this agreement was only finalised some time after PDVSA and its partners had already decided to go ahead with the Petrozuata and Cerro Negro projects, and even after the financing for both projects through the issuance of bonds in international capital markets had gone through.

The royalty agreement for the Orinoco AAs provided for the royalty obligations of the upgrading projects to be assessed at a reduced rate of one per cent (as opposed to the prevailing statutory rate of 16 2/3 per cent) from the moment that each upgrading plant started commercial operations, until such time as the cumulative gross income of an individual project had exceeded its total investment by a factor of three (but in no event for a period longer than nine years), whereupon the usual statutory royalty rate –

whatever that might be at the time – was to apply once again.²⁴ This particular tax break came into being through the creative interpretation of the 1943 Hydrocarbons Law, which gave the Venezuelan executive the faculty to reduce royalty rates, albeit only with the purpose of prolonging the useful life of a producing field and not to improve the start-up economics of development projects.²⁵ This legalistic sleight of hand was made considerably easier by the fact that the agreement was signed at a time when oil prices were at their lowest since the 1940s (in real terms).²⁶

In addition to this preferential royalty treatment, provisions were enacted to allow the participants in all upgrading projects (including PDVSA) to pay income tax under the ordinary corporate regime applicable in Venezuela.²⁷ In other words, both the taxable income and liabilities of these projects were to be calculated on the basis of the rates applicable – and the deductions allowable – to companies outside the petroleum sector.²⁸ It is worth pointing out that the projects could have been made subject to the income tax rate applicable to non-oil enterprises without their being moved out of the petroleum section of the Income Tax Law, but PDVSA insisted that international investors would view this as an inferior alternative, and its point of view prevailed.²⁹ However, the placement of the Associations in the non-oil section of the Income Tax Law was, again, not accompanied by any kind of assurance that they were to remain there indefinitely.

In the event, from 2000 onwards (and especially after 2003), oil prices began to rise in a way that made it possible for foreign participants in the associations to achieve very robust returns on their investments in the absence of any preferential fiscal treatment. By 2004, international oil price levels were more or less double those registered in 1998. Given this radical change in market circumstances, in October 2004, the Venezuelan executive disposed that the royalty obligations of the upgrading projects would thereafter be calculated on the basis of the 16 2/3% statutory royalty rate. This decision was taken pursuant to the 1943 Hydrocarbons Law, which gave the Venezuelan executive branch the faculty to reinstate the statutory royalty rate when, at

its sole discretion, the reasons that had justified a royalty reduction being granted in the first place no longer applied.³⁰

As oil prices continued to increase without letup, the Venezuelan government (in common with many other governments around the world) evaluated further measures to limit the windfall profits accruing to oil companies. Thus, in June 2005, the Minister of Energy and Mines announced that the Income Tax Law would be amended to subject the upgrading projects to the 50 per cent income tax rate generally applicable to companies in the hydrocarbons sector. These amendments only crystallized in August 2006, thereby bringing into effect a uniform income tax regime for all companies producing oil in Venezuela. Shortly before that, in May 2006, Venezuela had also introduced a uniform 33 1/3 per cent extraction (severance) tax against which royalties would be creditable, and assessed on the gross value of all liquid hydrocarbons extracted from any field. Even after these two measures, enacted in a year when the international price of crude oil for the first time ever averaged over 65 USD/B, the profitability of the upgrading associations was still way in excess of the profitability estimates that both COP and XOM had presented to prospective buyers of the bonds used to finance all three upgrading projects, and which had been calculated on the basis of oil prices which, nowadays, appear ridiculously low.³¹ In this regard, it is worth recalling that the breakeven heavy crude oil price for the Petrozuata project was only 8.63 USD/B.³²

As the migration was unfolding, further adjustments to the Venezuelan fiscal regime had to be made in order to keep it abreast of international oil market trends in 2007. Thus, as part of the migration fiscal package itself, a shadow tax was enacted whereby, if the sum of gross income levies and income tax paid by a project amounted to less than 50 per cent of its gross income, a supplementary payment would have to be made in order to bring the total government take up to the 50 per cent mark. And in 2008, with migration in the rearview mirror but oil prices reaching both cycle and historical maxima (in both nominal and real terms), the Venezuelan government enacted a windfall profits

tax targeting income accrued at prices exceeding 70 USD/B for the Venezuelan export basket.³³

An International Arbitration Primer

At this point, it is advisable to open a parenthesis to give a brief sketch of international arbitration procedures, covering the various fora where such arbitrations can take place, the rules and principles under which they unfold, the legal nature of the claims involved. For anybody wishing to discuss a specific arbitration in the context of the evolution of the international dispute regime, this constitutes helpful background information. For the Venezuelan cases at hand, however, such information is downright essential, mainly on account of the considerable potential for confusion inherent in the overlapping character of claims raised by COP and XOM against the Venezuelan government, on the one hand, and affiliates of PDVSA, on the other hand, their positioning in different fora, and their grounding in alleged breaches of radically disparate legal instruments.

In taxonomical terms, the first key distinction that has to be drawn is between institutional and *ad-hoc* arbitrations. The former take place in established fora which not only administer the proceedings under the aegis of comprehensive rules (dealing with matters such as the appointment, removal and replacement of arbitrators, or the duration of the proceedings, say) but also render practical assistance to the members of arbitral tribunals (in terms of timetables, communications, revision and publication of the awards, and so on), in exchange for structured fees paid by the parties to disputes. In contrast, *ad-hoc* arbitrations are administered by the arbitrators and the parties themselves, either under tailor-made or general (i.e. United Nations Commission on International Trade Law, “UNCITRAL”) rules. All of the recent international arbitrations involving either the Venezuelan government or state-controlled entities (and certainly all of the cases discussed in this article) are of the institutional variety.

Within this broad institutional category, one can classify arbitrations according to the nature of the legal instruments conferring on foreign private parties the right to take a

state and/or its national companies before an international tribunal in the first place. According to a leaked confidential cable originating in the US Embassy in Caracas, entitled *International Arbitration vs the BRV* (Bolivarian Republic of Venezuela), such instruments are as follows: "bilateral investment treaties (BITs), contractual provisions providing for international commercial arbitration, and domestic law". (This might seem like a peculiar document to cite as a background source in a discussion on international arbitration, but it is actually quite apposite, given the prominence of other such leaked cables throughout the rest of this paper).³⁴

With regard to treaty arbitration, the cable points out that this "refers to arbitration proceedings in which the underlying claim stems from a state's alleged breach of its obligations under an international treaty -- generally, a BIT. These claims are [commonly, albeit not invariably] submitted to [ICSID]".³⁵ Treaty arbitrations can be brought against states by investors qualifying as nationals of countries with which such states have signed a BIT. (Investors whose home countries have not signed such a BIT with a particular country may still claim treaty protection if their investments in such country have been structured through subsidiaries incorporated in jurisdictions that are covered by a BIT.) As well as not being subject to appeal, ICSID arbitral awards are equivalent to "a final judgment of a court" in all of the ICSID Contracting States. Approximately 63 per cent of all cases registered under the ICSID Convention and Additional Facility Rules concern investors invoking the protection of a BIT, while a further 11 per cent have been brought under the aegis of either an MIT (such as the Energy Charter Treaty, "ECT"), or else a number of Free Trade Agreements (including the North American Free Trade Agreement, "NAFTA") which, for these purposes, effectively function as BITs.³⁶ In addition, twenty per cent of the ICSID caseload is due to specific investment contracts between investors and host-states.

Structuring through a favourable BIT jurisdiction may not even be necessary if an investment is made in a country that happens to have in its statutes an investment protection or promotion law that unambiguously provides for international dispute resolution in a specific forum. In such a case, domestic legislation serves as a unilateral

consent to the jurisdiction of an international arbitral (generally ICSID) tribunal and, as the aforementioned US embassy cable notes, offers foreign investors “similar protection as BITs, protecting against expropriation or equivalent measures, requiring fair and equitable treatment for foreign investors, most-favored nation treatment (MFN) and free transfer of investment returns”.³⁷ Approximately 6 per cent of the ICSID caseload involves disputes where claimants have relied on provisions in investment laws of host states as the basis to invoke ICSID jurisdiction.³⁸ Such claims can be designated investment law claims, in order to distinguish them from treaty claims proper.

The third type of institutional dispute resolution is traditional international commercial arbitration, which “refers to resolving commercial disputes between transnational actors (whether private parties or states) pursuant to the terms of an arbitration clause in the underlying agreement”.³⁹ This type of arbitration goes much further back in history than investor versus state treaty arbitration, and it is rooted in the common sense notion that, given considerations of distance, language and lack of familiarity, parties of different nationalities engaged in international commerce will tend to be wary of each other’s respective jurisdictions, and may prefer to resort to a neutral and mutually convenient venue and forum to settle their disputes, not least since these will often hinge on matters of a technical nature and not involve grand legal principles. Among such fora, the ICC is far and away the most popular option (according to a 2010 survey, the ICC accounted for 50 per cent of commercial arbitration cases, distantly followed by the London Court of International Arbitration with 14 per cent, the International Centre for Dispute Resolution of the American Arbitration Association with 8 per cent, and the Singapore International Arbitration Centre with 5 per cent).⁴⁰ In common with ICSID arbitration awards, commercial arbitration awards are not subject to normal appellate review. However, commercial arbitration awards do require additional enforcement procedures for their execution; namely, to be confirmed in a domestic court of law (a process meant to be greatly facilitated by the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, which calls for signatory states – currently 146, including Venezuela – to enforce international arbitration awards in their domestic courts).

This is as much background information on international arbitration as is likely to be required by readers in order to follow the thread of the discussion of the cases at the heart of this article. In this regard, the key points that such readers should keep foremost in their minds are the following. First, whenever reference is made to ICSID cases, the underlying disputes pit either XOM or COP (and their affiliates) against the Republic of Venezuela. Second, the nationalities of claimants putting forth treaty-based claims may be different from that of claimants putting forth investment law-based claims, even though they may all be part of the same corporate group. Third, when reference is made to an ICC case, the underlying disputes involve XOM or COP (and their respective affiliates), on one side, and PDVSA and its affiliates, on the other side. Fourth, as of the time of writing, the ICC cases have been decided, but the ICSID cases are still pending.

Who Claimed?

The analysis of the cases begins with the identification of the specific parties that are raising claims, together with their nationalities. This can readily be done by enumerating the cases, starting with the contractual claims (where the nationality of the claimants has no bearing on the question of jurisdiction).

1. ICC Case No. 15415/JRF: *Mobil Cerro Negro Ltd. (Bahamas) v. Petróleos de Venezuela S.A. et al.* Case filed: January 25, 2008. Final award: December 23, 2011 (henceforth: "XOM ICC").
2. ICC CASE No. 16848/JRF/CA (C-16849/JRF): *Phillips Petroleum Company Venezuela Ltd. (Bermuda) and Conoco Phillips Petrozuata B.V. (The Netherlands) vs Petróleos de Venezuela*. Case filed: 30 December 30, 2009. Final award: September 17, 2012 (henceforth: "COP ICC").

In the ICSID cases, nationality is a datum of great importance, so the lists of claimant entities deserve some additional comment.

3. ICSID Case No. ARB/07/27: *Mobil Corporation, Venezuela Holdings, B.V., Mobil Cerro Negro Holdings Ltd., Mobil Venezolana de Petróleos Holdings Inc., Mobil Cerro Negro Ltd., and Mobil Venezolana de Petróleos, Inc. (Claimants) v. The Bolivarian Republic of Venezuela (Respondent)*. Case filed: October 10, 2007 (henceforth, "XOM ICSID").

Mobil Corporation, incorporated in Delaware, was the ultimate parent company of Venezuela Holdings B.V., incorporated in the Netherlands, which in turn owned 100 per cent of Mobil Cerro Negro Holdings, a Delaware company which owned 100 per cent of Mobil Cerro Negro Ltd., a Bahamian company which held a 41 2/3 per cent interest in the Cerro Negro association. Venezuela Holdings B.V. was also the parent of Mobil Venezolana Holding, incorporated in Delaware, which owned Mobil Venezolana de Petróleos, a Bahamian company which held a 50 per cent interest in the La Ceiba project.

4. ICSID Case No. ARB/07/30: *ConocoPhillips Petrozuata B.V., ConocoPhillips Hamaca B.V., ConocoPhillips Gulf of Paria B.V., ConocoPhillips Company (Claimants) v. The Bolivarian Republic of Venezuela (Respondent)*. Case filed: December 13, 2007 (henceforth: "COP ICSID").

ConocoPhillips Company, incorporated in Delaware, was the ultimate parent of ConocoPhillips Petrozuata B.V., ConocoPhillips Hamaca B.V. and ConocoPhillips Gulf of Paria B.V., entities incorporated in the Netherlands, which held interests of 50.1 per cent, 39.9 per cent and 32.5 in the Petrozuata, Hamaca and Corocoro projects, respectively.

What inferences can be drawn from the two lists above? The list of COP entities makes clear that the treaty claims were based on the Netherlands-Venezuela BIT (there is only one non-Dutch entity in this list, and it is from a jurisdiction that does not have a BIT with Venezuela: the USA).⁴¹ The nationalities of any non-Dutch entities occupying rungs below the Dutch holdings in the corporate chains are of no import, but the presence in both lists of the ultimate American parent companies (and the non-existence of a US-

Venezuela BIT) would be an indication that at least some claims necessarily were raised pursuant to Venezuela's Investment Law, promulgated in 1999.⁴² In other words, both of the ICSID cases are hybrids, in the sense that the alleged basis of jurisdiction for some of the claims was a treaty, while for others it was a domestic investment law.

How Much?

The aspect of the Venezuelan oil arbitrations that has been the focus of the most intense attention has unquestionably been the XOM and COP damages claims, not least on account of XOM's audacious *ex parte* attempt to secure a global asset freezing order against PDVSA for the sum of USD 12 billion (an action which could easily have brought PDVSA to its knees had it been successful). This is understandable, given the obvious – and potentially momentous – economic implications of these damages claims.⁴³ All sorts of immense but not necessarily well-founded monetary values have done the rounds, making it difficult for the neutral observer to discriminate between figures that may have some connection with reality, and others that have just been plucked out of thin air.

At least as far as the contractual claims are concerned, such discrimination ought to have been made easier by a 2010 PDVSA offering circular for certain debt instruments to be placed with international investors, where the company gave very specific details about the COP and XOM ICC arbitrations, reporting the amounts claimed as U\$S 158.38 million and U\$S 6.5-7 billion (reduced from an original figure of U\$S 12 billion).⁴⁴ However, PDVSA's figures were not accorded a great deal of credibility at the time (even though the document concerned had to be compliant with the disclosure requirements of Luxembourg's securities laws). Be that as it may, the publication of both ICC awards confirmed that PDVSA's 2010 disclosures were, on the whole, accurate, and that PDVSA had substantial defenses to the amounts claimed.⁴⁵ Just as importantly, it was also made clear that XOM's claims did indeed undergo a radical downward adjustment, despite the fact that the company had submitted an affidavit to the High Court in London to the effect that “the amount of damages payable by

Defendant PDVSA will approach U\$S 12 billion".⁴⁶ Finally, the publication of the awards also made it possible to compare the magnitude of the relief sought by claimants, on one side, with the sums that the tribunals eventually awarded both companies, on the other.

The results of such an exercise are most instructive. In the COP ICC case, the final amount claimed was U\$S 165 million, and the tribunal awarded U\$S 66.9 million to claimants. (The award has been paid in full.⁴⁷) In the High Court of Justice, as already mentioned, the XOM subsidiary initially calculated its claim at USD 12 billion, but abandoned this figure as soon as the High Court vacated the freezing order against PDVSA and eventually cut it nearly by half, without explanation. Indeed, the way XOM went about quantifying damages in the ICC case had a rather cavalier air about it, as PDVSA highlighted in its submissions to the tribunal:

it was not clear what amount Claimants expected Respondents to pay, whether it was the US\$12 billion calculated by Mr. Plunkett [the XOM officer who submitted the affidavit mentioned above], the US \$10 billion set forth in the Summary of Claimant's Position in the Terms of Reference, the US\$7.6 billion originally calculated by one of the Claimant's external experts, the US\$6.45 to US\$6.85 billion now claimed or the US\$5 billion that Claimant requested without explanation or discussion in the summer of 2007 for all of its interests in Venezuela.⁴⁸

It is difficult not to form the impression that this scattergun approach to valuation was informed by a corporate sense of entitlement, according to which the proper role of a tribunal (or a court of law, for that matter) should be merely to rubberstamp whatever claim is put before it by an investor who feels aggrieved. Ultimately, however, the XOM ICC tribunal handed down an award of 908 MMUSD (from which were deducted 161 MMUSD of uncontested debt owed to PDVSA, leaving an outstanding balance of about 747 MMUSD).⁴⁹ This award was very much in line with PDVSA's contention in the sense that "the full value of [XOM's] entire interest in the Project ... was less than US\$1 billion, and ... settlement with the Government would have been reached quite easily had [XOM] not insisted on receiving exorbitant compensation".⁵⁰

With the publication of the respective awards, the ICC arbitrations have now been laid bare for all to see, but no further analysis on them will be offered for the moment. The

reason behind this is that these proceedings did not revolve around mere contractual disagreements between business partners, as commercial arbitrations generally do. In fact, the ICC arbitrations were very much aimed at the Republic of Venezuela (albeit through the *interposita persona* of PDVSA), and are best understood as complementary – rather than parallel – judicial proceedings, meant to dovetail with the ICSID arbitrations. Hence, it makes more sense to reconstruct, first, the far more complex treaty/investment law claims and, only once this has been done, return to the ICC arbitrations in order to show where they fit in the litigation jigsaw puzzle.

As far as the reconstruction of the ICSID claims goes, their magnitude is also the best starting point for such an exercise because the monetary value of a treaty claim may be a telltale sign of the juridical nature – not the substance – of the breach being alleged in a given dispute (in much the same way as, for Sherlock Holmes, Dr. Watson's tanned hide and shoulder wound were a giveaway of the latter's military service in Afghanistan, but not necessarily of his occupation). Unfortunately, the exact amounts that XOM and COP are claiming before ICSID are not easily ascertainable on the basis of public documents. Nevertheless, there is sufficient information at hand to form reasonable ballpark approximations about both ICSID claims. Such estimates, in their turn, provide a good enough diagnostic tool for robust inferences to be drawn about the characterisation, in a legal sense, of the type of conduct that these two companies have accused Venezuela of engaging in when allegedly committing the breaches that gave rise to their respective suits.

The value of the XOM ICSID claim can be gleaned from the company's submissions to the High Court in London, where it was pointed out that XOM's “actual losses far surpass[ed] the compensatory formula [subject of the ICC arbitration, and valued at that point at U\$S 12 billion] by many billions of dollars”.⁵¹ Therefore, throughout the remainder of this article, we shall use a figure of “U\$S 12 billion plus” in connection with this claim.⁵²

Ironically, it is possible to give a rather better estimate for the COP ICSID claim, even though this company – unlike XOM – never submitted any evidence in open court in connection with its overall litigation strategy. However, COP's legal counsel in the ICSID case let it be known in 2009 that their client was “involved in what is arguably the biggest investment arbitration in history as it battles for the return of the U\$S 30 billion assets seized by the Venezuelan government”.⁵³ This figure also appeared in a story in the *Oil Daily*, which gave additional details about the breakdown of the claim: “Conoco is seeking \$30.3 billion, comprising \$20.5 billion for losses **incurred through August 2008** and \$9.8 billion to cover expected US taxes on an award”.⁵⁴

These reports are indicative of two points in terms of the legal analysis and reconstruction of the claim. Firstly, since the Dutch entities would not be liable for US tax in connection with this arbitration, the tax gross-up claim meant that ConocoPhillips Company (i.e. the US parent of these entities) had to invoke the Venezuelan Investment Law (again, because there is no US-Venezuela BIT). Secondly, and perhaps most importantly, the figures indicate that these ICSID arbitrations are not mere *differenda* about the value of the COP and XOM assets that PDVSA took over when these companies decided to leave Venezuela, but perforce involve allegations on the part of these companies that, in implementing its migration initiative, the Venezuelan government took actions that contravened international law.

Of course, the mere fact that an investor has couched a particular claim against a state in language that may allow an arbitral tribunal to adjudicate on it in the first place need not necessarily mean that the claim will get anywhere, because it may be jurisdictionally deficient in a variety of other ways. As it happens, jurisdictional issues have been very prominent in both of the ICSID cases under examination. The COP ICSID case details indicate that Venezuela requested that the tribunal deal with the objections to jurisdiction as a preliminary matter (December 2008) but no separate hearings on jurisdictional matters were held, as such matters were lumped together with the analysis of legal merits and quantum in the hearings held in The Hague over the summer of 2010 (May 31 to June 13).⁵⁵ In the XOM ICSID case, however, the tribunal decided to

hold a separate hearing to address Venezuela's jurisdictional objections (Paris, September 23-24, 2009), after which a partial decision on jurisdiction was handed down (June 10, 2010).⁵⁶ This decision dealt with the jurisdictional issues not only of claims brought under the Venezuelan Investment Law but also with treaty claims. In what follows, we shall examine each one of these aspects in turn, starting with the Investment Law claims.

The Investment Law Claims

ICSID arbitration proceedings are premised on states placing their sovereign prerogatives in abeyance as far as the matters involved in a specific case are concerned, and this is something which cannot be taken lightly (as it touches upon the very essence of a state's being).⁵⁷ It is on account of this factor that ICSID considers the written consent of the parties (and, more specifically, the state parties) to be "the cornerstone of the jurisdiction of the Centre".⁵⁸ It is not compulsory that such consent be expressed in a single instrument – like a BIT containing an ICSID arbitration clause or a compromissory clause in an investment agreement between a state and an investor – and ICSID considers it perfectly acceptable in principle for states to offer to submit disputes to ICSID jurisdiction through the medium of domestic legislation. However, this admissibility is always subject to the following proviso: "the **one basic requirement** that any consent clause **must** fulfill is that it should **unequivocally** show submission to the jurisdiction of the Centre of a particular dispute or class of disputes".⁵⁹

In the case of BITs or investment agreements, this particular requirement is easy to fulfill, as such instruments will include an ICSID arbitration clause submitting any future disputes between the parties to the jurisdiction of the Centre.⁶⁰ Domestic legislation, however, is subject to vagaries of draftsmanship, legal tradition and content which can produce texts that are anything but unequivocal. To be sure, it is possible to draft pithy and succinct formulations of unequivocal consent, as witnessed by Albania's law No. 7764 of November 2, 1993, which stipulates in its article 8(2) that "the foreign investor may submit the dispute for resolution and the Republic of Albania hereby consents to

the submission thereof, to the International Centre for Settlement of Investment Disputes".⁶¹ For whatever reason, though, laws containing such clear language are not abundant, and most of the cases brought before ICSID on the basis of domestic law provisions – starting with the very first one in the sequence: *Southern Pacific Properties (Middle East) Ltd. v. Arab Republic of Egypt*, dating from 1984 – have actually required that the tribunals hearing those cases do a fair bit of interpretation on the statutes concerned in order to ascertain whether or not they contain an acceptance of ICSID jurisdiction.⁶² The COP and XOM ICSID claims against Venezuela – which allege "that Venezuela consented to the jurisdiction of the Centre through Article 22 of the Venezuelan Decree with rank and force of law N°356 on the promotion and protection of investments of 3 October 1999" – have to be counted among such cases.⁶³

The text of the article cited above reads as follows:

Disputes arising between an international investor whose country of origin has in effect with Venezuela a treaty or agreement on the promotion and protection of investments, or disputes to which the provisions of the Convention establishing the Multilateral Investment Guarantee Agency (OMGI–MIGA) or the Convention on the Settlement of Investment Disputes between States and national of other States (ICSID) are applicable, shall be submitted to international arbitration according to the terms of the respective treaty or agreement, *if it so provides*, without prejudice to the possibility of making use, when appropriate, of the dispute resolution means provided for under the Venezuelan legislation in effect.⁶⁴

The antagonists in the disputes have offered lengthy explanations about the intentions and identity of actual and purported drafters of the law, and about the meaning of this clause, especially the four italicised words (which, for all the drafting infelicities of the clause, imbue it with a conditional character that cannot really be reconciled with the notion of unequivocal consent, in a plain language reading of the text). What all these arguments have in common is that they are both convoluted and complex, and can hardly be bettered as vehicles for inducing tedium in the layperson. For present purposes, therefore, explaining them in any detail would be pointless. Fortunately, there is no need to go down this path, not only because the decision on jurisdiction of the XOM ICSID tribunal summarizes the key points of the arguments very well but, even more importantly, because the members of that tribunal unanimously decided that they

could not “conclude from the ambiguous text of Article 22 that Venezuela in adopting the 1999 Investment Law consented in advance to ICSID arbitration for all disputes covered by the ICSID Convention” and, for good measure, that “if it had been the intention of Venezuela to give its advance consent to ICSID arbitration in general, it would have been easy for the drafters of Article 22 to express that intention clearly by using ... well known formulas”.⁶⁵ That being the case, and since “Mobil Corporation ... only raised claims on the basis of Article 22 of the Investment Law and not on the basis of the BIT”, the tribunal made it clear that it had “no jurisdiction over the claims of Mobil Corporation, which will thus not be a Party to the continuation of these proceedings”.⁶⁶

With the XOM ICSID decision on jurisdiction, Mobil's (presumed) tax gross-up claim would appear to be in tatters. However, because the principle of *stare decisis* technically does not apply to arbitral decisions, it would be possible *in theory* for the COP ICSID tribunal to reach a conclusion on this matter that is diametrically opposite to that of the XOM ICSID tribunal. In practice, though, this has become a rather more improbable outcome, the likelihood of which will have been further diminished because four more ICSID tribunals have subsequently arrived at an identical conclusion (and while it may be true that arbitral decisions create no precedent, tribunal members tend to pay close attention to the decisions and reasoning of their peers).⁶⁷ Nevertheless, there are plenty who still cling to the belief that it might be possible to secure decisions in favour of the investors in other cases.⁶⁸

To an observer unversed in the *arcana* of international law, the notion that Article 22 could still at this point in time be found to be an unequivocal unilateral expression of consent to arbitrate may seem preposterous. After all, purely as a matter of logic, once one tribunal (let alone five) has reached the conclusion that a piece of legislation is not an expression of unequivocal consent, then surely the one quality that from then on such legislation will never be able to shake off is that it is 'equivocal', even if the manner in which the conclusion had been drawn were unsound as a matter of law.⁶⁹ But such elementary logic fails to take into account the *Kompetenz-kompetenz* principle, whereby it is for arbitral tribunal itself to decide whether or not it is competent to hear certain

disputes. This principle effectively neutralises tricky questions that might have taxed Protagoras in his pomp, such as how is it that in situations where "the scope of the state's consent may be ambiguous, providing potential grounds for the respondent's objections to jurisdiction", a consent formulation might nevertheless still be held to be unequivocal, after being duly interpreted by a tribunal.⁷⁰ And such is the scope that *Kompetenz-kompetenz* gives to arbitration tribunals that there are quite a few legal commentators and practitioners who are clearly relying upon this principle to propose, in all seriousness, that "if a national foreign investment law is not a crystal-clear provision and incorporates certain grey areas of ambiguity, it is for the state making the unilateral act, who has unilaterally chosen, or chosen to maintain, an equivocal language when it enacted the legislation, to bear the risk of such ambiguity".⁷¹ If taken to heart by the arbitral community at large, such proposals would make it possible to find unequivocal consent in a statute not only through its interpretation, but by mere inference from it, even though it is an established principle that claimants bear the burden of proving that there is a positive basis for consent in any given case.

It goes without saying that this sort of innovative sophistry will do little to assuage the ever more widespread suspicion among state parties that the whole investor-state arbitration system might be biased against them, a suspicion which underlies the "growing dissatisfaction of states with the international arbitral process[, and which] looms as a major problem in investor/state relations and requires a critical assessment of the future of international arbitration as a means of settling investment disputes".⁷² This is a topic to which we shall be returning, at length, in the concluding section of this paper but, for the moment, suffice it to say that the mere fact that the jurisdictional arguments wielded by claimants on Article 22 might have come within striking distance of carrying the day can hardly be bettered as an illustration of why the whole system is sinking into disrepute. After all, taken together, these claims amount to tens of billions of dollars, and yet the flimsiness of their legal foundations is such that they would never have withstood even a modicum of scrutiny in a court of law in the United States, the home country of COP and XOM, and key backer and promoter of ICSID.

Such a statement might seem adventurous in the light of the strident American denunciations of the petroleum policies of the Chávez administration. Fortunately, we have at our disposal statements in which well informed officers of the US State Department addressed precisely this question of whether the Investment Law amounted to consent to ICSID jurisdiction, in the belief (mistaken, as fortuitous circumstances would have it) that their opinions would not end up in the public record. Their candid appraisal deserves quoting *in extenso*:

the international law firm Freshfields Bruckhaus Deringer, counsel to I&I Beheer and Vestey in their arbitration claims [and ICSID counsel for COP, as mentioned before] ... speculated ... that this law may give rights to ... pursue ICSID arbitration, even in the absence of a BIT with the BRV. (Comment: **While this is an attractive legal argument ... this claim is highly speculative and creative. Our reading of the Investment Promotion Law is that investors only have rights to ICSID arbitration if they can qualify under a BIT).**⁷³

It is hard to imagine a more scathing dismissal of the legal theories underlying the Article 22 claims than the "Comment" above, especially in the light of the role that the firm mentioned therein has played in promoting this type of claim in particular (and investment arbitrations against Venezuela in general).

Further Jurisdictional Issues

One of the salient aspects of the COP and XOM ICSID arbitrations against Venezuela is that the parties invoking the protection of the Netherlands-Venezuela (henceforth "N-V") BIT are those two well-known scions of Dutch enterprise, ExxonMobil (headquarters: Irving, Texas) and ConocoPhillips (headquarters: Houston, Texas). The perplexity of the proverbial person in the street when confronting this fact reflects an understandable lack of general knowledge regarding a corporate practice (known as "treaty shopping"), which may have been contentious at some point in the past but has now become all but ubiquitous; namely, that "absent treaty provisions barring the practice, an investor from a non-treaty country may structure its investment through a treaty jurisdiction even though it lacks any meaningful connection with it".⁷⁴ However, the highly problematic jurisdictional issues thrown up by the COP and XOM treaty claims do not concern the tenuousness of these companies' connection with the Netherlands but, rather, involve

both the moment in time when this tenuous link was established and whether there was a valid **business** reason (i.e. not related to litigation) for establishing such a link in the first place.

Without going deeper into the specific transgressions that Venezuela stands accused of, it is difficult to explain the jurisdictional issues mentioned above. Having said that, to tackle the detail of the COP and XOM allegations at this precise point is not necessarily a good idea. True, it is in the minutiae of these allegations that one finds the elements to reconstruct and highlight key features of both arbitrations which would otherwise remain hidden from public view (doubtless to the relief of some of the protagonists of the arbitrations). However, in order to identify such features in the first place, it is necessary to make reference to aspects of international law which are not necessarily relevant to questions of jurisdiction. For that reason, it is better to restrict the factual exposition in this section to a couple of essential points, while pleading for the reader's patience and forbearance through the invocation of the Holmesian formula that all will be eventually revealed.

The first of these points is that both COP and XOM were non-treaty investors when they went into Venezuela, and only sought to acquire treaty protection at a much later date by restructuring their unprotected investments into a treaty jurisdiction (The Netherlands, in both cases). The second point is that these companies' treaty claims have two dimensions to them, described by COP officers to the US ambassador to Venezuela thus: COP "has two basic claims: a claim for compensation for its expropriated assets and a claim based on the progressive expropriation of the underlying assets ... the claim based on the progressive expropriation of the assets ... was on top of the fair market value of the assets".⁷⁵ The XOM ICSID decision on jurisdiction throws additional light on what is meant, in the passage above, by progressive expropriation.

The restructuring of Mobil's investments through the Dutch entity occurred from October 2005 to November 2006. **At that time, there were already pending disputes relating to royalties and income tax.** However, nationalisation measures were taken by the Venezuelan authorities only from January 2007 on. Thus, the

dispute over such nationalisation measures can only be deemed to have arisen after the measures were taken".⁷⁶

As can be appreciated, then, as well as fighting over the quantum of compensation that COP and XOM maintain they are owed for the assets they left behind in Venezuela (which is what most people believe the arbitrations are about), the two companies, *in their capacity as "Dutch" investors*, are also challenging the right of the Venezuelan government to enact and implement the series of fiscal measures recounted earlier in this paper. Venezuela, for its part, has argued that they lacked any standing as Dutch investors to bring such a complaint, citing the dates of incorporation of the Dutch entities as proof that these were "created in anticipation of litigation against [Venezuela] ... for the sole purpose of gaining access to ICSID jurisdiction ... [an] abuse of the corporate form and blatant treaty-shopping [that] should not be condoned".⁷⁷ This principle was enunciated in lapidary fashion by an ICSID tribunal in the *Phoenix v. Czech Republic* case: "to change the structure of a company complaining of measures adopted by a state for the sole purpose of acquiring an ICSID claim that did not exist before such change cannot give birth to a protected investment".⁷⁸

Before turning the spotlight of the *Phoenix* decision on the COP and XOM claims, it is worthwhile to put to bed for good the jurisdictional issue raised by Article 22 claims. In a nutshell, the actions that both companies took in restructuring their Venezuelan interests belie their own argument that this article constituted an open-ended and unequivocal consent to ICSID jurisdiction. Had COP and XOM genuinely held this to be true, they would not have sought the protection of the N-V BIT, as they would have been aware that an elementary precept of international law says that, once consent to arbitration has been given, it cannot be unilaterally withdrawn. The fact that, nonetheless, both companies proceeded to table multi-billion dollar Article 22 claims underscores a rather unfortunate trait of international arbitration proceedings; namely, that claimants feel (seemingly, with good reason) that it makes sense to inflate their claims through any argument possible, as such abusive conduct seldom if ever carries serious consequences, and there is always a chance that a claimant might hit the jackpot.

We can now turn to the issue at the heart of the jurisdictional controversy in the treaty claims; namely the timeline for both the government measures and the restructurings. The XOM ICSID decision summed up the latter thus:

Initially, Mobil investments in Venezuela were structured as follows: (i) Mobil (Delaware) owned 100% of Mobil CN Holding (Delaware), which in turn owned 100% of Mobil CN Holding (Bahamas), which has a 41 2/3% participation in the Cerro Negro association [and] (ii) Mobil (Delaware) also owned 100% of Mobil Venezolana Holding (Delaware) which in turn owned 100% of Mobil Venezolana (Bahamas), which had a 50% participation in the La Ceiba Association.

On 27 October 2005, Claimants created a new entity under the law of the Netherlands called Venezuela Holdings. On **21 February 2006**, this entity acquired all the shares of Mobil CN Holding (Delaware). Then on **23 November 2006**, it also acquired all the shares of Mobil Venezolana Holding (Delaware). **The Dutch holding company was thus inserted into the corporate chain for the Cerro Negro and La Ceiba projects.**⁷⁹

The highlighted dates are of critical importance in the context of what the tribunal heard had been Mobil's reactions to some of the Venezuelan fiscal measures recounted before:

In two letters dated **5 February 2005**, and **18 May 2005** ... Claimants first complained of the increase from 1% to 16 2/3% of the royalties decided by Venezuela for the Cerro Negro and La Ceiba projects ... Then, on **20 June 2005**, [Claimants] informed the Venezuelan authorities that the recent ministerial decision to increase the royalties to 30% 'has broadened the investment dispute' ... They stated that the introduction of a bill that would increase income tax rates from 34% to 50% would further broaden that dispute.⁸⁰

As can be appreciated, then, the XOM restructuring is highly problematic in the context of the *Phoenix* decision because, as Venezuela repeatedly told the tribunal, "the disputes were not only foreseeable, but ... had actually been identified and notified to Respondent before the Dutch company was even created".⁸¹ Indeed, in a meeting held as early as September 2006, ExxonMobil Venezuela President Tim Cutt told the US ambassador that he had personally notified the Viceminister for Hydrocarbons that XOM already had already run up a tab against Venezuela for "USD 2 billion in claims".⁸²

As far as COP is concerned, similar evidence suggests that its restructuring resembled closely that of the XOM entities, as regards both to chronology and motivation. It comes in the form of a confidential cable reporting a meeting held in Caracas on 30 January

2007 between COP officials and the US ambassador to Venezuela, on the subject of "the state of negotiations on compensation for [COP's] expropriated assets in Venezuela". The cable says that "when the Ambassador asked about [COP]'s corporate structure in Venezuela, the executives replied that [COP] incorporated its subsidiaries last year [i.e. sometime in 2006] as Dutch companies in order to take advantage of the Dutch [BIT]. [COP] executives told Petatt [Petroleum attaché] that they had already taken administrative steps to preserve their arbitration rights".⁸³ Thus, the restructurings of the Venezuelan interests of both COP and XOM seem to fall foul of one of the *prima facie* tests of potential treaty abuse, in that there was no reasonable business explanation behind them, other than that of gaining access to a favourable forum for litigation.

Having weighed the factors mentioned above, the XOM ICSID tribunal reached what would appear to be a damning conclusion in the light of *Phoenix*: "**the main if not the sole purpose** of the restructuring was to protect Mobil investments from adverse Venezuelan measures in getting access to ICSID arbitration through the Dutch-Venezuela BIT".⁸⁴ However, the tribunal also opined that a five-minutes-to-midnight restructuring along such lines could still, nevertheless, be either "'legitimate corporate planning' as contended by the Claimants or an 'abuse of right' as submitted by the Respondents. It depends upon the circumstances in which it happened".⁸⁵ Then, the tribunal proceeded to finesse the thorny issue of the potentially "abusive manipulation of the system of international investment protection under the ICSID Convention and the BITs" by taking the line that minimal maintenance capital expenditures in the Cerro Negro project amounted to "new and important investments ... [being] projected and made" and, that being the case, XOM was – subsequent to the restructuring – entitled to enjoy all the rights that any other *bona fide* Dutch investor would have had.⁸⁶ Of course, such rights could not have existed before the XOM Dutch entities came into being so, for this reason, the tribunal only accepted jurisdiction "with respect to any dispute born after 21 February 2006 for the Cerro Negro project and after 23 November 2006 for the La Ceiba project, and in particular with respect to the pending dispute relating to the nationalisation of the investments".⁸⁷

At first glance, the XOM ICSID jurisdiction decision amounts to significant setback not only for this claimant, but also for others in comparable positions (notably COP). After all, while it is true that the decision may reflect a rather more expansive view of jurisdiction compared to the one that prevailed in *Phoenix*, it also seemed to set aside the very large fiscal claims antedating the restructuring. Nevertheless, the decision has still been perceived in some quarters as a victory for XOM because the case continued.

One fundamental question raised by both the COP and XOM cases is how it was possible for the companies involved to behave in a manner that is wholly at odds with their usual patterns of conduct (notably in terms of their apparent neglect to have all conceivable “i’s” dotted and “t’s” crossed on the legal front), making their investments without treaty protection from the start. If one reflects on this question starting from the assumption that both COP and XOM were – and remain – very experienced and sophisticated international investors who would not have let any obvious loose ends untied, a hypothesis arises that may account for their apparent indolence towards protecting their investments through a treaty suggests itself. Perhaps neither COP nor XOM was especially bothered about structuring through a BIT jurisdiction because both companies had actually secured a different sort of protection mechanism, which they felt was more effective and predictable, as well as quicker and less cumbersome than arbitration? The reader is asked to keep this possibility in mind throughout the discussion in the following section, which deals with the fine detail of the treaty claims that COP and XOM have put forward against Venezuela.

The Treaty Claims

There is a widespread perception that the main reason why the migration of association projects in Venezuela ended up in litigation was that Venezuela insisted on paying book value for the COP and XOM assets that PDVSA took over, whereas the companies refused to receive anything less than full market value for such assets.⁸⁸ As it happens, this narrative of events has no factual basis, but its enduring hold on the public imagination has been due, in no small part, to the succession of misleading statements

that claimants have been putting out on the issue of compensation from the moment that negotiations between the parties broke down for good, and of which the following constitutes an excellent example: “the ICSID dispute is not over Venezuela's right to expropriate the assets of our Venezuelan affiliate, Mobil Cerro Negro ... The dispute is over Venezuela's failure to meet its obligation under international law to pay compensation based on fair market value of the expropriated investment”.⁸⁹ In fact, the COP and XOM ICSID disputes most certainly are about the right of the Venezuelan government to expropriate the assets of these companies and, indeed, about its right to enact other public policy measures in the exercise of prerogatives which other governments in the world – not least those counted as among the shrillest critics of the Chávez administration – would see as being both inherent and essential to their own status as sovereigns.

In order to explain how, by means of legalistic sleights of hand, COP and XOM would in effect have the Venezuelan government stripped of its sovereign powers by arbitration tribunals (all the while professing not to be putting such powers into question), we have to start by looking at the treaty which Venezuela is alleged to have violated. The relevant provision is Article 6 of the N-V BIT, which reads thus:

Neither Contracting Party shall take any measures to expropriate or nationalise investments of nationals of the other Contracting Party or take measures having an effect equivalent to nationalisation or expropriation with regard to such investments, unless ... the measures are taken in the public interest and under due process of law ... are not discriminatory or contrary to any undertaking which the Contracting Party taking such measures may have given ... [and] are taken against just compensation.

The article goes on to define this just compensation as “the market value of the investments affected **immediately before the measures were taken or the impending measures became public knowledge**, whichever is the earlier ... paid and made transferable, without undue delay, to the country designated by the claimants concerned ... in any freely convertible currency accepted by the claimants”.

A number of questions arise in connection with the dispositions of this article, in the light of some of the details revealed thus far about the claims. Where, for example, does the

article mention that just compensation should include the taxes on such a payment which may be levied in some other jurisdiction (i.e. a tax gross-up)? And if the quantum of compensation depends on the market value of the asset on the eve of a nationalisation measure (and, with regard for future income streams, on price forecasts current at the time the measure was taken), how is it possible to arrive at a valuation of USD 12+ billion or USD 30 billion for the XOM and COP projects (respectively), on the basis of crude oil price forecasts available in July 2007 (rather modest in comparison to those that have come after the oil price spike of 2008) and/or taking into consideration the fiscal regime in place at the time Venezuela announced the migration initiative?⁹⁰ Furthermore, how is it that COP's counsel declared that their client was bringing suit for losses supposedly incurred **after** COP left Venezuela? And what should one make of the briefing on compensation negotiations that COP officers gave the US ambassador in Caracas in April 2008, in which they pointed out that, firstly, "given the recent increase in oil prices, the fair market value of the [expropriated] assets ha[d] increased" and, secondly, that "as for the claim based on the progressive expropriation of the assets ... [COP had] proposed a settlement number ... [but] also plan[ned] on increasing the settlement number for the second claim due to recent increases in oil prices"?⁹¹

The key to all of these questions lies in the distinction between lawful and unlawful nationalisations, because customary international law establishes that investors affected by the latter type of measure are entitled to receive not only compensation but **reparations**, in the form of the full restitution of their property (or its value at the time of taking) plus damages for any increase of the value of the property between the date of the nationalisation and the date when a judicial authority handed down a decision branding said nationalisation as unlawful.⁹² This principle of reparation was summed up in the seminal *Case Concerning the Factory at Chorzów*:

The essential principle contained in the actual notion of an illegal act . . . is that reparation must, so far as possible, **wipe-out all the consequences of the illegal act and reestablish the situation which would, in all probability, have existed if that act had not been committed**. Restitution in kind, or, if this is not possible, payment of a sum corresponding to the value which a restitution in kind would bear;

the award, if need be, of damages for loss sustained which would not be covered by restitution in kind or payment in place of it—such are the principles which should serve to determine the amount of compensation due for an act contrary to international law.⁹³

In other words, reparations entail that the affected party be placed in the position it would have enjoyed all along but for the intromission of the unlawful measures, with valuation of the assets involved being carried out on the date when a court or tribunal found in favour of the affected claimant (and not when the taking occurred).

These reflections lead straight to a series of fundamental questions: on what grounds, precisely, can the Venezuelan measures be held to have contravened the dispositions of the N-V BIT cited above? Is it that they were not taken in the public interest and under due process of law? Or were they discriminatory or contrary to an undertaking which Venezuela may have given to COP and XOM? Or is it that perhaps the measures were not taken against just compensation?

Given that the migration process was an industry restructuring, and not violative of any specific undertaking not to nationalise, the key issue under the N-V BIT expropriation provisions is compensation. There is no question that compensation is due. But the *Chorzów Factory* decision itself indicates that, if lack of compensation is the only issue, there is no basis for changing the valuation date under customary international law. In addition, one can wonder why that question is even relevant if the treaty itself provided the standard of compensation and points to valuation as of a time immediately prior to the nationalisation.

The issue of compensation, or lack thereof, can also be examined in light of the now published information on the facts. According to both COP and XOM, the measures at issue in their respective ICSID arbitrations constitute particularly egregious examples of expropriation without compensation. In the words of the principal memorial which XOM submitted to the ICC tribunal, notwithstanding the “use [of] euphemisms – such as ‘migration to a mixed enterprise’ or Mobil CN’s supposed refusal refusal ‘to confor[m] its activities to the existing regulatory framework’ ... [it] cannot [be] conceal[ed] ... that the

[Venezuelan] Government seized Mobil CN's entire interest in the joint venture without paying compensation".⁹⁴ However, while no compensation was paid to either COP or XOM in consideration for the loss of their Venezuelan interests before these companies filed for ICSID arbitration, this sort of situation is an understandable – not to mention common – occurrence where there exists a wide gap between the stances on valuation of private and governmental actors (and such a value gap is very much in evidence in the cases at hand).⁹⁵ In the historical record of international arbitration, there are many examples of nationalisation measures where no compensation had been agreed upon by the time arbitration proceedings were launched. With such cases in mind, Reinisch wrote that

a number of investment tribunals have dealt with the question whether the compensation requirement demands that compensation has actually been paid. In this context, tribunals have consistently held that an offer of compensation or other provision for compensation, in particular where the exact amount may still be in controversy, is enough to satisfy this legality requirement. **Thus, the mere fact that compensation has not yet been paid does not render an expropriation illegal.**⁹⁶

Moreover, the presumption that an expropriation may be unlawful due to an ongoing non-payment of compensation is even less warranted when a state has shown a demonstrable willingness to engage in good faith negotiations to reach an agreement with the affected parties.⁹⁷ Indeed, it is even possible to point to cases where expropriation measures have been held to be lawful although no offer to compensate the affected parties was made, let alone any indemnification paid.⁹⁸

It is not difficult to understand why states are not under an obligation to come to an agreement with parties affected by a nationalisation measure regarding the quantum of compensation owed to the latter, and much less by a given deadline (before a filing for arbitration is made, say). Quite simply, such an obligation would constitute a powerful lever whereby private parties could blackmail states into acquiescing to their proposed settlement terms, no matter how exorbitant these were. In this regard, it is worth noting that the XOM ICC tribunal was told that XOM's approach to negotiating a compensation figure for its Venezuelan interests simply consisted in tabling a "take-it-or-leave-it demand for US\$5 billion".⁹⁹

Although neither COP nor XOM deny participation in discussions on compensation with the Venezuelan government, they insist that Venezuela never made a settlement offer that complied with the exigencies of the N-V BIT, which provides for the “market value of the investments affected” as the standard of compensation. In public, both companies have consistently maintained that Venezuela only ever offered them book value for their expropriated assets.¹⁰⁰ There is, however, evidence available in the public record which undermines the credibility of such statements.

First of all, when XOM petitioned the High Court in London to maintain the worldwide freeze on PDVSA’s assets (obtained by virtue of a dawn raid in which the judge who granted a provisional freeze was assured of the clear and present danger that PDVSA might quickly dissipate its worldwide assets in a way that would not make it possible for XOM to collect on a supposedly cast-iron USD 12 billion claim), the argument was made time and time again that the legal dispute which made the attachment imperative had come about as a result of the “expropriation ‘without compensation’ by the government of Venezuela through a nationalisation decree”.¹⁰¹ However, the High Court was also told by PDVSA that XOM had been offered a very substantial sum in compensation for its interests.¹⁰² In dismissing XOM’s petition on all points of law at issue, Walker J. made the following observation regarding XOM’s allegations: “I doubt ... this can be properly be described as a case involving a lack of compensation”.¹⁰³ Obviously, Walker J. was not asked to adjudicate on this particular matter. Nevertheless, in deciding whether to confirm an injunctive relief measure only very seldom granted in the absence of manifest fraud, Walker J. had to consider the argument that, given the allegedly confiscatory nature of the expropriation and the XOM position that “the commercial interests of PDV and Venezuela ... were indistinguishable”, the case before him might be tinged by “concerns akin to those which arise in cases of fraud”.¹⁰⁴ Walker J. found XOM’s arguments lacking in merit.

When he handed down his reasons for lifting the worldwide freezing order, Walker J. also gave a *précis* of the oil policy of the Chávez government which is remarkable both for its concision and its tone: “there has been a change of government since the

Association Agreement was made. The new government strongly disagrees with previous policy. It has condemned the previous policy, and spoken of the need for change, in strong terms. [This]... has not prevented the negotiation of mutually acceptable arrangements with the vast majority of foreign oil interests".¹⁰⁵ And it is precisely these 'mutually acceptable arrangements' which further undermine the COP and XOM allegations of expropriation without compensation and/or compensation not undertaken in accordance with the N-V BIT standard.

As a consequence of the migration initiative, for example, Statoil and Total had to diminish their respective stakes in the Sincor upgrading project (by 16.77 percentage points and 5.323 percentage points, respectively), in order to accommodate an increased shareholding for CVP. A confidential cable from the US embassy in Caracas recounts a meeting held on 12 September 2007 between "Petroleum Attaché (Petatt) ... [and] Statoil Venezuela President Thore Kristiansen ... to discuss the terms of the Sincor migration to a PDVSA-controlled joint venture".¹⁰⁶ Kristiansen "would not state the amount of the compensation ... [but] implied that it was well above book value, which was PDVSA's opening offer". For good measure, "[h]e stated [that] Statoil would have refused to migrate its interest if it had only received book value". The compensation paid to the Sincor partners came to USD 1.1 billion, a figure which puts the gigantic COP and XOM damages claims into perspective, given that the Sincor upgrader was much larger than any of the Petrozuata, Hamaca or Cerro Negro upgraders.

Separately, when "Chevron Latin America president Ali Moshiri (strictly protect throughout) met with the Ambassador on June 28 [2007]", he was at pains to point out that "Chevron [had] received 'fantastic' terms for the migration of the Hamaca strategic association to a PDVSA-controlled joint venture ... [and] added [that] Chevron just kept what it had and 'could have had more'".¹⁰⁷ Faced with seemingly incontrovertible evidence that, at least in some cases, the standard of compensation had definitely not been book value, US Ambassador Patrick Duddy could only conclude that Venezuela must have "offered widely varying terms to at least some of the six companies that

invested in the Faja strategic associations”, since he was not prepared to call into question that “[b]oth ExxonMobil and ConocoPhillips stated the BRV has consistently stated it would only compensate them based on the book value of their investments”.¹⁰⁸

Numerous other conversations between company officials and US embassy personnel in Caracas (including Ambassador Duddy) are relevant (judging by the number of published *Wikileaks* cables, XOM officials met with US embassy personnel more often than their COP counterparts but, true to corporate form, the former tended to play their cards closer to their chest). According to a confidential cable recounting a conversation with Ambassador Duddy in April 2008, on the subject of compensation, COP’s President for Strategy, Integration, and Specialty Businesses, Greg Goff, explained that “the BRV ha[d] accepted that fair market value ... [as] the standard for the first claim”, and had “moved away from using book value as the standard for compensation and ... **agreed on a fair market methodology with discount rates for computing the compensation for the expropriated assets**”. Goff also pointed out that COP had “proposed a settlement number and the BRV appear[ed] to be open to it”.¹⁰⁹ However, in 2008 the value gap widened on account of COP’s belief that, “given the recent increase in oil prices, the fair market value of the assets ha[d] increased”.¹¹⁰

Fair and Equitable Treatment (FET): General Considerations

It is no exaggeration to say that FET, rather than expropriation proper, has become the heart and soul of investor-state arbitration. As Picherack points out, FET “has been invoked more than any other standard of international investment law as the basis for awarding damages against States, and tribunals are increasingly willing to grant significant damage awards for failure to accord fair and equitable treatment even where they find that no expropriation or discrimination of a foreign investor’s investment has occurred”.¹¹¹ For a concept on which so much seems to be riding (or perhaps precisely because of this), FET has proved to be remarkably malleable and elastic and, like beauty, very much in the eye of the beholder. Needless to say, these are not desirable attributes in a judicial environment, and they go a long way towards explaining why, in

Picherack's view, "the decisions and reasoning of many recent tribunals as to the [FET] standard's scope and content are fragmented, inconsistent and conflicting".¹¹² This, in turn, has encouraged the unbridled exercise of creative advocacy, with many legal practitioners seemingly acting on the assumption that, "if only properly argued, it will be possible to identify one or more aspects, individually or combined, which may amount to ... [a] violation" of FET.¹¹³

This is not the place to discuss the voluminous literature on the specialist debate surrounding the topic of FET in investment arbitration.¹¹⁴ For the purposes of this paper, suffice it to say that the international arbitration system – whose explicit *raison d'être*, after all, is *investment* protection – has been perceived to be tilted in favour of investors, as evidenced by a string of important decisions where, in the opinion of many, tribunals have "elicit[ed] obligations from an autonomous interpretation of the standard and then proclaim[ed] that such requirements are in accordance with the minimum standard under international law, with no apparent justification for such conclusions, and often with reasoning ... frankly disconnected from the minimum standard".¹¹⁵ State parties have expressed "considerable concern about the broad-reaching interpretations given to the [FET] standard by recent tribunal awards", particularly with regard to the way in which "some very prominent arbitrators have little difficulty in finding **new** norms of **customary** international law" (while displaying no reservations about the seemingly oxymoronic nature of this enterprise or, indeed, its grave political implications).¹¹⁶

The intensity of disquiet in state quarters can best be gauged not so much by the withdrawal from ICSID of states like Ecuador, Bolivia and Venezuela (or by the threats from Argentina and Nicaragua to follow suit) but, rather, from recent actions and statements of some governments that can be counted among the staunchest supporters of international dispute resolution structures. As far back as 2001, the three NAFTA signatories (led by the USA) had already felt impelled to issue a clarification that the FET standard in Article 1105 of NAFTA did "not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens".¹¹⁷ In 2011, a committee of the European Parliament on

international trade recommended (citing the NAFTA precedent) that the European Union should “include in all its future agreements a specific clause laying down the right of the EU and [Member States] to regulate”, and that “standards of protection should be strictly defined, in order to avoid abusive interpretations by international investors. In particular ... fair and equitable treatment must be defined on the basis of the level of treatment established by international customary law”.¹¹⁸ For its part, Australia, which found itself hauled before an arbitration tribunal on account of public health disposition affecting the marketing of cigarettes, has stated that it will no longer seek “the inclusion of investor-state dispute resolution procedures in trade agreements with developing countries at the behest of Australian businesses”.¹¹⁹ And the ultimate litmus test of whether FET has become the equivalent of Frankenstein’s monster even for capital-exporting countries may not now be long in coming: Germany – signatory of the first ever BIT in history (1956, with Pakistan) and the country that has subscribed the largest number of such treaties (over 130 at the latest count) – has recently been taken to ICSID arbitration by Swedish utility company Vattenfall over alleged FET violations of the ECT, attributable to the parliamentary decision to phase out nuclear power generation in the wake of the Fukushima disaster in Japan.¹²⁰ Thus far, and in sharp contrast to

other industrialized countries like the United States, Canada, and Australia [which] have decided to alter their approach to international investment treaties (including with regard to transparency, definitions and dispute settlement procedures), the German federal government continues to insist on secrecy in relation to treaty negotiations and dispute settlement procedures and on very far reaching and broadly formulated definitions and investment protection clauses.¹²¹

However, it will be most interesting to see whether the latest Vattenfall ICSID proceedings put a dent on the hitherto *blasé* stance of the German Federal government with regard to FET issues (not least in view of the strength of the German Green movement, which will take great exception to any challenge to the phasing out of nuclear power generation).¹²² Among other things, the unfamiliar experience of having now twice found itself on the ICSID dock might lead the German government to reconsider its initiative to re-negotiate its older BITs in order to incorporate in them provisions giving investors the right to sue governmental parties.¹²³

The above reflections are meant to give to the non-specialist reader an idea of the many interpretations which can be ascribed to the brief passage in the protocol to the N-V BIT where FET is addressed: “the Contracting Parties agree that the treatment of investments shall be considered to be fair and equitable ... if it conforms to the treatment accorded to investments of their own nationals, or to investment of nationals of any third State, whichever is more favorable to the national concerned, as well as to the minimum standard for the treatment of foreign nationals under international law”.¹²⁴ Now, there is no point in speculating about the gamut of colourable claims that could be advanced in connection with each and every one of the actions that the Venezuelan government took between 2004 and 2007, depending on whether one were to look at such actions through the prism of a broad or, alternatively, a narrow interpretation of the FET standard. For the purposes of this analysis, we will consider these actions from the standpoint of an **expansive** FET standard. This means an FET perspective according to which certain manifestations of governmental conduct, even though carried out in good faith, might still conceivably breach the standard. Such a perspective falls short of the extreme fundamentalist position – rejected in the texts of legal authorities and very seldom espoused openly even by investors but, in practice, often argued behind closed doors before arbitration tribunals – which sees a source of potential liability in any regulatory or tax measure taken by a state that may affect a foreign investor.

If the Venezuelan government measures were being evaluated on the basis of the **minimum** standard of treatment of aliens, all that would be required to give these measures a clean bill of health, FET-wise, would be that they not involve any bad faith, gross misconduct, manifest injustice, an outrage, or a willful neglect of duty. Satisfying a more expansive FET standard, however, poses additional requirements; to wit, the measures should not have frustrated any legitimate expectations that the investors might have harboured when they made the investment.

It is a well settled matter that “the determination of a breach of the obligation of ‘fair and equitable treatment’ by the host State must be made in the light of the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their own borders”.¹²⁵ Such deference is especially marked with

regard to taxation, as this is considered a quintessential sovereign prerogative, and hence the general view is that external limitations on the rights of any state to exercise it should themselves be tightly circumscribed.¹²⁶ Thus, it is a common feature of investment treaties to provide for a separate standard of treatment in regard to fiscal matters, which often means the outright exclusion of tax measures from the fair and equitable treatment standard.¹²⁷

The N-V BIT contains a separate provision (Article 4) which specifically addresses fiscal matters and makes no mention of FET as such, merely imposing a requirement of non-discriminatory tax treatment, both with respect to national investors and to investors from other countries.¹²⁸ If one analyses the COP and XOM tax claims through the lens of Article 4, there is no dispute that the various fiscal measures in question applied equally to all companies (both domestic and international) producing oil in Venezuela, and none among them was treated more favorably than (genuine or contrived) Dutch investors. Indeed, it was the objective of the various fiscal measures to create a sole unified fiscal framework for all oil exploration and production activities within Venezuela.

The drafting of Article 4 of the N-V BIT is not quite as clear-cut as that of other treaties which incorporate fiscal carve-out provisions.¹²⁹ But even if it did not exclude tax claims, and even if the FET standard were to be interpreted broadly, the COP and XOM accusations of systematic and egregious violations of FET would still look far-fetched when measured against the other elementary yardsticks that international tribunals are supposed to apply in any analysis of an FET claim.

It is a generally accepted proposition that “[a] state may tax aliens without unfair discrimination under international law only so long as the taxation is not confiscatory”.¹³⁰ None of the fiscal measures that the Venezuelan government took over the 2004–2007 timeframe rendered any of the COP and XOM projects “so marginal and unprofitable as effectively to deprive them of their character as investments”.¹³¹ Far from it. The behavior of oil prices over this period meant that, despite all of these measures, the projects generated very robust returns for their shareholders. These returns were

considerably in excess of anything that COP and XOM management had anticipated when the investments were undertaken, as becomes evident upon the most cursory perusal of the financing documents for the projects.

In the case of Cerro Negro, for example, the base case cash flow forecast assumed that the price of the upgraded crude from the project would increase “from US\$10.76 in 2001 to US\$15.97 in 2017, based on Maya crude prices increasing from US\$11.88 to US\$17.63 over the same time period”.¹³² In actual fact, by 2007, Cerro Negro upgraded crude was fetching an average of 53.04 USD/B in the market!¹³³ The overall profitability of oil industry operations in Venezuela increased very significantly given this favourable price environment, but nowhere more so than in the Orinoco Oil Belt. As a high Chevron official (Ali Moshiri, again) explained to Ambassador Duddy: “Chevron's margin per barrel in Venezuela before the recent changes in fiscal policies and equity structures was USD 24. **Even after the changes, Chevron's margin was still USD 13 per barrel, over twice the margin of its operations in Argentina** ... [T]he high margins in Venezuela stem from the fact that it is not necessary to explore for crude in the Faja [i.e. the Orinoco Oil Belt]”.¹³⁴ And a former senior officer in the PDVSA finance department, who left the company on account of the 2002 work stoppage (and was certainly no admirer of the Chávez government), explained to other embassy officials that

[d]espite the tax increases ... the strategic associations still offer[ed] a sufficiently lucrative rate of return for the IOCs”, further pointing out that “a sensitivity analysis on Cerro Negro and Sincor to review the change in internal rates of return (IRR) as a result of tax and royalty increases ... [indicated that] oil prices would have to drop below USD 35 per barrel for the companies to earn less than a 15 percent IRR, even with 30 percent royalty and 50 percent income rates.”¹³⁵

Such a drop has yet to materialize.

In the absence of the fiscal measures taken by the Chávez government, the post-2004 profitability of the various COP and XOM association projects obviously would have been even greater. However, as the *Link-Trading v. Moldova* tribunal explained, the fact that investors might forego some profit on account of changes in the tax

environment is not in itself “enough to constitute expropriation. Otherwise, the concept would be unlimited, since most tax measures have a cost impact on taxpayers”.¹³⁶ And if that can be said to be a truism for taxation in general, it is if anything even more so for taxes targeting profits derived exclusively from an exogenous price shock in the market for an internationally traded commodity, like oil. As Sornarajah pertinently observes: “[t]he taxing of windfall profits (i.e. **profits which arise without any act on the part of the investor**) cannot amount to a taking. Thus, taxation of the oil industry for windfall profits due to price hikes cannot amount to a taking”.¹³⁷

A good indication of the special place accorded to tax measures is the conduct of governments generally. Raising taxes during a period of extraordinarily high prices is hardly unusual, whether in Venezuela or elsewhere. Up until late 2004, when the statutory royalty rate for the Orinoco upgrading projects was reinstated, these projects were generating the lowest fiscal take in the history of foreign involvement in Venezuelan oil.¹³⁸ Even more tellingly, the Venezuelan fiscal measures and migration were but a local manifestation of a wider global trend which saw the governments of many oil-producing jurisdictions adjusting their respective tax and institutional frameworks in the face of the radically changed oil price environment (the list of such countries includes but is not limited to Algeria, Bolivia, Brazil, China, Denmark, Ecuador, Israel, Kazakhstan, Russia, the United Kingdom, as well as several provinces of Canada).

The rationale behind the actions on the fiscal front undertaken by these very disparate governments was articulated most eloquently in the words that the Chancellor of the Exchequer, George Osborne, used to explain to a parliamentary committee his decision to raise the Supplementary Charge rate applicable to upstream income from 20 per cent to 30 per cent in 2011:

I think it is perfectly legitimate for us to look at the price of oil at the moment ... to say that the industry is making profits which they were not forecasting to make ... [so] it is perfectly reasonable to look to the oil and gas industry for additional taxation ... Given the high price of oil ... it is still very profitable to invest and exploit these resources. The profits on a barrel of oil are going to be higher in the next five years

than they were in the last five years ... The companies were making £12.02 profit on a barrel of oil for the last five years. They are forecast to make £12.31 on the next five years on that barrel of oil, with the new tax. At the moment they are making £13.28 ... So their profits are going up even with the additional tax.

As a summing up of the economic factors which prompted the Venezuelan government to seek a rebalancing of the distribution of risk and reward between itself (*qua* natural resource owner) and oil companies, these lines can hardly be bettered. But sight should not be lost of the fact that, compared to the British government, the Venezuelan government would have been more alive to the implications of the structural change in the world oil market, for the simple reason that whereas the economic wellbeing of Great Britain is not entirely a function of upstream oil and gas tax revenues, that of Venezuela most certainly is.

Incidentally, during the same appearance before the Treasury Committee, Mr. Osborne neatly disposed of the curious notion that sovereigns are supposed to ascertain what parties to be affected by tax measures think about these, lest governmental action on the fiscal front be branded as arbitrary: “I don’t think it is possible to actively consult a business sector on a tax rise ... I think that would have been very, very difficult to undertake and the previous Government ... also took a similar view and didn’t consult on its very similar increase in the supplementary charge. . . . [A]nd I thought it was a reasonable thing to ask of the oil companies, given the very high price of oil”.¹³⁹ Interestingly, Mr. Osborne’s sentiments in this regard were very similar in overall thrust to those of President Chávez but the former kept inflammatory rhetorical flourishes to a minimum.

Notwithstanding the foregoing, arguments continue to be made that the tax measures violate FET, stoked by the notion of legitimate expectations, which as Westcott remarks, is of fairly recent vintage: “state action affecting an investor’s basic expectations was first considered part of the fair and equitable treatment lexicon around six years ago [i.e. *circa* 2000]. Its prominence in Tribunal Awards, particularly since 2004, makes it currently the most important aspect of the fair and equitable treatment standard”.¹⁴⁰ This prominence, in turn, can be attributed to the manner in which certain tribunals,

while outwardly paying lip service to the idea that “the FET obligation cannot serve the same purpose as stabilisation clauses specifically granted to foreign investors”¹⁴¹, have nonetheless attempted to square this particular circle by finding – very controversially – that in circumstances when treaties seem to “tie the [FET] clause to the fundamental goal of legal stability”,¹⁴² then any change to the legislation and fiscal and institutional frameworks in place when the investor undertook the investment may constitute a breach of the FET standard, if the effect of such state action was to frustrate the legitimate expectations of the investors.¹⁴³

International investors were quick to grasp the implications of this new status. They were eager to exploit the “increased willingness of tribunals to interpret fair and equitable treatment as an assurance that States will not act in a manner that goes against the investor's legitimate expectations” Most of all they welcomed the way this could become a bridgehead through which “to import additional obligations into the standard which are not necessarily required by an objective assessment of what is fair and equitable in a particular circumstance”.¹⁴⁴ This, in turn, explains why “allegations of breaches of the fair and equitable treatment standard based on a departure from the investor's legitimate expectations are increasingly popular with claimants”.¹⁴⁵

Despite the spirited efforts of international investors and their legal counsel, however, today there is still broad consensus among authorities that, in the words of the *Total v. Argentina* arbitration tribunal, “signatories of BITs do not thereby relinquish their regulatory powers nor limit their prerogative to amend legislation in order to adapt it to change, new emerging needs and requests of their people in the normal exercise of their prerogatives and duties”.¹⁴⁶ Among other things, this means that arbitrators are loath to accept the proposition that, in and of themselves, the texts of laws and regulations constitute *prima facie* evidence of promises and inducements underpinning the legitimate expectations of investors. As the *Total v. Argentina* tribunal put it, “legislative provisions, regulations of a unilateral normative or administrative nature, not so specifically addressed, cannot be construed as specific commitments that would be shielded from subsequent changes to the applicable law”.¹⁴⁷

For the cases at hand, this means that, on their own, neither the 1993 placement of the upgrading projects in the non-petroleum section of the Income Tax Law, nor the May 1998 royalty reduction agreement, constitute in themselves “memorialisations” that could have engendered any legitimate expectations on the part of COP and XOM that the Venezuelan government would refrain from either moving the projects back to the petroleum section of the Income Tax Law, or re-instating the statutory royalty rate, respectively. In the apt phrasing of the *Total v. Argentina* tribunal, aside from “the legal regime in force in the host country at the time of fact that the host country entered into a [BIT] with the country of the foreign investor,” there has to be “[a] specific provision in the [BIT] itself or some ‘promise’ of the host State”, if an expectation premised on the stability of such legal regime is to be rendered legitimate.¹⁴⁸

This point can be even better illustrated through reference to a somewhat analogous tax situation at issue in the *Link-Trading v. Moldova* arbitration. In that case, the tribunal rejected a purported “entitlement to protection from changes in taxes and customs duties”, explaining that “there were no reasonable grounds for assuming that this partial exemption would not be subject to legislative review and possible modification each year in the context of the annual budget”, given that the Law on the State Budget (which the tribunal identified as the “legislative basis” of the exemptions) specified that the amount and limits of any customs and VAT exemptions would be set every year.¹⁴⁹ The legislative basis of the preferential income tax treatment for the Orinoco upgrading projects was the Income Tax Law, which since its inception in 1943 has been subject to being amended by the Venezuelan legislative power from time to time and without notice, in a unilateral exercise of its sovereign faculties. As far as the royalty reduction is concerned, its legislative basis was the 1943 Hydrocarbons Law, which conferred on the Venezuelan executive the faculty to lower the applicable rate under certain circumstances, but also allowed the Executive to reinstate the statutory rate at its sole discretion, in the face of a change in such circumstances.

Another area where both FET hawks and doves profess to be in basic agreement is that legitimate expectations “may not be established unilaterally” by the investor, nor can

they be “solely the subjective expectations of the investor”.¹⁵⁰ In other words, tribunals are not supposed to take investors at their word, in terms of what the expectations of the latter allegedly were when they undertook an investment. Hard proof is a requirement, and not just loose talk about inducements, promises, representations, or guaranties. The following lines are a good example of such loose talk:

the Venezuelan Government gave repeated assurances after 2001 that it would honor contracts signed during the oil opening. In particular, the Government entered on 16 January 2002 into a Royalty Procedures Agreement accepting that the royalty rate for the Cerro Negro Project would remain at the reduced rate of 1% and would not for the life of the Cerro Negro Project exceed 16 2/3% (instead of the 30% provided for in the 2001 Law).¹⁵¹

The document referred to above is merely an instruction guide for the calculation of royalties and, needless to say, makes no mention whatsoever of any acceptance on the part of the government regarding the duration of the royalty holiday. And as far as the purported repeated assurances that the members of the government supposedly gave, these would ideally have had to be memorialised in an official document in order to be of assistance to the claimants because, as Newcombe and Paradell stress, “to create legitimate expectations, state conduct needs to be specific and unambiguous. **Encouraging remarks from government officials do not of themselves give rise to legitimate expectations.** There must be an ‘unambiguous affirmation’ or a ‘definitive, unambiguous and repeated’ assurance”.¹⁵²

Here, again, it is interesting to refer to a cable from the petroleum attaché in the US embassy in Caracas reporting that he had been told by an “ExxonMobil executive ... on May 17 [2006] that his firm did not believe it had a legal basis for opposing the tax increases” resulting from “amendments to the Organic Hydrocarbons Law (OHL) that raise income taxes on the strategic associations from 34 to 50 percent and introduced a 33.3 percent extraction tax”.¹⁵³ Reporting this conversation to his superiors in Washington D.C., Ambassador William Brownfield somewhat disconsolately concluded as follows: “it appears that the six international oil companies (IOCs) that are partners in the strategic associations have very little in the way of legal remedies to combat the tax increases”.¹⁵⁴

Apart from the above, legitimate expectations “must be examined as the expectations at the time the investment is made”.¹⁵⁵ From this, it follows not only that “[t]he duties of the host State must be examined in the light of the legal and business framework as represented to the investor at the time that it decide[d] to invest”, but also that “arbitrators have no mandate to evaluate laws and regulations that predate the decision of a foreigner to invest”.¹⁵⁶

What does this mean, in the context of the COP and XOM ICSID cases? As noted before, these legal proceedings were initiated by Dutch corporations, invoking the protection of the N-V BIT. But these Dutch avatars of COP and XOM only came into the picture very late in the day (2005 and 2006), when they “acquired” the investments by virtue of their being inserted into the corporate chains of ownership of the various projects at issue in the arbitrations. Therefore, that is the vantage point from which to examine any legitimate expectations that these Dutch investors might have had (and allegedly seen frustrated by actions of the Venezuelan government). It goes without saying that, at that point in time, no informed investor in the Venezuelan petroleum sector could possibly have harboured any expectations of an immutable fiscal regime (let alone one based on royalty and income tax rates that had already been changed), as XOM’s own submissions to the ICC tribunal make abundantly clear:

Mobil CN addressed a letter to the Minister of Foreign Affairs of Venezuela, the Minister of Energy and Petroleum of Venezuela, and the Attorney General of Venezuela, complaining of a **June 8, 2005** notice from an official of the Ministry of Energy and Petroleum that the 30% royalty rate under the 2001 Hydrocarbons Law should be applied to production under the A[ssociation] A[greement], as well as a statement by the Minister of Energy and Petroleum on **June 15, 2005** announcing the introduction of a bill to have the oil income tax rate of 50% apply to the associations operating in the Orinoco Oil Belt”.¹⁵⁷

And whatever expectations COP and XOM might have entertained back in 1995 and 1997 (and there is much of interest to be said on that crucial matter in a subsequent section), their Dutch offshoots could not have “inherited” such expectations through an inter-affiliate transfer of shares. In terms of corporate law, an inter-affiliate transfer of shares is the equivalent of a sale of those shares to a third party. And had COP and XOM sold their respective interests in the association projects to third parties (as XOM

told both the US embassy in Caracas and the ICC tribunal that it would have liked to do)¹⁵⁸, the buyers of such interests – which, for the sake of the argument, could be assumed to be genuine (rather than fly-by-night) third party Dutch investors – would not have been able to turn around and sue Venezuela for measures that frustrated alleged legitimate expectations that COP and/or XOM might have had either when they entered Venezuela or at any other time before the date of this hypothetical sale of their interests.

Specific undertakings or promises

The preceding discussion indicates that an investor does not have a “legitimate expectation” that the host country law will be frozen in time. This raises the question whether there were any clauses in the relevant agreements in the COP and XOM cases purporting to effect such a legal stabilization. The concise answer to that query is: “No”.

Had any governmental guarantees with regard to the 1 per cent royalty holiday existed, for example, the Cerro Negro partners would surely not have needed to tell prospective purchasers of the bonds used to finance the project that there could be “**no assurance** that the final royalty rate applicable to the Project will not differ materially from that assumed in the Original Base Case Projections or that any such difference would not have a material adverse effect and the ability of the Borrowers to repay the Senior Project Debt”.¹⁵⁹ Of course, had the partners been able to reassure the bond buyers thus, the task of selling these bonds would have been made easier and the bonds likely would have fetched a higher price. The Petrozuata Bond Offering Circular is even more forthright in this regard, noting that while it was true that “[i]n 1994, the Minister of Energy and Mines agreed in principle in a letter to reduce the royalty rate ... to 1% for approximately nine years ... [t]he Ministry could **unilaterally modify** (increase or decrease) the royalty **at any time**”.¹⁶⁰ And as for a purported stabilisation of other Venezuelan laws (such as the Income Tax Law), the XOM ICC tribunal concluded in this regard that “[t]here is no real dispute that the AA is governed by Venezuelan law and that there is no stabilisation or freezing clause that would purport to freeze Venezuelan law as it existed in 1997”.¹⁶¹

In light of the above, building a viable FET case on the basis of specific undertakings by the Venezuelan government to COP and XOM looks very much like a forlorn hope. Indeed, the following passage seems to encapsulate the legal position of these two companies down to a T (though it refers to an altogether different dispute on mineral taxation, in another jurisdiction):

foreign investors are acutely aware that significant modification of taxation levels represents a serious risk ... In many instances, they will obtain the appropriate guarantees ... in the form of, for example, stability agreements which limit or prohibit the possibility of tax increases ... An investor, without an agreement which limits or prohibits the possibility of tax increases, should not be surprised to be hit with tax increases in subsequent years.¹⁶²

And if there is one investor category in particular which should not be taken aback by sudden adverse tax changes, then that is investors in petroleum projects, not only because of the large rent element in the international price of oil, but also on account of its considerable volatility. Indeed, according to Click and Weiner,

political risk is probably more important in this [i.e. the oil] industry than in any other ... This is in part due to the large rent component in natural resource prices, and in part due to beliefs that natural resources are a country's national patrimony ... Volatile prices may exacerbate political risk during booms and mitigate it during busts ... [E]mpirical findings confirm the view that political risk depends on market conditions: as assets become more valuable owing to market conditions, a greater fraction of their value is destroyed by political risk".¹⁶³

These empirical findings were already very much in evidence in 1971, when Raymond Vernon published his famous "obsolescing bargain" model.¹⁶⁴ And of course, oil companies like XOM and COP make it a point to say that they had found themselves at the wrong end of such political risks during the mid- to late 1970s, when member countries of the Organisation of the Petroleum Exporting Countries ("OPEC"), including Venezuela, tightened fiscal control over their oil industries during a time of rising prices in a way that gave rise to "the largest non-violent transfer of wealth in human history".¹⁶⁵ So, are we to believe that, all of the above notwithstanding, each of COP and XOM nonchalantly decided to ignore "the business risk to be faced with changes of laws possibly or even likely to be detrimental to its investment", although it is clear that each of these companies "could (and with hindsight should) have sought to protect its legitimate expectations by introducing into the investment agreement a stabilisation

clause or some other provision protecting it against unexpected and unwelcome changes”?¹⁶⁶

COP and XOM maintain that they indeed took prudent steps to safeguard their investments, supposedly by obtaining from Venezuela promises of stability against unexpected and unwelcome changes, especially with regards to taxation.¹⁶⁷ None of the documentary evidence cited thus far supports the proposition that the Venezuelan state made any such promises (and the Congressional authorisations for the projects, to be examined in brief, fatally contradict it). However, this does not mean that the COP and XOM officers who negotiated the associations with PDVSA did not diligently try to secure strong protections against adverse governmental action for their companies' respective investments. As a matter of fact, these officers actually succeeded in this endeavour, albeit just not in the way that many assume. And as it happens, the key to unraveling the ICSID cases lies precisely in understanding not only the nature and rationale of the protection mechanisms that COP and XOM managed to negotiate for their Venezuelan investments, but also the extreme reticence on the part of these companies to discuss these mechanisms in any meaningful way, in the context of the measures taken by the Venezuelan government over the 2004-2007 timeframe.

The proverbial elephant in the room of the COP and XOM claims is the safeguards which, at a point in time when there were no Dutch companies in the picture and the Venezuelan Investment Law did not even exist, COP and XOM officials diligently bargained for in order to protect their companies' investments in Venezuela. These safeguards assumed the form of a mechanism whereby the companies would be compensated **by PDVSA** for governmental actions which adversely affected the economics of their upgrading projects, **but only up to a defined limit**. And it is the existence of these safeguards – which during the 1990s were clearly seen by both COP and XOM as a far superior and robust alternative to ICSID treaty arbitration – which explains not only why it was that the companies decided to go ahead with very large capital-intensive projects in Venezuela without taking the seemingly elementary precaution of structuring their investments through a friendly BIT jurisdiction, but also

why they only “became Dutch” post-haste, a full thirteen years after the N-V BIT was signed and on the eve of their exit from Venezuela.

The real guarantees against adverse governmental measures (and the no less real limitations to compensation)

As will be recalled from the discussion on page 29 of this paper, the projects at issue in the COP and XOM arbitrations owed their existence to a *régime d'exception* defined in Article 5 of the Oil Nationalisation Law, which spelled out two forms under which, after the promulgation of this law, private capital might be allowed to participate in the reserved hydrocarbons activities: (i) simple service contracts not affecting "the essence of the reserved activities" and (ii) association agreements, permitted only "in special cases and if convenient for the public interest", subject to congressional approval, and valid only if a State company had a participation in such associations that guaranteed their control by the State.

The apparently counterintuitive need to contemplate such participation in the context of a measure reserving all hydrocarbon-related activities to the State was rationalised as a form of insurance against the eventuality that the nationalised industry might one day find itself overwhelmed by technological/economic challenges arising from some new aspect of the development of Venezuela's hydrocarbons endowment. Many members of the Venezuelan Congress found this argument unpersuasive so, to appease them, revisions were included in Article 5 to comply with the imperative of “insulating such exceptional cases with great legal security and extreme control”, principles these which, in their turn, were embodied in the stipulation that “these association agreements will therefore **require for their validity** the approval of the [Congressional] Chambers in joint session, within **the conditions that they set forth**, once the National Executive has sufficiently informed them [that is, the joint Chambers of Congress] of all matters related to the relevant negotiation”.¹⁶⁸ For the avoidance of doubt, it is worth noting that these requirements (and associated conditions) were not mere formalities, but essential features of a law of public policy implementing the reservation to the State of the

hydrocarbons sector (i.e. the Nationalisation Law), itself the **sole source** of all rights that shareholders in the COP and XOM association projects in Venezuela might have had.

The basic terms and conditions in the key documents governing the Association projects – namely, the individual Congressional authorisations and the AAs – were patterned after those in a number of reports which the Bi-Cameral Congressional Commission had prepared and submitted to the consideration of Congress (relying on information provided by the Venezuelan executive) on the pertinent circumstances for each proposed project. The reason behind the close adherence to the precedents set out in such reports, in terms of both contents and language, was made abundantly clear in, for example, the *Congressional Authorisation of the Petrozuata Association Agreement*. “[t]his authorisation will have to be used within the legal framework of the ‘conditions’ **expressly enumerated** in said [Bi-Cameral Commission] Report, as they completely guarantee the strict fulfillment of the conditions of legality, legitimacy, opportunity and convenience expressed in the sole clause of Article 5 [of the Nationalisation Law]”.¹⁶⁹

Among the many “expressly enumerated” conditions in the Bi-Cameral Commission Reports was one which stipulated that the AAs were to include provisions whereby, in the event that the Venezuelan government took actions which adversely affected the economics of the projects, the PDVSA affiliates participating in the projects would compensate their foreign partners. This was expressed in the following terms in the Twentieth Condition of the Cerro Negro Congressional Authorisation:

The Association Agreement shall include provisions allowing the renegotiation of the Agreement as necessary to compensate any Party other than LAGOVEN [the PDVSA affiliate which initially participated in this project], on equitable terms, for adverse and significant economic consequences arising from the adoption of decisions made by governmental authorities, or changes in legislation, that cause a discriminatory treatment of THE ASSOCIATION, any entity or THE PARTIES in their capacity as participants in THE ASSOCIATION.¹⁷⁰

Crucially, though, the compensation for which PDVSA affiliates would be liable was not open-ended and unlimited. Instead, the foreign parties would be deemed not to have

suffered **any** economic damage when the price of crude oil in the international market exceeded a certain threshold:

However, it shall not be considered that a Party has suffered an adverse and significant economic consequence as a result of any of said decisions or changes in legislation, at any time when the Party is receiving income from THE ASSOCIATION equal to a price of crude oil above a maximum price that shall be specified in the Association Agreement”.¹⁷¹

This maximum price was defined as follows in the offering prospectus for the bonds used to finance the Cerro Negro project:

“Material Adverse Impact” will be deemed to have occurred when Mobil Sub’s Net Cash Flow in any fiscal year is decreased by more than an aggregate of 5% as compared to what Mobil Sub’s Net Cash Flow would have been absent the Discriminatory Action(s); provided that after the first period of six consecutive months during which **the average price of Brent crude oil (FOB North Sea) is in excess of US\$27 per barrel (in 1996 dollars)** (the “Threshold Price”), Lagoven Sub will not be required to compensate Mobil Sub for any Discriminatory Action(s) with respect to any day on which the price of Brent crude oil (FOB North Sea) is in excess of the Threshold Price...¹⁷²

As to how exactly this Threshold Price was to be applied, the best explanation of the mechanism is to be found in Section 15.2(a) of the AA:

Limitation on Lagoven CN’s Obligation ... [A]fter the first period of six (6) consecutive months during which the Price of Brent Crude Oil is in excess of the Threshold Price, Lagoven CN will not be required to compensate any Foreign Party for Discriminatory Measures with respect to any Fiscal Year in which the average Price of Brent Crude Oil is in excess of the Threshold Price, and such Foreign Party receives a Net Cash Flow, after taking into account the effect of the Discriminatory Measure, commensurate with a reference price for the Production produced by the Parties that bears at least a reasonable relationship, adjusted for quality and transportation differences, to the Threshold Cash Flow for such Fiscal Year.

In other words, **once the price of Brent crude oil had exceeded this Threshold Price for six consecutive months, no compensation would be payable by Lagoven for any subsequent year in which the price of Brent crude oil (expressed in 1996 dollars) averaged more than 27 USD/B.** Thus, subsequent to the original triggering event, the foreign parties to the AA would not be able to seek redress from Lagoven for **any** excess cash flows resulting from high oil prices that the government might

appropriate, **even if** said appropriation involved actions that actually qualified as Discriminatory Measures under the AAs.

There were some differences among the compensation provisions in the other AAs at issue in the ICSID arbitrations, but the overall concept was similar, including the notion of limitation of liability in high price scenarios. In the case of Petrozuata, compensation due was to be calculated (and limited)

by reference to an average price of Brent Crude Oil deflated annually to 1994 in the world market. If such price of Brent Crude Oil is less than \$18 per barrel, then compensation is at 100% of damages. **If such price of Brent Crude Oil is more than \$25 per barrel, then compensation is at 0% of damages.** If such price of Brent Crude Oil is between \$18 and \$25 per barrel, the percentage of damages to be compensated shall be determined according to a specified formula. If damages exceed \$75 million in any year, the amount compensated will be at the greater of 25% of the actual economic damage and the amount resulting from the Brent Crude Oil calculation. All dollar amounts are adjusted for inflation.¹⁷³

In the case of Hamaca, the foreign parties would be owed no compensation as long as they received a net cash flow in excess of a Threshold Cash Flow calculated at a Brent crude oil price of 27 USD/B in 1996 dollars, regardless of any adverse governmental measure (discriminatory or otherwise).¹⁷⁴

The idea behind the compensation mechanisms at the core of all the extra-heavy crude oil upgrading projects was that the government would be deterred from changing the fiscal conditions by the knowledge that any attempt on its part to do so would cost the Venezuelan state oil company and its affiliates dearly. This intent is patently obvious in clause 15.1(c) of the Cerro Negro AA, for example:

[i]n the event that a Discriminatory Measure for which Lagoven CN is paying compensation to a Foreign Party, or in response to which the Agreement has been modified, is reversed or ceases to be in effect, the obligation of Lagoven CN to pay compensation, or the modification made to the Agreement, shall cease to be in effect to the same extent; provided that the Foreign Party has been compensated for the damages previously suffered as a result of such Discriminatory Measure”.¹⁷⁵

However, so long as oil prices remained above certain levels, in a sustained fashion, the parties to the AAs were content not to have this Damoclean sword hanging over the head of the Venezuelan government. Needless to say, this did not arise out of a show

of generosity on their part, and to appreciate the tokenistic nature of their gesture, one need look no further than to the contemporary research into the matter carried out by someone who would eventually end up by playing a key role in the migration saga.

As viceminister of Hydrocarbons between 2005 and 2008, Bernard Mommer was credited by “company officials ... with orchestrating the GOV strategy toward them ... point[ing] to his career as an academic in which he studied how to maximize collection of oil rents on the part of the state”.¹⁷⁶ In 1999, Mommer published the following passage on the compensation limitation provisions in the AAs, and their relationship with oil market windfalls:

[t]he Cerro Negro Association Agreement . . . also contains a definition of what PDVSA and its partners could consider as an excess profit, which then could in fact be subject to some special tax. It is defined therein as the Base Price of Brent Crude Oil ... of US\$27, in 1996 dollars . . . The following assumptions are defined below: (1) Brent Crude must be above this level, of course, adjusted for inflation, without interruption for more than six months; (2) Brent Crude exceeds this level, on average, during the entire fiscal year. Only if these two assumptions are met, the government may then impose some additional tax on the Association, collecting a part of that excess [profit] without [triggering] a payment of compensation by Lagoven. **However, it must be noted that this price level has only been reached once during the 140-year history of oil, between 1980 and 1984, due to the Iranian revolution and the subsequent war with Iraq.**¹⁷⁷

Mommer decried these provisions because they made a hostage of PDVSA in order to inhibit the government from the legitimate exercise of its sovereign powers, and therefore represented a betrayal of the guiding principle of long-term Venezuelan oil policy since the 1940s. As Mommer saw it, starting in 1943, the government had “claimed the legitimate right of Venezuela, as the resource owner, to all excess profits that might accrue in its exploitation ... [but] fifty years later a state owned oil company, Lagoven, agreed with its foreign partners to deny this right of the nation, ie, to deny the very essence of nationalisation”.¹⁷⁸ In addition, Mommer vehemently objected to the fact that such freedom of action as these provisions supposedly afforded the government was in any case illusory, given the extreme unlikelihood that oil would ever exceed the Threshold Price for the requisite period of time (after all, this had only

happened “once during the 140-year history of oil”). And this, in turn, explains the nonchalance with which XOM and COP declined to structure their investments in Venezuela through The Netherlands: the protection afforded by this compensation mechanism – administered by PDVSA (which also provided a parent guarantee for its operating affiliates) and underpinned by ICC arbitration – was seen by the companies as a superior alternative compared to ICSID treaty arbitration (its main advantages being ease of calculation, enforcement and collection, and a very favourable price threshold).

With the benefit of hindsight, it is obvious that the COP and XOM vision of the likely behaviour of the oil market in the medium and long term was well wide of the mark. In making such a mistake, COP and XOM were in good company. It is no exaggeration to say that the post-2000 oil price explosion was foreseen by no one: not COP, not XOM, not PDVSA, not Mommer, not even Nostradamus. But that, of course, does not mean that the contractual conditions that these companies bargained for – including the formulae for compensation on account of adverse governmental action – can or should be jettisoned without further ado. In fact, these formulae should carry an enormous weight in terms of determining the fair market value of the Petrozuata, Hamaca and Cerro Negro upgrading projects on the eve of their nationalisation, as no diligent prospective buyer would have failed to take them into consideration when calculating a purchase price for the COP and XOM interests. After all, it goes without saying that, in post-2000 market circumstances, any hypothetical buyer would have conferred a much lower value to a project with an income cap of 27 USD/B, adjusted by inflation, than to one without.¹⁷⁹ Indeed, this is one of the reasons why Venezuela has always maintained that the compensation figures that COP and XOM bandied about were the stuff of fantasy. Such a stance has nothing to do with a purported attempt on Venezuela’s part to limit compensation to book value (in contravention of the relevant provisions of the N-V BIT), but merely reflects the well settled proposition that any restrictions or limitations on a contractual or property right must be taken into consideration when calculating the value of such right.¹⁸⁰

The fortuitous publication of leaked diplomatic cables originating from the US embassy in Venezuela shows that COP and XOM (and the US State department, incidentally) were perfectly aware that there was no factual basis to their steadfast allegations that Venezuelan offers of compensation were based solely on book value. But if what one is after is evidence of abuse of process on the part of these two companies (and irresponsible cheerleading on the part of their home government), then pride of place surely belongs to their repeated assertions that the legal disputes with Venezuela involve a breach of contract on the part of the government. To quote the words of Rex Tillerson, XOM CEO as of the time of writing, “[o]ur situation in Venezuela is a pure and simple contract. The contract was disregarded”.¹⁸¹

In order to appreciate the disconnection from reality of the statement above, it is necessary to put forward only one question: why was it that the AAs needed to incorporate compensation mechanisms in the first place? The answer – couched in unambiguous terms – can be found in some of the other essential conditions that the Venezuelan Congress stipulated for each one of the association projects (i.e. conditions without which the projects could not even have come into legal existence).

Consider, for example, the Sixteenth Condition of the Petrozuata Congressional Authorisation:

The Association Agreement shall include provisions that allow Maraven to compensate the other parties, under equitable terms, for the significant and adverse economic consequences directly derived from the adoption of decisions by the national, state or municipal administrative authorities, or from changes in legislation that, due to their content and purpose, cause an unfair discriminatory treatment to the Company or to such other parties, always in their capacity as such and as parties to the Association Agreement, **all without diminishing in any way the sovereign power to legislate, inherent in the very existence of the national, state and municipal legislative powers.**

For good measure, the Eighteenth Condition made it clear that the “Association Agreement to be executed, the commercial company to be created and the activities of a diverse nature that will derive from such acts” would, in no case, “in and of themselves give rise to liability on the part of the Republic of Venezuela, which could only arise in

the event that such liability were to be assumed through a valid express legal act of its authorities”.¹⁸²

In the case of the Hamaca project, the Nineteenth Condition of its corresponding Congressional Authorisation stated, along similar lines, that “[t]he Association Agreement, the creation and operation of the Entities and other activities **shall not impose any obligation on the Republic of Venezuela nor shall they restrict its exercise of sovereign powers**”.¹⁸³ The Twenty-first Condition in the authorisation complemented this by providing that, while foreign participants in the Hamaca Project would be entitled to receive compensation from a PDVSA affiliate – subject to the conditions and limitations established in the AA – in the event of certain specified changes in Venezuelan law or governmental actions, “[i]n no case will it be understood that the application of these mechanisms limits, affects or restricts in any way the power of governmental organs to adopt measures pursuant to the Constitution and applicable Laws”.¹⁸⁴ The content of the Eighteenth Condition of the Cerro Negro Congressional Authorisation is very similar: “[t]he Association Agreement, and all activities and operations conducted under it, **shall not impose any obligation on the Republic of Venezuela nor shall they restrict its sovereign powers, the exercise of which shall not give rise to any claim**, regardless of the nature or characteristics of the claim”.¹⁸⁵

At this point, a further question inevitably arises: is there any way in which informed investors could have taken any of the passages above as an assurance of tax stability from the Venezuelan government that would have engendered legitimate expectations on their part in this regard? It is worthwhile to let the representatives of the claimants themselves provide the reader with the answers.

In the case of COP, in a meeting held at embassy premises on September 5th, 2008 (“following a September 4 meeting with the Venezuelan Government (BRV) negotiating team”), the company’s Latin America President, Roy Lyons, told US diplomatic personnel that:

the original contracts for the Petrozuata and Hamaca Strategic Associations included clauses stipulating that, **if the fiscal terms of the contracts were changed by the BRV, PDVSA would cover the losses of the investor up to a certain point. The maximum oil price named in the clause is much lower than current world oil prices** which would be cited by ConocoPhillips in its claim to the ICSID panel. The heart of the BRV legal strategy, according to Lyons, is its belief that ICSID's jurisdiction will be thrown out. Lyons noted however, that ConocoPhillips has filed its claims against the Government of Venezuela and not PDVSA. The company has consulted with two major international law firms which both confirmed their belief that there was a greater than 95 percent possibility that ConocoPhillips would prevail on this legal point.¹⁸⁶

The latter part of the passage shows COP speculating that the basis for the Venezuelan jurisdictional challenges would be the contention that the dispute over valuation between the parties was a contractual affair, and that the claim should be thrown out because the government was not a party to the AAs.¹⁸⁷ In implied reply to this hypothetical challenge, COP seems to be offering the argument that what the contracts actually said is of no particular import in the arbitration because, after all, the company filed for breach of treaty against the government, as opposed to breach of contract against PDVSA.

The degree of confidence that COP and its counsel placed on this legal position is remarkable in the light of the contents of another diplomatic cable where an XOM executive was reported to have told US embassy officials “that his firm did not believe it had a legal basis for opposing the tax increases”. In connection with this opinion, it is candidly related elsewhere in the cable that the intractable problem faced by the companies really lay in the fact that

each of the strategic association agreements has some form of indemnity clause that protects them from tax increases. Under the clauses, PDVSA will indemnify the partners if there is an increase in taxes. However, in order to receive payment, a certain level of economic damage must occur. In order to determine the level of damage, the indemnity clauses contain formulas that, unfortunately, assume low oil prices. **Due to current high oil prices, it is highly unlikely that the increases will create significant enough damage under the formulas to reach the threshold whereby PDVSA has to pay the partners.**¹⁸⁸

Indeed, this distinct unlikelihood that the actions of the Venezuelan government would transgress the boundaries of contractual provisions drawn by the companies

themselves had proved to be an abiding source of frustration to them well before their exit from Venezuela. For example, as early as January 12, 2005, ExxonMobil de Venezuela President Mark Ward was informing the US embassy “that the company ha[d] decided to move ahead with some legal action in response to the unilateral GOV decision to increase the royalty payments levied on the extra heavy oil projects”, apparently by relying on “wording in Venezuela's investment law that will give it an avenue to avoid the Venezuelan courts and get to international arbitration”. Embassy officials saw XOM’s hardline stance as potentially fatal in terms of any future “attempts to expand its business with Venezuela”, but concluded that, in taking it, the company was “presumably looking at potential risks around the world”.¹⁸⁹ In the event, and despite XOM’s avowed concern at such world-wide ramifications, the company declined to embark on litigation over the royalty reinstatement, in all probability out of an appreciation that the contents of the AA would have doomed such an enterprise to failure.¹⁹⁰

What is more, despite a provision in the AA stating that “in the event that one of the Foreign Parties determines that a Discriminatory Measure has occurred which **may** result in a Materially Adverse Impact, such a Foreign Party shall **immediately** provide notice of the Discriminatory Measure to Lagoven CN”, XOM did not even hand formal notice to PDVSA about its objection to the royalty measure (or, indeed, to any of the subsequent fiscal measures).¹⁹¹ XOM would only do so – by means of an omnibus rejection of all the fiscal measures taken by Venezuela from October 2004 onwards – on June 22, 2007, on the eve of its exit from the country. Shortly thereafter, presumably lest anybody misinterpret this rather belated notice as being somehow not in line with the idea that XOM “takes sanctity of contract very seriously”¹⁹², the company initiated an ICC arbitration, alleging breach of contract against PDVSA on account of, *inter alia*, “failing to indicate its concurrence, pursuant to Section 15.1(b) of the AA, that Discriminatory Measures causing a Materially Adverse Impact had occurred”!¹⁹³

Earlier in this paper we asked whether it was possible to find a government guarantee in the suite of agreements which constituted the legal foundations of the COP and XOM

association projects. Our analysis of these agreements shows that, far from containing any specific undertakings or promises from Venezuela to either COP or XOM, the AAs stipulated that they imposed no obligations on the Republic, which was not even a party to these agreements. Furthermore, the Congressional authorisations for these projects expressly reserved the exercise of the Republic's sovereign rights, in no uncertain terms. Nevertheless, according to XOM's submissions to the ICC tribunal, the purpose of the compensation limitation provisions apparently was not to counterbalance the proviso that the AA would not "impose any obligation on the Republic of Venezuela nor ... restrict its sovereign powers, the exercise of which shall not give rise to any claim". Rather, these provisions supposedly reflected the fact that "the Parties knew that pursuing a claim against the Government would be difficult and lengthy and ... they, therefore, crafted the indemnity provisions such that they would function regardless of any claim that the Claimant may have against the Republic of Venezuela".¹⁹⁴ In other words, as XOM reads the clauses in the Cerro Negro AA quoted above, Venezuela's exercise of its sovereign powers could nevertheless give rise to claims against the Republic (over and above any PDVSA liabilities pursuant to the indemnity provisions), and this is supposedly confirmed by the fact that Article 15.1(a) of the AA "contemplates an action against the Republic of Venezuela that would be conducted independently, but in parallel, with [ICC] arbitration against PDVSA-CN".¹⁹⁵

It does not seem unfair to suggest that such fanciful hermeneutics would probably get short shrift in a court, were XOM not the company behind them and, perhaps even more importantly, were they not being aimed at Venezuela. Be that as it may, for the purposes of this exposition, XOM's arguments are useful because they provide an opening to bring the discussion round to the topic of the ICC arbitrations. As mentioned before, these particular ICC proceedings happen to be very different from run-of-the-mill arbitrations, not least because they do not arise from commercial disagreements between business partners but, rather, revolve around actions taken by a government which was not a party to the contracts at issue, in exercise of basic sovereign prerogatives, whether it be the regulation of production of a natural resource whose

property is vested in the nation (as in the COP ICC case) or the taxation of the proceeds obtained from the exploitation of that natural resource (as in the XOM ICC case).

The ICC cases: COP

The COP ICC case is somewhat of an outlier in the context of the disputes in international courts of arbitration pitting COP and XOM, on one side, and PDVSA and Venezuela, on the other. This is a function both of its comparatively modest magnitude (COP's claim amounted to "only" 165 MMUSD), as much as of its somewhat peculiar timing (the request for arbitration was only filed on December 30, 2009, more than two and a half years after the conclusion of the events underlying the claim).¹⁹⁶ Also, COP's ICC claim did not seem to be obviously duplicative of a claim before ICSID. The overall impression of marginality is reinforced because, in sharp contrast to what happened in the XOM ICC case, the publication of the award was greeted with indifference by COP, PDVSA, Venezuela, and the oil market and industry at large.

The COP ICC case revolved around the production curtailments that the Venezuelan government imposed on the Petrozuata and Hamaca projects between November 2006 and May 2007, in order to comply with OPEC quota commitments. According to COP, such cutbacks breached assurances that PDVSA affiliates had given COP affiliates, and which were embodied in two different legal instruments. In the case of Hamaca, it was section 13.1 of the AA itself which, according to the COP affiliate, obliged the PDVSA affiliate participating in the project to "(i) ensure that the curtailments were established in a proportionate manner and (ii) mitigate the effects produced by the OPEC curtailments".¹⁹⁷ In the case of Petrozuata, it was a confidential side letter to the AA, signed on the same day as the latter by the chief executives of Maraven and Conoco, respectively.¹⁹⁸ Under the terms of this side letter, Maraven (and/or any successor in interest) assumed "the obligation ... to absorb any impact that OPEC curtailments may have had on the Petrozuata Project out of its own production".¹⁹⁹ Crucially, this letter "was never shown to the [Venezuelan] Congress, neither in form, concept or content, and none of the contractual arrangements shown to Congress ever mentioned - either

directly or through reference to further agreements – the obligation set out in the Petrozuata Side Letter”, even though “[t]he Conditions approved by Congress ... [were] of an exhaustive nature ('taxativas') and ... [could not] cover issues which were not duly disclosed to Congress”.²⁰⁰

The COP ICC tribunal rejected all claims related to the Hamaca project, and concluded that the sole basis of PDVSA liability was indeed “any damage or loss resulting from Maraven's failure to comply with its obligations under the Petrozuata Side Letter, in particular the obligation to absorb the relevant production curtailments”.²⁰¹ The resulting award came to around 65 MMUSD.

Notwithstanding its relative insignificance, the COP ICC case is revealing from the standpoint of the Venezuelan political process during the decade of the 1990s. In the first place, the side letter episode provides an insight as to the inordinate lengths to which PDVSA managers were ready to go in order to further the agenda of oil liberalisation in Venezuela during those years, even when this meant overstepping very clear statutory boundaries. The ultimate example of this, of course, was the leading role that PDVSA upper management played in promoting not one but two separate attempts to unseat the constitutional government of the country (a military *putsch* in April 2002, and a three-month strike that paralysed the oil industry and much of Venezuela's economic activity, starting in November of that same year), events which would culminate in the separation of thousands of white collar workers from the company.

On a symbolic plane, this arbitration is as much a consequence as a reflection of a long-term project cherished by those PDVSA managers who devised and implemented the AA projects; namely, to subvert the whole OPEC quota system, and even to call into question the very right of the Venezuelan government to regulate the output of a valuable, non-renewable and depleting natural resource like oil. Their ambition in this regard crystallised in the text of the Thirteenth Condition of the Hamaca Congressional authorisation, which established that “[i]n the event that the Association is required to reduce its production as a result of international commitments of the Republic of

Venezuela, such reduction shall not exceed the percentage reduction generally applicable to the Venezuelan oil industry as a whole ... calculated on the basis of available production capacity".²⁰² What is striking about this passage is not so much the requirement for proportionality, but the extraordinary idea that decisions of the Venezuelan government regarding possible curbs on oil production would only be valid if undertaken in the context of some sort of international agreement (whether this be OPEC, or else the sort of arrangement that many governments would like to see as OPEC's successor: a commodity agreement involving both producers and consumers, and for which the International Energy Forum is likely to be laying the foundations). Again, such a notion ran completely counter to the direction of Venezuelan oil conservation policy since the Second World War, which was predicated on the State's absolute right to regulate the exploitation of the natural resources belonging to the Nation, irrespective of whether the State carried out these functions on its own or in concert with other like-minded sovereigns. And it is remarkable that this radical policy about-face should have been adopted thanks to the good offices of PDVSA, an entity that was meant to be the key vehicle for Venezuela's assertion of its sovereign control over its petroleum resources, ostensibly for the greater welfare of its population. The Thirteenth Condition of the Hamaca AA was likely only the thin end of what promised to be a much wider and formidable wedge, aimed at rending OPEC asunder through the effective withdrawal of Venezuela from the organisation.

The ICC cases: XOM

The AAs for the upgrading projects in the Orinoco Oil Belt were representative examples of a type of petroleum exploration and production agreement that became quite widespread during the 1980s and 1990s. The most distinctive feature of these agreements was that "instead of targeting the legislative power of the state founded on sovereignty", they sought to "set up a contractual mechanism of allocating the financial effect of political risk to the state enterprise", thereby displacing the centre of gravity of the resource owner/investor relationship from "a sovereign and state-related promise to a mechanism of commercial contracting with regard for the implications of damages for

breach of obligation – a move from a predominantly public law perspective to one based primarily on commercial contract law".²⁰³ In such a manner, once a national oil company ("NOC") like PDVSA became a party to an agreement whereby its home state was to receive minimal fiscal benefits from the exploitation of the hydrocarbon resources under its jurisdiction, the resulting asymmetrical division of the spoils would be safeguarded thereafter by the prospect of the NOC having to cough up large sums of money in the event that the government in question changed its mind about such arrangements.

The protection mechanisms embedded in the AAs, underpinned by ICC arbitration, proved to be as ill-suited for the post-2000 conditions in the oil market as the Maginot Line was for defending France against mechanised armoured columns, and for a similar reason, namely, that they were both conceived to deal with very specific contingencies that stubbornly failed to materialise. The AAs were prime examples of the sort of contract that was meant to become *de rigueur* in a market environment characterised by resource abundance, untrammelled output and a fiscal race to the bottom among natural resource owners, as in a scenario imagined by Michael Klein of Royal Dutch/Shell:

[w]ith declining real oil prices the fight over upstream rents continues to intensify. Many oil-exporting countries are crucially depend on oil revenues ... As population grows and the price of oil declines, producer countries open up all parts of the oil and gas business for foreign investors. They revise tax regimes to attract investors. In particular, countries with marginal fields abolish royalties ... [B]y 2040 ... tax systems for upstream operations converge to regular corporate tax regimes as upstream rents diminish.²⁰⁴

Ironically, as these lines were being published in 1999, the oil price was already on the rebound from its catastrophic 1998 cycle lows, and being vertiginously propelled, by a feeble supply response in the face of runaway demand emanating primarily from China, along an upward path that would take it to historical highs in 2008. This price behaviour reflected the fact that Klein's oil cornucopia turned out to be illusory, as comes across clearly in Thane Gustafson's pithy appraisal of global oil prospects at the beginning of the 21st Century: "[i]n 1980, over 360 billion barrels of discovered oil lay undeveloped worldwide, two-thirds of it not even covered by a development plan. Now, in the new century, nearly 90 per cent of all discovered oil resources are under development, and

much of what remains undeveloped consists of difficult or inferior prospects”.²⁰⁵ Thus, the defeat, **by the market itself**, of the premises underlying the agenda of radical oil liberalisation, did indeed lead to a wholesale revision of tax regimes all over the globe, but in the exact opposite direction to that foreseen by Klein. This process of revision got underway in earnest in 2003 with an event as unheralded as it is momentous: the “migration” of the DUC oil and gas concession in Denmark (treated in more detail in the conclusions to this paper).

High oil prices may have swamped the AA protection mechanisms in terms of their reason for being (i.e. deterring the government from adjusting the fiscal regime for the project) but, from the very outset, ICC arbitration was nevertheless a central plank of the legal strategy that XOM decided to pursue against Venezuela. This is because ICC proceedings offered XOM the means “to obtain a worldwide freezing order and attachments not available in the context of the ICSID proceeding” (because such actions are not allowed under the ICSID Convention), and also “to build an argument under the Chalmette Offtake Agreement supporting a future seizure of the 50% interest of a PDVSA subsidiary in the Chalmette refinery in Louisiana”.²⁰⁶

In the ICC claim, XOM alleged breach of the covenant (guaranteed by PDVSA) whereby PDVSA-CN had undertaken to provide an indemnity to Mobil Cerro Negro in the event of certain adverse governmental measures (i.e. under the limitation of liability clauses that are supposedly irrelevant in the ICSID cases). XOM claimed the breach arose from the fact that neither PDVSA CN nor PDVSA paid the damages that XOM had unilaterally determined it was owed. The measures that XOM alleged entitled it to an indemnity were as follows:

(a) direct expropriation of Mobil CN’s interests in the Cerro Negro joint venture without compensation and (b) measures preceding such direct appropriation, including (i) repudiation of Royalty Reduction Agreement and imposition of the so-called extraction tax; (ii) refusal to allow the expansion of the Cerro Negro project under previously agreed terms and conditions; (iii) income-tax increases that were levied solely on participants in Orinoco Oil Belt ventures, which were inconsistent with the Framework of Conditions; and (iv) imposition of production and export curtailments to the Cerro Negro Joint Venture.²⁰⁷

The XOM ICC claim, then, overlapped with the ICSID case, with both cases presumably meant to dovetail into one another so that, if XOM were to fail to get a satisfactory result in the speedier ICC process, it would still have ICSID to fall back on.²⁰⁸ The ICC tribunal found that while there had been no breach of contract on the part of PDVSA, some of the governmental acts referred to above – specifically, the nationalisation itself and the change in income tax rate – were compensable events (i.e. “Discriminatory Measures” under the AA definition) for which PDVSA was liable under the indemnity provisions of the AAs.²⁰⁹

As mentioned before, the tribunal awarded XOM a total of 907.58 MMUSD (less counterclaims of 160.64 MMUSD), after applying the agreed contractual formulae on limits to compensation. XOM has sought to portray this award as representing “recovery on a limited, contractual liability of PDVSA that was provided for in the Cerro Negro project agreement”, a determination that supposedly has no bearing on the “larger” proceeding before ICSID.²¹⁰ However, this interpretation of the outcome of the ICC arbitration is very much at odds with other key provisions in the Cerro Negro AA. According to XOM, “the ICSID arbitration fulfills [sic.] Article 15.1(a) AA which requires the Claimant to pursue legal actions to mitigate damages suffered as a result of a Discriminatory Measure”.²¹¹ However, that same article also requires XOM to credit any and all net proceeds from any award obtained pursuant to such legal actions against damages payable calculated under the Cerro Negro formulae or, in the event of such damages having already been paid, to reimburse such proceeds in full to PDVSA Cerro Negro (successor to Lagoven’s interest in the project).²¹² That being the case, and with it having been adjudicated that the 2007 nationalisation of XOM’s interest in Cerro Negro constituted a Discriminatory Measure and, furthermore, with the “Damages payable” having been calculated in accordance with the compensation formulae, the question arises as to whether the XOM ICC tribunal has effectively rendered XOM’s ICSID claims moot (insofar as they relate to the Cerro Negro project).²¹³

The XOM ICC decision is also of great significance as far as the COP ICSID arbitration is concerned, in terms of the determination of the discount rate to be applied to future

cash flows in the calculation of the fair market value of nationalised assets. XOM's submissions before both the English courts and the ICC tribunal highlight how the manipulation of discount rates, if unchecked, will lead to distortions in compensation. In the High Court in London, for instance, XOM arrived at a damages figure of USD 12 billion for its claim by calculating the cash flows for 27.5 years and then adding them up, without discounting the sum to present value terms (in other words, XOM relied upon a discount rate of zero, ostensibly because the Association Agreement formulae made no provision for discounting).²¹⁴ In the ICC case, XOM retreated from this position, but the company still argued for an extraordinarily low discount rate of 3.37 per cent (i.e., less than a U.S. Treasury bond at the time). In other words, XOM argued that the indemnity cash flows from PDVSA had the same risk profile, or were as safe as, a U.S. Treasury bond.

The ICC tribunal did not buy XOM's approach to discounting. Instead of a discount rate of 3.37 per cent, the ICC tribunal selected a rate of 18 percent, a figure which "while lower than the rates provided in the *Phillips [v. Iran]* decision and the *Himpurna [California Energy Ltd. v. Republic of Indonesia]* case, appropriately reflect[ed] the risks related to the indemnity cash flow analysis in the ... case [of Mobil Cerro Negro]". As well as categorically stating that "[t]he 'risk free' rate proposed by the Claimant is not acceptable"²¹⁵, the tribunal made it clear that, had it been tasked with quantifying cash flows not subject to a protection mechanism, the discount rate it would have used would have been higher still: "[t]he Tribunal considers that there is a difference between valuing future cash flows under an indemnity formula and valuing the potential cash flows from a project. There is a valid distinction between the two exercises, not the least of which being that there may be fewer risks to indemnity cash flows than to Project cash flows".²¹⁶

Some reputedly well-informed observers of the arbitration scene were taken aback by the stance on discount rates on the part of the XOM ICC tribunal.²¹⁷ This is puzzling, given that the overall approach that the tribunal followed was in accordance with previous guidance from other arbitral tribunals as pertains the issue of country risk²¹⁸,

not to mention the specific procedures by which supra-national institutions go about quantifying the risks posed by international mineral exploitation projects, in general, and oil exploration and production projects, in particular.²¹⁹ Furthermore, the figure that the ICC tribunal arrived at is broadly consistent with the evidence of the internal hurdle rates that oil companies rely upon in order to weigh their investment and acquisition options. Ascertaining what these rates might be in the cases of individual companies has always been a notoriously tricky affair, because company officers studiously avoid going into specifics whenever this topic crops up in public discussions. That is why one should be particularly appreciative of the forthright manner in which Sergey Bogdanichov (former CEO of Rosneft) discussed the sort of discount factor that his company would factor in a bid for interests in projects located in high-risk countries (like Venezuela): “[w]e have a strict rule not to buy assets with an internal rate of return of less than 20%. There aren’t many overseas plays that meet that requirement ... We have no intention of buying assets that would lower those metrics. We don’t need deals that bring nothing except press items”.²²⁰

Mr. Bogdanichov's threshold level is very much in line with the minimum returns that the government of the United Kingdom believes international oil companies expect to obtain from oil and gas exploration and production activities in that country, as witnessed by the workings of the fiscal regime applicable to such activities. The centrepiece of this fiscal regime is the so-called Petroleum Revenue Tax (PRT), a special levy on oil and gas production which seeks to tax windfall profits on a field by field basis at a relatively high rate (currently 50 per cent). PRT incorporates a series of special reliefs and mechanisms meant to ensure that projects which generate no windfall profits are protected from the tax. Among these mechanisms is one known as the "Safeguard", designed "to give companies **a degree of assurance about the minimum level of profits they can expect to enjoy after PRT** (but before CT), with a view to ensuring that marginal fields remain profitable".²²¹ The Safeguard restricts "the amount of PRT payable by a participator in a chargeable period if the effect of the PRT would be to reduce after-tax profit below a **minimum return on investment in the field**".²²² That minimum return is defined as "**15 per cent of the participator's 'accumulated capital**

expenditure' in the field up to the end of the chargeable period in question", with 'accumulated capital expenditure' in turn defined as "the cumulative amount of field expenditure allowed as qualifying for supplement".²²³ Of course, if 15 per cent is the minimum return that oil and gas projects have to attract in a highly developed jurisdiction such as the UK (a country with deep and liquid markets for oil, financial services, labour, construction services and so on), the returns that investors will demand to take their capital to (say) Venezuela, will have to be significantly higher, if for no other reason than to reflect country risk. The rules for the application of PRT also stipulate that "where an interest in a field changes hands, the new owner inherits the position of the old owner, including any unused expenditure relief and allowable losses, and also the 'cumulative capital expenditure' for safeguard".²²⁴ With this provision, the UK government is doing nothing more than recognising the common-sense position that investors expect to meet or exceed their hurdle rate in any venture, whether this involves undertaking a start-up project or else buying into an extant project (as in the case of a hypothetical sale of XOM's interests in Venezuela).

The unsoundness of XOM's approach to the issue of the applicable discount rate for the purpose of valuing a nationalised interest is perhaps best laid bare in the aforementioned *Himpurna* decision (rendered by a tribunal whose president was Prof. Jan Paulsson, joint lead counsel in the COP ICSID arbitration against Venezuela):

The fact remains that it is riskier to enter into a 30-year venture in Indonesia than in more mature economies. And it is no answer to say that the contract has allocated 99% of the risk to the Indonesian side. After all, there are documents which by their terms allot 100% of the risk to the debtor: bonds. Although they may be denominated in US dollars, although they may stipulate absolute obligations to pay, it still makes a difference whether the issuer is Switzerland or Swaziland ... This is the fundamental issue of country risk, obvious to the least sophisticated businessman.²²⁵

There is no reason to believe that either COP or XOM have any great problem in recognising such a fundamental issue, of course. But companies such as these seem to have considerable difficulties in recognising that they themselves are bound by the rules that they insist apply to everybody else. And, ironically, their tacit pretension to be somehow above such rules comes across most obviously when one analyses their own

conduct through the prism of the principle that supposedly triggered their disputes with Venezuela: sanctity of contract.

What contracts are COP and XOM talking about, exactly?

During a visit to Venezuela at the beginning of 2005, US Senator Norm Coleman (R-Minn.) asked Mark Ward, president of ExxonMobil de Venezuela, whether it was a good idea to dispute the reinstatement of the 16 2/3 per cent royalty rate for the Association projects, especially when “other international oil companies affected by the GOV decision had decided not to protest”. Ward’s response was that “ExxonMobil perhaps had a ‘different perspective’ on contract sanctity than other companies. For ExxonMobil, he said, the sanctity of contracts is paramount ... Unilateral contract changes without compensation, he said, are very troubling”.²²⁶ However, it appears that the XOM perspective on *pacta sunt servanda* – one that COP clearly shares – is that the *pacta* whose inviolability has to be defended tooth and nail extends to bargains which these companies wish they had struck, as opposed to those contracts and provisions which they actually negotiated and signed (and may have come to regret).

The picture of the fiscal measures and subsequent migration that emerges from a review of the voluminous paper trail of documents produced in fulfillment of the exacting regulatory procedures contemplated in Article 5 of the Nationalisation Law, is at significant variance with the COP and XOM account of such measures.²²⁷ As these companies would have it, the Venezuelan government and PDVSA treated the AAs “as the proverbial ‘scrap[s] of paper’ that they can disregard at their convenience”, in the process “breaking all the commitments they made to induce that investment”.²²⁸ In fact, the documentary record shows that all Orinoco projects were authorised by the Venezuelan Congress subject to the express and essential condition that the State was to reserve all of its sovereign powers, including the power to enact and change laws and taxes. Precisely **because** of this broad reservation of sovereign rights, COP and XOM (and all other foreign participants in the AAs, for that matter) bargained with PDVSA to obtain protection for their investments through very specific compensation mechanisms, whose premises were also incorporated as essential conditions in the Congressional

authorisations for the projects. But these compensation mechanisms, in turn, made explicit reference to a limitation of liability on the part of PDVSA, and provided that foreign investors would be deemed not to have suffered any adverse economic consequences when the price of crude oil exceeded a certain threshold level specified in the respective AAs. Thus, contrary to the claims of COP and XOM, the documents would indicate that the Venezuelan government had the right to take the succession of fiscal measures at issue in the arbitrations.

As far as the nationalisation of the projects is concerned, not even XOM is prepared to contest the fact that this came about through the exercise of a legitimate sovereign prerogative: “the ICSID dispute is not over Venezuela's right to expropriate the assets of our Venezuelan affiliate, Mobil Cerro Negro”.²²⁹ But it should not be forgotten that the Venezuelan government neither intended nor wished to take over all of the COP and XOM interests in the country, and that this outcome was the consequence of these companies’ refusal to reduce their equity participation in the projects in the context of the migration initiative.²³⁰ The companies’ intransigence left the Venezuelan government facing a much higher compensation bill than would otherwise have been the case, which renders all the more objectionable their position that the limitations formulae should be set aside for the purposes of calculating compensation.

Such a position is tantamount to asserting that the arbitration tribunals concerned should ignore the Congressional authorisations for the AAs, thereby conferring upon COP and XOM rights that they never had in the first place and which would allow these companies to appropriate windfall profits for which they never bargained (and which mainstream economics from Ricardo onwards recognise as rightfully belonging to the natural resource owners). All in all, then, the ICSID arbitrations constitute an attempt on the part of COP and XOM to conjure alleged breaches of treaty out of thin air so as to avoid the unacceptable outcomes of contractual mechanisms of their own devising.

The oil companies’ “different perspective” on contract sanctity also manifests itself when what is at issue is their own adherence to agreements they **have actually signed**.

Consider the following example (quite well publicised, as it is a central episode in a chapter in Steve Coll's bestselling journalistic account of XOM's business dealings all over the world). After the nationalisation of XOM's interests in the Cerro Negro project, XOM and PDVSA agreed to cooperate on re-purchasing all outstanding Cerro Negro bonds in order to free funds belonging to both companies which were resting in accounts controlled by the Security Trustee of the bonds.²³¹ PDVSA funded the bond re-purchase in whole and XOM duly received its share of the funds. PDVSA, in contrast, did not, because unbeknownst to it, XOM had secretly (i.e. *ex parte*) served a levy upon the monies contained in PDVSA CN's account at 4:10 pm on December 28, 2007 (45 minutes before the Termination Agreement became effective), "despite the express representation made by the Mobil parties in the Termination Agreement that no order existed which would prevent the consummation of the transactions".²³² Shortly after this (late afternoon) dawn raid in New York, XOM moved to obtain the worldwide freezing order in London and attachments on PDVSA assets from courts in The Netherlands, Curaçao and the Netherlands Antilles, all on an *ex-parte* basis.²³³ The PDVSA CN funds attached in New York were to remain frozen until early 2012, when they were released in order to liquidate (in part) the XOM ICC award.

The notion that all may be fair in love and in war and – as certain oilmen see it – in the purported defense of shareholder value, comes across even more clearly in the notorious case of XOM's underpayment of royalties in some prolific offshore gas leases found in waters under the jurisdiction of the state of Alabama. Throughout a protracted and convoluted litigation process, the state of Alabama asserted that "Exxon [had] made a fraudulent decision to misrepresent and continually suppress the fact that it was underpaying on the royalties it owed, with the hope and expectation that its breach would pass undetected and thus unredressed by the State".²³⁴ Ultimately, after a couple of iterations, the Alabama Supreme Court determined that XOM had not been guilty of fraud, but only of breach of contract deriving from its interpretation of certain clauses in the leases, notably those relating to the netting of allowable costs.²³⁵ The manner in which XOM construed these cost-netting provisions (described here in the words of Judge Tracy McCooley, who denied XOM any post trial motions after the

second time the case was tried in court) ought to resonate with readers who, by now, have become familiar with XOM's take on the compensation limitation clauses in the Venezuelan AAs:

Although Exxon knew it did not have a legitimate basis for saying that "actually drilling wells on the leased area" could be "interpreted" to mean drilling a well somewhere on the unitized area, that is just what Exxon ultimately did ... Notwithstanding that many ... expenses were not even arguably "direct expenses incurred in actually drilling wells on the leased area," Exxon suggested that, because they were not "expressly excluded," these expenses could somehow be "included" in the cost of drilling a well on the leased area²³⁶ ... It took the position that a well drilled on another leased area was a well drilled on this leased area; and that building something else, somewhere else, was part of the direct expense of actually drilling a well on this leased area. Exxon did not inform the State of its position. Instead, it simply withheld royalties under the auspices of the payout provision as if it had in fact incurred the relevant expenses in drilling wells on the leased area, reporting to the State based on the reduced payout royalty on the two leased areas without wells.²³⁷

Also instructive in terms of understanding XOM's overall approach to judicial proceedings is Judge McCooley's appraisal of XOM's behaviour throughout two trials (and numerous associated hearings):

This Court feels impelled to note the egregious nature of Exxon's misconduct, which sharply departs from good faith compliance with the rules of discovery and from what the Court considers fair practice ... The record is now all too clear. And it is appalling. Exxon "gamed" the State's discovery requests, defied the terms of this Court's order, silently reneged on its representations to the Court, and held the requested information in its hip pocket until it saw fit ... to use it in assailing the basis for the jury's verdict ... The Court is at this point convinced that Exxon bound itself neither by rule nor by conscience in resisting the State's lawful efforts in this litigation to investigate, expose, and remedy its misconduct ... Exxon has proven to be incorrigible in its secrecy and misdirection ...²³⁸

From the characterisation above, it is safe to assume that Judge McCooley would not have been particularly surprised by the judicial tactics that XOM employed in order to pressure Venezuela to accede to its compensation demands, notably its covert pursuit of worldwide freezing orders and attachments in support of outlandish damages claims.

It is ironic that the damages claims which XOM submitted in London should have been calculated without any discounting to present value, given that in 2005, XOM had argued before the Alabama Supreme Court that "the State ... [had] consistently

manipulated and inflated ... [its damages] figures in indefensible ways”, among other things by “ignor[ing] the time value of future cash flows [i.e. using a discount rate of zero] despite ... [the] ostensible purpose of generating a comparison with a punitive award that is to be assessed in today's dollars”.²³⁹ And what conclusions are to be drawn from the gamut of damages calculations that XOM submitted in ICC-related proceedings alone (“the US\$12 billion calculated by Mr. Plunkett, the US \$10 billion set forth in the Summary of Claimant's Position in the Terms of Reference, the US\$7.6 billion originally calculated by one of the Claimant's external experts, the US\$6.45 to US\$6.85 billion ... claimed [in the final pleadings to the ICC tribunal]”)?²⁴⁰ In this instance, XOM’s counsel before the Alabama Supreme Court provides useful guidance:

the State [of Alabama] and its lawyers have approached the potential harm question in a totally unprincipled, manipulative, and unconscionable way. The State's various potential harm estimates ranged in the first trial from \$1.8 billion ... to between \$650 million and \$3.75 billion ... and in the second trial from \$255 million to \$930 million ... The absurdly wide range of these calculations – approximately \$3.5 billion – is alone enough to confirm that these figures are wildly speculative, plucked from thin air, and obviously intended for the sole purpose of parading huge figures before the jury as fodder for lawyer exhortations.²⁴¹

There is little that can be added to these mordant observations with respect to XOM’s conduct *vis-à-vis* Venezuela, beyond highlighting the even wider range of XOM’s own estimates of damages (around 6,000 MMUSD, 80 per cent wider than the one XOM took such great exception to in Alabama), and the considerably greater magnitude of the XOM claims, relative to the “huge figures” that Alabama had calculated.

From the above, it should be clear that there is nothing, either in law or in fact, that supports the uncritical and pervasive acceptance among governmental actors and the general public of the premise that the ultimate motive behind the COP and XOM arbitrations against Venezuela and PDVSA is the defense of the principle of sanctity of contract. Once again, these arbitrations are best understood as an attempt on the part of these multi-national companies to exact an immense windfall as a way of cashing out from a country whose politics they had come to dislike for a variety of reasons, through the expedient of enlisting arbitration tribunals to re-draft terms and conditions that might have been exceptionally favourable for the companies initially, but which were left

looking considerably less rich by an unforeseen development: “the oil price spike that began in 2002 and that, though with some intermittence, continues”.²⁴² In effect, the companies want to revisit, with the benefit of hindsight and out to the full term of their original agreements, the issue of “how the economic benefits of this oil price spike must be distributed”²⁴³, despite the fact that the governing documents made it crystal clear that the Venezuelan government could appropriate all the economic benefits beyond a certain specified price.

This roundabout attempt on the part of COP and XOM to enlist international arbitrators as drafters-in-hindsight, however objectionable it might be in strictly legal terms, seems to make a good deal of economic sense (even though it is neither cheap nor assured of success), given that the costs involved are a vanishingly small fraction of the potential rewards, while the potential fallout from frivolous suits is negligible.²⁴⁴ Furthermore, and perhaps even more importantly, the claims are also meant to have a demonstration effect on other oil producers, conveying the message that their respective governments should think carefully before doing anything that oil companies such as these might take exception to, whether or not it affects genuine vested rights. The rationale behind the latter motivation can be discerned in the following exchange between the U.S. ambassador to Kazakhstan and an XOM representative, at a time of particularly tense conversations involving the Kashagan Production Sharing Agreement (PSA):

ExxonMobil Kazakhstan's Government Relations and Public Affairs Director Patricia Graham ... told the Ambassador on January 11 [2008] that ExxonMobil will not change its position. ExxonMobil is a world-wide operation, she said, and cannot afford to create a precedent in Kazakhstan that will affect it elsewhere. She said that progress has been made on other issues, but not on the question of establishing the fair market value of an increased ownership share for KMG [KazMunaiGas]. Graham indicated that ExxonMobil does not have any new ideas to offer and she expects “tough negotiations”.²⁴⁵

But while it may be true that in economic terms and on a micro (i.e. company-specific) scale, these arbitrations have a relatively favourable risk/reward balance, at a macro level and from a political standpoint, things look considerably more fraught.

By way of conclusion: the wider political meaning(s) of the Venezuelan arbitrations

In 2006, shortly before the migration of associations got underway in Venezuela, heralding the present era of mega-arbitrations, Joshua Robbins hailed “the dramatic proliferation of bilateral investment treaties”, which in his view had done a great deal to attenuate the “conflict between developed, capital-exporting states and developing, capital-importing states ... thereby encouraging increased flows of foreign direct investment to developing countries”. Robbins attributed this salutary effect in part to the fact that “[m]odern investment treaties typically empower foreign investors to enforce their own treaty-generated substantive rights by initiating international arbitral proceedings directly against the host state”, but he conceded that this system had “also given rise to a growing number of rather creative claims by investors”.²⁴⁶

At the time that Robbins was penning these lines, such creative claims – involving a variety of economic activities and industries – were already giving rise to tensions and anomalies that put the global system for the protection of investments under some stress.²⁴⁷ However, the stress levels associated with the creativity underlying the COP and XOM cases against Venezuela – much in evidence throughout this paper – are of an altogether different intensity, on account of the magnitude of the claims. Indeed, the claims, and even a small percentage of them, are actually too big – quite apart from too flimsy – to succeed, in terms of the integrity and viability of the dispute resolution system. At the moment, states still seem to be reconciled to the idea that, for a variety of technical and practical reasons, this system is stacked objectively against them.²⁴⁸ However, it would be difficult for states to continue tolerating this situation in the face of unprecedented awards in favour of the claimants in these cases.

The legal disputes and contract renegotiations involving countries such as Algeria, Russia, Kazakhstan and Venezuela are a direct consequence of the behaviour of the oil market from 2000 onward. The oil price explosion revealed the hollowness of predictions such as Michael Klein’s, in the sense that a supply cornucopia would inevitably materialise on the back of the worldwide adoption of ultra-liberal oil policies.

The asymmetrical and fiscally disadvantageous outcomes embedded in certain contracts became simply intolerable as oil prices shot up. In the case of Venezuela, for example, on the eve of the reinstatement of the statutory royalty rate for the Orinoco upgrading projects (October 2004), fiscal receipts from these projects were so paltry – at a grand total of USD 0.25 per barrel – that, even though oil prices were already at record-breaking levels, there would have been no discernible impact on public finances had all the active upgraders ceased to operate. Likewise, in Kazakhstan, as a result of catastrophic cost overruns in the Kashagan project, the government was looking at receiving a similarly catastrophic grand total of 2 percent of the oil produced for at least the first decade of production (after a start-up delay of at least 8 years, into the bargain), from an output that was supposed to reach 1.5 million barrels per day at peak.²⁴⁹

In the light of this kind of situation, it is not surprising that governments such as these should have decided to marshal their limited resources (financial but even more so managerial) towards the restructuring of legacy projects, as no new project could offer a payoff remotely comparable to that which could be obtained by rebalancing outrageously lopsided agreements at a time of extraordinarily high oil prices. In the specific case of Venezuela, as we have seen, the restructuring of AAs involved projects whose very authorizations contained conditions specifying that the State reserved all of its sovereign powers. But similar compulsory restructuring has been very much the order of the day even in the case of many contracts, licenses or concessions that did not provide for such explicit safeguards of their sovereign prerogatives.

Consider the following announcement put out by the holder of an important concession which was the subject of a “migration” initiative remarkably similar, both in conception and execution, to Venezuela’s:

[The Concessionaire] has reached an agreement with the ... Government. The agreement **changes and increases taxation of income** under the ... concession until its expiry in 2012 [and] the Government will receive a **20% share of the profit** [profit sharing was zero up until this point]. Simultaneously, the concession is extended to 2042 with the ... Government joining [the consortium exploiting the concession] with an **ownership share of 20%** as of 2012 **without payment**.

[The Concessionaire] has found it unreasonable to negotiate the existing agreement **under pressure of new legislation**, but found it prudent to accept a complete solution which should ensure a continued economically and for the society proper development of the oil and gas fields in question, also after 2012.²⁵⁰

These measures, which increased government take on the gross income generated by the concession from 41 per cent (for the 2000-2003 period) to 66 per cent (for the 2004-2011 period),²⁵¹ were adopted less than 7 months after the legislature had asked the executive for a report “outlining the possibilities of ... ensuring that the State gains a larger share of the values in connection with the present and future exploitation of the oil and gas resources”.²⁵²

At first glance, this chain of events might seem a good example of the “demonstration effect” that the fiscal measures implemented in Venezuela over the 2004-2008 timeframe have had around the world. Appearances, however, are deceptive. As a matter of fact, the restructuring of this particular concession was undertaken when the oil price spike was just beginning (2003), way before the Venezuelan government reinstated the statutory royalty rate for the Orinoco projects. Furthermore, it was carried out by the government of a country not usually included among the standard-bearers of radicalism. The concession in question was that held by the Dansk Undergrunds Consortium (DUC), granted originally on 8 July 1962 to A.P. Møller–Mærsk A/S for the exploration and production of hydrocarbons throughout the whole of the landmass and territorial waters of Denmark.

It is highly significant that it should have been a Danish Liberal-Conservative coalition government which fired the first salvo in the ongoing round of restructuring stemming from the post-2000 oil price spike, as this neatly underscores the fundamental flaw in the suits that international oil companies have promoted against Venezuela and other states. In a nutshell, such suits are predicated on denying these states the exercise of sovereign prerogatives which are jealously guarded by the governments of the home countries of companies like COP, XOM, Total, RD/Shell, BP, Eni, and Mærsk. Consider the following example: in the United Kingdom, in 1993, royalties were abolished and an exemption from PRT granted to all fields developed after that year, which meant that all

such fields enjoyed the same fiscal arrangements as a bakery or a bike shop from that point until the year 2002, when the British government decided to introduce an additional Supplementary Charge of 10 per cent to the Corporation Tax rate applicable only to 'ring-fenced' profits from oil and gas exploration activities. In other words, for nearly 10 years, the British government was content to receive a compensation of precisely zero from the exploitation of certain hydrocarbon resources belonging to the Crown (i.e. although the income they generated came from the liquidation of a non-renewable Crown patrimony, Corporation Tax was the only levy these fields had to pay, like any other "ordinary" business). However, it was always made absolutely clear that such a situation could change, since "no British government will give up its sovereign rights in the fiscal area to make adjustments as it deems necessary".²⁵³ Subsequently, upward adjustments have indeed been made from time to time. The Supplementary Charge was raised to 20 per cent in 2006 and again to 30 per cent in 2011, and since 2008, the corporation income tax rate for oil activities has been left at 30 per cent, though the general rate of Corporation Tax has been progressively reduced to 21 per cent – as has been deemed necessary by the governments of the day (and, needless to say, without previous consultation with the companies affected).²⁵⁴

The increases to the Supplementary Charge left oil companies active in the UK North Sea reaching for the smelling salts, not least because they lacked any legal recourse whatsoever against them.²⁵⁵ Among the aggrieved companies was Mærsk Oil, but its spirited protests against the measures availed it nought, as indeed had its preceding protests against the restructuring of the DUC concession in Denmark (officially referred to as the 2003 North Sea Agreement).²⁵⁶ In contrast, Mærsk (and its partner Anadarko) successfully challenged an Algerian windfall profits tax (the *Taxe sur les profits exceptionnels* or TPE), enacted in August 2006. This is attributable primarily to the fact that, thanks to the existence of an Algeria-Denmark BIT and the arbitration clause in their PSA with Sonatrach (the Algerian NOC), they were able to bring simultaneous multi-billion dollar claims against Algeria and Sonatrach in international arbitration tribunals (in a two-pronged litigation strategy redolent of that pursued by XOM against Venezuela and PDVSA), rather than in Algerian courts.²⁵⁷

The economic effects of both the migration of the DUC concession and the TPE were not hugely different (although the burden of TPE was heavier, which is not surprising given the much higher productivity of Algerian oil and gas fields). This similarity extends to the political plane, of course, since *prima facie* it is difficult to grasp how one of these two measures could somehow constitute an undisputed and legitimate exercise of a state's sovereign police powers, whereas the other allegedly amounted to an internationally unlawful act. This reflection leads to an obvious question: had Sonatrach been a party to the DUC concession, would it have had grounds to take the Danish government to arbitration under this same BIT? The answer, if the two ICSID Vattenfall cases against Germany are anything to go by, would appear to be yes. But, of course, the Danish signatories of this BIT never lost any sleep over such an eventuality, for the simple reason that they expected that all the investment flows protected by the treaty would be going in one direction, and one direction only (and there would almost certainly not be a PSA with a Danish state entity giving guarantees against sovereign measures that might be taken by the government). This aspect of the Algeria-Denmark BIT is thoroughly representative of BITs in general, and therein precisely lies the rub: for the most part, the only thing that was ever meant to be bilateral about BITs is their name, because the *ethos* of the whole investor-state international dispute resolution system that these treaties underpin was to constrain the freedom of governmental action, but only in certain countries. In a nutshell, the proliferation of BITs has given rise to a situation where the essential identifying trait of sovereignty – to be the highest unit of decision and action in a given territory, not subject to the will of any superior instance ("the supreme power of enacting and derogating laws ... that is to say, to give laws to each and every one and receive them from no one", in Jean Bodin's classic formulation) – continues to hold and be true for some governments, but not for others.²⁵⁸

The analysis of BITs from a juridical viewpoint has called forth the spillage of rivers of ink, but is rather beside the point here because, to paraphrase Keynes, this concluding section is "concerned ... not with the justice of the treaty ... but with its wisdom and its consequences".²⁵⁹ And as regards the current state of the world petroleum industry and oil market, the main consequence of a two-decade-long spell of BIT-underpinned

hydrocarbons governance, effectively predicated on stripping many resource-rich nations of their rights of taxation and eminent domain, seems to be a worldwide dearth of investment opportunities involving anything other than difficult or inferior prospects (relative to likely future requirements, especially of crude oil), which manifests itself most tellingly by way of very high oil prices. To an extent, this is a consequence of the fact that a growing number of countries have had to continue focusing their attention and resources on restructuring and renegotiation (and their unavoidable handmaiden, litigation), which in turn has led to a reduction in the number of projects "in the pipeline" in such countries, and has even shut some oil companies out from some highly prospective areas. There are many other places where no restructuring has occurred (or is even likely to occur), and yet investment flows there have also suffered, albeit on account of the calamitous economic and political sequels derived from the wholesale relaxation of fiscal terms in countries for whom, as Silvan Robinson put it so well, the overhead costs of the oil industry include "the cost of running the whole country".²⁶⁰ Thus, the fact that 2011 was the first year in history when the international price of crude averaged over 100 USD/B is an indicator that confirms once again, as Keynes warned in vain, that "[t]here are ... arguments, which the most obtuse cannot ignore, against a policy of spreading and encouraging further the economic ruin of ... countries".²⁶¹

But could it be that this cautionary recommendation has now been rendered irrelevant by the unfolding – and totally unforeseen, but no less welcome for that – oil and gas shale revolution in North America (which is likely to spread to other countries)? After all, a mere handful of years after getting underway, this revolution has radically transformed both the US natural gas market (which has swung from a situation of impending shortage to one of surplus), and the US petroleum market (where flows of imported crude oil have shrunk markedly). However, the very high variable lifting costs of non-conventional hydrocarbons makes their output contingent not only on persistently high price levels but also on a measure of stability prevailing in the world petroleum market (otherwise, extreme price volatility will wreak havoc on the balance sheets of companies with a large exposure to non-conventional hydrocarbon plays). This set of conditions

will, of necessity, continue generating very large rents in prolific conventional hydrocarbons provinces with low to moderate production costs. And attempts to deny the resource owners the right to collect such rents will make it more rather than less difficult for oil and gas output to keep pace with rising worldwide demand, in a way that maintains prices within reasonable bounds and, crucially, gives a chance to hundreds of millions of consumers in developing countries to emerge from poverty (quite apart from allowing consumers in developed countries to continue enjoying the standards of living they have become accustomed to). Simply put, just as taxation without representation is a byword for tyranny, access without taxes is a recipe for political paralysis, endless litigation, and obstacles in the path of smooth investment and production. For all their thirst for abundant and cheap oil and gas, and the talk from oil executives about an endless succession of attractive investment prospects (especially non-conventional ones, of late), both oil companies and consuming country governments alike (but especially the latter) need to reconcile themselves with the ideas that resource owners have to be remunerated with a fair price and that they cannot be denied the sovereign prerogative of taxing windfall gains. After all, as Chancellor of the Exchequer George Osborne so devastatingly put it when challenged by standard bearers for the oil companies to explain both the justice and the wisdom of increasing direct levies on oil and gas companies in Great Britain in 2011: “It is worth bearing in mind that this oil and gas is not theirs. It is ours, as a nation”.²⁶²

NOTES

¹ A.A. Fatouros, "Permanent Sovereignty Over Oil Resources, a Study of Middle East Oil Concessions and Legal Change, by Muhamad A. Mughraby; *The Law of Oil Concessions in the Middle East and North Africa*, by Henry Catton; *The Evolution of Oil Concessions in the Middle East and Africa*, by Henry Catton," *Indiana Law Journal*: Vol. 43 (1968): 969.

² George Kahale, III, "A Problem in Investor/State Arbitration", *Transnational Dispute Management*, Vol. 6 (1), 2009: 2 (available at <http://www.curtis.com/siteFiles/Publications/TransNational%20Dispute%20Management%20%28Kahale%29%20%28March%202009%29.pdf>). By the end of the 1970s, 170 BITs had been concluded, of which only 136 had entered into force. Up to 1990, there were still less than 400 BITs. By the end of 2005, in contrast, around 2,500 BITs were in force. As the number of BITs signed and ratified has risen, the number of arbitrations pitting investors against states has increased dramatically (from 14 until early 1998 to more than 300 at the time of writing). At 46, the year 2011 saw the highest number of investment arbitrations yet filed (*World Investment Report 2012: Towards a New Generation of Investment Policies*. Geneva, United Nations Conference on Trade and Development, 2012: xxi).

³ Fatouros, *op. cit.*: 954.

⁴ "Decree with Rank, Effect and Force of Law on the Migration to Mixed Companies of the Association Agreements of the Orinoco Oil Belt, as well as the Exploration at Risk and Profit Sharing Agreements" (hereafter "*Decree No. 5.200*"), *Official Gazette*, No. 38.632, published February 26, 2007.

⁵ COP retained an interest in the Plataforma Deltana offshore natural gas project, which was sold to PDVSA in February 2009.

The US Embassy in Caracas reported that four companies in total did not sign memoranda of understanding regarding migration of oil projects: COP, XOM, the Chinese National Petroleum Company (CNPC) and PetroCanada. The first two companies had already "told Post that they would not be signing the documents on June 25". In contrast, "CNPC's decision not to sign was somewhat surprising. Industry insiders believed the Chinese would eventually sign for geopolitical reasons. XM Government Relations Manager Carlos Ernesto Rodriguez (strictly protect throughout) told Petroleum Attache (Petatt) on the morning of June 26 that he received a call from CNPC stating that they were going to continue negotiating and were going to meet with BRV [Bolivarian Republic of Venezuela] officials roughly two and one-half hours before the signing ceremony. During the ceremony, Ramirez was somewhat vague on the subject of CNPC. He stated the parties to the Sinovensa project had signed an agreement to complete the original terms of the project and that a new agreement forming a joint venture would be submitted to the National Assembly. The new joint venture would be in the spirit of agreements signed between the Venezuelan and Chinese governments ... CNPC officials have complained bitterly about the migration and their treatment by the BRV". In the event, CNPC did not reach an agreement with the government in time to meet the deadline, and the Sinovensa assets were expropriated and taken over by PDVSA. Shortly afterwards, however, CNPC and PDVSA set up a new mixed enterprise, Petrolera Sinovensa, which complied with the terms of the 2001 Organic Law of Hydrocarbons. As for PetroCanada, the embassy reported that this company had "reached a settlement with the BRV and will be exiting Venezuela. PetroCanada holds a 50% stake in La Ceiba ... Ramirez stated during the settlement that the BRV had reached agreement with PetroCanada on compensation". PetroCanada was paid 75 MMUSD by way of settlement (Cable 07CARACAS1281 (confidential), dated 26 June 2007, "Exxonmobil And Conocophillips Exit Venezuela": ¶¶4, 13).

⁶ *Mobil Cerro Negro, Ltd v PDVSA Cerro Negro SA (Case 1:07-cv-11590-DAB)*, United States District Court for the Southern District of New York (hereafter "*New York Attachment Proceedings*"); documents initially placed under seal at petition of claimant, but seal subsequently removed.

⁷ *In the High Court of Justice, Queen's Bench Division, Commercial Court Claim No 2008 Folio 61, between Mobil Cerro Negro, Ltd. (Claimant) and Petróleos de Venezuela S.A. (Defendant)* (hereafter ("*London Proceedings*"); "Outline Argument on Behalf of the Claimant in Support of an Application to Vary an Worldwide Freezing Order Dated 24 January 2008": ¶3.

⁸ *ICSID Case No. ARB/07/27: Mobil Corporation et. al. (Claimants) v. The Bolivarian Republic of Venezuela (Respondent), Decision on Jurisdiction Dated June 10, 2010* (hereafter "*XOM ICSID Decision on Jurisdiction*"; available at <http://italaw.com/sites/default/files/case-documents/ita0538.pdf>).

⁹ ICC No. 16848/JRF/CA (C-16849/JRF/CA): *Phillips Petroleum Company Venezuela Limited and Conocophillips Petrozuata B.V. v. Petróleos de Venezuela, S.A. (PDVSA)*; Final Award Dated 17 September 2012 (hereafter “COP ICC”; available at <http://www.iareporter.com/downloads/20120924>).

¹⁰ ICC Case No. 15415/JRF: *Mobil Cerro Negro Ltd. v. Petróleos de Venezuela S.A. and PDVSA Cerro Negro S.A.*; Final Award Dated 23 December 2011 (hereafter “XOM ICC”; available at http://arbitrationlaw.com/files/free_pdfs/mobil_cerro_negro_ltd_v._petroleos_de_venezuela_sa_award_icc_arbitration_case_no._15416.pdf).

¹¹ “Law that Reserves to the State the Industry and Trade of Hydrocarbons” (hereafter “*Nationalisation Law*”), *Official Gazette*, No. 1.769 (Extraordinary), published August 29, 1975.

¹² “For reasons of national convenience, everything related to the exploration of national territory in search of oil, asphalt and other hydrocarbons; the exploitation of fields of the same, the manufacture or refining, transportation through special means and storage; domestic and foreign trade of the exploited and refined substances, and all of the works required for the management thereof, in the terms set forth by this law, are reserved to the State” (*Nationalisation Law*, article 1).

¹³ *Nationalisation Law*, article 5.

¹⁴ “Exposición de Motivos, Ley Orgánica que Reserva al Estado la Industria y el Comercio de los Hidrocarburos”, in *Nacionalización del petróleo en Venezuela, tesis y documentos fundamentales* (Caracas, Catalá Centauro Editores, 1975).

¹⁵ Umberto Eco, *Il nome della rosa* (Milano, Bompiani, 1980).

¹⁶ Some of the documents in the public domain cited in this paper (like, for example, the Congressional Authorisations to the Association Agreements, or the Association Agreements themselves) are not easy to get hold of, though, primarily because they exist only in hard copy form in archives in Venezuela. In the past, the Venezuelan Ministry of Petroleum manifested an intention to place all such documents, as well as other more accessible ones, in a website that would be open for consultation by the general public. This project has not materialised yet so, in the meantime, electronically scanned copies of these documents can be obtained by request from the author of the paper.

¹⁷ “Congressional Authorisation of the Exploration at Risk and Profit Sharing Association Agreements”, *Official Gazette*, No. 35.754, published July 17, 1995.

¹⁸ The original PDVSA affiliate participating in this Association was Maraven.

¹⁹ The original PDVSA affiliate participating in this Association was Corpoven.

²⁰ OPIC Karimun is an affiliate of CPC Corporation, the Taiwanese state oil company.

²¹ The original PDVSA affiliate participating in this Association was Lagoven.

²² See, for example, *Report Approved by the Bicameral Commission for the Study of the Strategic Associations of PDVSA Concerning the Projects Maraven-Conoco and Maraven-Total-Itochu-Marubeni for the Exploitation and Upgrading of Extra-Heavy Petroleum of the Orinoco Oil Belt*, dated August 12, 1993 (hereafter “*Bicameral Commission Report Petrozuata*”). The report indicated that “the Associations will apply for incentives in the area of royalties for the first years through the relevant institutional channels”.

²³ *Royalty Agreement of the Strategic Associations of the Orinoco Oil Belt between the Ministry of Energy and Mines and Petróleos de Venezuela, S.A.*, dated May 29, 1998. The adhesion of the association projects to this agreement occurred in November 1998.

²⁴ In 1998, when Hugo Chávez was elected to the presidency of Venezuela, PDVSA was in the process of implementing a plan to lower the statutory royalty rate to a maximum of 5 per cent.

²⁵ 1943 Hydrocarbons Law, *Official Gazette*, No. 31, published March 13, 1943, Article 41(3) sole paragraph: “for the purpose of extending the economic exploitation of certain concessions, the Federal Executive is hereby authorized to reduce the exploitation tax referred to in this subparagraph in those cases in which it is demonstrated to its satisfaction that the increasing production cost, including tax amounts, has reached the limit which does not permit commercial exploitation”. This creative interpretation of the 1943 Hydrocarbons Law was the subject of a challenge before the Venezuelan Supreme Court in 1999. The Court upheld the legality of royalty remission even at the onset of a project, but emphasized that “as provided for by the specified rule, the adjustment that is made by the National Executive Branch can be revised again and the original amount can be restored whenever it is believed that the causes on which the reduction was based have changed” (*Corte Suprema de Justicia, Judgment, Acción de nulidad por inconstitucionalidad de Simón Muñoz Armas, Elías Eljuri Abraham y otros en contra de las cláusulas décima, decimoséptima, segunda y cuarta del Artículo 2° del Acuerdo*

del Congreso de la República aprobado en fecha 4 de Julio de 1995, Caso No. 812-829, August 17, 1999: 32; available at <http://www.analitica.com/BITBLIO/venezuela/apertura.asp>).

²⁶ Petrozuata Finance Inc., *Confidential Offering Circular, Petrolera Zuata, Petrozuata C.A., dated June 17, 1997* (hereafter "*Petrozuata Offering Memorandum*"). Cerro Negro Finance Ltd., *Bond Offering Memorandum, dated June 11, 1998* (hereafter "*Cerro Negro Offering Memorandum*").

²⁷ "Law of Partial Reform of the Income Tax Law", *Official Gazette* No. 4.300 (Extraordinary), published August 13, 1991, Article 7 (which modified Article 9).

²⁸ The income tax rate for oil activities was 67.7 per cent until 2000, and 50 per cent thereafter. The income tax rate for non-oil activities was 30 per cent until 1992 and 34 per cent thereafter.

²⁹ Bernard Mommer, "El régimen petrolero venezolano en los tribunales internacionales de arbitraje. 1. parte: Petróleos de Venezuela, Sociedad Anónima", in *Le Monde Diplomatique Edición Venezolana* (special supplement); Year IV, Num. 35, July 2012: 12.

³⁰ See n. 25 above. The second part of the sole paragraph of Article 41(3) reads: "the Federal Executive may also increase again the reduced exploitation tax until restoring it to its original amount, when, in its judgment, the causes which gave rise to the reduction have changed".

³¹ For example, the Petrozuata project was predicated on a long-term price for West Texas Intermediate crude of 18 dollars per barrel, in nominal terms (*Petrozuata Offering Memorandum*: C-26).

³² Benjamin C. Esty, "Petrozuata: A Case Study on the Effective Use of Project Finance", *Journal of Applied Corporate Finance*, 12, no. 3 (fall 1999): 37.

³³ "Law of Special Assessment on Extraordinary Prices on the International Hydrocarbons Market", *Official Gazette* No. 38.910, published April 15, 2008; superseded by "Decree with Rank, Effect and Force of Law That Creates a Special Assessment for Extraordinary Prices and Exorbitant Prices in the International Hydrocarbons Market", *Official Gazette* No. 6.022 (Extraordinary), published April 18, 2011.

³⁴ Cable 07CARACAS217 (confidential), dated 1 February 2007, "International Arbitration vs the BRV":

¶1.

³⁵ *Ibid.*: ¶4. All these cables are available (in searchable form) from <http://cablegatesearch.net>.

³⁶ The ICSID Additional Facility Rules authorise the Secretariat of ICSID to administer certain categories of proceedings between States and nationals of other States that fall outside the scope of the ICSID Convention. These are (i) factfinding proceedings; (ii) conciliation or arbitration proceedings for the settlement of investment disputes between parties one of which is not a Contracting State or a national of a Contracting State; and (iii) conciliation and arbitration proceedings between parties at least one of which is a Contracting State or a national of a Contracting State for the settlement of disputes that do not arise directly out of an investment, provided that the underlying transaction is not an ordinary commercial transaction. Awards rendered under the ICSID Additional Facility Rules) do require additional domestic enforcement procedures.

³⁷ Cable 07CARACAS217 (confidential), dated 1 February 2007, "International Arbitration vs the BRV":

¶10.

³⁸ *The ICSID Caseload - Statistics (Issue 2012-2)*: 10 (available from the ICSID website).

³⁹ Cable 07CARACAS217 (confidential), dated 1 February 2007, "International Arbitration vs the BRV":

¶4.

⁴⁰ 2010 *International Arbitration Survey: Choices in International Arbitration*: 23 (available at: http://www.whitecase.com/files/upload/fileRepository/2010International_Arbitration_Survey_Choices_in_International_Arbitration.pdf).

⁴¹ *Agreement on Encouragement and Reciprocal Protection of Investments (with Protocol)*, Venezuela-Netherlands, October 22, 1991, entered into force November 1, 1993, 1788 U.N.T.S. 45 (2000). In a formal communication dated April 30, 2008, Venezuela notified the Netherlands of its intention to terminate the treaty as of November 1, 2008. The treaty is available at http://www.sice.oas.org/Investment/BITSbyCountry/BITs/VEN_Netherlands.pdf.

⁴² "Decree with Rank and Force of Law on the Promotion and Protection of Investments (Decree No. 356)", *Official Gazette* No. 5.390 (Extraordinary), published October 22, 1999.

⁴³ Petróleos de Venezuela, S.A., *Offering Circular for US\$2,394,239,600 9% Senior Notes due 2021. Unconditionally and Irrevocably Guaranteed by PDVSA Petróleo, S.A., dated November 11, 2011*: "we may incur losses arising from our pending arbitrations and litigation... the aggregate cost of unfavorable decisions could have a material adverse effect on our financial condition and results of operations" (19).

⁴⁴ *Ibid.*: 81-2.

⁴⁵ In the XOM ICC case, "for FY [Fiscal Year] 2007, Claimant seeks an indemnity in the amount of 80.8 million. For FYs 2008–2035, Claimant seeks an indemnity in an amount ranging from US\$6.45 billion to US\$6.86 billion" (*XOM ICC*: ¶199). In the COP ICC case, "Claimants updated the amount of damages ... claiming for a total of USD 165,190,000 as of 31 December 2011" (*COP ICC*: ¶120).

⁴⁶ "First Affidavit of Hobert E. Plunkett dated January 21, 2008", *London Proceedings*: ¶19.

⁴⁷ *COP ICC*: ¶120.

⁴⁸ *XOM ICC*: ¶3.

⁴⁹ Out of this sum, 305 MMUSD were paid with funds previously attached in New York in connection with the arbitration and a further 195 MMUSD were paid through the retirement of Mobil Cerro Negro bond debt, leaving an outstanding balance of around 250 MMUSD (which has been paid in full).

⁵⁰ *XOM ICC*: ¶8.

⁵¹ *London Proceedings*, "Full Transcripts – In Public": 198.

⁵² Michael D. Goldhaber, "Arbitration Scorecard 2011, dated June 2011" (available at http://www.law.com/corporatecounsel/PubArticleCC.jsp?id=1202499018258&The_2011_Arbitration_Scorecard_High_Stakes&slreturn=20130204045743), reporting the claim value in the XOM ICSID case as "up to \$20 billion".

⁵³ Freshfields Bruckhaus Deringer, *A Year Like no Other ... Our Work in 2009* (for a time, report was available for downloading at the website of the firm, but it appears to have been taken down).

⁵⁴ *Oil Daily*, October 29, 2010; emphasis ours.

⁵⁵ The procedural details of all ICSID cases can be consulted in the ICSID website.

⁵⁶ It used to be the case that ICSID tribunals were required to bifurcate proceedings to deal with any jurisdictional objection raised before hearing the merits. The rule that forced them to do so – Arbitration Rule 41(3) – was amended in 2006, thereby making bifurcation a matter left to the discretion of individual tribunals (Christoph Schreuer, *The ICSID Convention: a Commentary*. Oxford, Oxford University Press, 2009: 533).

⁵⁷ "[I]t is a general principle of international law that international courts and tribunals can exercise jurisdiction over a State only with its consent. The principle is often described as a corollary to the sovereignty and independence of the State. A **presumed** consent is not regarded as sufficient, because any restriction upon the independence of the State (not agreed to) cannot be presumed by courts" (*Wintershall Aktiengesellschaft v. Argentine Republic*, ICSID Case No. ARB/04/14. Award Dated December 8, 2008, ¶ 160(3); emphasis in original; available at <http://www.italaw.com/sites/default/files/case-documents/ita0907.pdf>).

⁵⁸ Michele Potestà. "The Interpretation of Consent to ICSID Arbitration Contained in Domestic Investment Laws", *Arbitration International*, 27.2 (2011): 150.

⁵⁹ "Model Clauses Recording Consent to the Jurisdiction of the International Centre for Settlement of Investment Disputes", 7 *International Legal Materials*, 1968: 1162.

⁶⁰ Article 9 of the Netherlands-Venezuela BIT, for example, reads thus: "Disputes between one Contracting Party and a national of the other Contracting Party concerning an obligation of the former under this Agreement in relation to an investment of the latter, shall at the request of the national concerned be submitted to the International Centre for Settlement of Investment Disputes, for settlement by arbitration Of conciliation under the Convention on the Settlement of Investment Disputes between States and Nationals of other States opened for signature at Washington on 18 March 1965 ... Each Contracting Party hereby gives its unconditional consent to the submission of disputes as referred to in Paragraph I of this Article to international arbitration in accordance with the provisions of this Article".

⁶¹ *Tradex Hellas (Greece) v. Republic of Albania*, ICSID Case No. ARB/94/2, *Decision on Jurisdiction*, 24 December 1996: 174 (available at <http://italaw.com/sites/default/files/case-documents/ita0870.pdf>).

⁶² *Southern Pacific Properties (Middle East) Limited v. Arab Republic of Egypt* (ICSID Case No. ARB/84/3); decision available at the ICSID website. The tribunal in this case reached the conclusion that article 8 of Egypt's Foreign Investment Law was indeed a unilateral consent to arbitration, whereupon Egypt had to change the language of this article, whose amended version stated "that the reference to ICSID had to be intended not as binding consent, but as a mere 'offer to deal', the final decision being left to a subsequent agreement between the parties" (Potestà, *op. cit.*: 163).

⁶³ *XOM ICSID Decision on Jurisdiction*: ¶38.

⁶⁴ *Ibid.*: ¶68.

⁶⁵ *Ibid.*: ¶¶140 and 139.

⁶⁶ *XOM ICSID Decision on Jurisdiction*: ¶207.

⁶⁷ The decisions are *CEMEX Caracas Investments B.V. and CEMEX Caracas II Investments B.V. v. Bolivarian Republic of Venezuela ICSID Case No. ARB/08/15* (available at <http://italaw.com/sites/default/files/case-documents/ita0142.pdf>); *Brandes Investment Partners, LP v. Bolivarian Republic of Venezuela ICSID Case No. ARB/08/3* (available at <http://italaw.com/documents/BrandesAward.PDF>), *Tidewater Inc. and others v. Bolivarian Republic of Venezuela ICSID Case No. ARB/10/5* (available at <http://www.italaw.com/sites/default/files/case-documents/italaw1277.pdf>) and *Opic Karimun Corporation v. Bolivarian Republic of Venezuela ICSID Case No. ARB/10/14* (available at ICSID website). As Kahale points out, "anyone practicing in this area is aware of the impact individual decisions can have. That is why memorials seem to be getting longer and longer, sometimes reaching hundreds of pages, explaining to tribunals what other tribunals have done in cases that supposedly have no *stare decisis* effect" (George Kahale, III, "Is Investor-State Arbitration Broken?", *Transnational Dispute Management*, 7 (2012): 19; available for downloading at <http://www.curtis.com/siteFiles/Publications/Is%20Investor-State%20Arbitration%20Broken.pdf>).

⁶⁸ See also Victorino J. Tejera Pérez, *Arbitraje de Inversiones en Venezuela*. Caracas, Universidad Central de Venezuela, 2010 (thesis). Besides the COP ICSID case, an Article 22 jurisdiction decision is still pending in *Venoklim Holding B.V. v. Bolivarian Republic of Venezuela (ICSID Case No. ARB/12/22)*. Procedural details about this case are available on the ICSID website.

⁶⁹ CEMEX, Brandes and Tidewater were unanimous decisions, whereas OPIC was a majority one.

⁷⁰ Potestá, *op. cit.*: 150.

⁷¹ David Caron, "The Interpretation of National Foreign Investment Laws as Unilateral Acts under International Law", in Mahnouch Arsanjani *et al.* (eds.), *Looking to the Future: Essays on International Law in Honor of W. Michael Reisman* (Leiden, Martinus Nijhoff, 2010): 673, n. 51.

⁷² George Kahale, III, "A Problem in Investor/State Arbitration...": 1.

⁷³ Cable 07CARACAS217 (confidential), dated 1 February 2007, "International Arbitration vs the BRV": ¶10; emphasis ours. The cable was signed by Ambassador William R. Brownfield, who later became Assistant Secretary of State for International Narcotics and Law Enforcement Affairs under President Obama. As early as 2005, the Freshfields Bruckhaus Deringer law firm was telling prospective clients with interests in Venezuela that "the law on the promotion and protection of investments enacted by Venezuela in October 1999 ... arguably may give rights to ICSID convention signatories who have not concluded a bilateral treaty" (*Venezuela. Proposed measures against oil and gas investors*, newsletter dated May 2005: 3; available at www.freshfields.com/uploadedFiles/SiteWide/Knowledge/Venezuela%20-%20proposed%20measures%20against%20oil%20and%20gas%20investors.pdf).

⁷⁴ George Kahale, III, "Is Investor-State Arbitration Broken?": 21-2. The Netherlands has become a particularly favoured jurisdiction in this regard, thereby giving rise to "the investment law version of what tax lawyers used to call the "Dutch sandwich," referring to the practice of non-Dutch investors taking advantage of the vast network of Dutch tax treaties to structure investments in third countries through The Netherlands" (*ibid.*: 22). Currently, the Netherlands is home to about 20,000 "letterbox companies" and this number is rising, on average, by 5 every day (Corporate Europe Observatory, *The Story of a Dutch Letterbox*, 27 January 2009; available from: <http://corporateeurope.org/news/story-dutch-letterbox>). Furthermore, about 10 per cent of investor versus state arbitrations have been launched invoking a Netherlands BIT as the basis for jurisdiction (Roeline Knottnerus and Roos van OS, "The Netherlands: A Gateway to 'Treaty Shopping' for Investment Protection", *Investment Treaty News*, 12 January 2012 (available at: <http://www.iisd.org/itn/2012/01/12/the-netherlands-treaty-shopping/>). A good indication of the extent to which the Netherlands BIT network is being gamed by international investors can be seen in the following anecdote. After Venezuela revoked the N-V BIT (effective November 1, 2008), personnel from the US embassy in Caracas met with "Minister Elsa Geveke de da Costa and Commercial Advisor Mariana Nunez of the Royal Netherlands Embassy", who told them that "that the small Dutch embassy in Caracas has been deluged with inquiries from international firms and law firms. **She stated she and her staff were taken aback by the large number of international firms that are covered by the BIT**" (Cable 08CARACAS648 (confidential), dated 12 May 2008, "Dutch BIT Bites the Dust": ¶¶ 2, 5; emphasis ours).

⁷⁵ Cable 08CARACAS487 (confidential/no foreigners), dated 4 April 2008, "ConocoPhillips Briefs Ambassador on Compensation": ¶¶14-15.

⁷⁶ *XOM ICSID Decision on Jurisdiction*: ¶203.

⁷⁷ *Ibid.*: ¶27.

⁷⁸ *Phoenix Action Ltd. v. Czech Republic, ICSID Case No. ARB/06/5, Award dated April 15, 2009*: ¶ 92 (available at <http://italaw.com/sites/default/files/case-documents/ita0668.pdf>).

⁷⁹ *XOM ICSID Decision on Jurisdiction*: ¶¶186-87.

⁸⁰ *Ibid.*: ¶201.

⁸¹ *Ibid.*: ¶188.

⁸² Cable 06CARACAS3131 (confidential) dated 17 October 2006, “MEP Presents Terms for Strategic Association”: ¶7.

⁸³ Cable 07CARACAS218 (confidential), dated 1 February 2007, “ConocoPhillips meets with Energy Viceminister”: ¶6.

⁸⁴ *XOM ICSID Decision on Jurisdiction*: ¶190.

⁸⁵ *Ibid.*: ¶191.

⁸⁶ *Ibid.*: ¶¶188, 32. XOM’s annual capital expenditure on Cerro Negro over the 2002-2005 period fluctuated between a minimum of 45 MMUSD and a maximum of 175 MMUSD, and was all covered with internally generated funds (*ibid.*: ¶¶ 193-194). This is a very modest amount compared to the 1,915 MMUSD invested over the 1999-2002 timeframe.

⁸⁷ *Ibid.*: ¶209.

⁸⁸ See for instance Alejandro Arreaza, Juan C. Cruz, Alejandro Grisanti and Donato Guarino, “PDVSA and Venezuela. Marching to the Beat of the Oil Drums” (*Barclays Capital Emerging Market Research*, 14 March 2011: 3).

⁸⁹ Mark Curriden, “Exxon Mobil’s Dispute with Venezuela Has Global Implications”, *ABA Journal*, April 2011 (available for downloading at www.abajournal.com/magazine/article/exxon_mobils_dispute_with_venezuela_has_global_implications).

⁹⁰ The applicable fiscal regime consisted in an extraction tax of 33 1/3 per cent (against which a royalty of 16 2/3 per cent would be creditable), and an income tax rate of 50 per cent. As for the valuation of future cash flows, and the publication dates of reputable third party price forecasts that would have had to be used in any valuation exercises, the Iran-US Claims Tribunal observed that “the determination of the fair market value of any asset inevitably requires the consideration of all relevant factors and the exercise of judgment. In the absence of an active and free market for comparable assets at the date of taking, a tribunal must, of necessity, resort to various analytical methods to assist it in deciding the price a reasonable buyer could be expected to have been willing to pay for the asset in a free market transaction, had such a transaction been possible at the date the property was taken. Any such analysis of a revenue-producing asset ... must involve a careful and realistic appraisal of the revenue-producing potential of the asset over the duration of its term, which requires appraisal of the level of production that reasonably may be expected, the costs of operation, including taxes and other liabilities, and the revenue such production would be expected to yield, which, in turn, **requires a determination of the price estimates for sales of the future production that a reasonable buyer would use in deciding upon the price it would be willing to pay to acquire the asset.** Moreover, any such analysis must also involve an evaluation of the effect on the price of any other risks likely to be perceived by a reasonable buyer at the date in question, excluding only reductions in the price that could be expected to result from threats of expropriation or from other actions by the Respondents related thereto” (*Phillips Petroleum v. Iran*, 21 Iran-U.S.C.T.R. 79: ¶111; emphasis ours; available at <http://www.trans-lex.org/232300>).

⁹¹ Cable 08CARACAS487 (confidential/no foreigners) dated 4 April 2008, “ConocoPhillips Briefs Ambassador on Compensation”: ¶¶4-5.

⁹² See *Phillips Petroleum v. Iran*, 21 Iran-U.S.C.T.R. 79: ¶110.

⁹³ Permanent Court of International Justice, File E. c. Docket XI, Judgment No. 8 (26 July 1927), Twelfth (Ordinary) Session, *Case Concerning the Factory at Chorzów (Claim for Indemnity)*: 47; emphasis ours (available at http://www.icj-cij.org/pcij/serie_A/A_17/54_Usine_de_Chorzow_Fond_Arret.pdf).

⁹⁴ *XOM ICC*: ¶4.

⁹⁵ In August 2007, COP’s Roy Lyons explained to the Economic Counselor and Petroleum Attaché that he had “met with Energy Viceminister Bernard Mommer twice last week but stated the parties are still billions of dollars apart. He stated CP was willing to lower its valuation of the assets by hundreds of millions of dollars but not by billions” (Cable 07CARACAS1672 (confidential) dated 22 August 2007, “Conocophillips Update: Still Far Apart”: ¶1). On the day of the nationalisation, XOM’s Tim Cutt told the

US Ambassador that the company would “enter into settlement negotiations with the BRV while crude supplies continue to be shipped to Chalmette”, but that “the two sides were billions of dollars apart” (Cable 07CARACAS1281 (confidential) dated 26 June 2007, “Exxonmobil And Conocophillips Exit Venezuela”).

⁹⁶ August Reinisch, “Legality of Expropriations”, in A. Reinisch (ed.), *Standards of Investment Protection* 171 (Oxford, Oxford University Press, 2008):198-199; emphasis ours.

⁹⁷ “If, on the facts of a particular case, a tribunal establishes that a State has made good faith efforts to comply with its obligation to pay compensation, it should not be held to be in violation of the compensation requirement” (Sergey Ripinsky and Kevin Williams, *Damages in International Investment Law*. London, British Institute of International and Comparative Law, 2008: 68).

⁹⁸ “The Government of the State of Kuwait v. The American Independent Oil Company (Aminoil), Final Award dated March 24, 1982”, 21 *International Legal Materials* 976 (1982); “Libyan American Oil Company (LIAMCO) v. The Government of the Libyan Arab Republic, Award dated April 12, 1977”, 20 *International Legal Materials* 1 (1981).

⁹⁹ XOM ICC: ¶3. Bernard Mommer testified in London that XOM’s proposal was for “a package consisting of US\$800 million in cash, crude oil deliveries and the transfer of the 50% interest of a PDVSA subsidiary in a refinery in Chalmette, Louisiana. The total value of this package ... was approximately US\$5 billion” (*London Proceedings*, “First Affidavit of Bernard Mommer, dated 11 February 2008”: ¶12). Mommer noted that, despite an “open attitude towards settlement” by the Government, this value “was in excess of any reasonable settlement amount” (*ibid.*). XOM has relied on the Government’s rejection of its *ultimata* “to paint this as a simple case of expropriation without compensation, requiring Respondents to either pay what it considers appropriate compensation or suffer accusations of bad faith” (XOM ICC: ¶3).

¹⁰⁰ Cable 07CARACAS504 (confidential) dated 8 March 2007, “ExxonMobil: Out by July 1”: ¶3.

¹⁰¹ *London Proceedings*, “Reasons for Judgment. Approved by the Court for Handing Down”: ¶137.

¹⁰² *London Proceedings*, “Full Transcripts – In Public”: 232.

¹⁰³ *London Proceedings*, “Reasons for Judgment. Approved by the Court for Handing Down”: ¶137.

¹⁰⁴ *Ibid.*

¹⁰⁵ *Ibid.*: 16-7.

¹⁰⁶ Cable 07CARACAS1822 (confidential/no foreigners) dated 14 September 2007, “Statoil: a Good Deal”: ¶2.

¹⁰⁷ Cable 07CARACAS1314 (confidential) dated 2 July 2007, “Chevron, Exxon, And CNPC Comment On Recent Events”: ¶¶2,4.

¹⁰⁸ Cable 07CARACAS1822 (confidential/no foreigners) dated 14 September 2007, “Statoil: a Good Deal”: ¶¶1, 9.

¹⁰⁹ Cable 08CARACAS487 (confidential/no foreigners), dated 4 April 2008, “ConocoPhillips Briefs Ambassador on Compensation”: ¶5.

¹¹⁰ *Ibid.*: ¶4. The cable also reported that “Goff stated CP has been looking at cash compensation for its claims as well as a trade for Citgo assets. For the past six weeks, CP personnel have been doing due diligence on Citgo assets in order to determine their value. Goff said CP has a clear preference for an asset swap rather than cash compensation” (*ibid.*: ¶4).

¹¹¹ J. Roman Picherack, “The Expanding Scope of the Fair and Equitable Treatment Standard: Have Recent Tribunals Gone Too Far?”, *The Journal of World Investment and Trade* 9.4 (2008): 255.

¹¹² *Ibid.*: 256.

¹¹³ Rudolf Dolzer, “Fair and Equitable Treatment: A Key Standard in Investment Treaties”, *International Lawyer*, 39 (2005): 87-8.

¹¹⁴ Consult Picherack, *op. cit.* and Dolzer, *op. cit.*

¹¹⁵ Picherack, *op. cit.*: 287.

¹¹⁶ *Ibid.*: 288.

¹¹⁷ *Ibid.*: 262-3. This move came in “response to a perception in and by the United States that a definition of ‘fair and equitable treatment’ unbounded by custom had left the door open to adventurist arbitrators to exercise an unfettered discretion as to the appropriateness of State policy” (*ibid.*).

¹¹⁸ European Parliament, Committee on International Trade, *Report on the Future European International Investment Policy (2010/2203(INI))*, dated March 22, 2011, Report No. A7-0070/2011, “Explanatory Statement”: 11-12 (at www.europarl.europa.eu/sides/getDoc.do?type=REPORT&reference=A7-2011-0070&language=EN).

¹¹⁹ Department of Foreign Affairs and Trade of Australia, *Gillard Government Trade Policy Statement: Trading our Way to More Jobs and Prosperity*, April 2011: 14 (available at <http://www.dfat.gov.au/publications/trade/trading-our-way-to-more-jobs-and-prosperity.pdf>).

¹²⁰ *Vattenfall AB and others v. Federal Republic of Germany* (ICSID Case No. ARB/12/12). Procedural details available from ICSID website.

¹²¹ Nathalie Bernasconi-Osterwalder and Rhea Tamara Hoffmann, *The German Nuclear Phase-Out Put to the Test in International Investment Arbitration? Background to the new dispute Vattenfall v. Germany (II)*, Briefing Note June 2012. Winnipeg, International Institute for Sustainable Development, 2012: 12 (available at: http://www.iisd.org/pdf/2012/german_nuclear_phase_out.pdf).

¹²² The first time also involved Vattenfall, which initiated an arbitration over a decision by the Environment Minister of Hamburg to impose environmental restrictions on a €2.6 billion coal-fired power plant located on the banks of the Elbe river (the request for arbitration submitted by Vattenfall is available at: http://italaw.com/documents/Vattenfall_Request_for_Arbitration_001.pdf). See also the 2009 briefing on the first Vattenfall case by Nathalie Bernasconi-Osterwalder, *Background Paper on Vattenfall v. Germany Arbitration*. Winnipeg, International Institute for Sustainable Development, 2009 (available at: www.iisd.org/pdf/2009/background_vattenfall_vs_germany.pdf).

¹²³ Bernasconi-Osterwalder, *op. cit.*: 3.

¹²⁴ N-V BIT, Protocol, Ad Article 3(1).

¹²⁵ *Saluka Investments BV v. Czech Republic, Partial Award dated March 17, 2006, UNCITRAL, IIC 210* (2006): ¶¶304-305 (available at <http://italaw.com/sites/default/files/case-documents/ita0740.pdf>).

¹²⁶ See *Nations Energy Corporation, Electric Machinery Enterprises Inc., and Jamie Jurado v. The Republic of Panama* (ICSID Case No. ARB/06/19); available at <http://italaw.com/sites/default/files/case-documents/ita0560.pdf>. In this case, the tribunal explained that the reason to exclude taxation measures from the FET obligation of the bilateral investment treaty “is easy to understand, given the importance of tax policy to the sovereignty of the State” (¶481).

¹²⁷ Such exclusions can be found in, to name but a few notable examples, NAFTA, the ECT, the 2004 U.S. Model BIT and the 2004 Canada Model BIT.

¹²⁸ “With **respect to taxes, fees, charges, and to fiscal deductions and exemptions**, each Contracting Party shall accord to nationals of the other Contracting Party with respect to their investments in its territory treatment not less favourable than that accorded to its own nationals or to those of any third State, whichever is more favourable to the nationals concerned. For this purpose, however, there shall not be taken into account any special fiscal advantages accorded by that Party; (a) Under an agreement for the avoidance of double taxation; or (b) by virtue of its participation in a customs union, economic union, or similar institutions; or (c) on the basis of reciprocity with a third State” (N-V BIT, article 4; emphasis ours).

¹²⁹ For example, Article 16.1 of the Canada Model BIT (2004) specifies that “[e]xcept as set out in this Article, nothing in this Agreement shall apply to taxation measures” (available at <http://italaw.com/documents/Canadian2004-FIPA-model-en.pdf>).

¹³⁰ A. R. Albrecht, “The Taxation of Aliens under International Law”, 29 *British Yearbook of International Law* 145 (1952): 173.

¹³¹ *EnCana Corporation v. Republic of Ecuador, LCIA Case No. UN3481 (UNCITRAL), Award dated February 3, 2006, IIC 91* (2006): ¶174 (available at http://www.italaw.com/sites/default/files/case-documents/ita0285_0.pdf).

¹³² *Cerro Negro Offering Memorandum*: C-40.

¹³³ Data obtained from the commercial transactions repository of Petróleos de Venezuela S.A.

¹³⁴ Cable 07CARACAS1977 (confidential) dated 9 October 2007, “Ambassador Meets With Chevron”: ¶10.

¹³⁵ Cable 06CARACAS1445 (confidential) dated 19 May 2006, “Temperature Rises for Strategic Associations”: ¶6.

¹³⁶ *Link-Trading Joint Stock Company v. Department for Customs Control of the Republic of Moldova, Ad Hoc/UNCITRAL, Final Award dated April 18, 2002* (hereafter “Link-Trading”): ¶91 (available at <http://italaw.com/documents/Link-Trading-Moldova.pdf>).

¹³⁷ Muthucumaraswamy Sornarajah, *The International Law on Foreign Investment* (Cambridge, Cambridge University Press, 2010): 405; emphasis ours.

¹³⁸ Gross income for the upstream segment of the Cerro Negro project during the first three quarters of 2004 (i.e. before the reinstatement of the 16 2/3 per cent royalty) came to 24.80 USD/B of extra-heavy crude oil (as per the company's accounts). Royalty payments came to 0.25 USD/B and there were no income tax payments at all. Such a level of fiscal income is comparable, both in relative and absolute terms (at suitably deflated prices), to the one generated exactly eighty years before in the concession that produced the country's first oil for export: the General Asphalt concession. General Asphalt gross income in 1924 (at 2004 prices) was \$11.32 per barrel, and fiscal income was \$0.35 per barrel (3.1 per cent of gross income). Steve Coll mistakenly reported that even though Cerro Negro royalty obligations were minimal, the project nevertheless paid substantial income tax: "ExxonMobil's complex at Cerro Negro enjoyed a royalty rate of just 1 per cent during the project's early years of production ... [a] low rate (distinct from the corporate taxes the government collected, which were substantial)" (Steve Coll, *Private Empire. ExxonMobil and American Power*. London, Allen Lane, 2012:416). In fact, Cerro Negro paid virtually nothing by way of income tax either.

¹³⁹ *Transcript, The Rt. Hon. George Osborne MP, Chancellor of the Exchequer, United Kingdom, before the Parliamentary Treasury Committee, (Oral Evidence taken before the Treasury Committee on Tuesday 29 March 2011 Examination of Witnesses, questions 417-529)*; available at <http://www.publications.parliament.uk/pa/cm201011/cmselect/cmtreasy/897/11032902p.htm>.

¹⁴⁰ Thomas J. Westcott, "Recent Practice on Fair and Equitable Treatment", *The Journal of World Investment and Trade*, 8.3 (2007): 414.

¹⁴¹ *EDF (Services) Limited v. Romania*, ICSID Case No. ARB/05/13, Award dated 8 October 2009 (hereafter "EDF"): ¶218 (available at <http://www.italaw.com/sites/default/files/case-documents/ita0267.pdf>).

¹⁴² Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (Oxford, Oxford University Press, 2008: 122).

¹⁴³ For example, the tribunal in *the Occidental v. Ecuador case (Occidental Exploration and Production Company v. The Republic of Ecuador, LCIA Case No. UN3467, Final Award, 1 July 2004*; available from <http://italaw.com/sites/default/files/case-documents/ita0571.pdf>) cited the preamble to the U.S.-Ecuador BIT to establish that the fair and equitable treatment of investment "is desirable in order to maintain a stable framework for investment and maximum effective utilization of economic resources" (¶183). On the basis of this language, the Occidental tribunal then found that "[t]he stability of the legal and business framework is thus an essential element of fair and equitable treatment" under the U.S.-Ecuador BIT (*ibid.*).

¹⁴⁴ Picherack, *op. cit.*: 277.

¹⁴⁵ *Ibid.*: 272.

¹⁴⁶ As Dolzer and Schreuer put it, "the standard of fair and equitable treatment will nevertheless not be understood to amount to a stabilisation clause" (*op. cit.*: 148).

¹⁴⁷ *Total S.A. v. Argentine Republic (ICSID Case No. ARB/04/1), Decision on Liability dated 27 December 2010*: ¶309 (f); available at http://italaw.com/documents/TotalvArgentina_DecisionOnLiability.pdf.

¹⁴⁸ *Ibid.*: ¶117.

¹⁴⁹ *Link-Trading*: ¶83.

¹⁵⁰ *EDF: ¶219 and LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc. v. The Argentine Republic, ICSID Case No. ARB/02/1, Decision on Liability dated October 3, 2006*: ¶130 (available at <http://italaw.com/sites/default/files/case-documents/ita0460.pdf>).

¹⁵¹ *XOM ICSID Decision of Jurisdiction*: ¶31. The document cited is the *Procedure for Payment of Extraction Tax (Royalty) for Extra Heavy Crude Oil Produced and Sulfur Extracted by Operadora Cerro Negro S.A.*, dated January 16, 2002 (reproduced in *XOM ICC*: ¶90).

¹⁵² Andrew Newcombe and Lluís Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (London, Kluwer Law, 2009): 281. Professor Newcombe created and maintains the excellent Investment Treaty Arbitration website (<http://www.italaw.com>), but used to work in the international arbitration and public international law groups at Freshfields Bruckhaus Deringer, counsel for COP in the COP ICSID case. Mr. Paradell is counsel at the same firm.

¹⁵³ Cable 06CARACAS1445 (confidential) dated 19 May 2006, "Temperature Rises for Strategic Associations": ¶¶3, 5.

¹⁵⁴ *Ibid.*: ¶1.

¹⁵⁵ *EDF*: ¶219.

¹⁵⁶ *BG Group plc. v. The Republic of Argentina, Ad Hoc/UNCITRAL, Final Award dated December 24, 2007*: ¶298 (available at http://italaw.com/documents/BG-award_000.pdf) and *GAMI Investments, Inc. v. The Government of the United Mexican States, NAFTA/UNCITRAL, Final Award dated November 15, 2004*: ¶93 (available at http://italaw.com/sites/default/files/case-documents/ita0353_0.pdf).

¹⁵⁷ XOM ICC: ¶147; italicised in original, emphasis ours.

¹⁵⁸ Cable 07CARACAS504 (confidential) dated 8 March 2007, “ExxonMobil: Out by July 1?”, ¶¶3-4.

¹⁵⁹ *Cerro Negro Offering Memorandum*: 37. The fact that XOM acknowledged that no such assurances existed is telling, in that making a misstatement in such an offering document would risk serious civil and criminal penalties under the applicable securities laws.

¹⁶⁰ *Petrozuata Offering Memorandum*: 29

¹⁶¹ XOM ICC: ¶309.

¹⁶² *Sergei Paushok, CJSC Golden East Company and CJSC Vostokneftegaz Company v. Mongolia, Ad Hoc/UNCITRAL, Award on Jurisdiction and Liability dated April 28, 2011*: ¶¶302, 305 (available at <http://italaw.com/documents/PaushokAward.pdf>).

¹⁶³ Reid W. Click and Robert J. Weiner, “Resource Nationalism Meets the Market: Political Risk and the Value of Petroleum Reserves”, *Journal of International Business Studies*, 17 December 2009: 784-5, 799

¹⁶⁴ Raymond Vernon, *Sovereignty at Bay: Sovereignty at Bay: the Multinational Spread of U.S. Enterprises* (New York: Basic Books, 1971).

¹⁶⁵ Steven Schneider, *The Oil Price Revolution* (Baltimore, Johns Hopkins, 1983): 1.

¹⁶⁶ *Parkerings-Compagniet AS v. Republic of Lithuania, ICSID Case No. ARB/05/8, Award dated 11 September 2007*: ¶336 (available at <http://italaw.com/sites/default/files/case-documents/ita0619.pdf>).

¹⁶⁷ In the words of the XOM Chairman of the board, “ExxonMobil’s legal dispute with Venezuela is over the country’s failure to abide by its terms and obligations ... This is an issue about contract sanctity that provides the basis for all parties to know their rights and responsibilities” (“Exxon: Venezuela Row About Government Honoring Contract”, *TDM News Digest*, Issue #06, week 08, 21 February 2008 (http://money.cnn.com/news/newsfeeds/articles/djf500/200802180952DOWJONESDJONLINE000245_FORTUNE5.htm)).

¹⁶⁸ “Exposición de Motivos, Ley Orgánica que Reserva al Estado...”: pp. 92-93

¹⁶⁹ “Congressional Authorisation of the Petrozuata Association Agreement (*Autorización del Convenio de Asociación entre las Empresas Maraven S.A. y Conoco, Inc.*; hereafter “*Petrozuata Congressional Authorisation*”), *Official Gazette No. 35.293*, published September 9, 1993, Preamble. The term used in the original Spanish passage is “taxativamente”, which denotes conditions that are rigorous, strict and limiting.

¹⁷⁰ “Congressional Authorisation of the Framework of Conditions for the Cerro Negro Association Agreement (*Acuerdo mediante el cual se aprueba el Marco de Condiciones que regirá el Convenio de Asociación para la explotación, transporte, mejoramiento y comercialización de crudos extrapesados a ser producidos en el área Cerro Negro de la Faja Petrolífera del Orinoco, a celebrarse entre Lagoven, S.A. Filial de Petróleos de Venezuela y las empresas Mobil Corporation y Veba Oel AG*; hereafter “*Cerro Negro Congressional Authorisation*”), *Official Gazette No. 36.224*, published June 10, 1997, Eighteenth Condition.

¹⁷¹ *Petrozuata Congressional Authorisation*, Sixteenth Condition: “The Association Agreement shall include provisions allowing Maraven to compensate the other parties, on equitable terms, for adverse and significant economic consequences directly arising from the adoption of decisions made by the national, state or municipal administrative authorities, or changes in legislation that, due to their content and purpose, cause an unfair discriminatory treatment to the Company or to such other parties, always considered in their capacity as such and as parties to the Association Agreement ...”. *Congressional Authorization of the Framework of Conditions for the Hamaca Association Agreement (Acuerdo mediante el cual se aprueba el Marco de Condiciones del Convenio de Asociación para la producción, transporte y mejoramiento de crudos extrapesados a ser producidos en el área Hamaca de la Faja Petrolífera del Orinoco, así como la comercialización del crudo mejorado y otros productos que se generen durante el proceso de producción y mejoramiento de dichos crudos, a celebrarse entre Corpoven, S.A. Filial de Petróleos de Venezuela y las empresas Atlantic Richfield Co. (ARCO), Phillips Petroleum Company y Texaco, Inc.*; hereafter “*Hamaca Congressional Authorisation*”), *Official Gazette No. 36.209*, published May 20, 1997, Twenty-First Condition: “The Association Agreement shall include provisions allowing for the compensation of Participants, through amendments to the provisions of the Association Agreement or

through the payment of damages, in the event that the Net Cash Flow of a Participant of the Association's activities is substantially and adversely affected as a direct, necessary and demonstrable consequence of discriminatory and unjust measures ...").

¹⁷² *Cerro Negro Offering Memorandum*: 33–42.

¹⁷³ *Petrozuata Offering Memorandum*: 72.

¹⁷⁴ *Hamaca Association Agreement*, Section 14.2.

¹⁷⁵ *Cerro Negro Association Agreement*, clause 15.1 (c).

¹⁷⁶ Cable 05CARACAS1721 (confidential) dated 7 June 2005, "Oil Companies with Operating Service Agreements Face Additional Pressure": ¶3.

¹⁷⁷ Bernard Mommer, "Venezuela, política y petróleo", *Cuadernos del CENDES*, 16, no. 42, (September-December 1999): ¶4.3.5.

¹⁷⁸ Bernard Mommer, *The Political Role of National Oil Companies in Exporting Countries: The Venezuelan Case. Working Paper WPM-18* (Oxford, Oxford Institute for Energy Studies 1994): 26. In this passage, Mommer is referring to an abortive AA known as Cristóbal Colón, for a liquefied natural gas (LNG) project which originally involved affiliates of RD Shell, Exxon and Mitsubishi. The project received congressional authorisation but never went ahead.

¹⁷⁹ As Marboe observes, "many investment projects are based on or connected to a contract with the respondent State, a Statal entity, or a State-owned enterprise. The provisions of this contract naturally have a decisive impact on the value of the investment. This means that, for valuation purposes, the contractual provisions must be applied, even if the breach of the contract itself lies outside the jurisdiction of the tribunal" (Irmgard Marboe, *Calculation of Compensation and Damages in International Investment*. Oxford, Oxford University Press, 2009:178-179.).

¹⁸⁰ "[I]t is important to bear in mind ... the terms upon which that interest was held ... [as the contractual term] had an effect on the value of the asset in the Claimants' hands" *Waguih Elie Georg Siag and Clorinda Vecchi v. Egypt*, ICSID Case No. ARB/05/15, Award dated June 1, 2009: ¶¶577-578 (available at http://www.italaw.com/sites/default/files/case-documents/ita0786_0.pdf).

¹⁸¹ Coll, *op. cit.*: 426.

¹⁸² *Petrozuata Congressional Authorisation*, Sixteenth and Eighteenth Conditions.

¹⁸³ *Hamaca Congressional Authorisation*, Nineteenth Condition; emphasis ours.

¹⁸⁴ *Hamaca Congressional Authorisation*, Twenty-first Condition.

¹⁸⁵ *Cerro Negro Congressional Authorisation*, Eighteenth Condition; emphasis ours. The Nineteenth condition of the Congressional Authorisation covering both the Corocoro and La Ceiba projects stipulates: "The Agreement, as well as all activities and operations derived therefrom, shall in no case create liability on the part of the Republic of Venezuela nor diminish its sovereign rights . . ." ("Framework of Conditions for the Exploration at Risk and Profit Sharing Association Agreements" (*Acuerdo mediante el cual se autoriza la celebración de los Convenios de Asociación para la Exploración a Riesgo de Nuevas Áreas y la Producción de Hidrocarburos bajo el Esquema de Ganancias Compartidas*), *Official Gazette* No. 35.754, published July 17, 1995.

¹⁸⁶ Cable 08CARACAS1246 (confidential) dated 5 September 2008, "Venezuela: ConocoPhillips Negotiations Stall": ¶3.

¹⁸⁷ The likelihood is that any jurisdictional challenge would have centred on the issue of treaty abuse, as in the XOM ICSID case (see *XOM Decision on Jurisdiction*).

¹⁸⁸ Cable 08CARACAS1246 (confidential) dated 5 September 2008, "Venezuela: ConocoPhillips Negotiations Stall": ¶3.

¹⁸⁹ Cable 05CARACAS163 (confidential) dated 19 January 2005, "Exxonmobil Ready To Take On The Gov Over Royalty Issue": ¶¶2, 6.

¹⁹⁰ Coll erroneously reports that "Chavez drifted through 2006 and never really forced the royalty issue" (*op. cit.*: 416). In fact, after the statutory royalty rate was reinstated for the upgrading projects in October 2004, XOM sent a letter of protest to the Minister of Foreign Affairs, the Ministry of Energy and Petroleum and the Attorney General of Venezuela, stating that "the Cerro Negro Parties consider that the Government of Venezuela is not honoring its contractual commitments under the Royalty Agreement or the obligations undertaken by the Bolivarian Republic of Venezuela under the [...] Investment Law" (*XOM ICC*: ¶383).

It should be pointed out also that *the Hamaca Association Agreement* specifically refers to increases in the royalty rate up to the maximum legal rate specified for the oil industry in general as **not** being

discriminatory (Section 14.1). The precise language of this carve-out is as follows: “reductions or increases in the royalty rate applicable to the crude oil produced by the Parties in their capacity as participants in the Association, will not be considered Discriminatory Actions under this provision unless such changes result in a royalty rate for the Parties in their capacity as participants in the Association, in excess of the maximum rate specified by law for the hydrocarbon industry in general” (Section 14.1(b)(4).

¹⁹¹ *Cerro Negro Association Agreement*, clause 15.1(a).

¹⁹² Cable 05CARACAS163 (confidential) dated 19 January 2005, “Exxonmobil Ready To Take On The Gov Over Royalty Issue”: ¶6.

¹⁹³ *XOM ICC*: ¶779

¹⁹⁴ *Ibid.*: ¶211.

¹⁹⁵ *Ibid.*

¹⁹⁶ *COP ICC*: ¶¶101-102.

¹⁹⁷ *Ibid.*: ¶145.

¹⁹⁸ *Ibid.*: ¶113. The relevant provisions of this secret side letter read as follows: “In the event that any crude oil restrictions are imposed on the Venezuelan oil industry during the term of the Association Agreement, the Class A Privileged Shareholder [...] shall fulfill any production cutback requirements out of its own production so that: (i) the Company shall be able to keep the upgrader facilities working at Full Capacity; (ii) any company production above that necessary to keep the upgrader at Full Capacity shall be affected (cut back) by the same percentage as the one affecting the Class A Privileged Shareholder's own production; and (3) the Company's total crude oil production shall not be reduced below 120 MBPCD [sic.!] at any time in which the upgrader is working at Full Capacity, it is understood that any production restriction protection mechanism or treatment which is generally applied to all extra heavy crude oil strategic associations, and which is more favorable than the one established herein, shall prevail” (*ibid.*: ¶44).

¹⁹⁹ *Ibid.*: ¶144.

²⁰⁰ *Ibid.*: ¶152.

²⁰¹ *Ibid.*: ¶282.

²⁰² *Hamaca Congressional Authorisation*, Thirteenth Condition.

²⁰³ Thomas W. Wälde and George Ndi, “Stabilizing International Investment Commitments: International Law Versus Contract Interpretation”, *Texas International Law Journal*, 31 (2), 1996:218-19.

²⁰⁴ Michael Klein: “Energy Taxation in the 21st Century”, *Oxford Energy Forum*, Issue 40, December 1999: 134. Infamously, the 4 March 1999 issue of *The Economist* predicted a long-term price in the range of 5-10 USD/B, and *Business Week* followed suit in its 30 March 1999 issue.

²⁰⁵ Thane Gustafson, *Wheel of Fortune: The Battle for Oil and Power in Russia* (Cambridge, Mass. The Belknap Press of Harvard University Press, 2012:188).

²⁰⁶ *XOM ICC*: ¶787. With regard to the latter, XOM made it clear that a “ruling that PDVSA-CN has breached the AA is a form of relief that is available before the ICC, but not ICSID. Such a ruling would enable the Claimant to purchase PDV Chalmette’s interest in Chalmette Refining LLC under Section 8.6 of the Chalmette Agreement” (*ibid.*: ¶213).

²⁰⁷ *London Proceedings*, “First Affidavit of Jim R. Massey, dated January 21, 2008”: ¶25.

²⁰⁸ “The Discriminatory Measures at issue in this ICC arbitration are among those at issue in the ICSID proceeding” (*XOM ICC*: ¶209).

²⁰⁹ *Cerro Negro Association Agreement*, Clause I, Definition of “Discriminatory Measure”. Among the events deemed to constitute a “Discriminatory Measure” under the definition, for which indemnity may be granted, was “the expropriation or seizure of assets of the Project or of a Foreign Party’s interests in the Project”.

²¹⁰ “Exxon Mobil files another complaint against Pdvsa”, *El Universal* (online English edition), 3 January 2012 (available at <http://www.eluniversal.com/economia/120103/exxon-mobil-files-another-complaint-against-pdvsa>).

²¹¹ The article in question states that “[t]o the extent any legal remedy is available to reverse or obtain relief from such Discriminatory Measure, the Foreign Party shall commence and pursue legal actions to mitigate any damages suffered as a result of the Discriminatory Measure” (*Cerro Negro Association Agreement*, Article 15.1(a)).

²¹² “Any net proceeds received by the Foreign Party as a result of the pursuit of the aforesaid legal actions (after deduction of the legal costs incurred by the Foreign Party in connection therewith) shall be (i)

applied against any amount ultimately determined to be owed by Lagoven pursuant to this Article or (ii) reimbursed to Lagoven if Lagoven previously has made payments to the Foreign Party with respect to the Discriminatory Measure in question" (*ibid.*).

²¹³ The ICC award has no effect on the ICSID claims deriving from the nationalisation of the La Ceiba project.

²¹⁴ *London Proceedings*, "First Affidavit of Hobert E. Plunkett, dated January 21, 2008": ¶¶7-18.

²¹⁵ *XOM ICC*: ¶777. For the *Phillips* case, see n. 91. The *Himpurna* case involved the termination of a long-term power purchase agreement in Indonesia. In the arbitration, claimant's expert argued for a discount rate of 8.5 per cent ("Himpurna California Energy Ltd. v. PT (Persero) Perusahaan Listrik Negara, Final Award dated May 4, 1999" (hereafter "*Himpurna*"), *XXV Yearbook Commercial Arbitration* 11 (A. Jan van den Berg ed., London, Kluwer Law International, 2000): ¶598. The tribunal rejected that position as inadequate, on the grounds that it did not give sufficient weight to country risk, and applied a discount rate of 19 per cent (*ibid.*: ¶¶348-378).

²¹⁶ *XOM ICC*: ¶777.

²¹⁷ Mark Kantor, "How Damages Were Calculated in Mobil Cerro Negro v PDVSA –A Short Note", *Transnational Dispute Management*, Vol. 9, issue 3, April 2012. Kantor noted that "a discount rate well above the discount rate likely sought by Mobil, will explain the significant disparity between the sum sought by Mobil and the sum awarded by the ICC tribunal" (*ibid.*: 3). While suggesting that the figure chosen by the tribunal was "rather high discount rate for a U.S. Dollar oil field that has long since passed the exploration phase and been in production for years" (*ibid.*), Kantor acknowledged that "an 18% discount rate would appear to include Venezuelan political risk ... [an] approach ... similar to the approach taken in the Himpurna/Patuha arbitrations with the Indonesian State electricity company, PLN, Pertamina, some years ago" (*ibid.*: 4).

²¹⁸ See, for example, *American Manufacturing & Trading Inc. v. Republic of Zaire*, ICSID Case No. ARB/93/1, Award dated February 21, 1997: ¶¶7.14-7.15 (available at <http://italaw.com/sites/default/files/case-documents/ita0028.pdf>): "AMT would have liked to adopt a method of calculating compensation including interests practicable in the normal circumstances prevailing in an ideal country where the climate of investment is very stable, such as Switzerland or the Federal Republic of Germany. The Tribunal does not find it possible to accede to this way of evaluating the damages with interests in the circumstance under consideration ... Preferably, the Tribunal will opt for a method that is most plausible and realistic in the circumstances of the case, while rejecting all other methods of assessment which would serve unjustly to enrich an investor who, rightly or wrongly, has chosen to invest in a country such as Zaire, believing that by so doing the investor is constructing a castle in Spain or a Swiss chalet in Germany without any risk, political or even economic or financial or any risk whatsoever".

²¹⁹ A recent book on petroleum and mineral taxation sponsored by the International Monetary Fund ("IMF") has this very thorough explanation of how a hurdle rate for a petroleum project is to be derived for analytical purposes: "[c]ost of capital estimates for integrated petroleum companies and petroleum producers in the US in 2008 seemed to lie in a range of 8 to 9 per cent in nominal terms. An appropriate 'project' margin over this may be 3 to 4 percentage points, bringing this discount rate conveniently close to 12.5 per cent nominal or 10 per cent in real terms [convenient because the US Securities and Exchange Commission requires all public oil companies, in their financial statement valuations, to discount future cash flows from proven reserves at a 10 per cent discount rate, to assure the comparability of those companies for investors in the stock market]. What then is the appropriate discount rate for an activity outside the investor's home country, incorporating country risk? On dollar denominated bond spreads, the additional margin is somewhere in the range of negligible [for the less risky countries] to 10 per cent [for the riskier ones]" (Philip Daniel, Brenton Goldsworthy, Wojciech Maliszewski, Diego Mesa Puyo and Alistair Watson, "Evaluating Fiscal Regimes for Resource Projects. An Example from Oil Development", in *The Taxation of Petroleum and Minerals: Principles, Problems and Practice*. Philip Daniel, Michael Keen and Charles McPherson, eds. London, Routledge/IMF, 2010: 205-206.

²²⁰ Gustafson, *op. cit.*: 355.

²²¹ HM Revenue and Customs, *A Guide to UK and UK Continental Shelf Oil and Gas Taxation - January 2008*: ¶4.16 (available at <http://www.hmrc.gov.uk/international/ns-fiscal3.htm>).

²²² *Ibid.*

²²³ *Ibid.*: ¶4.18. If the adjusted profit is less than 15 per cent, then the PRT for that chargeable period is reduced to nil. If the adjusted profit is more than 15 per cent of accumulated capital expenditure, then the PRT charge will be the lesser of 80 per cent of the excess or else the amount of the PRT charge calculated in the normal way.

²²⁴ *Ibid.*: ¶4.3.

²²⁵ *Himpurna*: ¶¶358-359, 364.

²²⁶ Cable 05CARACAS1029 (confidential) dated 11 April 2005, "Senator Coleman Meets with Energy Companies in Venezuela": ¶11.

²²⁷ The narrative of the companies is repeated even in accounts that purport to be critical of their doings in general (such as Coll, *op. cit.*).

²²⁸ *XOM ICC*: ¶¶5, 18.

²²⁹ Statement by XOM spokesperson David Eglinton quoted by Curriden, *op. cit.*

²³⁰ "BP, Chevron, Total, ENI of Italy, Sinopec of China and Statoil all negotiated compromises ... [and] accepted new terms as minority owners, *subordinate to the Chávez regime*. Only ConocoPhillips joined ExxonMobil in refusal and departed" (Coll, *op. cit.*: 425; italics ours). Needless to say, the passage in italics represents an interjection of personal views on this subject.

²³¹ See Coll, *op. cit.*: 429-434.

²³² *New York Attachment Proceedings*, "Memorandum of Law of Defendant PDVSA Cerro Negro S.A. in Opposition to Motions to Confirm December 27, 2007 Order of Attachment and January 8, 2008 Order of Supplementary Attachment": 16-17.

²³³ The London freezing order was lifted, but the others stayed in place until the conclusion of the XOM ICC case.

²³⁴ This case centred on allegations of breach of contract and fraud raised against Exxon by the Alabama Department of Conservation and Natural Resources, and involving the interpretation of the royalty provisions for three producing blocks in Mobile Bay. In December 19, 2000, a jury awarded Alabama 87.7 MMUSD for the underpayment of royalties and fraud and 3,400 MMUSD as punitive damages. The Alabama Supreme Court reversed the judgment on a technicality (improper admittance into evidence of a privileged legal opinion), and ordered a new trial, in which a jury awarded 63.6 MMUSD for breach of contract damages and punitive damages of USD 11.8 billion. The Trial Court then remitted the punitive damages to 3.5 billion. On appeal to the Alabama Supreme Court, Exxon obtained in 2007 the reversal of the punitive damages award in its entirety.

²³⁵ The court ruled that XOM's interpretation of some terms of the lease (all related to measurement issues) was the correct one. It ruled in favour of the State on the remaining lease interpretation issues, including the crucial one of cost-netting. See *Exxon Corp. v. Department of Conservation and Natural Resources*, 859 So. 2d 1096 (Alabama 2002), "Supreme Court of Alabama Opinion" (available at <http://www.alabamaappellatewatch.com/Exxon%20v.%20Alabama.pdf>).

²³⁶ In other words, all sorts of costs with no relation to the drilling activities in the lease were accounted for as if they had been incurred in such activities.

²³⁷ *State of Alabama, Department of Conservation and Natural Resources and M. Barnett Lawley, et al., Plaintiffs v. Exxon Corporation, Defendant, Civil Action Case No. 99-2368*, Circuit Court of Montgomery Alabama, Fifteenth Judicial Circuit: 36 (available at <http://www.cunninghambounds.com/pdf/04-03-29POSTJUDGMENTORDER.pdf>).

²³⁸ *Ibid.*: 48.

²³⁹ *ExxonMobil Corporation, Appellant vs. Alabama Department of Conservation and Natural Resources, et al., Appellee, Supreme Court of Alabama No. 1031167*, "Brief of Appellant ExxonMobil Corporation on Appeal from the 15th Judicial Circuit (Montgomery County) CV 99-2368": 129 (available at [http://www.balch.com/files/Publication/f94cb9ae-d2a4-4fd5-99ec-13d7a316714c/Preview/PublicationAttachment/36abf7be-103e-45a0-aa65-1575920a320b/HadenExxonv.Alabama%20BriefofAppellant\(Exxon\).pdf](http://www.balch.com/files/Publication/f94cb9ae-d2a4-4fd5-99ec-13d7a316714c/Preview/PublicationAttachment/36abf7be-103e-45a0-aa65-1575920a320b/HadenExxonv.Alabama%20BriefofAppellant(Exxon).pdf)).

²⁴⁰ *XOM ICC*: ¶3.

²⁴¹ "Brief of Appellant ExxonMobil...": 127.

²⁴² *Burlington Resources Inc. v. Republic of Ecuador*, ICSID Case No. ARB/08/5. *Decision on Liability Dated 14 December 2012*: ¶6 (available at http://italaw.com/sites/default/files/case-documents/italaw1094_0.pdf).

²⁴³ *Ibid.*

²⁴⁴ The XOM ICC arbitration cost the claimant 25 MMUSD (XOM ICC: ¶868), while COP spent 6 MMUSD on its own much shorter and simpler ICC proceeding (COP ICC: ¶318). See also Sarah Anderson, Manuel Pérez-Rocha, Rebecca Dreyfus, and J. Alejandro Artiga-Purcell, *Mining for Profits in International Tribunals: How Transnational Corporations Use Trade and Investment Treaties as Powerful Tools in Disputes Over Oil, Mining, and Gas (Updated November 2011)*, Washington D.C., Institute for Policy Studies, 2011 (available at http://www.ips-dc.org/files/3936/Mining_for_Profits_November_2011_FINAL-2.pdf).

²⁴⁵ Cable 08ASTANA56 (confidential) dated 11 January 2008, "High-level Kashagan Talks Scheduled In Astana for January 13": ¶5.

²⁴⁶ Joshua Robbins, "The Emergence of Positive Obligations in Bilateral Investment Treaties", *University of Miami International and Comparative Law Review*, 13 (403): 474.

²⁴⁷ George Kahale, III "Is Investor-State Arbitration Broken?": 16-18.

²⁴⁸ See George Kahale, III, "A Problem in Investor/State Arbitration..."

²⁴⁹ "In the renegotiation, the national oil company's subsidiary doubled its stake in the project, a new 'priority share' was allotted to the Government off the top, and new cost and schedule control mechanisms were introduced to help guard against future cost increases and delays" (George Kahale, III, "The Uproar Surrounding Petroleum Contract Renegotiations", *Oxford Energy Forum*, August 2010, Issue 82: 5).

²⁵⁰ Mærsk Oil, *Oil Activities in the North Sea - Taxation and Concession*; press release dated 30 September 2003 (available at <http://www.maerskoil.com/Media/NewsAndPressReleases/Pages/OilActivitiesintheNorthSea-TaxationandConcession.aspx>)

²⁵¹ Preben Joker Thorsen, "'Denmark: Changes in Tax Regime' Danish Underground Consortium (DUC). The North Sea Agreement 2003", presentation delivered at *23rd International Tax Conference*, 31 October–1 November, 2012 Oslo, Norway (available at <http://www.npf.no/getfile.php/konferanser/offentlig/Denmark%20-%20changes%20in%20tax%20regime.pdf>): 7.

²⁵² Minister for Economic and Business Affairs, Denmark, *Report to the Danish Parliament on the North Sea October 2003*: 2 (available at http://www.ens.dk/en-US/OilAndGas/Licences/AgreementMoeller/Documents/Report_parliament.pdf).

²⁵³ Alexander Kemp, "A Tax Reprieve for the North Sea?", *FT Energy Economist*, September 1988 (203): 24.

²⁵⁴ See H.M. Revenue and Customs, *Corporation Tax Rates* (available at <http://www.hmrc.gov.uk/rates/corp.htm>).

²⁵⁵ The tone of their complaints and representations comes across well in the written evidence compiled in connection with hearings held by the House of Commons Scottish Affairs Committee (*Effects of Tax Increases on the Oil Industry. First Report of Session 2007–08 Report, Together with Formal Minutes, Oral and Written Evidence, HC 35, Incorporating HC 1326-i to iii, Session 2005–06*; available at <http://www.publications.parliament.uk/pa/cm200708/cmselect/cmscotaf/35/35.pdf>).

²⁵⁶ See "Letter to the Chairman from Mærsk Oil North Sea UK Limited", in *ibid.*: EV42. Mærsk alleged that the tax increase it was protesting "will deplete significant value from any recent purchaser's investment in oil and gas in the UK. In Mærsk Oil's case, approximately USD 0.42 billion (GBP 0.25 billion) or 15% has been depleted from the value of the USD 2.95 billion (GBP 1.75 billion) investment" (*ibid.*: EV43).

²⁵⁷ *Mærsk Olie, Algeriet A/S v. People's Democratic Republic of Algeria* (ICSID Case No. ARB/09/14); see also cable 10ALGIERS104 (confidential) dated 4 February 2010, "Anadarko Vs. Sonatrach -- Update On Their International Arbitration Case".

²⁵⁸ "[J]ubendae ac tollendae leges summa potestate ... scilicet universis ac singulis civibus leges dare, a civibus accipere nunquam".

²⁵⁹ John Maynard Keynes, *The Collected Writings of J.M. Keynes. Vol. 2: The Economic Consequences of the Peace* (London, The Royal Economic Society, 1971): 40.

²⁶⁰ M. Silvan Robinson, "Real Cost Base of Oil Isn't What You Think", *Petroleum Intelligence Weekly*, April 3 1989: 6.

²⁶¹ Keynes, *op. cit.*: 187. In this passage, Keynes talks only about “great” countries (hence the ellipsis), but events in Venezuela and elsewhere demonstrate that ruining less rich and smaller countries is a thoroughly rotten idea as well.

²⁶² *Transcript, The Rt. Hon. George Osborne MP ... Oral Evidence taken before the Treasury Committee on Tuesday 29 March 2011...*