VENEZUELA AS AN OPPORTUNITY FOR INVESTMENT IN THE PETROLEUM INDUSTRY

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I. INTRODUCTION

Venezuela, Mexico, Argentina, Colombia, Brazil, Peru, and Bolivia seem poised for a period of sustained economic development in their petroleum and electric sectors. Factors such as political stability, regional economic and energy integration, debt reduction, fiscal equilibrium, and the sustained withdrawal of the government from the marketplace by privatization and deregulation favor strong economic growth. Venezuela, like other Latin American countries,[1] has been concentrating on privatization of its various public sectors, and has sought to reduce the State's influence over economic matters, to open foreign trade by reducing tariffs, to implement export incentives, to eliminate protectionist measures, and to provide incentives and security for foreign investments. Such developments will encourage regional solidarity, as well as political and economic

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1. Venezuela is located on the northern coast of South America north of Brazil, flanked by Colombia and Guyana. Venezuela is slightly more than twice the size of California, with approximately 23.2 million residents. The estimated Gross Domestic Product (GDP) in 1998 was $102.7 billion, or about 1.2% of that of the United States. (According to the Commerce Department's Bureau of Economic Analysis, U.S. GDP in 1998 was $8,511.0 billion. Bureau of Economic Analysis, *National Accounts Data* (visited Sept. 3, 1999) <http://www.bea.doc.gov>.) According to a 1999 report by the United States Energy Information Administration (EIA), petroleum is the backbone of Venezuela's economy, with oil export revenues accounting for about 70 to 78% of total exports over the past four years, about half of government revenues, and about one-third of GDP. *Venezuela: Energy Information Administration* (July 1999) <http://www.eia.doe.gov/emeu/cabs/venez.html> [hereinafter *EIA July 1999 Venezuela Report*]. Venezuela is the only Latin American member of the Organization of Petroleum Exporting Countries (OPEC). In 1998, Venezuela was the largest supplier of total U.S. oil imports, and is currently the fifth largest oil producer in the world. *Id.* State-owned Petróleos de Venezuela S.A. (PdVSA) is the third largest petroleum company in the world. In 1996, PdVSA was the most profitable company in Latin America, with sales totaling $33,855 million and net profits of $4,495 million. Alexander's Gas and Oil Connections, *Oil Companies Doing Well in Latin America* (Feb. 25, 1998) <http://www.gasandoil.com> (citing ECON. AMERICA). Despite these riches, however, Venezuela has a ballooning budget deficit, as great as 5% of GDP, caused by the drop in oil prices. *EIA July 1999 Venezuela Report, supra.* A small recovery in prices during the first half of 1999 has helped, but the price of oil is still too low for a full recovery. New estimates have diminished the importance of the rise in oil prices; the economy is expected to decline by 4.8% this year despite the price increase. Richard Lapper, *Growth Rates in Latin America Set to Diverge*, FIN. TIMES (LONDON), June 29, 1999, (The Americas Section), at 6 (also found at <http://www.ft.com>). Furthermore, economists consider the *bolívar*, Venezuela's currency, to be overvalued, making devaluation a serious possibility for the near future. *EIA July 1999 Venezuela Report, supra.* If the oil price averages $15 for the year, the government would see an increase in revenue of $5 billion. Unemployment has been on the rise in Venezuela also, increasing from 10.6% in 1998 to approximately 18% in 1999. *Reforms Hang Over Caracas*, FIN. TIMES (LONDON), Aug. 19, 1999, (World Stock Market Section), at 40.

On the other hand, the EIA predicts a 23% rise in oil revenues for all OPEC countries during the second half of 1999. So far, EIA has been on the right track, with a reported rise in the average from $10.57/bbl in 1998 to $19.65/bbl as of July 21, 1999. *Oil Price Slips 33 Cents* (June 28, 1999) <http://www.vzlanet.com/news>; Alexander Brideau, *Crude Oil Futures Prices Drop 10 Cents on Incomplete Inventory Data*, THE OIL DAILY, July 22, 1999, at 2.

stability. This stability is fundamental in order to attract external capital, because stability minimizes the risks associated with investment.[2]

In the twenty-first century, Latin America promises to be characterized by a growing number of regional trade agreements and rapid energy project integration.[3] In fact, some signs of cooperation are already appearing. In June 1999, Reuters reported that Venezuela and Brazil had reached an agreement for joint investments in oil exploration and production. The two countries had been discussing a partnership for years, but only recently did these talks come to fruition.[4] While the details have yet to be worked out, the underlying agreement is in place. A summer 1999 meeting of the Caribbean Community Trade Group resulted in offers under the San José Pact[5] from Venezuela and Mexico to sell oil under a concessionary pricing agreement to Central America, the Dominican Republic, Barbados, Haiti, and Jamaica. In exchange, those countries have agreed to focus on Venezuela and Mexico in government contracting decisions.[6]

Since the early 1990s, many Latin American countries have been imple-

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2. Roberto Mayorga L. (Inter-American Development Bank consultant), *Foreign Investment Regimes in Countries Within the Hemisphere: Legal Challenges*, OECD/IDB, Brazilian Ministry of External Relations, Ministry of Commerce of Spain, Rio de Janeiro, Brazil, July 16-18, 1996, at 5.

3. For example, the San José Pact between Mexico and Venezuela was first signed in August 1980. Under the Pact, the two countries agreed to supply a certain number of barrels of crude oil or refined products per day to Barbados, Belize, Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, Jamaica, Nicaragua, and Panama, and to offer financing for the purchases. *President Caldera Joins Mexico's Ernesto Zedillo in San José Pact Oil Supply Renewal to 11 Central American and Caribbean Nations*, VHEADLINE/VENEWS, Aug. 2, 1997. The Pact was renewed in August 1999, reincorporating Haiti, which had dropped out in 1991. Venezuela has promised to continue lobbying for the inclusion of Cuba. *Venezuela Renews San José Oil Supply Pact*, REUTERS (Aug. 6, 1999).

Another regional agreement, the Treaty of Asunsion, was signed in 1991. This treaty established a market among Argentina, Brazil, Paraguay, and Uruguay. Treaty Establishing a Common Market Between the Argentine Republic, the Federative Republic of Brazil, the Republic of Paraguay and the Eastern Republic of Uruguay, (MERCOSUR), Mar. 26, 1991, 30 I.L.M. 1041. As of 1998, "MERCOSUR [made] up a market of 200 million people with a GDP per capita of US $ 3,168. This subregional area also include[d] 44.3% of the population and 53.7% of Latin America and the Caribbean." José Tavares De Araujo, Jr. & Luis Tineo, *Harmonization of Competition Policies Among MERCOSUR Countries*, 24 BROOK. J. INT'L L. 441, 441 n.1 (Summer 1998), originally appearing in 43 ANTITRUST BULL. 45 (1998).

The Andean Pact, effective as of May 25, 1988, included Venezuela, Colombia, Ecuador, Peru, and Bolivia. It was originally conceived as an import substitution vehicle to allow these economies to develop. Later, however, liberalization of the protectivist agreement occurred through various decisions by the Commission of the Andean Pact. Andrew J. Markus, *Going International in Latin America*, *in* COUNSELING EMERGING COMPANIES IN GOING INTERNATIONAL, at 451, 466-68 (Alan S. Gutterman ed., 1989). *See also Andean Pact* (visited Aug. 23, 1999) <http://americas.fiu.edu/trade_agreements/andean.htm>.

In addition, there have been talks among some Latin American countries about the formation of a Central American free trade agreement similar to NAFTA, called the Free Trade Area of the Americas (FTAA). Themes of the discussions have included deregulation, harmonization of taxes, attracting investment, joining electricity grids and telecommunications networks, and building roads. National Center for Policy Analysis (NCPA), *Central America Reforming and Trading* (visited Aug. 3, 1999) <http://www.ncpa.org/pd/pdint155.html> (citing *Central America Opens for Business*, THE ECONOMIST, June 21, 1997, at 35).

4. *Brazil, Venezuela To Sign Oil Association Deal*, REUTERS, June 27, 1999, at 1.

5. *See supra* note 3, for a discussion of the San José Pact.

6. Christina Hoag, *Venezuela Offers Cheap Oil to Caribbean Countries*, FIN. TIMES, July 8, 1999, (World Trade Section), at 6.

menting various programs, policies, and initiatives to encourage private investment in the petroleum industry.[7] Such efforts have not gone unnoticed. American investors became enthusiastic again[8] about Venezuelan oil as early as 1995. This enthusiasm was evidenced by a show in Houston that attracted a "packed house" to a discussion of Venezuelan petroleum, referred to as "Aladdin's Cave of Wonders."[9] Venezuela has the most proven natural gas reserves in Latin America, and the seventh largest in the world.[10] The South American continent as a whole possesses some 86 billion barrels of conventional reserves.[11] The Latin American region also boasts approximately 300 trillion cubic feet (Tcf) of proven natural gas reserves.[12]

Venezuela has been called "the most important South American country in the oil business scenario."[13] It accounts for almost 70% of South America's 223 Tcf of natural gas,[14] and has 72.6 billion barrels of established oil reserves and 142.5 Tcf in proven natural gas reserves.[15] In addition, Venezuela has been at the forefront of the political and economic policy changes undertaken by the Latin American nations over the past ten to fifteen years. Perhaps most importantly, the United States' reliance on oil imports from Venezuela has increased over recent years.[16] The U.S. State Department considers Venezuela to have enormous potential due to the country's "vast natural resources," and appears to be especially interested in the petroleum sector.[17]

Since Venezuela's "Opening" began in the early 1990s, opportunities can

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7. For example, according to the EIA, Argentina leads the privatization movement among Latin American countries, while Mexico has adopted only minor reforms. OVERVIEW AND DOMESTIC AND INTERNATIONAL TRENDS FOR CRUDE PETROLEUM AND NATURAL GAS EXPLORATION, DEVELOPMENT, AND PRODUCTION, 1998, CHAPTER 3: CRUDE PETROLEUM AND NATURAL GAS (1997) <http://www.eia.doe.gov>.

8. The Venezuelan oil industry was off limits to foreign investment from 1976 to late 1992. Jay G. Martin, *International Petroleum Investment Opportunities in Latin America: Creating a Proper Balance Between Risks and Rewards, reprinted from* The Forty-Ninth Annual Institute on Oil and Gas Law and Taxation, June 1998, at 5-1, 5-60 [hereinafter Martin, *International Petroleum*].

9. Scott Pendleton, *US Firms See Venezuela's Oil As Aladdin's Cave of Wonders*, CHRISTIAN SCI. MONITOR, July 25, 1995, at 9.

10. *EIA July 1999 Venezuela Report, supra* note 1.

11. *EIA, World Crude Oil and Natural Gas Reserves (Table 8.1)* (Jan. 1, 1998) <http://www.eia.doe.gov/emeu/iea/table81.html> [hereinafter *EIA, Table 8.1*].

12. *Latin American Overview*, LATIN AMERICAN GAS (Jan. 14, 1999) <http://www.latinamericangas.com/letter.htm.>.

13. *Argentina & South America: Investment Opportunities in Energy & Regional Integration*, Price-Waterhouse's World Energy Group Report, June 1997, at 42.

14. *EIA, Table 8.1, supra* note 11.

15. *EIA July 1999 Venezuela Report, supra* note 1.

16. The U.S. Department of State reported, for instance, that despite the deep Asian recession and the 1998 drop in oil prices, Venezuela did not allow its privatization program to be derailed. The government passed new laws opening the petrochemical and internal fuels sectors, while other laws increased the regulation of the securities business. A new Customs Law was adopted, designed to crack down on illegal and undervalued imports. The report also cites Venezuela's efforts to diversify its economy with non-oil exports and increased concentration on promoting and financing exports with the creation of a new Foreign Trade Bank (BANCOEX) in October 1997. U.S. Department of State, *Country Report on Economic Policy and Trade Practices: Venezuela*, 106th Cong., 1st Sess., March 1999, at 322-23 [hereinafter *State Dept. Report: Venezuela*]. The report can be found online at <http://www.state.gov>.

17. *State Dept. Report: Venezuela, supra* note 16.

be found in virtually every aspect of the petroleum sector, e.g. crude oil, natural gas, refining, pipelines, and electricity, despite the country's often cumbersome and sometimes archaic legislative requirements. Some of these requirements have been improved by a range of vehicles approved by the Venezuelan Congress. After adopting this and various other legislation, Venezuela has refashioned itself into a country ripe for foreign investment in petroleum.

This article examines the political, legal, regulatory, fiscal, and operating environment in Venezuela, and the opportunities available there to foreign investors in the petroleum industry.

II. BACKGROUND

A. Nationalization: The Lean Years

In the 1990s, Venezuela has had to "re-market" itself as an international nation. The world had turned away from investing in Venezuela in the 1970s by a series of laws designed to preserve government control of the oil and gas industries. For example, the 1975 Nationalization Law (Organic Law that Reserves to the State the Industry and Commerce of Hydrocarbons) had the most impact, creating "a monopoly in favor of the Venezuelan State in respect of *all* activities related to hydrocarbons."[18] The state-owned company responsible for nationalized oil properties is *Petróleos de Venezuela S.A.* (PdVSA).

The Nationalization Law limited private involvement to such an extreme that it was no longer significantly profitable to invest in Venezuelan petroleum. Private sector entities could participate only through association or operating service agreements. Association agreements required PdVSA participation, Congressional approval, and State control. While Congressional approval was not required for operating service agreements, the products remained under PdVSA ownership at all times, and the private participant received only a fee for its services.[19]

B. Privatization: The Opening

Recognizing the need for a new approach, the Government instituted a new policy in 1989 called "*Apertura Petrolera*," or "the Opening." The United States Energy Information Administration (EIA) explains that "[t]he central goal of the policy change was to increase Venezuela's productive capacity through the rejuvenation of its existing fields, the development of its huge resources of extra-heavy crude oil, and the discovery of new fields of medium and light crude outside of the traditional producing regions." The results of the change quickly became evident. From 1990 to 1997, output increased by 55% to 3.3 million barrels per day (mb/d), replacing the previous production slide of 17%. The EIA concluded that "[t]here can be little doubt that the *Apertura Petrolera* contrib-

18. BAKER & MCKENZIE'S GAS NEWSL., March 1999, at 1.

19. *Id.* Venezuela's oil-dependent economy suffered soon after this policy was enacted when the price of oil dropped sharply after 1981. Venezuela did not have the domestic funds to make upgrades in financial and technological devices desperately needed to upgrade productive capacity, which declined by 17% between 1976 and 1989.

uted to this reversal in trend."[20]

"The Opening" occurred in three separate rounds. The first took place in 1992 and the second in 1993. The two rounds are referred to as the Marginal Fields Reactivation Program. Round I was designed to expand Venezuela's oil production at minimum cost. The fields had high overhead costs, thus making them poor prospects for PdVSA and its subsidiaries, but smaller foreign firms were thought to be equipped to make the marginal and mature fields profitable.[21] Unfortunately, this theory apparently did not garner the attention Venezuela had hoped; only five of the nine offered fields received bids.[22]

Having learned its lesson from Round I, Venezuela improved the auction process for Round II. Thirteen more attractive units were offered, and unlike Round I, these offers included the right to drill to all depths and outside of existing field limits. Bidder qualification procedures and processes for selecting the highest bidder were strengthened. The result was a more successful auction, as forty-four companies or groups of companies submitted bids on August 2, 1993, for eleven of the thirteen offered units.[23] Upon completion of Rounds I and II of privatization, fourteen contracts were awarded, under which operators received twenty-year contracts mandating certain minimum investment levels, and the operator received a fee for each barrel produced. One source estimates that these fourteen fields can be expected to produce 500,000 barrels per day (b/d) within the next few years.[24]

Venezuela auctioned off twenty additional marginal oil fields during Round III, which was completed in 1997. Two hundred fifty-nine pre-qualified bidders competed in the auction.[25] Under the contracts from this round, the companies must invest a minimum amount of capital over a certain period of time, receive a set fee per barrel, and turn the oil over to PdVSA.[26] The operators can receive the full market value of additional output, less one-sixth royalty and administrative costs, until they recover their investment. In addition, operators are entitled to a cut of the value above costs as the field matures.[27] The Venezuelan government raised $2 billion from the third round alone.[28]

20. *Id.*

21. Johnnie W. Hoffman, Jr., *The Service Contract as a Vehicle for International Petroleum Exploration and Production*, Paper 14, Exxon Exploration Co., at 14-18, *citing* JUAN CARLOS BOUÉ, VENEZUELA, THE POLITICAL ECONOMY OF OIL (1993).

22. *Id.* at 14-19.

23. Hoffman, *supra* note 21, at 14-20.

24. *EIA Report, Performance Profiles of Major Energy Producers*, 1997, DOE/EIA-0208(97) (Jan. 1999), at 78, [hereinafter Performance Profiles, 1997] (citing Benard Mommer, *The New Governance of Venezuelan Oil*, OXFORD INST. FOR ENERGY STUDIES, 1998, at 48).

25. Martin, *International Petroleum*, *supra* note 8, at 5-60.

26. *Id.* at 5-61.

27. Performance Profiles, 1997, *supra* note 24, at 78.

28. Success in opening the petroleum industries has encouraged the Venezuelan government to apply the policy to other sectors, such as electricity. New laws designed to encourage competition and extend private investment in the electricity sector were adopted in August 1999, and the government announced that it hopes sell three regional power companies (Semda, Enelven-Enelco, and Enelbar) in 1999. *Venezuela Enacts Electric Law to Lift Competition*, REUTERS (Aug. 3, 1999). It should be noted that while the Opening helped encourage investment somewhat, Venezuela's continued price controls have discouraged investment. Thomas

C. Venezuela's Legal Framework

The Nationalization Law was not the only matter that discouraged foreign investment until the Opening in the mid-1990s. Generally, Venezuela has not treated gas and oil investment favorably. The Government is entitled to 16-2/3% of the field, which is called a royalty or exploitation tax. In addition, oil companies are subject to a high corporate income tax rate of 67.7%. Projects related to the production and refining of free natural gas, carried out through strategic associations formed under the Nationalization Law, are taxed at ordinary tax rates between 15% and 34%, but the law provides several conditions that an oil company must meet before being entitled to the exception.[29]

To further complicate matters, most oil- and gas-related agreements in Venezuela are governed by the individual contracts between PdVSA and each particular investor. Also, some petroleum-related activities are still reserved for the State under the Nationalization Law.[30] These include exploration for oil, asphalt, and other hydrocarbons on national territory, the production, manufacture, refining, transport by special means, and storage of the hydrocarbons, and the foreign and domestic trade in the substances produced and refined, as well as any works required for these purposes.[31] While local distribution of motor gasoline has been opened up to foreign and local companies, continued price controls have discouraged investments in this area.

The legal drawbacks may be only temporary. The State Department reported in its 1998 Country Report on Economic Policy and Trade Practices that "Venezuela made major strides in modernizing the country's legal framework during 1998."[32] A new Petrochemicals Law opened the sector to more extensive foreign investment. Significantly, Venezuela created a macroeconomic stabilization fund designed to save money during prosperous years for use during the lean years when oil prices fall.[33] The plan dictates that half of PdVSA's profits over $9 per barrel be sent to the Macroeconomic Stabilization Investment Fund until 2004.[34] PdVSA has protested the $9 per barrel threshold, so it is possible it may be raised as a legal issue. These legal changes have made the foray into the

Hughes, Correspondence, July 29, 1999 (on file with author) [hereinafter Hughes Correspondence].

29. José L. Valera, *International Transactions Involving Oil and Gas, Part One: The Western Hemisphere—Mexico and Further South*, AKIN, GUMP, STRUASS, HAUER & FELD, L.L.P. (Jan. 1, 1995), at N-11; Araque, Reyna, De Jesús, Sosa, Viso & Pittier, *The abc of the Legal Regime of the Oil Industry in Venezuela* [hereinafter Araque, Reyna, *ABCs*] (visited Aug. 4, 1999) <http://www.internet.ve/araqreyn>.

30. In contrast, Argentina, Peru, Colombia and Bolivia are the most ambitious of the privatizing oil countries. Argentina, for example, passed a global deregulation and privatization plan in September 1989; consequently, nearly every company participating in the energy sector is very profitable. *Argentina Report, Energy Information Administration*, (Nov. 1998) <http://www.eia.doe.gov>.

31. Araque, Reyna, *ABCs*, *supra* note 29.

32. *State Dept. Report: Venezuela*, *supra* note 16.

33. *Id.* Not everyone, however, agrees that the formation of the fund is advisable. Gustavo García, chief economist of the Economic and Financial Advisory Office, believes that the government's Macroeconomic Stabilization Investment Fund may hurt PdVSA's long-term investment plans by limiting its "financial capability." Christian Schmollinger & Eric Kronenwetter, *PDVSA Chief Rejects Dumping Allegations; Producer Group Faces Wednesday Deadline*, THE OIL DAILY, June 28, 1999, at 5.

34. Schmollinger & Kroenwetter, *supra* note 33. Apparently, PdVSA has protested the $9 figure, and consequently, it might be raised in the future. Hughes Correspondence, *supra* note 28.

Venezuelan oil and gas industries easier, and a bit less risky.

III. OPPORTUNITIES FOR INVESTMENT

Venezuela's economic situation requires foreign investment in its most valuable resources: oil and gas. While the price of oil has risen during the summer of 1999, it remains more volatile and lower than the Venezuelan government would like. This, combined with the need to develop or purchase advanced technologies, means investment money has to be found somewhere outside of Venezuela.[35] Luis Giusti, former chairman and chief executive officer (CEO) of PdVSA, predicts that oil prices will be lower in the future due to "abundant new upstream supplies com[ing] on line." Consequently, Giusti recommends that national oil companies streamline their operations to remain competitive in an increasingly free market.[36]

A. Service Contracts for Reactivation and Development of Mature Oil Fields

PdVSA and private service companies enter service contracts to perform specific tasks. The relationship is not like a partnership; instead it is somewhat like a government contract under which the contractor performs certain operational activities for Venezuela and receives a fee.[37] Under Venezuelan law, the contracted activities are not among the activities reserved to the state under the Nationalization Law of 1975.[38] Therefore, Congressional approval is not required.[39] This simplification makes service contracts an attractive tool by which to invest in the petroleum industry, assuming the interested parties are equipped for contracting work.

Generally, these contracts are entered into for the reactivation of marginal fields. PdVSA classifies fields as marginal when they require a large investment for reactivation.[40] The agreements are designed "to increase PdVSA's production capacity in a timely manner by introducing private investment capital and

35. Recent changes in Venezuela's laws allow for partnerships between Venezuela and foreign private companies, particularly in these areas: service contracts for reactivation and development of mature oil fields; the Orinoco Heavy-Oil Belt; offshore natural gas; new exploration; and outsourcing of certain functions.

36. Marin Sieff, *Former Venezuelan Oil Chief: Low Oil Prices Here To Stay*, THE ENERGY DAILY, June 1, 1999, at 3.

37. Araque, Reyna, *ABCs, supra* note 29.

38. Article 1 of the Nationalization Law reserved most activities involving gas and oil to the state, but not every activity. Thus, under specifically drawn service contracts, there was some room for foreign investment even while the Nationalization Law was fully effective. Freddy Vásquez B., *Legal Framework for the Exercise of the Industrialization, Transportation, Storage, Distribution and Commercialization of the Gas*, Paper No. 15-A, March 1999, at 15A-3 (on file with author). Specifically, Article 1 stated in part:

> For reasons of national convenience, everything relative to the exploration of the national territory in search of petroleum, asphalt and other hydrocarbons; the exploitation of such deposits; the manufacture or refining, transport by special means and storage; the national and international commerce of the exploited and refined substances, and the installations which its management requires in accordance with the terms contemplated by this Law, is reserved to the State.

Venezuelan Nationalization Law, Art. 1 (1976), *reprinted in* Hoffman, *supra* note 21, at 14-10.

39. Luís Eduardo López & Larry P. Pascal, *Doing Business in Venezuela*, TEX. TRANSNAT'L L.Q. 11, 21 (1999).

40. Araque, Reyna, *ABCs, supra* note 29.

new technology which may result in new discoveries in mature oil fields." These contracts have been applied to approximately thirty-two inactive or marginal oil fields since the Opening began.[41]

B. The Orinoco Heavy-Oil Belt

The Orinoco Belt is a 270-mile by 40-mile strip in eastern Venezuela, which has the largest heavy oil reserves in the country.[42] There have been numerous strategic associations consisting of joint ventures between PdVSA and various private sector companies formed to increase production of crude oil from this lucrative region.

1. Petrozuata

Conoco Inc. and PdVSA joined to form an investment venture in Petrozuata, with Conoco owning 50.1%, and PdVSA owning the other 49.9%. In 1997, approximately seventy-five horizontal wells were drilled. Production began in September 1998. As of mid-1999, this project was producing about 36,000 bbl/d, and production is expected to reach 103,000 b/d by 2000, as approximately 500 more wells will be drilled by then. Beginning in 2000, 64,000 bbl/d will be sent to Conoco's refinery in Lake Charles, Louisiana. The remaining 39,000 bbl/d will be processed by PdVSA at its Cardón refinery. The heavy crude produced from the project will be diluted to allow it to flow through the 125-mile, 36-inch pipeline, resulting in 251 API synthetic light oil. The estimated cost of the project is $2.45 billion.[43]

The project's construction is proceeding fairly smoothly. However, the project has gone $325 million over budget because of the decline of the *bolívar* and higher-than-expected labor costs. As a result of financing difficulties, Standard & Poor has cut the credit rating of the project to "junk bond" grade.[44]

2. Sincor

TotalFina, Statoil, and PdVSA make up the partners in a joint venture in Sincor, claiming 47%, 15%, and 38% ownership, respectively. Approximately 1,200 wells are expected to be drilled, which will yield around 175,000 barrels of 321 synthetic crude by the time full production is achieved in 2002. Recoverable reserves are estimated at 2.4 to 3.6 billion barrels. The project is estimated to cost between $4.3 and $4.6 billion.[45]

The project, however, stalled in 1999 due to financing difficulties, specifically the suspension of a $1.5 billion bond issue forced by last summer's market turbulence.[46] PdVSA announced that, as a result, it will sell 15% of its stake,

41. López & Pascal, *supra* note 39, at 21.

42. Performance Profiles, 1997, *supra* note 24, at 78.

43. Performance Profiles, 1997, *supra* note 24, at 78-79; *EIA July 1999 Venezuela Report*, *supra* note 1.

44. David Pike, *Variety of Problems Combines to Weigh Down Venezuela's Orinoco Belt*, THE OIL DAILY, July 22, 1999, at 6.

45. Performance Profiles 1997, *supra* note 24, at 79.

46. *EIA July 1999 Venezuela Report*, *supra* note 1; Pike, *supra* note 44, at 6.

cutting its share to 23%.[47]

3. Cerro Negro

A joint venture among PdVSA (41.67%), Mobil (41.67%), and Veba Oel (16.66%) in Cerro Negro was designed to produce, upgrade, and market 120,000 b/d of extra-heavy crude. While this venture has been slowed by PdVSA's budget cuts, the venture was awarded a $500 million contract to build an upgrading plant in 1997. In addition, approximately 350 wells will be drilled.[48] Initial production, scheduled for 1999, is expected to yield approximately 58,000 b/d.[49] Eventually, upgrading of heavy oil from this project is expected to occur largely in the United States at a refinery in Chalmette, Louisiana, jointly owned by Mobil and Citgo. This project will cost between $1.9 and $2.3 billion.[50]

Recently, the project has been plagued with problems. Construction delays were prompted by labor disputes at the Cerro Negro project site. The disputes were ultimately quelled by the Venezuelan National Guard, and work was allowed to restart. The delays have, however, pushed the project's central production plant four months behind schedule.[51]

4. Petrolera Ameriven

The Ameriven project is a heavy crude upgrading partnership in the Hamaca area between PdVSA (30%) and several U.S. companies, including Atlantic Richfield Co. (Arco) (30%), Phillips Petroleum Co. (20%), and Texaco Inc. (20%).[52] Approximately 1,300 horizontal wells are expected to be drilled in the next thirty-five years. The project will cost approximately $3 billion.[53] Lately, however, this project has stalled. The Ameriven project is likely to be delayed at least several years due to uncertainties regarding financing.[54] In addition, Arco recently announced its decision to withdraw from the project. Although the other partners plan to continue the project, Arco's withdrawal is not

47. Pike, *supra* note 44, at 6. In August, PdVSA extended its deadline for this sale to September 3, which apparently has attracted the interest of at least ten companies. The project was approximately 23% completed when the extension was announced. *Venezuela Extends Heavy Oil Project Sale Deadline*, REUTERS (August 4, 1999).

48. Pike, *supra* note 44.

49. *Cerro Negro Heavy Oil Project Financing Special Report*, MOODY'S INVESTOR'S SERVICE, July 1998, at 3.

50. *EIA July 1999 Venezuela Report*, *supra* note 1.

51. Pike, *supra* note 44, at 6.

52. These original percentages changed in July 1999 when Phillips exchanged its 18% working interest in the LL-652 oil field in Lake Maracaibo for two-thirds of Arco's 30% interest, bringing its share to 40%. Texaco agreed to acquire the other 10% of Arco's share, making its investment 30%. *Phillips Ups Interest in Oil Field*, ASSOCIATED PRESS (July 1, 1999) <http://www.washingtonpost.com>.

53. Peter Eisen, *Arco to Leave Hamaca Heavy Oil Project; Remaining 3 Partners Plan to Proceed*, THE OIL DAILY, July 2, 1999, at 5.

54. Jason Feer, *Ameriven Project Delayed for Several Years*, THE OIL DAILY, Jan. 14, 1999, at 1. Another slowdown is demonstrated by Coastal Corp., which dropped out of a proposed heavy oil project in 1998. The other projects described here are on track despite the downgrading of their bonds in late 1998. *Id. See also* Thomas Hughes, VENEZUELAN LEGAL DEVELOPMENTS (Client Newsletter), December 12, 1998, at 2 [hereinafter Hughes Newsletter].

encouraging to the success of the venture.[55]

5. Orimulsión

Orimulsión, Venezuela's boiler fuel, consists of 70% bitumen, an abundant chemical in the Orinoco Belt. The production and marketing of the fuel is managed by Bitúmenes de Orinoco (Bitor), a PdVSA subsidiary. It has unfortunately not yet provided a significant opportunity for American companies to invest, due at least in part to the denial of Florida Light & Power's contract in 1998 to buy 4.5 million tons of the fuel over twenty years. Despite this result, Orimulsión is marketed to Canada, Japan, and several other countries, and South Korea's Korean Power Engineering Co. has signed an agreement with Bitor to explore the use of Orimulsión in power plants.[56]

In July 1999, Venezuela agreed to sell its trademark boiler fuel to India. While the deal was not finalized as of this writing, India's ambassador to Venezuela, N.N. Dosai, has stated that the deal is close to fruition.[57]

C. Offshore Natural Gas.

Cristóbal Colón was a project which included Exxon, Shell, Mitsubishi, and PdVSA.[58] PdVSA had been studying the possibility of a $4.9 billion liquefied natural gas (LNG) refinery as part of this project since 1988.[59] The project, however, was put on hold for ten years when Venezuela and neighboring Trinidad agreed to explore oil and gas sources in the waters shared by the two countries. As part of that deal, Venezuela agreed to send its natural gas to an LNG plant in Trinidad instead of building the Cristóbal Colón facility.[60]

On the positive side, the failure of this LNG deal has not stifled other similar deals. Shell is still interested in closing an LNG export project deal by the end of the year. Shell wants to participate in the project despite the Cristóbal Colón failure, saying that it "learned a great deal" from that experience.[61]

D. New Exploration

Exploration of potential new oil fields is accomplished primarily through risk exploration agreements. These agreements, technically referred to as profit sharing agreements (PSAs), were authorized by the Venezuelan Congress in

55. Eisen, *supra* note 53, at 5.

56. The state blocked the deal because Orimulsión contains high levels of sulfur and other pollutants which would have violated environmental laws. *EIA July 1999 Venezuela Report, supra* note 1.

57. *India Set to Buy Orimulsión* (July 13, 1999) <http://www.vzlanet.com>.

58. Hughes Newsletter, *supra* note 54, at 2; *Shell Still Interested in Venezuelan LNG Project*, REUTERS (July 14, 1999) [hereinafter *Shell Still Interested*]. The contract specifically involved Lagoven on the Venezuelan side, a PdVSA affiliate.

59. *Venezuela: Energy Information Administration*, (Sept. 1998) <http://www.eia.doe.gov> [hereinafter *EIA Sept. 1998 Venezuela Report*]; *Venezuela Studies LNG Plant to Develop Associated Gas; Facility in José Expected*, LNG EXPRESS (Aug. 1998) <http://www.lngexpress.com>.

60. *EIA Sept. 1988 Venezuela Report, supra* note 59. Apparently, "the lack of valuable liquids in the offshore gas field included in the project" was also a problem. *Shell Still Interested, supra* note 58.

61. *Shell Still Interested, supra* note 58 (quoting Joaquín Moreno, President of Shell in Venezuela's Andean region).

1996.[62] Private investors take on the costs and risks for a maximum of nine years to search for new petroleum sources in semi-explored areas in return for a share of the profits. The company must spend $40 to $60 billion per block during the nine-year period. When these PSAs were auctioned off in 1996-97, over seventy-five companies participated despite the very high potential tax burden of 85 to 94%. The PSAs include several different ventures.[63]

La Ceiba is a project involving Mobil, Repsol S.A., Sipetoal S.A., and Tecpetrol S.A. The investment looks especially promising in light of the early 1998 discovery of a well with a flow of 16,000 b/d. Conoco is the sole holder of another new exploration in the Gulf of Paria, which consist primarily of an offshore block between Trinidad and Venezuela. Finally, Guanaré is a project in which Conoco and Elf Aquitaine share equal interests, and is located in western Venezuela, in the foothills of the Mérida Andes.[64]

E. Outsourcing of Certain Functions

Operations that are not directly involved in "key aspects for PdVSA" may be contracted to third parties. Some services that may be undertaken by outside companies include "the construction and operation of plants and installations for the generation and distribution of electricity, steam, water, hydrogen, nitrogen, special products management and port services." Certain retail functions may also be carried out by private companies, such as storage, transportation, distribution, and retail of hydrocarbons.[65]

IV. External Factors Favorable to Foreign Investors

In spite of the challenges associated with many projects in Venezuela discussed in the previous section, the opportunities in the Venezuelan petroleum and natural gas industries are promising today for many reasons. For example, environmental concerns about pollution and the need to find cheap, long-term natural energy sources will almost certainly increase the international demand for natural gas over the next several decades. The world is "highly sensitive to the question of environmental conservation."[66] Venezuela has a total of 142.5 Tcf of natural gas reserves.[67] Although a large portion of the natural gas is sold to domestic users (89% in 1992), Venezuela's natural gas supply is sufficient to provide for some of the international demand, and the country will undoubtedly

62. On August 19, 1999, Venezuela's Supreme Court of Justice sent a very positive signal to foreign petroleum investors by upholding the constitutionality of PdVSA's risk exploration contract. The law allows private foreign and domestic investors to explore for, produce and transport natural gas. Investors pay a 20% royalty on gas extraction (up from 16.7%) but enjoy a reduction of income tax from 67% to 34%. PdVSA has estimated it will need $8 billion (U.S.) to carry out the development of its gas sector. Peter Eisen, *Court Upholds Venezuela's High-Risk Contract*, THE OIL DAILY, Aug. 19, 1999, at 1.

63. Performance Profiles, 1997, *supra* note 24, at 79. As of February 1999, PdVSA had offered ten exploratory areas for international bidding. López & Pascal, *supra* note 39, at 21.

64. *Id.*

65. López & Pascal, *supra* note 39, at 21.

66. HARRY A. MICHAEL, (Director, Corpoven, S.A.), NATURAL GAS IN VENEZUELA (1993) (on file with author).

67. *EIA July 1999 Venezuela Report*, *supra* note 1.

benefit from international environmental planning.[68]

Venezuela's dependence on the oil market may be decreasing. The EIA reported in May 1999 that "[o]n the positive side, reforms undertaken by Venezuela over the past several years (i.e., encouraging privatization measures and increased foreign investment, strengthening the banking sector, and increasing foreign exchange reserves), could help make Venezuela's economy more resilient and better able to withstand the current sharp decline in oil prices."[69]

New opportunities may be opening for investors as companies that had earlier invested in Venezuela seek out partners to scale back their own investments. In April 1999, Benton Oil and Gas Co. decided to seek a partner to help increase production at its South Monagas field. Royal Dutch/Shell also announced plans in early 1999 to sell half its investment in Urdanetta West. Lasmo cut its capital investment in the Dación field nearly in half, from $332 million to $183 million.[70] These and other future cutbacks present opportunities for small, relatively inexperienced companies to join with knowledgeable investors for their mutual benefit in Venezuelan oil and natural gas.

V. THE RISKS PRESENTED TO FOREIGN INVESTORS IN VENEZUELA'S PETROLEUM SECTOR

While the Venezuelan petroleum industry presents many opportunities for investment, the country also presents several risks which should be taken into account before any major decisions are made.

A. United States-Venezuela Relations

Recent relations between the United States and Venezuela have been more volatile than under the previous Caldera Administration. The first half of 1999 was uneventful, capped off in June with an agreement between the United States and Venezuela to do feasibility studies on two major natural gas projects. The agreements were negotiated by the U.S. Trade Development Agency (TDA) which each year gives five or six grants to Venezuela totaling approximately $1 million.[71] The U.S.-Venezuela relationship suffered considerable strain during the summer of 1999, however, when an Oklahoma-based group of oil producers called Save Domestic Oil Inc. (SDO) asked the Commerce Department and the International Trade Commission to investigate Venezuela and several other

68. MICHAEL, *supra* note 66. Oil production since the Opening has been significantly increasing, and estimates of eventual production rates has risen even for mature oil fields. Production rates have increased to 112×10^3 bbl/day in 1992.

69. *EIA's OPEC Revenues Fact Sheet, Overview, Venezuela* (May 1999) <http://www.eia.doe.gov/emeu/cabs/opecrev.html>. On the other hand, Venezuela's non-traditional exports (all exports excluding oil and steel) fell 25.9% in the first half of 1999 from the export rate during the first half of 1998. *Venezuela June Non-Oil Exports Fall 23.7 pct*, REUTERS (Aug. 6, 1999).

70. *Benton Oil Scales Back in Venezuelan Upstream as Uncertainty Reigns*, THE OIL DAILY, Apr. 9, 1999, at 5 [hereinafter *Benton Oil Scales Back*].

71. One was a $150,000 study for two gas pipelines, and the other a $309,000 study for a gas-to-liquids (GTL) conversion plant. Peter Eisen, *U.S. Trade Agency Funds Feasibility Study of Gas Market in Venezuela Tourist Regions*, THE OIL DAILY, June 3, 1999, at 5.

countries for allegedly dumping crude oil in the U.S.[72] The petition, filed on June 29, 1999, with the U.S. Commerce Department, which had to "determine if the dumping case has merit and can proceed to the U.S. International Trade Commission [ITC]," charged several countries with dumping.[73] Venezuela has vehemently denied any such plans, and blames "the Asian financial crisis, a warm winter and increased Russian oil exports" for the price drop.[74] PdVSA representatives reportedly met with a public relations firm to improve PdVSA's image in the United States, Venezuela's largest customer of oil exports.[75]

On August 9, the Commerce Department rejected the SDO petition. Apparently persuaded by domestic industry opposition to the petition, as well as Venezuela's input[76] and remarks from Chávez himself,[77] the Commerce Department found that opposition outweighed support within the industry. Therefore,

72. Schmollinger & Kronenwetter, *supra* note 33, at 5. Notably, Texaco filed comments with Commerce opposing the SDO petition in mid-July, 1999. *Texaco Opposes Crude Oil Anti-Dumping Petition* (Texaco press release), BUSINESS WIRE (July 14, 1999). Mobil followed soon after. *Mobil Corporation Announces Opposition To Dumping & Countervailing Duty Petitions,* (Mobil press release) BUSINESS WIRE (July 19, 1999). Opposition from oil companies of this size may weaken SDO's position significantly. Commerce Department rules require the petitioners to demonstrate that they represent at least 25% of domestic oil production in the U.S. and that companies representing at least 50% of domestic production support the petitions. *Id.* The SDO case lacks the support of the Independent Petroleum Association of America (IPAA) and the California Independent Petroleum Association (CIPA). *Coalition Plows Ahead in Anti-Dumping Battle Despite Absence of 2 Groups From Ranks,* THE OIL DAILY, Apr. 22, 1999, at 5; *IPAA Press Release* (June 30, 1999) <http://www.ipaa.org>. In late July, the Commerce Department sent questionnaires to 811 oil producers to gauge SDO's support. Early predictions anticipate slim backing for SDO's petition. Eric Kronenwetter, *Commerce Questions Industry in Dumping Probe,* THE OIL DAILY, July 30, 1999 at 1, 4. The Commerce Departments announced on August 3 that it may already have enough evidence to dismiss the case even though the deadline for the decision is not until August 9. Tom Doggett, *Will Oil-Dumping Case be Dismissed?,* REUTERS, (Aug. 4, 1999).

73. Chris Holly, *Anti-Dumping Complaint Could Roil Oil Politics,* THE ENERGY DAILY, July 1, 1999, at 2. The petition—the first ever anti-oil dumping petition—includes Saudi Arabia, Venezuela, Mexico, and Iraq. If the Commerce Department determines that the case has merit and proceeds to the ITC, the ITC has 190 days to issue a preliminary decision regarding financial injury to U.S. oil producers. If the ITC finds financial injury, it can impose tariffs on oil imports from the targeted countries. *Id.* at 1.

74. *Venezuela State Oil Firm Denies U.S. Oil Dumping,* REUTERS (June 25, 1999) (citing PdVSA CEO Roberto Mandini). Arguably, Venezuela has ample reason to deny the accusations. It does not make economic sense for Venezuela to sell oil—upon which it is almost completely dependent—below cost. As PdVSA CEO Roberto Mandini pointed out, "Pushing down oil prices would be suicidal for Venezuela. [Venezuela] depends on oil revenues for a major portion of its national income." Schmollinger & Kronenwetter, *supra* note 33, at 5.

75. *PDVSA Tries PR Angle to Soften Dumping Accusation* (June 14, 1999) <http://www.vzlanet.com/oil>.

76. Venezuelan Energy and Mines Minister Alí Rodríguez warned that if the ITC imposed tariffs on oil, "the case would [have] significantly raise[d] the price of oil in the United States and cause[d] major disruptions in supply." *Exporters Vow to Take Dumping Case to WTO,* THE OIL DAILY, July 2, 1999, at 3. Venezuela, Saudi Arabia, and Mexico had allegedly agreed to go to the World Trade Organization if the Commerce Department found the SDO's complaints to be valid. Iraq, on the other hand, was never concerned. *Id.*

77. In a letter to President Clinton, new Venezuelan President Hugo Chávez seemed to give a veiled warning to the United States, denouncing the SDO's complaint as "totally contrary to the free market and to the close energy relationship that has benefitted our countries." *Venezuelan Pres. Denies Dumping,* ASSOCIATED PRESS (July 24, 1999) <http://www.dailynews.yahoo.com>. Later warnings were more direct; Venezuela Energy Minister Alí Rodríguez warned that severe social unrest might occur in Venezuela and other Latin American countries if SDO's petition succeeds. Martin Roberts, *U.S. Oil Dumping Case Could Spur Venezuela Unrest,* REUTERS (July 27, 1999) <http://www.biz.yahoo.com>.

trade laws prohibited the full launching of the complaint. Venezuela responded favorably to the announced rejection, calling the accusations "false and [reflective of] a fundamental misunderstanding of the workings of world oil markets."[78]

Nevertheless, SDO took a risk in filing the petition. Alienating the main suppliers of "the United States' growing crude oil needs" might not have been the best move.[79] If the U.S.-Venezuela relationship continues to have these types of problems, Venezuela may become wary of further opening its markets, especially to U.S. investors.[80]

B. *Venezuela's Domestic Situation*

Venezuela's uncertain political and socio-economic situation present some very serious risks. President Chávez took office in February 1999, and has been controversial within the international business community. Formerly a paratrooper, lieutenant-colonel, and the head of a failed military coup, Chávez, nicknamed *El Comandante*, is very popular among Venezuela's large poor population.[81] His initial goals were predictably "to end the corruption spawned by 40 years of rule by a cozily, clientelist two-party system, and to reverse the impoverishment and economic malaise into which his oil-rich country had sunk." He

78. Chris Holly, *Commerce Dumps Oil Dumping Petitions*, THE ENERGY DAILY, Aug. 10, 1999, at 1-2.

79. Matthew Robinson & Eric Kronenwetter, *Dumping Motion Filed; Mexico Eyes Retaliation*, THE OIL DAILY, June 30, 1999, at 1. Mexico, for example, threatened to rescind its offer to eliminate the 4% tariff on U.S. natural gas imports. *Id.*

80. Venezuela has also taken some considerable political risks as of late. For example, Chávez recently denied permission for United States' anti-drug aircraft to fly over Venezuela on the way to Colombia. The new president, who has formed close ties with Fidel Castro, supports plans to build a railroad-track factory with Iran and China and has apparently become a penpals with imprisoned Venezuelan-born terrorist Ilich Ramirez Sanchez, better known as "Carlos the Jackal." Anthony Faiola, *In Venezuela, A Revolution From the Top*, WASHINGTON POST, July 27, 1999, at A1.

Furthermore, the country is hoping to host an OPEC summit in Caracas in early 2000. Venezuela's government has not only invited the United States' arch rival Saddam Hussein to the conference, but has also vowed to provide him with "'all the security of [their] intelligence and armed forces if he decides to come.'" The potential for close ties between Venezuela and Iraq certainly will be closely monitored by United States officials. *Venezuela Urges Saddam to Visit*, REUTERS (July 12, 1999) <http://www.biz.yahoo.com>, (quoting Venezuela's Deputy Foreign Minister Jorge Valero). The U.S. will also be watching support for a new Venezuelan activist agenda. At the top of the agenda is the adoption of a price band for world oil prices; other proposals suggests coordinating upstream terms among producers, the creation of a commercial department, and swapping customers to divide oil markets among producers on a regional basis. Stephen MacSearraigh & Jason Feer, *Venezuela Offers Ambitious Agenda for OPEC*, THE OIL DAILY, Aug. 12, 1999, at 1. The positive proposals from Venezuela include, most notably, maintaining the policy of output restrictions at least until the end of 1999; Chávez believes the price per barrel is stabilizing. *Venezuela Won't Raise Output*, THE OIL DAILY, Aug. 18, 1999, at 7.

81. In 1997, approximately 42% of Venezuelans lived below the poverty line, up from 34% in 1990 and well above the 36% Latin American average. *La Pobreza a Fines de Los Años Noventa, Pobreza e Indigencia por Paises, 1990-1997* (table). The Washington Post reported a 50% poverty rate in July 1999. *World in Brief*, WASHINGTON POST, July 2, 1999, at A20. Thus far in 1999, around 800 construction, textile, manufacturing, and petroleum companies have closed, and 600,000 have lost their jobs, increasing the unemployment rate to over 17%. Fabiola Sanchez, *Venezuela Recession May Worsen*, ASSOCIATED PRESS (Aug. 5, 1999) (citing polling firm's Datanalisis figures). Notwithstanding this economic landscape, Chávez is so popular among Venezuela's poverty-stricken population that his televised birthday celebration in July brought tears to the eyes of some citizens. Richard Chácon, *Remaking Venezuela*, BOSTON GLOBE, Aug. 4, 1999, at A1.

is seen by many political observers as an unpredictable leader.[82] Robert Bottome, editor of *VenEconomia*, an economic newsletter, calls Chávez "President Jekyll and Colonel Hyde" because of his allegedly ambiguous record.[83] For instance, during the campaign, Chávez was an active opponent to the continued opening of Venezuela foreign investment, arguing for "suspending foreign debt payments, slowing the pace of privatizations, reviewing concessions to foreign oil companies, selling off some of . . . PdVSA's overseas assets, and cutting PdVSA's investment program by 15%."[84] Recently, Chávez demanded that Congress be dissolved after it rejected thirty-four of 267 Chávez proposed military promotions.[85] Since his election, however, he has backed away from these extreme positions.[86] A new Constituent Assembly was elected July 25, 1999, to rewrite the Constitution,[87] but some of Chávez's opponents see the move as way to legitimize an eventual dictatorship rather than improve democracy, as Chávez claims.[88]

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82. *The Chávez Enigma*, THE ECONOMIST, June 5, 1999, at 33 [hereinafter *The Chávez Enigma*].

83. Chávez himself has remarked, "Before, I was the devil. . . . Now I'm the president." *Id.* Prominent Venezuelan economist and Chávez critic Maxim Ross explains, "Some days he can sound very moderate, and talk about opening up the economy. And other days he talks about redistributing wealth with leftist rhetoric that will only take this country backwards. That's why no one knows who he really is." Chácon, *supra* note 81.

84. *EIA Sept. 1998 Venezuela Report*, *supra* note 59.

85. Paul Hughes, *Venezuela's Chávez Wants Congress to Close*, REUTERS (July 1, 1999). Chávez plans to go ahead with the promotions anyway. *Id.*

86. In a July 28 speech to an annual meeting of leading employers' association Fedecamaras, Chávez revealed his economic agenda. Privatization and investment were prominent themes, as was lowering uncertainty among business leaders. *Chávez Unveils Economic Measures in Bid to Woo Business Leaders*, AGENCE FRANCE PRESS (July 28, 1999).

87. The assembly's first meeting was held August 3, 1999. In an early positive sign, some assembly members said one of their top goals is "to cure Venezuela's recession-ridden economy by including strong guarantees for investors in the new constitution." Steven Gutkin, *Venezuela Constitutional Body Meets*, ASSOCIATED PRESS, Aug. 3, 1999.

88. At least 119 members of the new 131-member Constitutional Assembly were candidates supported by Chávez, including his wife and former chief of staff. This strong political support for Chávez was greeted with "cautious optimism" by analysts, one of whom hoped that "with no opposition there should be less political uncertainty and Chávez will have more time to dedicate to the economy." Paul Hughes, REUTERS, *Venezuela's Chávez Basks In Popular Endorsement* (July 26, 1999).

Criticism of Chávez, however, has been especially harsh this summer. During a recent speech, Jorge Olavarría, a former Chávez ally, referred to the new president as a "demagogue endowed with a talent for awakening hatred and violence." Olavarría described the situation in Venezuela under Chávez's administration as "a moment full of dangers and threats for those of us who want to live in liberty and democracy." The speech apparently did not faze Chávez, but caused at least one fistfight between opposition legislators outside Congress. Bart Jones, *Venezuelan Leader Comes Under Attack*, ASSOCIATED PRESS ONLINE (July 8, 1999) <http://www.washingtonpost.com>. Chávez has been criticized for failing to use his new powers to formulate an economic plan for the future or to reassure investors of his nation's economic stability. Chácon, *supra* note 81. Chávez has also been cited for flouting campaign laws, and electoral officials have "pulled the plug" on the president's two radio and television programs he hosts on state-run channels. Chávez has continually thumbed his nose at these types of reprisals, and has assured his supporters that he will continue to host the shows in defiance of the National Electoral Council's orders not to do so. Bart Jones, *Venezuela Pulls Chávez Shows Off Air*, YAHOO! NEWS (July 14, 1999) <http://dailynews.yahoo.com>. The Washington Post referred to these new South American leaders as "'democratic dictators,' elected presidents who run roughshod over other national institutions, such as the legislature, the courts and the media." Anthony Faiola, *Peruvian Government Targets Critical Media*, WASHINGTON POST, July 13, 1999, at A14.

This news has had a negative impact on Venezuela's international reputation as a solid investment. As Venezuelan Exchange President Alejandro Salcedo admitted, "[w]ithout any doubt, a confusing political atmosphere doesn't create the best climate for investors to put capital in the local market."[89] For example, Moody's downgraded the bank financial strength ratings (bfsrs) of Banco Mercantil and Banco Provincial, Venezuela's two strongest banks, from D+ to D in July 1999. The investors' service cited "growing political uncertainty; increasing indications of political pressure on the banking system; and a rapidly deteriorating real economy" as reasons for the downgrade.[90] Foreign oil companies have warned that they will delay or withdraw investment from oil and gas projects in Venezuela until they know more about Chávez's plans for his country's energy policies.[91] One observer predicts that if Chávez's newly elected assembly dissolves Congress and the Supreme Court, investors "would see Mr [sic] Chávez branded as the dictator his opponents claim him to be."[92] The eventual outcome of the Chávez puzzle is of vital interest to the United States, "which depends on oil from Venezuela more than from any other nation in the world."[93]

Despite these and other similar setbacks,[94] Chávez's approval rating at home remains high.[95] In addition, the United States government reports that "[t]he Chávez administration has made the liberalization and expansion of the vast natural gas sector a central theme of its energy policy."[96] With Chávez's

89. Christina Hoag, *Chávez Faces Storm Over Promotions*, FINANCIAL TIMES (July 7, 1999) <http://www.ft.com>. The "confusing political atmosphere" has worsened during the summer. Town halls and trade union offices across the country have been seized by *Chavistas*, Chávez's most dedicated supporters. Three state governors may be dismissed from their positions, and municipal mayors and officials have been tossed to the street. All this has led to a situation labeled by one observer as "Caribbean Jacobinism." *Caribbean Jacobinism*, THE ECONOMIST, Aug. 14, 1999, at 29 [hereinafter *Caribbean Jacobinism*].

90. *Moody's Cuts Banco Mercantil S.A., Banco Provincial*, MOODY'S INVESTORS SERVICE (press release) (July 16, 1999).

91. Peter Eisen, *Chávez Increases Power With Big Election Win*, THE OIL DAILY, July 27, 1999, at 1. At least one analyst has gone so far as to refer to the drain of foreign investment from Venezuela as "a boycott" and a " strike." Juan O. Tamayo, *Venezuela's Chávez Stands Tall—So Far Leader Basks in String of Successes*, MIAMI HERALD, July 29, 1999, at A1, (quoting Ricardo Hausmann, chief economist for the Inter-American Development Bank). Another has called it "a very dicey situation." Pike, *supra* note 44, at 5. The prospect of six months of constitutional debate has also discouraged investment. The political uncertainty inherent in such a major governmental change have caused investors to hedge their bets and wait until the new constitution is complete. Sanchez, *supra* note 81.

92. *Chávez Cleans the Slate*, THE ECONOMIST, July 31, 1999, at 29. Another observer adds, "There is a great deal of speculation about whether the new assembly will dissolve Congress and the Supreme Court. If that happens, the price of Venezuelan bonds will decline because it could be interpreted as a de facto coup by the president." Hugh Bronstein, *Week Ahead: Brazilian Reforms, Venezuela Constitution*, REUTERS (Aug. 1, 1999) (quoting Carlos Janada, a Latin American economist at Morgan Stanley Dean Witter).

93. Chácon, *supra* note 81.

94. *See, e.g.*, discussion *infra*, Section V.D., concerning recent reductions in foreign investment.

95. Chávez's approval rating was over 80% in June 1999. *Chávez Enigma*, *supra* note 82, at 33. As of July, it had fallen only slightly to around 70%. *Venezuelan President Defies Talk Show Ban*, BBC NEWS (July 19, 1999) <http://headlines.yahoo.com/Full_Coverage/World/Venezuela/>.

96. *EIA July 1999 Venezuela Report*, *supra* note 1. More specifically, the EIA explains in its July 1999 report:

> The government wants to dramatically increase the use of gas, and to encourage large amounts of

short-term record, however, it is impossible to know what kind of leader Chávez will be until more time has passed.[97]

C. *Unpredictable Dispute Resolution*

The state of dispute resolution mechanisms in Venezuela also is a risk factor. The new arbitration law was passed in April 1998,[98] and, therefore, there is little history available for predicting the outcome of a particular dispute. While this new law is certainly an improvement over the former Calvo Doctrine, which insulated Latin American countries from "intrusive foreign pressures" and basically forbade arbitration, hurdles still exist.[99] For instance, state-owned entities like PdVSA must obtain approval of the board of directors, as well as written authorization from the governing entity, to participate in international arbitration. This provision is especially relevant to petroleum-related disputes because PdVSA is a partner is nearly every venture. Furthermore, some disputes cannot be submitted for arbitration, such as those directly related to powers, functions, or public policy of the Venezuelan government.[100] This scenario may result in expensive, drawn-out court battles between investors.[101]

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foreign investment, as well as increase the use of natural gas-driven cars. Overall, PdVSA would like to double Venezuela's gas production over the next 10 years, investing up to $5 billion. The government's new policy is still to be formalized, but in mid-1999 it was discussing plans to create a national gas company that might be independent of PdVSA to oversee the development of new projects and promote investments, and possibly to assume responsibility for gas exploration and production, as well as distribution and transportation. The new plan would establish an integrated legal framework including tax provisions for the sector, a regulated structure, pricing rules, and measures to encourage foreign investment by liberalizing the exploration and production terms for natural gas.

In addition, Chávez submitted proposals for the new constitution that are "surprisingly pragmatic" and not that different from the current constitution. Although he wants to increase the power of the president and the armed forces, the economic chapters remain the same. *Caribbean Jacobinism*, *supra* note 89, at 29-30. According to one source, the political changes regarding the presidential and military branches "in the short term should have no impact on market sentiment . . . ." Thomas T. Vogel, Jr., *Proposals for Venezuela's Constitution Are Less Drastic Than Critics Expected*, WALL ST. J., Aug. 9, 1999, at A14, (quoting Ricardo Penfold, Santander Investment). However, some ambiguous clauses appear to allow the government to ignore international agreements while others might hamper private investment in other ways. *Id.*

97. To complete the picture: Chávez allegedly used to be linked to an anti-Semitic Argentinian sociologist; he has threatened to use the Constituent Assembly to dissolve Congress and the Supreme Court; and he responded to the National Election Commission ruling not to allow him to campaign for assembly candidates by saying, "They're not going to chain me up." *Chávez Enigma*, *supra* note 82, at 33.

The Venezuela Supreme Court may make matters worse by striking down royalty and tax provision exemptions that were granted for the formation of eight exploration contracts in 1995. Existing tax provisions are very hard on gas and oil companies, making Venezuelan investments less attractive. The exemptions were granted to counteract this detrimental Venezuelan law, but those efforts may prove fruitless should the Supreme Court disallow the exemptions.

98. The new law replaces Code of Civil Procedure 608-629, eliminating the requirement that arbitration be characterized by subject matter. Instead, there are now two types of arbitration: "institutional" and "ad hoc." The law applies to commercial arbitration regardless of multi- or bilateral arbitration treaties that may also apply. R. Doak Bishop & James E. Etri, *International Commercial Arbitration in South America*, at 11-17 *reprinted in part from* R. Doak Bishop, *The United States' Perspective Toward International Arbitration with Latin American Parties*, 8 INT'L L. PRACTICUM 63 (1995).

99. Bishop & Etri, *supra* note 98, at 11-1, 11-18.

100. *Id.* at 11-18.

101. Venezuela's court system is chronically backlogged. The president of the constitutional assembly

On the other hand, the Round III agreements[102] indicate a shift in Venezuela toward less formal and less expensive settlement procedures. They provide, for example, for expert settlement for some disputed items. Experts are appointed by agreement of the parties or by the International Center of Expertise of the International Chamber of Commerce in Paris, France. Agreements involving mature or marginal oil fields, annual work programs and budget, and other similar topics cannot be settled by experts, but they can be submitted to arbitration. The outcome of the arbitration is final and binding.[103]

D. The Oil Market

Finally, a major risk of Venezuelan investment would be any weakness of the oil market itself. The country's economy suffered greatly in 1998, partially as a result of the Asian crisis, but also due to the sharp drop in oil prices.[104]

The expected long-term price slump also is a problem. Former PdVSA chairman and CEO Giusti has warned that "[w]orld oil prices will remain extremely low in the years ahead."[105] The slump has already caused an increase in the deficit and a decrease in international reserves;[106] the price rise in 1999 has proved to be only a momentary respite.[107] The recession that has resulted from the price drop likely will be worse than first expected despite improving projections for Mexico and Brazil.[108] In fact, the expected Venezuelan economic decline as of April 1999 was 3.8%, but that projection changed quickly to 4.8% in late June, despite the rise in oil prices over the first few months of the year.[109] The slump is having a crippling affect on Venezuelan oil.[110]

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elected in July promised to declare a "judicial emergency" to resolve outstanding cases, but it may take more than that to cure the problem. Gutkin, *supra* note 87.

102. *See supra* Section II.B. for a discussion of Round III agreements.

103. Thomas Hughes, VENEZUELAN OIL, Sept. 1997 (presentation) (on file with author). Unfortunately, the Round III arbitration clauses may be at risk. The Supreme Court recently upheld the arbitration clause of the 1995 law that controls Round III "New Fields" agreements, but the Minister of Energy and Mines has stated that the decision "is not the last word" regarding the legality of the clause. The final outcome of the conflict remains to be seen. Thomas Hughes, correspondence, Aug. 23, 1999 (on file with author).

104. *Energy in the Americas, Ch. 1: The Americas in a World Context*, EIA (July 1999) <http://www.eia.doe.gov/emeu/cabs/theamericas.html#world_context>.

105. Sieff, *supra* note 36, at 3.

106. *EIA Sept. 1998 Venezuela Report*, *supra* note 59. Venezuela is heavily dependent on oil—it loses approximately $1 billion for $1 per barrel drop in the price of oil—so even small price changes have a significant impact. *Id.*

107. Thomas Hughes, VENEZUELAN LEGAL DEVELOPMENTS (client newsletter), June 14, 1999, at 2. Despite the rise in prices, Venezuela's total oil revenues went from $11.7 billion in 1998 to $7.4 billion in 1999, with profits down 84%, from $4.8 billion in 1997 to $766 million in 1998. *EIA July 1999 Venezuela Report*, *supra* note 1.

108. Lapper, *supra* note 1. Although history indicates that most Latin American countries' economies ebb and flow together, recent trends reflect a new divergence. *Id.*

109. Lapper, *supra* note 1.

110. In fact, all of Latin America is suffering economically. Analysts have called it the deepest slump since the 1980s debt crisis; "the slowdown has inspired doubts about whether governments should continue free-market reforms championed by the United States over the past decade." Anthony Faiola, *Deep Recession Envelops Latin America*, WASHINGTON POST, Aug. 5, 1999, at A1. These doubts may lead to increasing government control over economic issues and consequently, shrinking investment opportunities.

While the search for partners by many investors may be an opportunity, slowing foreign investments may also be a sign of weakness and uncertainty. While foreign companies are scaling back their investments, projected production levels are also falling. At the end of 1998, foreign operations accounted for over 13% of Venezuela's 3 million b/d output. This was expected to rise to 20% by the end of 1999, but that now looks "more and more unlikely."[111]

VI. CONCLUSION

Venezuela presents a unique opportunity for investment, resulting from the combination of a growing need for foreign funds, a highly desirable geographic location, an industry trying to solidify its place in the worldwide oil and gas business by further privatizing, and a history of friendly relations with the United States. Opportunities abound in several areas, including service contracts for reactivation and development of mature oil fields, the heavy oil-rich Orinoco Belt, offshore natural gas, new exploration and the government's desire to outsource the performance of certain functions. The opportunities in Venezuela are made even more attractive by external factors such as the increasing interest in natural gas, rising oil production, and the country's efforts to reduce its dependence on its petroleum industry.

The international investment community has already recognized Venezuela's potential, with the percentage of the world's total foreign direct investment jumping from 5.4% in 1990 to over 12% in 1994.[112] Even more noteworthy are the large investments and decades of experience that U.S. oil companies have in Venezuela. Despite the risks described above, most of these companies plan to remain invested in Venezuelan gas and oil projects for the long-term. Moreover, several U.S. government agencies have supported Venezuela projects.[113]

This very attractive investment landscape is marred by some risks that must be taken into consideration. Relations with the United States have been strained as a result of the SDO's dumping complaint. Venezuela itself is in a state of uncertainty as President Chávez increasingly asserts control over key economic decisions impacting the petroleum business. The country's dispute resolution mechanisms are relatively untested and may still be problematic for foreign companies in some situations involving large projects with long development and payment periods. Finally, although Venezuela's dependence on petroleum has dropped somewhat, the economy still responds to fluctuations in the price of oil. With predictions of long-term low oil prices, this interdependence could mean trouble ahead for companies hoping to make big bucks from Venezuelan gas and oil.

At bottom, however, it appears that Venezuela's petroleum industry is des-

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111. Benton Oil Scales Back, *supra* note 70, at 5.

112. Mayorga L., *supra* note 2, at 4 (citing Investment: Sectoral Studies, Aladi General Secretariat, Study 89 (1995, at 8)).

113. For instance, the Export-Import Bank and the Overseas Private Investment Corporation (OPIC) have supported Venezuela projects. The Ex-Im Bank granted a $1 billion loan to Venezuela for purchasing U.S. goods. *EIA July 1999 Venezuela Report*, *supra* note 1.

tined for increasing amounts of foreign investment over the long term. Although the real risks of investing in Venezuela's petroleum sector—notably the near-term uncertainties created by Chávez's populist rhetoric—cannot and should not be ignored, with careful research and proper planning, companies should be able to successfully manage this risk.