12.2.1 Introduction

In Argentina and Brazil, as well as in other countries in Latin America, a major drive of legal developments in the oil industry during the 1990s marked the opening up to private investment, in the context of liberalization and policies aimed at the creation of enabling environments for investment. While Brazil notably allowed for private participation following a radical constitutional amendment in 1995, Argentina went the furthest in the trend towards liberalization, fully privatizing its State-owned company and reinstating the use of the concession system to grant exploration and exploitation rights to private investors. At the other end of the spectrum, Mexico has retained ownership of its state-owned company as well as control over the industry. Since the late 1990s, Venezuela has shown a countervailing trend to the one prevailing earlier that decade, with legal instruments allowing for more State participation.

The countries in the region have generally opened up – to different extents – to private investment in the upstream of natural gas, and all of them, without exception, have liberalized the downstream (transportation and distribution) of natural gas (Campodónico, 2004). In the current context, one can witness different expressions of states seeking to assert increased control over their hydrocarbon resources.

The legal forms used to allow for private participation in the hydrocarbons industry in the countries under study are basically the concession system (granting ownership over the hydrocarbons extracted) on one hand, and contractual approaches (particularly service contracts) on the other. This section focuses on the analysis of the legal framework for the hydrocarbons activity – particularly on the upstream – in Argentina, Brazil, Mexico and Venezuela. It will focus on the description and analysis of a range of issues under each legislation, including: a) ownership of hydrocarbon resources underground; b) state involvement in the industry; c) legal forms; d) rights and operating conditions; e) unitization provisions if relevant; f) environmental regulation; g) fiscal structure and government take; and h) price mechanisms and dispute settlement. It will also describe the provisions on investment protection, including a broader reference to the general foreign investment regime.

It is relevant to point out that there is a significant range of processes and initiatives of integration in Latin America (see Inter-American Development Bank, IADB website). These include MERCOSUR (MERcado COMún del SUR) – of which Argentina, Brazil, Paraguay and Uruguay are members, and Bolivia and Chile have signed economic complementation agreements – and the CAN (Comunidad Andina de Naciones), of which Bolivia, Colombia, Ecuador, Peru and Venezuela are members. Mexico is a member of NAFTA (North America Free Trade Agreement). There has been a number of regional integration initiatives for the energy sector in recent years, including those within the emerging CSN (Comunidad Sudamericana de Naciones) created in 2004.

It is noteworthy that Venezuela stands as the major Latin American oil and gas producer. It ranks seventh world-wide vis-à-vis the estimate of proven reserves of crude oil, and ninth in the estimate of proven reserves of natural gas (Campodónico, 2004). Mexico is a major oil producer, being thirteenth in the ranking of countries according to the estimate of proven reserves of crude oil, and thirty-fourth in the estimate of proven reserves of
natural gas (Campodónico, 2004). Brazil ranks third in the estimate of oil reserves in the region, after Venezuela and Mexico. While still an importer of oil, the gap between supply and demand has decreased significantly in recent years. For natural gas reserves, Brazil stands fifth in the region.

Following a governmental decision to increase the use of natural gas, its importance has steadily increased, although Bolivia supplies about half of Brazilian demand (Campodónico, 2004). In terms of estimated proven oil reserves, Argentina stands fourth in Latin America, after Venezuela, Mexico and Brazil. Although energy supply is dominated by crude oil and natural gas, Argentina depended rather heavily on imported oil for a long time, until a radical change in oil and gas legislation allowed the flow of private investment into the industry and the privatization of the sector. As to reserves of natural gas, Argentina ranks fourth in the region after Venezuela, Mexico and Bolivia. It ranks first as producer and second as consumer of natural gas in the region, having developed the industry back in the 1940s (Campodónico, 2004).

12.2.2 Argentina

Ownership and title to resources underground

The Argentine nation has adopted a federal representative republican form of government, as set forth by the constitution (art. 1 of the National Constitution of the Republic of Argentina 1853, as amended in 1994).

For most of the Twentieth century, the hydrocarbon industry of Argentina was dominated by a state company (Sociedad del Estado) Yacimientos Petrolíferos Fiscales (YPF), created in 1922. Hydrocarbon exploration and production were carried out either by, or on behalf of YPF. Over time, a range of contractual forms were used to allow for private participation, including the risk contracts introduced under Law No. 21778/1978 and those of the Houston Plan provided under Decree No. 1443/1985. Law No. 17319/1967 (Hydrocarbons Law), which is the core legal statute of the legal framework for hydrocarbons in Argentina and which provides for exploration permits and exploitation concessions, was rarely used for granting concessions up until the launching of the Argentina Plan in the early 1990s.

During the 1990s, in the framework of the overall liberalization of the economy and opening up to private investment, and as set out under the State Reform Law No. 23696/1989 (State Reform Law), the government encouraged competition, reliance on market mechanisms and the privatization of YPF. The Argentina Plan was launched by Decree No. 2178/1991, which also provided the regulations for the implementation of the Hydrocarbons Law 1967, and followed the enactment of three decrees. These decrees, among other provisions, established new rules for the upstream sector and reinstated the application of the concession system stipulated under the Hydrocarbons Law 1967 (Decree No. 1055/1989); deregulated downstream activities (Decree No. 1212 /1989), and granted companies involved the right to freely sell and dispose of hydrocarbon production (Decree No. 1589/1989). Furthermore, Decree No. 2411/1991 authorized YPF to negotiate with the parties the contracts executed under Law 21778 and under the Houston Plan, the contracts’ conversion into exploration permits or exploitation concessions pursuant to the Hydrocarbons Law. At present, the Argentina Plan is still in force and in effect. However, for the past years, and mainly due to the increased involvement of provinces in the bidding system, there are virtually no bids at the federal level.

A recent modification to the Hydrocarbons Law by virtue of Law No. 26197 (Short Law), introduced significant changes to the legal framework for hydrocarbons in Argentina. As from the enactment of the Short Law, the provinces will assume the administration of the hydrocarbons fields located in their respective territories and in the bed and subsoil of the territorial waters along their coastlines. Moreover, all exploration permits and hydrocarbons exploitation concessions and any other type of hydrocarbons exploration and/or exploitation agreement granted or approved by the Federal State in exercise of its powers, are transferred to the respective province.

Before the enactment of the Short Law, a transitory regime for the exploration and exploitation of some specific areas was in force. According to Law No. 24145/1992 (Hydrocarbons Federal Law), Presidential Decree No. 1955/1994 and Presidential Decree No. 546/2003, ownership of hydrocarbons would be subsequently transferred to the provinces (Areas under Transfer). Provinces were entitled to grant new oil and gas exploration permits and exploitation and transportation concessions within its respective territory over those Areas under Transfer and over those defined by their relevant competent local authorities in accordance with their exploration and/or exploitation plans and the Hydrocarbons Law.

Apart from constitutional provisions and the above-mentioned Hydrocarbons Law 1967, the State Reform Law 1989 and the Short Law, statutes of the
current legal framework for hydrocarbon activities in Argentina include Law No. 24076/1992 (Gas Law). The natural gas statutory framework is based on the Hydrocarbons Law for exploitation and production, and the Gas Law for transmission and distribution. Both laws are regulated by several decrees and resolutions.

Upstream operations are regulated by the granting authorities, while the national gas regulator, ENARGAS (Ente Nacional Regulador del GAS), an independent agency created in 1992 by the Gas Law, regulates the transportation and distribution of natural gas. It is also the arbitrator for disputes within the downstream gas sector.

As from the enactment of the Short Law, the provinces, as enforcement authority, will exercise counterpart functions in relation to the exploration permits, exploitation concessions and hydrocarbons transport subject to transfer. They will be entitled, among other things, to: a) fully and independently exercise the control and audit activities of the mentioned permits and concessions, and of any other type of hydrocarbons exploration and/or exploitation agreement granted or approved by the Federal State; b) demand the fulfilment of all statutory and/or contractual obligations applicable as to investments, rational exploitation of resources, information, and payment of fees and royalties; c) determine the extension of statutory and/or contractual terms; and d) apply the penalty regime set forth in the Hydrocarbons Law and its regulatory provisions (fines, suspension of records, termination, and any other penalty provided for in the bidding terms and conditions or in the agreements). The national executive branch is responsible for the creation of energy policies at federal level.

According to art. 1 of the Short Law, liquid and gaseous hydrocarbons fields located in the Republic and in its continental platform belong to the Federal State or to the Provincial State, according to the territory where they are located.

Those hydrocarbon fields located within 12 marine miles measured from the baselines and up to the external limit of the continental platform, belong to the Federal State.

Those hydrocarbon fields located within provincial territories belong to the Provincial States, including those located at the sea adjacent to their shores until a distance of twelve 12 marine miles measured as from the base lines.

**State involvement in the petroleum industry**

Until 1993, YPF was the Argentinean state-owned company responsible for the exploration and exploitation of oil and gas, and the transportation and distribution of gas. Following the full privatization of YPF S.A. and the liberalization of the industry, these activities are now performed by local and foreign companies. The transmission and distribution system is also owned and operated by private companies. Additionally, other companies hold sub-licenses for export transmission.

With a view to reducing the foreign dominance of the sector and amid a controversial debate, a new state oil company – ENARSA (ENergía ARgentina Sociedad Anónima) – has been created, as approved by Law No. 25943/2004. Pursuant to art. 5 of this law, 53% of ENARSA's shares will belong to the Federal State, 12% to the provinces, and the remaining 35% will be listed on the stock market. The purpose of ENARSA is the appraisal, exploration and exploitation of hydrocarbons, as well as their transportation, storage, distribution, trade and industrialization, the provision of public transportation and distribution services of national gas, and the generation and trade of electricity in domestic and foreign markets (art. 1). ENARSA has full powers to operate in the oil, natural gas, electricity, coal and nuclear sectors, as well as in regard to non-conventional energy sources.

The new oil company will also hold title over the exploration permits and concessions in maritime areas which are not already subject to permits or concessions on the date of entry into force of the law (art. 2). Circular 2004 No. 67, enacted by the Secretariat of Energy, eliminates offshore areas that were previously put up for private bid from the Argentina Plan.

**Concessionary regime and/or contracts**

According to art. 2 of the Short Law, the Federal State and the Provincial States will exercise their powers as Granting Authority pursuant to Hydrocarbons Law and its regulatory provisions and pursuant to the Federal Hydrocarbons Agreement (Acuerdo Federal de los Hidrocarburos).

It should be noted that the federal system basically establishes a concession system. Article 4 of the Hydrocarbons Law entitles the executive power to grant exploration permits and temporary exploitation concessions (with the Short Law this power is now vested in the provinces with respect to hydrocarbons located in their territories, the federal executive power keeping the concession power over fields located in federal jurisdiction), as well as concessions for the transportation of hydrocarbons (see discussion infra), pursuant to the requirements and under the conditions set forth by this law. At the provincial level, and as of the enactment of the Short
Law, provinces have been using risk service-type contracts over those Areas Under Transfer.

In regards to transport concessions, art. 3 of the Short Law provides that within a term of 180 days from its enactment, the National Executive Branch and the provinces shall agree the transfer, to domestic jurisdictions, of all those transport concessions related to the hydrocarbons exploitation concessions transferred by virtue of the new regime.

The National Executive Branch will be the Granting Authority of all those hydrocarbons transport facilities comprising two (2) or more provinces or of those which are directly aimed at exportation. All those transport concessions which begin and finish within a same provincial jurisdiction and which are not directly aimed at exportation will be transferred to the provinces. The aforementioned agreement and transfer process is pending.

**Bid process**

Exploration permits and exploitation and transportation concessions are awarded by means of public bids. The term of the relevant exploration periods (see below) are important from the standpoint of the exploration bid mechanism. All bids for exploration must include a minimum amount (K) of 150 work units, where each unit is valued at 5,000 dollars. Thus, the minimum work commitment for any block is 750,000 dollars worth of exploration. In general terms, these minimum work units may be completed during any of the two (or three) basic periods, but a permit holder may only extend its permit into the second period by committing to drill at least one exploration well.

Similarly, the permit holder must undertake to drill at least one exploration well in the third period (Decree No. 2178/1991, Annex II, art. 5.1, subpara. 3).

Exploration bidders are required first of all to present an ‘Envelope A’, which must contain such financial and operational information as will allow the Secretariat of Energy to qualify the applicants as competent bidders, as well as the bid guarantee in the amount of 100,000 dollars (Decree No. 2178/1991, Annex II, art. 4). After confirmation of qualification, consideration is given to the bidders’ Envelope B. Envelope B should specify the bidders’ pledged work units in excess of K; the time (T) in which such commitments will be carried out; and agreements to drill at least one exploration well if the agreement extends into the second or third period (Annex II, art. 5). The work performance guarantee is provided within thirty days after the award of the exploration permit (Annex II, art. 10.1).

Awards, which are made relatively quickly, are confirmed by Resolution of Chief Staff (Annex II, art. 7.3).

As of the enactment of the Short Law, and as more areas became subject to provincial jurisdiction, provincial authorities defined areas for exploration and/or exploitation, using their own bidding systems. With the enactment of the Short Law, this trend is reinforced and the use of a diverse range of bidding systems is likely to be consolidated.

**Right to prospect, explore, develop, produce and dispose of petroleum resources**

At the Federal Level, and pursuant to the Hydrocarbons Law, the successful applicant may either acquire exploration permits or exploitation concessions. Exploration permits (Hydrocarbons Law, arts. 16-26) grant the holder the exclusive right to perform all operations needed to explore for hydrocarbons within the area specified in the permit, as well as the right to convert the permit into an exploitation and transportation concession, once a commercial discovery is made.

Exploitation concessions (Hydrocarbons Law, arts. 27-38) grant the exclusive right to fully produce all productive reservoirs in the concession area. Article 6 of the Hydrocarbons Law establishes that the permit or concession holders own the extracted hydrocarbons. As a consequence, they have the right to transport, commercialize and industrialize these hydrocarbons. They also have the right to their by-products. They are bound to the relevant technical and economic regulations which take into consideration the domestic market needs and lead to the development of the exploration and exploitation of hydrocarbons. Additionally, the concessionaire is entitled to construct all such facilities, including pipelines, which may be necessary for the commercial exploitation of the reserves (arts. 30-31).

Construction and operation of transmission facilities may be obtained: under the Hydrocarbons Law; under the Gas Law, by companies that apply for concessions to ENARGAS; and under the Gas Law, as part of the extension of the existing concessions.

Argentine onshore exploration blocks have a maximum area of 10,000 km². Blocks over the continental shelf have a maximum area of 15,000 km² (Hydrocarbons Laws, arts. 24-25). Although the Hydrocarbons Law provides that no person or legal entity may simultaneously hold more than five exploration permits or five exploitation concessions (art. 34), Decree No. 2178/1991 specifies that limitations apply fairly narrowly to the same entity. The Hydrocarbons Law allows for a “basic period”
consisting of three subsequent terms (four years, three years, and two years each) and an “extension period”; each basic term in offshore areas can be extended for an additional year; once the basic period has elapsed, the exploration permit can be extended by up to five further years (art. 23).

Decree No. 2178/1991 – regulating the Hydrocarbons Law – entitles the holder to the right to “use in advance” a fraction of the five year-extension period by extending the second or third exploration term for three years (or two years to the end of the second term if there is no third term). Decree seems to envisage that the permit holders may be able to extend their exploration periods (with permission from the Secretariat of Energy), by a further one year (in the case of three-term permits) or a further two years (in the case of two-term permits). In any event, with just one exception, no exploration permit may be extended by more than an aggregate of four years (Annex II, art. 9.2).

At the end of the basic exploration terms, the permit holder is entitled to hold the area for further extended terms in the following situations: the operator has made a discovery but is investigating commerciality (extension not exceeding one year); the operator has made a predominantly gas discovery or discoveries, but there is a lack of a market for the gas (extension not exceeding five years, but subject to extension at the option of the Secretariat of Energy in instances of continuing lack of a market). This is according to Decree No. 2178/1991, Annex II, art. 9.3.

Regarding relinquishment obligations, the Hydrocarbons Law requires the surrender of 50% of each exploratory block at the end of the last two basic exploration periods (art. 26). Generally speaking, the permit holder is required to give up the whole remaining exploratory area (25% of the original block) at the end of the third term.

The standard term for exploitation concessions is twenty five years, subject to a possible further ten-year extension (art. 35). Permits and concessions can be assigned prior to executive approval (art. 72).

At the provincial level, service type-contracts in place tend to regulate these matters pursuant to the Hydrocarbons Law.

**Operating conditions**

At the Federal Level, holders of exploration permits are required to carry out exploration activities with due diligence and in accordance with efficient techniques, as well as to invest minimum amounts (Hydrocarbons Law, arts. 16, 19 and 20) and to inform the enforcement authority of any discoveries made within 30 days. Following field appraisal, and a ‘commerciality statement’ – whereby the permit holder requests the granting of an exploitation concession upon determination of commercial viability of the field – a concession will be awarded within 60 days (arts. 21-22). Within 90 days from the date of declaration of commerciality, the concessionaire must prepare a development plan and list of investment commitments (Hydrocarbons Law, art. 32).

At the Provincial level, service type-contracts in place tend to regulate these matters pursuant to the Hydrocarbons Law.

**Unitization**

Hydrocarbons Law (art. 36, part 2) provides that the Secretariat of Energy should control that the holders of exploration or production rights do not cause damage to neighbour exploration permit holders or concessionaires. Should a problem arise between the holders of adjoining concessions or exploration permits, and in the case of no agreement being reached between such parties, exploitation conditions in the bordering zones of the concessions may be imposed by the Secretariat of Energy. This regulation would be the legal basis of starting a process of so-called unitization or unification, if it became necessary. There are no other specific legal rules regarding unitization and there is very little experience in this matter in Argentina.

**Environmental protection**

The 1994 constitutional amendment to the Constitution of Argentina has adopted the concept of human development and the principle of inter-generational equity in art. 41, which grants any inhabitant the right to enjoy a healthy and balanced environment, suitable for human development. This provision incorporates the environmental dimension into the decision making of any development project. Such provision is also a source of obligations both for individuals (who have the “duty to preserve the environment”), and for the state, which “will provide for the protection of this right, the rational utilization of natural resources, the preservation of natural and cultural heritage, and biological diversity, and environmental information and education […]”. The Federal State must establish minimum standards for protection, while the provinces have the right to establish supplementary regulations to these minimum standards.

At a national level, the General Law of the Environment No. 25675/2002, provides these basic standards for attaining an “adequate and sustainable management of the environment, the preservation
Fiscal structure and government take

Upstream and downstream activities are subject to some of the municipal, state and federal taxes and contributions for commercial activities, but are exempt from certain special taxes that also apply to the distribution of fuels. These include gross income, tax over assignment of fuel, gas oil contribution, hydro infrastructure contribution, valued-added tax, income tax, stamp tax, real state tax, and import duties among others.

Regarding royalties, at the Federal Level, the holder of exploitation concessions is subject to a 12% royalty due either to the appropriate provincial government or to the Federal Government. The Central Government has authority to reduce royalty down to a base of 5%, determined by economic and operational considerations (Hydrocarbons Law, arts. 59 and 62, and Decree No. 2178/1991, Annex II, art. 9.9). Royalties are calculated on the basis of the price of hydrocarbons at the wellhead. In other words, transportation costs to the point of commercialization are deductible (Hydrocarbons Law, art. 61), up to the value of 3% of total production. At the Provincial Level, service type-contracts in place tend to regulate these matters pursuant to the Hydrocarbons Law.

According to art. 2 of the Short Law, the hydrocarbons royalties corresponding to exploration permits and hydrocarbons exploitation concessions in force upon the entering into effect of said law, will be calculated pursuant to the provisions of the relevant titles (permits, concessions or rights) and shall be paid to the jurisdictions to which the fields belong.

There is also a small surface fee (canon) obligation which is different for exploration permits and exploitation concessions (Hydrocarbons Law, arts. 57 and 58 and Decree No. 2178/1991, Annex II, art. 9.5), at the Federal Level; at the provincial level, as in other matters, service type-contracts in place tend to regulate these matters pursuant to the Hydrocarbons Law.

Under Decree No. 310/2002, the national government established a 20% export duty on crude oil and a 5% duty on most of its by-products. Resolution 337/04 of the Ministry of Economy increased the export duty to 25%. Finally, pursuant to resolution No. 532/2004 of the Ministry of Economy, the export duty was maintained at 25% for the cases where the oil price equals or is less than 32 dollars per barrel. But, if the West Texas Intermediate (WTI) exceeds 32 dollars per barrel, the export duty percentage should be increased by the following percentage points: 32.01-34.99 $/bbl: 3%; 35.00-36.99 $/bbl: 6%; 37.00-38.99 $/bbl: 9%; 39.00-40.99 $/bbl: 12%; 41.00-42.99 $/bbl: 15%; 43.00-44.99 $/bbl: 18%; 45.00 $/bbl: 20%.

Pursuant to resolution No. 534/2006, a 45% export duty on gas exportations is in force.

Moreover, resolution No. 776/2006, established several export duties on gas, crude oil and by-products from Tierra del Fuego, Antártida e Islas del Atlántico Sur, Special Customs Area (Area Aduanera Especial). It should be noted that exports and imports from and to this Special Custom Area have always been duty free.

Fixing the price of oil and gas

There is no mandatory price setting regime for crude oil or crude-oil products, although this is subject to certain exceptions when local production cannot satisfy the domestic demand. In these cases, the executive branch has the power to condition oil exports on the prior satisfaction of domestic demand and to regulate internal oil prices during a period when local demand cannot be satisfied.

In the case of gas, prices for pipelines services are based on the Gas Law, on licences, and on the ENARGAS regulation concerning the price cap system. Prices of the distribution services are set as tariffs based on the price cap system. These general principles are described in the Gas Law and defined in the licences and ENARGAS’ regulations.
To ensure market competition, companies transporting natural gas cannot produce or distribute the product, and are prohibited from discriminating between clients. Pipelines are common carriers, earning revenue through transportation tolls for shipping gas but not taking ownership of the volumes. Distributors sell the product to final users, buy gas from producers, and pay tolls to transportation companies. Their tariffs are regulated by ENARGAS. Large gas users are entitled to directly negotiate gas contracts with producers and can be connected to the truck gas pipelines. Customers of gas distribution services (industrial, commercial and residential) pay tariffs on their gas consumption. The terms of services are described on the licences and cannot be changed without the approval of ENARGAS. Tariffs of the distribution service contain components such as the pass-through of their gas purchasers to gas producers and the cost of the transmission service.

Foreign investment

Argentina has a very open foreign investment system. Article 20 of the National Constitution guarantees foreigners the enjoyment of all the civil rights of nationals, including the right to operate any industry, trade and commerce, and to own, buy and sell real property. Property is protected under constitutional provision (art. 17). Accordingly, the Foreign Investment Law No. 21382/1976 and its subsequent amendments, as well as regulatory Decree No. 1853/1993, adopted high standards for investment protection, such as equal treatment of both foreign and domestic investment and net profits remittance. Foreign companies are allowed to enter the Argentine market through the most appropriate Argentine corporate, or other commercial vehicle.

While foreign investors are not generally required to obtain prior authorization to undertake investment in Argentina, certain registration conditions apply to all private companies – domestic or foreign – in the hydrocarbons sector, including registration with the Secretariat of Energy. Foreign oil companies do not need to associate with domestic private companies. Foreign oil companies operating through Argentine shell companies are required (by administrative fiat of the Secretariat of Energy) to put up a parent company guarantee in support of their exploration and/or production activities, as well as to provide very specific and sometimes cumbersome corporate information by the Argentine Office of Corporations.

To provide an understanding of the general framework for foreign investment, it is noteworthy that Argentina has concluded around 51 Bilateral Investment Treaties (BITs) and joined the International Centre for Settlement of Investment Disputes (ICSID) in 1994. Typically, BITs guarantee most-favoured-nation treatment, double taxation avoidance and transfer of investment-related payments, as well as for international arbitration in case the investor is subject to discriminatory treatment or non-fulfilment by the Argentine state of the conditions granted to the foreign investor. Nevertheless, the scope of their application is being questioned by the current central government.

Recently, by virtue of Law No. 26154 of 2006, promotional regimes – tax incentives – were created within the framework of the Hydrocarbons Law. All provinces are invited to adhere to said regimes. In order to enjoy the benefits granted, the interested parties are required to associate with ENARSA.

The following are the tax incentives:

- Value Added Tax: credit or reimbursement on the expenses and investments made during exploration and exploitation periods.
- Income Tax: amortization in three equal and consecutive annual installments, of all capital expenditure and investments made during the exploration and exploitation periods.
- Assumed Minimum Income Tax: exclusion from the imposition basis for assets belonging to permit holders and exploitation concessionaires.

The regimes are as follows:

- Promotional Regime for Hydrocarbons’ Exploration: includes areas granted to ENARSA with its creation (maritime areas not already subject to permits or concessions) and areas with geological potential over which there are no third parties’ rights granted by the Hydrocarbons Law, in jurisdiction of the provinces that adhere to this regime. This regime classifies areas in the Continental Platform, areas in Sedimentary Basins without production and areas in Sedimentary Basins with Production. The duration of the benefits varies depending on the area: ten to fifteen years from the acquisition of the corresponding permit.
- Exception Regime for Exploration Areas in Concessions granted by the Hydrocarbons Law. Permit holders and exploitation concessionaires may adhere to this regime subject to the following classification: subdivided areas in production-in-continental platform; subdivided areas in production-on land. In both cases, the permit holder and exploitation concessionaires request the subdivision of their area so that a new area is formed. The duration of the benefits varies depending on the area: twelve to ten months running
as from the acquisition of the proper exploration permit, subject to extension.

Currency regulation

Regarding currency regulation, Argentine currency is fixed in pesos, but large transactions are usually convened in US dollars. In general terms, the inflow and outflow of foreign currency is allowed, although certain restrictions are in force and effect. Concerning the oil and gas activity, Decree No. 1589/1989 granted crude oil producers free disposal of hydrocarbon proceeds in sales – either in the domestic or the international market – and in a percentage not higher than 70% of the value of each transaction.

Due to other general regulations in force and effect during the 1990s, producers were not obliged to surrender the foreign exchange proceeds out of exports of crude oil or by-products resulting from the processing of crude oil. Moreover, they could dispose 100% of those proceeds as they deemed fit. However, after the devaluation crisis which occurred in late 2001, the National Executive Power issued Decree No. 1601/2001, under which the obligation of surrendering proceeds of exports was restated, by virtue of applying the old Decree No. 2581/1964. This led to a big controversy between the industry and the government as to whether the contracts executed under the scope of the above mentioned Decree No. 1589/1989 were reached by Decree No. 1601/2001. Industry representatives argued that those contracts enjoyed the benefit of a special foreign exchange regime and therefore, the rule contained in Decree No. 1601/2001 only affected 30% of the proceeds. Decree No. 1638/2001 was issued by the executive power days later, clarifying that those activities which enjoyed a special foreign exchange regime were out of the scope of Decree No. 1601/2001. Notwithstanding this last rule and further Presidential Decree No. 2703/2002, which entitles oil and gas producers to freely dispose of 70% of their proceeds from export oil, gas and their by-products, the matter is currently still under debate.

Settlement of disputes

Operational disputes are not likely to occur under the dominant concession regime, as the private companies are entirely in control of upstream operations. With respect to legal disputes, the Hydrocarbons Law provides that permits and concessions may provide for arbitration on nullity and termination issues and with respect to specific technical matters. Otherwise, the federal jurisdiction shall hear all disputes related to the interpretation and/or execution of the Hydrocarbons Law. The Hydrocarbons Law does not specifically mention what kind of arbitration panel would hear such cases. However, it says that each party will choose one arbitrator with a third one being selected upon the agreement of both arbitrators or in case of disagreement, by the president of the National Supreme Court. One could expect that this type of arbitration might involve domestic experts (from one to three), as old service contracts provided (i.e. Houston Plan). The Hydrocarbons Law does not have a specific provision stating what the applicable law in case of controversies is, but if these refer to the Hydrocarbons Law or regulating legislation thereof, Argentine law will prevail.

At the Provincial Level, amicably settlement prior to any judicial claim seems to be the tendency in service type-contracts in force.

12.2.3 Brazil

Ownership and title to resources underground

Brazil is a federative republic, formed by the indissoluble union of states and municipalities, as well as the Federal District (art. 1 of the Constitution of the Federative Republic of Brazil 1988, with amendments).

The opening of the Brazilian petroleum industry was formally launched with the approval of the Constitutional Amendment 1995 No. 9, which amended the Federal Constitution 1988. By allowing for the participation of private investment in hydrocarbon activities, Petroleo Brasileiro S.A (PetroBras), the Brazilian state-owned company founded in the 1950s to run the state monopoly over those activities, is exposed to competition.

The relevant laws applicable to the hydrocarbons sectors are Law No. 9478/1997 (Petroleum Law); Decree No. 2705/1998 (Participation Decree, concerning government participation calculations and collection guidelines for the Petroleum Law); Decree No. 2455/1998 (concerning the National Petroleum Agency); Decree No. 3520/2000 (concerning the National Council for Energy Policy); and associated laws and regulations. Draft laws on a specific regulatory framework for gas activities are under discussion.

The Conselho Nacional de Politica Energetica (CNPE) is created by art. 2 of the Petroleum Law. This body is presided over by the Ministry of Mines and Energy and is responsible for proposing and advising national policies and measures relating to the energy sector to the President of Brazil, including those related to the promotion of the
rational use of energy resources and their supply.

Article 7 of the Petroleum Law also creates a new regulatory agency for Brazil, the Agencia Nacional do Petróleo, Gás Natural e Biocombustíveis (ANP), which is linked to the Ministry of Mines and Energy, but operates under a special autarchic regime. The role of the ANP is set out in art. 8 of the Petroleum Law and is generally to promote the regulation, contracting and inspection of economic activities related to the petroleum industry (see also amendments introduced by Law No. 11097/2005). More specifically, its functions include: a) implementing the national oil, natural gas and biofuels policy; b) coordinating the data necessary to delimit blocks for exploration; c) managing the bidding process for concessions for exploration, development and production, and executing the relevant contracts; d) authorizing refining, processing, transportation, and import and export activities; e) inspecting/monitoring (either directly or through agreements with other state entities) the operation of the petroleum industry; and f) applying penalties provided for in law, regulation or contract.

The Constitution of Brazil art. 20, para. IX sets forth that mineral resources, including those of the subsoil, are owned by the Union (federal government). Article 176 of the Constitution confirms this principle and states that property over mineral resources is separate from that of the soil. Exploration and exploitation rights are granted by means of exploration authorizations and concessions.

Article 3 of the Petroleum Law states that the Union owns all oil, natural gas and other fluid hydrocarbons reservoirs existing in the national territory (which includes onshore areas, territorial waters, the continental shelf and the exclusive economic zone) regardless of whether the same are located in private or public land.

**State involvement in the petroleum industry**

As mentioned earlier, PetroBras is the state-owned Brazilian company which exercises the entrepreneurial function of the state in the petroleum industry. The Brazilian state owns 55.7% of voting stock in the company. PetroBras draws its power from Law No. 2004/1953, which authorized the state to set up a state-owned oil company to run its monopoly in the oil and gas industry. PetroBras was eventually founded on 12 March 1954 and the government approved the founding on 2 April 1954 in Decree No. 35308/1954.

The Petroleum Law revoked Law No. 2004/1953 and all matters relating to PetroBras’ specific performance are defined and supported by the new law. Arts. 61 to 68 of the Petroleum Law make provision for PetroBras, stating its objective as the exploration, exploitation, refining, processing, commerce and the transportation of oil (and its products) from wells, oil shale or other rocks, of natural gas and other fluid hydrocarbons, as well as other similar activities. According to art. 61, PetroBras must carry out its economic activities in free competition with other enterprises (so when PetroBras wishes to engage in upstream exploration and production, it must bid for concession contracts in the same way as any other entity). Moreover, it is authorized to form consortia with either domestic or foreign enterprises and it also has the power to establish subsidiaries. Thus, unlike the parallel case in Venezuela, for example, there is no requirement of mandatory participation by PetroBras in joint ventures.

**Concessionary regime and contracts**

Constitutional Amendment 1995 No. 9 caused a sweeping change in the legal framework of the oil and gas industry in Brazil. Previously, art. 177 of the Constitution of Brazil 1988 had provided that the state (which acted through PetroBras) had a monopoly on certain oil and gas related activities: a) exploration and exploitation of deposits of oil and natural gas or other fluid hydrocarbons; b) the refining of domestic or foreign oil; c) the import and export of oil and gas products and by-products deriving from the activities listed in a) and b); d) transport of domestic oil by ship, and transport of oil and gas through pipelines. The 1995 amendment to art. 177 s. 1 established that these activities could be carried out by state and private companies as agreed with the Union.

On this constitutional basis, art. 4 of the Petroleum Law still provides that the state has a monopoly over the activities in a) to d) above, but art. 5 stipulates that private sector operators (which must be enterprises established under Brazilian law with headquarters and management in Brazil) may engage in these activities by way of concession or authorization. Upstream exploration and production activities work under a concession regime which in all cases requires the granting of a concession contract, as explained below. Article 21 confirms that all rights to oil and natural gas exploration and production in the national territory belong to the Union and shall be administered by the ANP. Article 23 states that private sector operators may carry out oil and natural gas exploration, development and production activities, by way of
concession contracts. The ANP shall define the blocks subject to the concession contracts.

In regard to the refining of oil and the processing of natural gas, arts. 53-55 provide that private sector operators may build and operate oil refineries, as well as natural gas processing plants and storage facilities, subject to an authorization issued by the ANP. Arts. 56-59 of the Petroleum Law allow private sector operators to engage in the transportation of oil, oil products and natural gas, and finally, art. 60 provides for authorizations for private entities to engage in the import and export of oil (and its products), natural gas and condensate.

With regard to the execution of geological and geophysical services for petroleum prospecting aimed at gathering technical data, the ANP is entitled to provide authorizations which are \textit{intuitu personae} to data-gathering companies. These are defined as companies with expertise in the acquisition, processing and interpretation of data regarding exploration and production of oil and natural gas (ANP Ordinance 1998 No. 188, as amended by ANP Ordinance 1999 No. 35).

**Bid process**

Arts. 36 to 42 of the Petroleum Law deal with the bidding process for the granting of concession contracts. The bid announcement should attach the model concession contract and include such requirements as: the block and duration of the concession; the minimum work programme and investments; the minimum governmental participation, as well as the participation of surface rights owners; the criteria to assess the relevant technical and financial requirements as well as the technical and economic-financial viability of the proposal; and relevant documentation. The bid announcement should also include some further requirements if the participation of companies under consortium is allowed (art. 38) and for foreign companies participating in the bid, either on its own or in consortium, including the commitment that they will set up a company pursuant to Brazilian laws and headquartered and administered in Brazil if they win the bid (Petroleum Law art. 39; ANP Ordinance No. 84/2000).

The winning bid will be identified on the basis of the objective criteria established in the bid announcement, in accordance with principles of legality, impersonality, morality, publicity and equal standing of the participants. The general work programme, as well as the governmental participations, are essential in the selection of the winning bid. The ANP Ordinance 1999 No. 174 sets forth regulations for the bid procedures, and establishes that bids will be conducted by a special bid commission in six stages: prequalification; qualification; publication of the public announcement; bid award; bid ratification; and execution of the concession contract.

CNP Resolution No. 8/2003 sets forth certain guidelines for ANP to implement a policy of expansion of oil and gas production, with a view to achieve self-sufficiency and further exploration to increase reserves. These comprise the inclusion of blocks or areas in mature areas, and the requirement that in the process of assessment of the bid applications, the ANP will set out criteria to encourage exploration programmes.

**Right to prospect, explore, develop, produce and dispose of petroleum resources**

Unlike the data-gathering companies referred to above, concessionaires are not required to request authorization for data-gathering activities. Nevertheless, they must inform the ANP about any transaction related to the acquisition of data, either by themselves or by a data-gathering company, with whom there is a contractual relationship for that purpose (art. 6 of ANP Ordinance 1998 No. 188).

Concessionaires have a right and a duty to explore for oil and natural gas at their own expense and risk, in a particular block, and, where successful, to produce oil or natural gas. Concessionaires have the property in the goods produced, subject to the relevant charges and state participation (Petroleum Law, art. 26).

**Operating conditions**

Private operators must comply with the technical, economic and legal requirements of the ANP before they may obtain a concession to explore for and produce oil and natural gas. The operating conditions for concessions are partly set out in the Petroleum Law and partly in the Model Concession Agreement.

The Petroleum Law provides for the concessionnaire’s general duties to explore for oil and natural gas – at its own expense and risk – in a particular block and, where successful, to produce oil or natural gas. Where a concessionaire is successful in the exploration stage, it must submit its plans regarding the development and production of the block to the ANP for approval. The ANP must, within 180 days, make a decision on whether the plans submitted are to be approved. The Petroleum Law sets out two other conditions worthy of note. First, when the concession is extinguished, the concessionaire must remove any equipment which is not subject to reversion to the state, repair any
damages arising out of the activities, and carry out any environmental recovery directed by the relevant entities. Second, the transfer of concession contracts is permitted, provided that the contractual conditions are preserved and the new concessionaire conforms to the technical, economical and legal requirements established by the ANP.

Arts. 43 and 44 of the Petroleum Law set out what must be included in concession contracts as operating conditions. These are: a) the definition of the block subject to the concession; b) the term and the conditions for its extension; c) the work programme and expected investment required; d) state participations; e) the guarantees required to be provided by the concessionaire of compliance with the contract; f) the rules on relinquishing areas; g) procedures for inspecting the operations and auditing the contract; h) the obligations on the concessionaire to provide data to the ANP; i) procedures relating to the transfer of the contract; j) dispute resolution procedures; k) the possibilities for cancellation/extinction of the contract; and l) penalties for breach of contract.

Article 44 sets out more general duties of the concessionaire that must be included in the contract. These include obligations regarding: a) conservation of reservoirs, safety, and preservation of the environment; b) the immediate reporting of discoveries; c) the evaluation of discoveries, including potential commerciality; d) the submission to the ANP of development plans for fields discovered to be commercial; e) the responsibility for its agents; and f) the adoption by the concessionaire of petroleum industry best practices.

We will take as an example the model concession contract released by ANP in 2004. Clause 4.2 of that document gives the term of the contract as the period starting from the date it comes into effect, until 27 years after the declaration of commerciality. The declaration of commerciality is at the sole discretion of the concessionaire, according to clause 7.1.1. Also of interest is clause 20, which provides for minimum local content in the goods and services utilized by concessionaires in the performance of the contract. The ANP has also provided for minimum requirements of using local workers.

The transport of oil, natural gas, and oil products in Brazil is made through pipelines – via seas and rivers, roadways, and railways. Pursuant to the Petroleum Law, any company or consortium of companies that meets the provisions of such law may receive authorizations from ANP to build facilities and carry out any type of oil and gas product transportation, whether for domestic supply or for import and export. It should be noted that the Petroleum Law treats differently activities relating to transfer of oil and transport of oil depending on whether the oil, its by-products and natural gas are owned by the concessionaire of the facilities, or are in the public domain.

In order to obtain authorization from the ANP for the construction, extension works and operation facilities for transport or transfer of oil, its by-products and natural gas, the interested party must comply with the provisions of the Petroleum Law and ANP Ordinance 170/98.

Unitization

Article 27 of the Petroleum Law establishes that in the case of reservoirs extending on neighbour blocks held by different concession holders, these shall enter into an agreement for the individualization of production.

Clause 12 of the ANP model concession contract 2004 contains unification provisions. Where a concessionaire discovers that a reservoir extends beyond the concession area, it must immediately inform the ANP. If the adjacent area is also under a concession, the ANP must notify all parties involved so a unification agreement can be negotiated and signed (the ANP may request to be present as an observer at the relevant negotiations). Exploration activities may be suspended while the unification agreement is pending. The ANP can, within a certain timeframe, request amendments to the unification agreement. Once the ANP approves the unification agreement, a new concession agreement, valid for the unified area, must be signed. Where the adjacent area is not the subject of a concession, the ANP may – at its discretion – ensure the continuity of operations. It is noteworthy that experiences in unitization in Brazil are just emerging and they are likely to increase due to the features of oil reservoirs and the more recent adoption of cell system, with small blocks for concessions.

Environmental protection

Brazil’s environmental laws are rather advanced, having introduced the environmental dimension into law and policy earlier than other countries in Latin America, such as Colombia and Mexico (Acuña, 1999). The Federal Constitution 1988 devoted an entire chapter to protection of the environment; it establishes a series of obligations applicable to the public authorities and community at large. Law No. 6938/1981 (Federal Law) is Brazil’s framework environmental law, which defined a National Environmental Policy and
created a national environmental council known as CONAMA (CONselho Nacional do Meio Ambiente). Balancing environmental objectives and economic development policies is one of the key objectives.

There is an entire system of federal agencies designed to enforce environmental legislation in Brazil. The Brazilian environmental system, SISNAMA (SISTema Nacional do Meio Ambiente), comprises the Brazilian environmental council (CONAMA, the normative, consulting, and decision-making agency); the IBAMA (Instituto Brasileiro do Meio Ambiente e dos Recursos Naturais Renováveis, the Brazilian Environmental and Renewable Natural Resources Institute, the executive agency). SISNAMA also includes other agencies of the federal administration, public foundations that deal with environmental protection, and entities of both state and municipal executive branches (state and municipal environmental offices, environmental agencies – such as the Companhia de Tecnologia de Saneamento Ambiental, or CETESB, the Fundação Estadual de Engenharia do Meio Ambiente, or FEEMA, the Conselho de Política Ambiental do Estado de Minas Gerais Câmara de Bacias Hidrográficas Conselheiro, or COPAM, among others), in their responsible jurisdictions. Article 8, para. IX, of the Petroleum Law includes among the functions of ANP, the enforcement of best practices for the conservation and rational use of petroleum, as well as environmental preservation. The Environmental Management Coordinating Unit (Coordenadoria de Meio Ambiente) was created to coordinate the environmental and operational safety aspects relating to ANP (ANP Ordinance 2004 No. 160).

As per Law 6938, art. 9, instruments of national environmental policy include inter alia environmental impact assessments, licenses, environmental standards, planning, incentives, protected areas, national environmental information system, penalties and compensations.

The Environmental Crimes Law, Law No. 9605/1998, regulated by Decree No. 3179/1999, sets out criminal offences against the environment. It includes the possibility of jail sentences of up to four years for individuals responsible for pollution, and introduces liability for corporations for environmental offences. Other sanctions include fines and restrictions of rights. As per CNPE Resolution No. 8/2003, the relevant governmental agencies publish specific environmental guidelines for the areas to be offered for bidding. In general terms, petroleum-related activities must comply with environmental licenses (CONAMA Resolutions No. 23 of 1994, No. 237 of 1997 and No. 350 of 2004); reclamation of areas under concession in the exploration phase that have been relinquished (ANP Ordinance No. 114 of 2001); procedures for abandonment of petroleum wells (ANP Ordinance No. 25 of 2002), as well as a range of obligations related, inter alia, to the prevention of oil spillages; reporting and standards for transportation, and those specified under the relevant concession contract.

Fiscal structure and government take

Oil and gas activities are subject to general federal, state and municipal taxes. These include the federal income tax; the tax on distribution of goods and services (ICMS, Imposto Sobre Circulação de Mercadorias e Serviços), which is a Brazilian state responsibility; the tax on services; the contributions for the profit participation programme and the social security financing contribution in it (PIS/COFINS, Programa de Integração Social/Contribution for the Social Security Financing), which are federal matters and payroll deductions.

We must point out the REPETRO (Dispõe sobre a aplicação do regime aduaneiro especial de exportação e importação de bens destinados às atividades de pesquisa e de lavra das jazidas de petróleo e de gás natural), Special Customs System for Export and Import Goods Intended for Prospecting and Drilling of Oil and Natural Gas Deposits, created by the federal government. REPETRO exempts – from all federal import duties (II – Import Duty – and IPI – Tax on Manufactured Products in its Portuguese acronym) – imports under the temporary admission system of certain products relating to oil and natural gas, prospecting and drilling activities. The REPETRO benefits include special customs systems which are effective up to 31 December 2020.

Articles 45 to 52 of the Petroleum Law provide for state participations in the form of signature bonuses, royalties, special participations and fees for the occupation or retention of areas (see also Decree No. 2705/1998).

The signature bonus, according to art. 46, shall be paid on execution of the concession contract and its minimum value shall be established in the bidding announcement.

Royalties are payable monthly in domestic currency from the start of commercial production of each field and shall correspond to 10% of the production of oil or natural gas. Reduction of the royalty to a minimum of 5% is possible given the geological risks, production expectations, and other relevant factors. The criteria for the computation of...
the value of the royalties shall be established by Presidential Decree. Arts. 48 and 49 set out precisely how the royalties from a particular block are to be distributed amongst the state(s) where production occurs, the relevant municipalities, the Ministry of Science and Technology, and other government institutions. This precision should help to eliminate the uncertainty of distribution found in other countries that can lead to contradictory claims being made on the operator by different levels of government.

Special participations, set out in art. 50 of the Petroleum Law, are only possible for operations of large production volumes or great profitability, and are further regulated by arts. 21 to 27 of the Participation Decree. ANP Ordinance 1999 No. 10 sets forth the procedures to be adopted in the calculations. These provisions set out what the rate of special participation will be, depending on the location of the block (for example, whether it is onshore or offshore), the year of production as well as the level of production. The rate can be as high as 40%. The manner of distribution of special participations is also provided for in great detail in the Petroleum Law.

The bid announcements and the concession contract shall set out the yearly payments to be made for the occupation or retention of the block, on a km² basis. Where the relevant block is onshore, the concessionaire must also make a monthly payment to the surface owner of the property, which will consist of 1% of the value of the oil or natural gas production (ANP Ordinance No. 143 of 1998).

**Fixing the price of oil/gas**

Pursuant to the Petroleum Law, the prices of oil by-products are free to be set by the market. Nevertheless, CNP, by means of Resolution No. 4/2002, established that, in the event of there being evidence that predatory prices are being practised, or that there are circumstances affecting proper pricing, ANP may take such action necessary as to remove the disruption, including setting ceiling prices.

**Foreign investment**

Foreign investment is governed by art. 171 of the Federal Constitution, as amended by Constitutional Amendment 6, and 172, as well as by varying federal and state statutes and regulations. Chief amongst these are Investment Law No. 4131/1962 and Law No. 4390/1964, both regulated by Decree No. 55762/1965.

Investment activities in Brazil are overseen by the FIRCE (Department of Foreign Capital of the Central Bank of Brazil). Foreign capital investment is accorded a similar legal treatment to that applicable to national capital, in identical conditions. Any distinction not sanctioned by law is prohibited. A few sectors are exclusively reserved or partially restricted for the state. Other economic activities are open to foreign capital under certain conditions. In addition to restrictions in the petroleum sector (illustrated above), other restrictions on foreign investment in certain areas, including *inter alia*, energy, health services, media, rural property acquisition, fishing, mail and telegraph, aviation and aerospace, remain in effect. Mining on areas within the national border strip (an area of 150 km width along the surface borders) is also restricted: the majority of capital (51%) must lie in the hands of Brazilians and two thirds of workers have to be nationals; and exploration and exploitation activities are subject to additional authorization from the National Defence Council.

According to art. 170 of the Federal Constitution, anyone may freely engage in any economic activity. Thus, no authorization from government agencies would be needed except in the cases provided for by law. One example is the requirement that all investment or reinvestment must be registered with the FIRCE to provide for the remittance of profits, capital repatriation and registration of profit reinvestment. In addition, foreign investors have to comply with nationality quota restriction imposed by Decree No. 5452/1943 regulating foreign investment whereby two thirds of the labour force must be Brazilian.

Article 5 subpara. 4 of the Federal Constitution establishes protection for property rights. Thus expropriation is only permitted in cases of necessity or public utility and upon the payment of fair compensation. On a more general aspect, Brazil has not joined ICSID and BITs signed have not entered into force.

**Currency regulation and settlement of disputes**

Protection against foreign exchange losses has been reduced in recent times in Brazil. The Brazilian Central Bank used to guarantee that the original amount invested could be repatriated tax free, but this is no longer the case. This change is mitigated to a certain extent by the fact that under certain situations, Brazilian companies engaging in oil and gas activities are able to maintain a US dollar bank account in a Brazilian bank.

Art. 43 para. X of the Petroleum Law provides that the concession contract must set forth the rules for dispute settlement related to the contract and its execution, which can include conciliation and international arbitration.
The ANP model concession contract 2004, in clause 31, requires parties to attempt to resolve their disputes amicably and if this is not possible, to submit the dispute to ad hoc arbitration using the International Chamber of Commerce (ICC) Arbitration Regulations. Law No. 9307/1996 governs arbitration in Brazil. It is chiefly fashioned on the UNCITRAL (United Nations Commission on International Trade Law) conceived as a model law, though the new Brazilian law does not distinguish between domestic and international arbitration (Bosco Lee, 2002), except for the requirement of recognition of the foreign award by the Superior Court of Justice. The law allows the enforcement of arbitral awards (including foreign arbitral awards) in court. Where there are issues arising from the arbitration that need to be resolved by a court, or where one party seeks to enforce the arbitral award in court, the ANP model concession contract 2004 provides that the parties submit to the jurisdiction of the courts of the city of Rio de Janeiro. Brazil became a party to the New York Convention 1958 with the enactment of Decree No. 4311/2002. The ANP Model Concession Contract 2004, according to clause 31.1 of that document, must be executed, governed and construed in accordance with Brazilian law.

12.2.4 Mexico

Ownership and title to underground resources

Mexico is a representative, federal and democratic republic, comprised of states which are free and sovereign as regards to their own regimes, but united in a federation pursuant to constitutional principles (art. 40 of the Political Constitution of the United states of Mexico, the Mexican Constitution).

Article 27 of the Mexican Constitution sets the definition and status of ownership of the Mexican nation over its petroleum and other hydrocarbons, as well as the scope, principles and modalities of the legal regime for their development. Pursuant to arts. 25 and 28, petroleum and other hydrocarbons are considered as strategic areas, which are entrusted exclusively to the public sector. The state manages these areas by means of agencies or enterprises which are controlled by the Federal Government (see also the Foreign Investment Law 1993, art. 5).

From this constitutional basis, the core legal framework for hydrocarbons is comprised of: the Regulatory Law of Constitutional Art. 27 in the Field of Petroleum and its Regulations (the Petroleum Law), as well as of the Natural Gas Law 1995 (the Gas Law); the Law of Public Works and Related Services of 2000 (the Procurement Code); the Law of Petróleos Mexicanos 1992 (the PEMEX Charter) and other relevant laws and regulations. The Federal Government has exclusive jurisdiction over the oil and gas industry.

Following the expropriation of the assets of petroleum companies by the Decree of 18 March 1938, the main actor in the Mexican petroleum industry has been Petróleos Mexicanos (PEMEX). This is a decentralized public entity created by the Decree of 7 June 1938, whose purpose is to conduct the strategic activities of the state in the petroleum, other hydrocarbons and basic petrochemicals industry (PEMEX Charter, arts. 1 and 2). The upstream sector is virtually closed to private companies, so the focus of this section is somewhat different to that of most countries in Latin America. There is no possibility for private investors to acquire title to petroleum, and the only way they can participate in the upstream sector is by way of service contracts issued by PEMEX. With the aim of developing a market for domestic consumption, private investment can participate in downstream activities (transportation, distribution and storage) of natural gas. More recently, PEMEX-Exploration and Production developed the Multiple Services Contract (MSC), a new contractual scheme whereby several services are performed by a single contractor, which allowed the participation of both national and international companies in the exploitation of natural gas.

Pursuant to art. 27 of the Mexican Constitution, the nation retains direct ownership (dominio directo) of petroleum and all hydrocarbons located in the national territory, including the continental platform. Ownership is defined as inalienable and non prescriptive. Only the nation can carry out the exploitation of such resources in accordance with the terms of the Petroleum Law. This Law reiterates the constitutional provision and further defines the scope of the term petroleum as comprising all natural hydrocarbons – whatever their physical condition (Petroleum Law, arts. 1 and 2).

State involvement in the petroleum industry

Only the nation may carry out all the activities in the petroleum industry (Mexican Constitution, arts. 25, 27 and 28; and Petroleum Law, art. 2). The exact extent of the petroleum industry is defined in art. 3 of the Petroleum Law. It includes: all exploration, exploitation, refining, transportation, storage, distribution and first hand sales of oil (and products derived from oil refining); the exploration, exploitation, preparation (including the
transportation/storage related to those activities) and first hand sales of gas; and the preparation, transportation, storage, distribution and first-hand sales of derivatives from oil and gas that might be used as basic industrial raw materials and which constitute basic petrochemicals.

PEMEX and its subsidiary companies have been entrusted to act on behalf of the nation to carry out the activities in the petroleum industry described in art. 3 (Petroleum Law, art. 4.). PEMEX and its subsidiaries are “decentralized public entities” (PEMEX Charter, art. 2), meaning that they have their own legal existence and equity but that the state retains ownership and control over them (Mexican Constitution, art. 25). Due to their public nature, PEMEX and its subsidiaries are subject to the special legal regime established by the PEMEX Charter and other applicable statutes and regulations which have implications for their contractual practices. They are also bound by normal commercial laws.

PEMEX is a vertically integrated company, and is divided into the following subsidiaries: (a) PEMEX-Exploration and Production, whose purpose is the exploration and exploitation of petroleum and natural gas; (b) PEMEX-Refining, which is responsible for industrial processes of refining; elaboration of petroleum products and petroleum derivatives; (c) PEMEX-Gas and Basic Petrochemical, which processes natural gas, liquefied natural gas and synthetic gas; and (d) PEMEX-Petrochemical, which is responsible for processing petrochemical industrial products constituting part of the basic petrochemical industry. In all cases, these entities are also in charge of the transportation, storage and marketing of their products (PEMEX Charter, art. 3).

PEMEX-International Trade is the commercial arm of PEMEX in the international market, dealing with crude oil imports and exports.

It follows that direct participation in the upstream petroleum sector in Mexico is closed to the private sector, and that, in the downstream sector, only certain gas-related activities, principally those involving transportation and storage not related to the upstream sector, and distribution, are open to private participation (Petroleum Law, art. 4.2).

However, according to art. 6 of the Petroleum Law, PEMEX may engage individuals or companies on a work or service contract basis to help it to conduct its activities, but such contractors must be paid in cash and may not take percentages or participations in the production. Likewise, art. 4 of the PEMEX Charter states that PEMEX and its subsidiaries may, in accordance with their relevant purposes, enter into all types of acts, agreements or contracts and issue credit instruments with individuals or companies. In any case, neither PEMEX nor any of its subsidiaries has a right of ownership in Mexico’s domestic hydrocarbons. Turnkey drilling contracts have been the most common form of private participation in Mexico’s petroleum industry.

**Contracts**

The principal avenue for private sector participation in the Mexican oil industry is entered into with PEMEX by way of service contracts – typically for drilling and other forms of exploration, in accordance with art. 134 of the Mexican Constitution, the Law of Public Works and Related Services (the Procurement Code), and associated statutes and regulations. The Procurement Code (art. 3) mandatorily applies to contracts for, among other things, the following activities: a) exploration, geotechnics, location and drilling works; b) integral or turnkey projects where the contractor is obligated from the design of the work to its total completion, including, when applicable, transfer of technology; c) exploration, location and drilling works other than oil and gas extraction; improvement of soil and subsoil; disassemble; extraction and the like, the purpose of which is the exploitation and development of natural resources located in the soil or subsoil; and d) installation of artificial islands and platforms directly or indirectly used in the exploitation of natural resources.

As can be seen from the above, the service contracts may extend only to exploration and appraisal of oil and gas reservoirs; any production has to be undertaken by PEMEX itself.

The contracts can be unit price contracts (where compensation is based on the completion of units of work), lump sum contracts (where compensation is a fixed aggregate amount) or alternatively a mixture of the two. Turnkey drilling contracts are usually lump sum contracts. Article 46 of the Procurement Code sets out thirteen basic terms which must be included in the contract. These are: a) authorization of the budget to pay the contract; b) indication of the procedure by which the contract was awarded; c) contract price; d) term of the contract, which obliges the contractor to finish the works by a certain time; e) procedure for payment; f) requirement of a performance guarantee (including a guarantee for any advance payments), which must be provided within 15 days of the day the notification of the award of the contract (art. 48 of the Procurement Code deals with the performance guarantee); g) details of payments for already performed works;
penalties for delays in the works, which may not exceed the amount of the performance guarantee; i) method for reimbursing any excess payments received; j) cost adjustment procedure; k) circumstances in which PEMEX may terminate the contract; l) detailed description of the works to be performed; and m) dispute resolution procedures. The actual content of these clauses is for the parties to negotiate.

The Procurement Code prevents the assignment of contracts awarded (art. 47). It is possible for the contractor to receive advance payments prior to the date for starting the works in a particular year (up to 30% of the approved budget allocation) in order to cover upfront capital expenditure, though these payments must be included in the performance guarantee (Procurement Code, art. 50).

As the contract is performed, the contractor must, at least once a month, submit to PEMEX an estimate of the performed works (Procurement Code, art. 54). PEMEX should, where appropriate, approve the estimate within fifteen days after its submission and then make the necessary payment within twenty days after approval is given. Where economic circumstances occur which are not provided for in the contract, and result in a change to the cost of the works, arts. 56, 57 and 58 of the Procurement Code allow for cost adjustments to be made.

As described below, the Ministry of Public Function (the Ministry) has an important supervisory role to play in respect to the provision of the services under the contract, including a right to inspect in situ the services being provided to determine if they are being performed in accordance with the terms of the Procurement Code (art. 75). PEMEX must deduct a certain percentage from the contractor’s invoices in order to pay this Ministry for performing its role. If the Ministry decides that the relevant contract needs to be annulled for reasons attributable to PEMEX, the latter must reimburse the contractor for any non-recoverable expenses it has incurred.

Once the works are complete, the contractor is liable for any hidden defects that may appear in the works, and, pursuant to art. 66 of the Procurement Code, must provide a guarantee for a term of twelve months in case any such defects occur. Such a guarantee can either be a bond amounting to 10% of the value of the works, a letter of credit for 5% of the value of the works, or else, funds amounting to 5% of the value of the works placed in a trust.

PEMEX has full power to temporarily suspend a contract at any time with justified cause, and to terminate it early where there are general interest reasons for doing so or where the contractor has not complied with the terms (Procurement Code, arts. 60 and 61). Where early termination is attributable to PEMEX, the latter shall pay for the contractor’s performed works and non-recoverable expenses.

In 2002, PEMEX-Exploration and Production developed a new contractual scheme that allows the participation of both national and international companies. This was with a view to promoting natural gas projects in areas with geological potential, increasing the internal supply of such resources, and strengthening project, technology and financing capabilities.

As explained before, this is the MSC, a form of service contract which brings together into one single contract the type of services that are usually performed for PEMEX under several contracts, for a fixed fee. A draft generic form of MSC was available for the first bidding round in 2003. This scheme was under revision at the time of writing. The MSC has been criticised in parliamentary discussion by those who argue that pursuant to the constitution, only PEMEX can undertake activities aimed at the exploitation of natural gas and hence, they cannot be granted to private companies.

**Tender process**

With a few exceptions, the service contracts must be awarded by public tender (Procurement Code, arts. 27 and 28), and the Procurement Code is very detailed about how the tender process should occur. All participants in the tender must be treated equally and have the same access to information.

The tender will only be open to Mexican participants, except where the terms of treaties or the provision of external credit demand international participation; no proposals were submitted in the course of a Mexican-only tender; or else an investigation has shown that Mexican contractors lack the necessary skills or capacity (art. 30). The Procurement Code sets out what tender proposals must contain, how the terms of a call for tender may be modified and the procedure for the delivery, opening and evaluation of tender proposals.

In certain cases, the public tender requirement may be dispensed with, and PEMEX may award a contract through either an invitation to bid to at least three persons or a direct award to a person (Procurement Code, art. 42). The circumstances in which public tendering is not required include where: a) a person holds exclusive rights which are required for the performance of the contract; b) there is some sort of emergency or disaster which precludes a public tender process; c) potential losses or costs justify the alternative procedures; d) there...
have been two unsuccessful public tender procedures.

**Right to prospect, explore, develop, produce and dispose of petroleum resources**

Activities in the petroleum industry as defined in art. 3 of the Petroleum Law are carried out by PEMEX, and will be performed by way of assignments of lands granted to PEMEX by the Energy Secretariat either at PEMEX's request or as considered convenient by the Federal Executive branch (Regulation to Petroleum Law, art. 5). Each assignment – the number of which is unlimited – can cover up to 100,000 ha and has a 30-year term, renewable at PEMEX's request (Regulation to Petroleum Law, art. 6). PEMEX cannot assign, transfer, sell or by any means compromise the assignments.

Reconnaissance and surface exploration require prior authorization from the Energy Secretariat (art. 7) at PEMEX's request. The Petroleum Law and its Regulation set out a procedure for access to land in case of opposition by the landowner or landholder, or, in certain cases, by legal representatives of ejidos or communities (Petroleum Law, art. 7 and Regulation of Petroleum Law, art. 8), as well as for temporal occupation or expropriation of land and for compensation (Regulation of Petroleum Law, chapter X). In any case, the overarching principle is that of public utility of the petroleum industry, whereby the use of land for this industry takes precedence over any other land use (Petroleum Law, art. 10).

As for the downstream gas-related activities in which the private sector may participate pursuant to art. 4.2 of the Petroleum Law, terms, conditions and related matters (including the issuing of permits) are regulated by way of the Natural Gas Regulation as set out in art. 14 of the Petroleum Law. Permits may be granted to private entities and other decentralized agencies of the energy sector (Natural Gas Regulation, art. 14). They shall be granted by the Energy Regulatory Commission either on the basis of application (Natural Gas Regulation, arts. 32 to 37) or public bidding (arts. 38 to 46). Permits shall be for a 30-year term, renewable for additional terms of 15 years each (Natural Gas Regulation, arts. 19 and 53).

As far as operating conditions in this section are concerned, see operating conditions in service contracts above.

**Environmental protection**

The petroleum industry is subject to the rules and procedures set out in the General Law of Ecological Balance and Environmental Protection 1988 (amended 2005; i.e. the Environmental Law). This law’s purpose is to promote sustainable development and set the basis for, *inter alia*, ensuring the right of every person to live in an environment adequate for their development, health and well-being (Environmental Law, art. 1). The petroleum industry is under federal jurisdiction (art. 5), and the competent authority is the Secretariat of the Environment, Natural Resources and Fisheries (the Environmental Secretariat; art. 6). The Environmental Attorney General also has supervisory powers in order to protect the environment. PEMEX must comply with these environmental provisions. The Procurement Code, art. 20, requires that contractors consider the effect on the environment that the works may cause, and prior to commencing the project, undertake an environmental assessment in accordance with the Environmental Law.

The Environmental Law defines environmental impact assessment as the procedure whereby the Environmental Secretariat sets forth the operating conditions for works and activities subject to compliance, with a view to avoiding or minimizing their negative environmental impact. The petroleum industry is one of the industries in Mexico which requires prior authorization from the Environmental Secretariat, in so far as the environmental impact of its activities (art. 28) is concerned. It must submit an environmental impact statement (art. 30) which is to be made available to the public. Public consultation can be carried out by the secretariat at the request of any person from a relevant community (art. 34). In addition, those conducting activities classified as of high-risk pursuant to art. 147 of the Environmental Law and associated regulations must submit an environmental risk study and provide an environmental risk guarantee (art. 147 bis). The Environmental Law includes a definition of hazardous wastes, which are identified, classified and characterized by Mexican Official Standards, specifically by NOM-052-SEMARNAT-93.

The secretariat can approve, authorize subject to certain conditions, or reject the submitted statement (art. 35). The Environmental Law provides for the use of economic instruments (arts. 21 and ff.) and coordination with voluntary processes of environmental self-regulation and auditing (arts. 38 and ff.). It relies on administrative mechanisms (from fines to temporary and definite shutdown, administrative detention up to 36 hours, and suspension or revocation of the relevant concession, license, permit or authorization) to enforce compliance.
(art. 171).Transgressors are also subject to civil and criminal liability under the relevant regimes.

**Fiscal structure and government take**

Main taxes and applicable fees to the petrochemical industry include income tax, value-added tax, special production and services tax, oil earnings tax, import taxes, oil extraction fee, extraordinary oil extraction fee, oil extraction additional fee and hydrocarbon fee (Basham, et al., 2000).

PEMEX’s tax regime is established under art. 7 of the Income Law of the Federation. PEMEX is exempted from paying the Income Tax, but is subject to the payment of: a) the oil extraction fee which is due per each petroleum extraction region; b) extraordinary oil extraction fee; c) additional oil extraction fee; d) oil earnings tax; e) hydrocarbons fee; f) special production and services tax; g) value added tax; h) import duties and export taxes; and i) fees for exceeding earnings, as well as other generic fees (Income Law of the Federation for 2005; Basham et al., 2000).

PEMEX does not have either economic or financial autonomy. Its budget has to be approved by congress as part of the budget of the republic, hence macroeconomic objectives might prevail over the company’s investment strategies and decisions. A comprehensive tax reform has been discussed in congress over the past few years, but the issue has not yet been resolved (Campodónico, 2004).

**Fixing the price of oil/gas**

The gas price is fixed in accordance with art. 8 of the Gas Act. The maximum price for first hand sales of gas by PEMEX shall be set in accordance with directives issued by the Energy Regulatory Commission. The price calculation methodology shall reflect gas opportunity costs, competitive conditions in international markets, and the place where the sale is made. The maximum price of gas shall not affect the right of the purchaser to negotiate more favourable conditions in the purchase price.

**Foreign investment**

The Foreign Investment Law of 1993 repealed the Law to Promote Mexican Investment and Regulate Foreign Investment of 1973. A list of restricted areas exclusively reserved for the state is mentioned in art. 5 of the Foreign Investment Law. These include oil and other hydrocarbon activities, as well as electricity, broadcasting, and postal services. According to art. 6 of the Foreign Investment Law, several activities are exclusively reserved for Mexicans or Mexican firms with a clause excluding foreigners. Such restriction can be of a limited effect since once an investment is made through an enterprise registered in accordance with Mexican laws, it is deemed a Mexican enterprise with the guarantees that this provides.

The administrative authorities chiefly comprise of the Secretariat of Commerce and Industrial Development, the National Foreign Investment Commission and the National Foreign Investment Registry created under the Foreign Investment Law 1993. Investors must register their investment within 40 days of establishing their activities. In order to renew their investment, investors are further required to report their economic and financial activities to the National Registry.

Under the general foreign investment regime, foreign investors have the same procedural recourse as national investors. Special recourse for foreign investors is envisaged only in the dispute settlement sections of the free trade treaties to which Mexico is a party. Mexico is not a member of ICSID, however, the country is a member of UNCITRAL, and has enacted an arbitration law fashioned in UNCITRAL Model Law pattern (von Wobeser, 2002).

Mexico has been a NAFTA member since 1993. Chapter 11 of the agreement permits investors of a member state to arbitrate any investment dispute against a hosting member state. The country has also signed free-trade agreements with a number of Latin American states and the European Union (EU). These treaties usually provide for arbitration relating to investment disputes. The current legislation pertaining to arbitration is found in various domestic and international instruments. These include the national Commercial Code, the Federal Code of Civil Procedure as well as various states’ civil procedure laws. Other related laws include the federal laws relating to consumer protection, copyright and telecommunications (von Wobeser, 2002).

On our specific area of study, investment protection is based on the Procurement Code and is discussed above. If a service contract is prematurely terminated for reasons not attributable to the contractor, the contractor has the right to claim payment for its performed works and compensation for its expenses.

**Currency regulation and settlement of disputes**

Since production sharing and concessions are not possible for private investors in Mexico’s oil and gas sector, the only relevance of currency regulation is the currency in which service contract fees are paid. According to the Monetary Law of Mexico,
international service contract fees can be
denominated in either foreign currency (usually US
dollars) or Mexican pesos. Where a US dollar
contract is payable in Mexico, it may be paid in
pesos, subject to the conversion rate set out in the
contract or else the official Banco de Mexico rate. In
the event that proceedings are brought in Mexico
seeking performance of any of the parties
obligations in Mexico, pursuant to the Mexican
Monetary Law, the relevant party may discharge its
payment obligations denominated in a foreign
currency by paying any such sums, in Mexican
currency at the rate of exchange prevailing in
Mexico on the date when payment is made.
Disputes are provided for in arts. 83-91 of the
Procurement Code. Disputes involving the
contracting procedure may be notified to the
ministry, which may investigate the dispute and
request further information from the parties. Where
the ministry finds that the contracting procedures set
out in the Procurement Code have been breached, it
may issue a resolution suspending the contracting
procedure. Such a resolution may be appealed to the
relevant courts.
For disputes that involve non-compliance with
the terms of service contracts, the parties may file
complaints to the ministry, which shall hold a
conciliation hearing to determine the matter. If the
parties reach an agreement pursuant to the
conciliation, it shall be binding on them. If not, they
may still pursue a remedy through the courts.
Article 15 of the Procurement Code deals with
arbitrations in respect of matters under the
Procurement Code, and limits arbitrations to those
matters set out by the Ministry, and agreed on by the
Ministry of Finance and Public Credit and the
Ministry of Economy.
In most cases, Mexican law is the applicable
law. The Procurement Code (art. 16) provides that
the service contract should be governed by the law
of the place of execution of the contract, and that
where a contract is awarded on the basis of a
public tender and the works or services under it
are to be performed in Mexico, the contract should
be executed in Mexico. Article 15 of the
Procurement Code provides that disputes
concerning contracts executed in accordance with
the Procurement Code must be referred to the
Mexican federal courts.
It should be borne in mind that while the
Procurement Code must apply to the service
contracts, it is not the only law that can apply. In
1993, the PEMEX Charter was amended so that, for
contracts with an international element, PEMEX
could agree to an applicable law other than that of
Mexico, if it were convenient (PEMEX Charter, art.
14). Thus, the possibility exists that the law of other
jurisdiction applies as well as the Procurement
Code. Importantly, PEMEX is not able to claim
sovereign immunity in Mexico, according to art. 14
of the PEMEX Charter.
As a matter of public policy, under art. 4 of the
Federal Code of Civil Procedure of Mexico (Código
Federal de Procedimientos Civiles), attachment prior
to judgment or attachment in aid of execution will
not be enforced by Mexican courts against property
of PEMEX and its subsidiaries. This provision is
included in every agreement in which a public entity
is a party and it has been accepted by the
international financial community.

12.2.5 Venezuela
Ownership and title to underground resources
The Bolivarian Republic of Venezuela is a
democratic and social state (Constitution, art. 2); it
has a decentralized federal structure (Constitution,
art. 4).
The legal framework for hydrocarbons in
Venezuela has evolved over different periods,
coloured by diverging paradigms of development
and attitudes to private investment. The period of
use of concession agreements lasted for most of the
Twentieth century, until the nationalization of the
hydrocarbons industry occurred. Nationalization
was gradually implemented in the early 1970s and
culminated with the enactment of the Organic Law
Reserving the Hydrocarbons Industry and Trade to
the state (the Nationalization Law) in 1975. This
law established the state monopoly over
hydrocarbon exploration, production, refining,
marketing and exporting, and set up the basis for
the creation of a state-owned company to
administer and manage these activities. Petróleos
De Venezuela Sociedad Anónima (PDVSA) was
formed later that year. In the early 1990s, the
government launched the opening of the oil
industry to private investment. This was
implemented by different modalities of association
with PDVSA: the exploitation of marginal fields
through operating agreements; strategic
associations (for the development of extra heavy oil
projects in the Orinoco belt); and association
agreements for the exploration at risk of
non-traditional areas and production of
hydrocarbons under a profit-sharing scheme.
This state of affairs would see radical changes
with the administration of Hugo Chávez-Frias in the
late 1990s. President Chávez supported the

enactment of a new constitution (the Constitution of 1999) which strengthens the legal implications derived from the “social state clause” (art. 2) and reaffirms resources ownership and state control over oil and gas activities. The core principles and modalities of the current legal regime of hydrocarbons are set forth in the Venezuelan Constitution of 1999, the Organic Law of Hydrocarbons of 2001 (the Hydrocarbons Law) which was partially modified in 2006, and the Organic Gaseous Hydrocarbons Law of 1999 (the Gas Law).

Since President Chávez passed the Hydrocarbons Law and the Gas Law, the hydrocarbons industry in Venezuela has been governed by two fundamentally different legal regimes. The gaseous hydrocarbons regime is designed to attract private investors – with a view to increase gas consumption – as is the petroleum regime with respect to downstream activities. However, whilst not fully closed to private sector investment, upstream petroleum activities are now much less open than they were before 2001.

The Hydrocarbons Law, enacted after the Gas Law, did not make it entirely clear how the two pieces of legislation were to fit together. For instance, while the Gas Law excluded upstream activities related to associated natural gas, the Hydrocarbons Law did not expressly state that it covered such activities. On the contrary, art. 2 of the Hydrocarbons Law provided for a general statement in virtue of which activities associated with gaseous hydrocarbons were to be governed by the Gas Law. The ambiguity in the determination of the applicable law to upstream activities of associated natural gas was finally cleared up by art. 2 of the 2006 amendment to the Hydrocarbons Law which submitted those types of activities to the provisions of the Hydrocarbons Law.

The competent authority for the administration of hydrocarbons, with the capability of inspection of activities and monitoring operations is the Ministry of Energy and Petroleum, (the Ministry; Hydrocarbons Law, art. 8, Gas Law, art. 6). The national gas entity ENAGAS (Ente NaCional del Gas) is responsible for the supervision and police functions of the transportation and distribution of gaseous hydrocarbons (Gas Law, art. 36).

According to art. 12 of the Venezuelan Constitution 1999, all hydrocarbon deposits that exist within the territory of Venezuela, including the territorial sea, the exclusive economic zone and the continental platform, are “the property of the Republic, are of public domain, and therefore inalienable and imprescriptible”. This article is the basis of the Hydrocarbons Law and the Gas Law, and has been used by the government to justify requiring all upstream petroleum activities to be conducted under the control of the state (as is described below).

Ownership and title to petroleum and gas reservoirs underground vests with the state, as per art. 12 of the Venezuelan Constitution 1999. This is reaffirmed by art. 3 of the Hydrocarbons Law and art. 1 of the Gas Law.

The following summary deals for the most part with petroleum and gas resources separately. Petroleum is used to refer to liquid hydrocarbons and associated gases, and gas is used to refer to hydrocarbon gases.

State involvement in the hydrocarbons industry

Petroleum

The state participates in the petroleum industry directly via PDVSA, the state oil company, PDVSA’s subsidiaries or other entities provided for in arts. 27-32 of the Hydrocarbons Law. This gives the National Executive the power to create companies solely owned by the state or to agree on incorporated joint ventures with private investors for the execution of hydrocarbons activities. PDVSA is subject to the rules of private law but it is also a state company. According to art. 303 of the Venezuelan Constitution of 1999, the state must retain all shares in PDVSA, though this does not apply to its subsidiaries and affiliates. In accordance with the Hydrocarbons Law (art. 29) PDVSA’s actions must follow government policy implemented through the Ministry, and it is subject to the supervision of the National Executive through the Ministry (Hydrocarbons Law, art. 30). The Ministry’s objectives include coordination, supervision and control of the activities of state-owned companies and private entities performing in the hydrocarbons sector, throughout all stages including exploration, production, refining, commercialization, transport and any other hydrocarbons-related activity.

Gas

Article 22 of the Gas Law states that the various activities in the Gas Law may be carried out by private persons with or without state participation, or directly by the state. Since state participation is not essential in gaseous hydrocarbon ventures, the provisions relating to state companies in the Gas Law are not as crucial as those in the Hydrocarbons Law. Articles. 43-46 of the Gas Law provide for state companies, and allow the National Executive to create corporations which are solely owned by the state.
Contracts and licences

Petroleum

Article 302 of the Venezuelan Constitution of 1999 reserves petroleum activity to the state, for reasons of national interest. Based on this article of the constitution, the state has specifically reserved to itself—in art. 9 of the Hydrocarbons Law—certain activities associated with the search for petroleum: exploration; production; gathering; and initial transport and of storage. These are called primary activities.

Primary activities may only be performed directly by the state, by 100% state-owned companies or by incorporated joint venture companies in which more than 50% of the shares are held by the state. These companies performing primary activities are operating companies (Hydrocarbons Law, art. 22). The fact that exploration cannot be carried out by companies in which the state holds less than a 50% stake may restrict the level of upstream activity in Venezuela, since this requires significant investment and risk exposure for the state in every new venture. Moreover, a company in which the state holds more than 50% of the shares is deemed to be a state-owned company (Organic Law on Public Administration, art. 100). Indeed, for this same reason, the company shall be subject to a number of laws and regulations applicable to public entities only, that in practice might result in hindrances, as delays affecting the day-to-day operations (borrowing of funds, acquisitions of goods and services, etc).

Per art. 24 of the Hydrocarbons Law, the National Executive, may transfer by decree to operating companies, the right to carry out the primary activities, as well as the property of movable or immovable assets vested in the private domain of the state which might be instrumental for performing those activities efficiently.

Regarding the contracts entered into under the previous regime opening up the oil industry which was implemented in the early 1990s, in April 2005 the Ministry ordered the conversion of the 32 operating agreements into incorporated joint ventures (empresas mixtas) arguing the illegality of such agreements and the need to adapt such ventures to the terms of the Hydrocarbons Law. This was part and parcel of President Chavez’s Full Petroleum Sovereignty Policy, which also comprised a new package of tax burdens over the oil sector.

In March 2006, the Venezuelan National Assembly approved the conditions for the new joint ventures, and weeks later the law for the regularization of private participation in the primary activities referred to in the Hydrocarbons Law. The main purpose of these laws was to declare the illegality and extinction of the operating agreements executed during the 1990s and to establish the conditions of the new joint ventures.

As a result, almost all former partners in the operation agreement assented to the conversion into incorporated joint ventures. Nevertheless, some fields were returned to PDVSA: B2X68/79 (formerly operated by Hocol), Maupa (formerly operated by Inemaka), Sanvi-Güere (formerly operated by Teikoku), Guárico Occidental (formerly operated by Repsol) and Quaimare-La Ceiba (formerly operated by Repsol). Therefore 22 incorporated joint ventures were constituted with a state stake above 51% in accordance with the Hydrocarbons Law (Table 1).

The new incorporated joint ventures (or empresas mixtas) have the following features: a) the property of the fields is not transferable and the state maintains sovereignty over them; b) the state, through its company Corporación Venezolana del Petróleo (CVP) has a participation stake of not less than 51% in the joint venture; c) oil production must be sold to PDVSA and its commercialization is an exclusive right of the state (PDVSA); d) as discussed below, the incorporated joint ventures are subject to a new tax regime.

The Strategic Associations were joint ventures to upgrade extra-heavy oil into synthetic crude from the Orinoco basin which is located along the Orinoco River in the south-east of Venezuela. Between the years 1993 and 1997, PDVSA entered into four Strategic Associations (Boyaca, Junin, Ayacucho and Carabobo; Table 2).

Under the full petroleum sovereignty policy these association agreements as well as the associations for exploratory risks and profit sharing of Paria Este, Paria Oeste, la Ceiba and Orifuels Sinovensa, are also bound to shift into incorporated joint ventures with PDVSA or any of its affiliates holding a majority stake of at least 60%.

2 Official Gazette of the Bolivarian Republic of Venezuela No. 38410, dated 31 March 2006. Conditions of the shareholders’ joint ventures that will rule the terms of the joint venture companies (empresas mixtas).
3 Regularization Law of private Participation in the Primary Activities in Decree No 1510 per Crjanic Hydrocarbons Law.
4 Except Eni of Italy and Total of France.
In accordance with the rules for the migration of the Orinoco Belt joint ventures and other profit sharing joint ventures into new incorporated joint ventures (empresas mixtas), investors are meant to keep ownership of the infrastructure, transport services and converters (art. 3) and the use of these facilities will be compensated by the new joint venture pursuant to further negotiation.

Refining (distillation, purification and transformation of natural hydrocarbons) and the commercialization of the products obtained may be carried out by the private sector (Organic Law of Hydrocarbons, art. 10). The right to carry out refining activities is subject to obtaining a licence (art. 12), and those engaged in refining activities must be registered (art. 14). Natural hydrocarbons and by-products as indicated by the National Executive may only be commercialized by the Venezuelan state-owned companies. Other products may be commercialized by either state-owned companies, joint ventures or private entities as long as they hold a permit issued by the Ministry (art. 61). However, the state has the right to reserve such activities to 100% state-owned companies. Supply, storage, transportation and distribution of petroleum by-products may neither be continued except by way of a ministry permit (art. 61).

Gas

Article 302 of the Venezuelan Constitution of 1999 refers specifically to “petroleum activity”, and as a result non-associated natural gas is not subject to the state reservation which is applied to the petroleum industry. The Gas Law (art. 2) expressly allows private entities, whether foreign or national, to engage in the exploration for and exploitation of reservoirs of non-associated gas, as well as the gathering, storage, utilization, processing, industrialization, transport and domestic/foreign marketing of natural gas, be it associated or non-associated. These activities may, of course, also be carried out by the state. The Gas Law equally applies to non-hydrocarbon elements of gaseous hydrocarbons and liquid hydrocarbons which can be extracted from natural gas. The activities set out in art. 2 of the Gas Law may only be conducted by private persons where the person receives a licence or a permit to do so from the Ministry (art. 22).

Right to prospect, explore, develop, produce and dispose of petroleum resources

We refer here to the above mentioned possibility to transfer by decree the right to carry out the primary activities to operating companies (Hydrocarbons Law, art. 24).

The National Executive will set the boundaries of the geographical areas in which the primary activities are to be performed by operating companies into blocks of up to 100 km² each (Hydrocarbons Law, art. 23). Petroleum activities are of public utility and social interest, and take precedence over other land uses. Those authorized to perform these activities are entitled to request the temporary occupation or expropriation of assets, as well as the constitution of servitudes. Arts. 38 and ff. of the Hydrocarbons Law provide for the rules and procedures to get access to land, including

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Table 1. Stake distribution of the incorporated joint ventures

<table>
<thead>
<tr>
<th>Fields</th>
<th>PDVSA</th>
<th>Investor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kaki</td>
<td>60%</td>
<td>Inemaka (40%)</td>
</tr>
<tr>
<td>Cabimas</td>
<td>60%</td>
<td>Suelopetrol (40%)</td>
</tr>
<tr>
<td>Onado</td>
<td>60%</td>
<td>CGC (40%)</td>
</tr>
<tr>
<td>Guárico Oriental</td>
<td>70%</td>
<td>Teikoku (30%)</td>
</tr>
<tr>
<td>Mene Grande y Quiriquire</td>
<td>60%</td>
<td>Repsol (40%)</td>
</tr>
<tr>
<td>Boscán</td>
<td>60%</td>
<td>Chevron (40%)</td>
</tr>
<tr>
<td>LL-652</td>
<td>75%</td>
<td>Chevron (25%)</td>
</tr>
<tr>
<td>Falcón Este y Falcón Oeste</td>
<td>60%</td>
<td>VINCCLER (40%)</td>
</tr>
<tr>
<td>Casma-Anaco</td>
<td>60%</td>
<td>OPEN (40%)</td>
</tr>
<tr>
<td>Colón</td>
<td>60%</td>
<td>Tecpetrol (40%)</td>
</tr>
<tr>
<td>Urdaneta</td>
<td>60%</td>
<td>Shell (40%)</td>
</tr>
<tr>
<td>Acema</td>
<td>60%</td>
<td>Petrobras (40%)</td>
</tr>
<tr>
<td>La Cconcepción</td>
<td>60%</td>
<td>Petrobras (40%)</td>
</tr>
<tr>
<td>Mata</td>
<td>60%</td>
<td>Petrobras (40%)</td>
</tr>
<tr>
<td>Oritupano Leona</td>
<td>60%</td>
<td>Petrobras (40%)</td>
</tr>
<tr>
<td>Pedernales</td>
<td>60%</td>
<td>Perenco (40%)</td>
</tr>
<tr>
<td>Ambrosio</td>
<td>60%</td>
<td>Perenco (40%)</td>
</tr>
<tr>
<td>B2X70/80</td>
<td>80%</td>
<td>Hocol (20%)</td>
</tr>
<tr>
<td>Monagas Sur</td>
<td>60%</td>
<td>Harvest (40%)</td>
</tr>
<tr>
<td>Carareoles y Intercampo</td>
<td>75%</td>
<td>CNPC (25%)</td>
</tr>
<tr>
<td>D.Z.O.</td>
<td>60%</td>
<td>BP (40%)</td>
</tr>
<tr>
<td>Boquerón</td>
<td>60%</td>
<td>BP (25%)</td>
</tr>
</tbody>
</table>

Source: PDVSA (Petróleos De Venezuela Sociedad Anónima).

In accordance with the rules for the migration of the Orinoco Belt joint ventures and other profit sharing joint ventures into new incorporated joint ventures (empresas mixtas), investors are meant to keep ownership of the infrastructure, transport services and converters (art. 3) and the use of these facilities will be compensated by the new joint venture pursuant to further negotiation.

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5 Presidential Decree No. 5200 of 26 February 2007 (published in Official gazette of same date No. 38632).
notification to landowners and rules for expert appraisal and compensation.

### Operating conditions

#### Petroleum

The operating conditions under which joint venture companies may perform the primary activities set out in art. 9 must be approved by the National Assembly of Venezuela, acting on the advice of the Ministry through the National Executive (Hydrocarbons Law, art. 33). The minimum conditions, which are set out in art. 34 of the Hydrocarbons Law and in the Venezuelan National Assembly resolution of March 2006, are:

- a) a twenty-five year maximum term, renewable for not more than fifteen years;
- b) indication of the location, orientation, extension and shape of the area where the activities are to be carried out;
- c) an obligation to maintain the lands and permanent works (including the facilities, accessories and equipment, and any other equipment acquired for the performance of the activities) in good condition and to hand these over to the state at the end of the term; and
- d) any disputes that cannot be settled in a friendly way (including by arbitration) shall be decided by Venezuelan courts.

Article 15 of the Hydrocarbons Law deals with the operating conditions for refining activities. The licences granted regarding refining activities must contain the provisions described in c) and d) above. Article 66 sets out the penalties for violations of the Hydrocarbons Law, including fines and suspensions.

#### Gas

The licences by which private persons may conduct exploration and exploitation of non-associated natural gas must contain certain minimum terms (art. 24) which are not unlike the minimum conditions under which joint ventures may conduct primary activities for petroleum:

- a) a description of the project, including the destination of the gas;
- b) a thirty-five-year maximum term which may be extended for not longer than thirty years (the extension must be applied for after completion of half the initial period and not later than five years before the end of the initial period); and
- c) a maximum period of five years (part of the initial period) during which the exploration (and any further work specified by the Ministry) must be carried out.

Gas regulations may establish other conditions which apply to the exploration and exploitation of non-associated natural gas. Permits issued by the Ministry for activities other than exploration and

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**Table 2. Strategic Associations into which PDVSA entered between 1993 and 1997**

<table>
<thead>
<tr>
<th>Strategic Associations</th>
<th>Stakeholders</th>
<th>Participation (%)</th>
<th>Production (bbl/d)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Junin (formerly Petrozuata)</strong></td>
<td>PDVSA</td>
<td>49</td>
<td>130</td>
</tr>
<tr>
<td></td>
<td>ConocoPhillips</td>
<td>51</td>
<td></td>
</tr>
<tr>
<td><strong>Boyaca (formerly Sincor)</strong></td>
<td>PDVSA</td>
<td>38</td>
<td>200</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>47</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Statoil</td>
<td>15</td>
<td></td>
</tr>
<tr>
<td><strong>Ayacucho (formerly Hamaca)</strong></td>
<td>PDVSA</td>
<td>30</td>
<td>170</td>
</tr>
<tr>
<td></td>
<td>ChevronTexaco</td>
<td>30</td>
<td></td>
</tr>
<tr>
<td></td>
<td>ConocoPhillips</td>
<td>40</td>
<td></td>
</tr>
<tr>
<td><strong>Carabobo (formerly Cerro Negro)</strong></td>
<td>PDVSA</td>
<td>41.67</td>
<td>120</td>
</tr>
<tr>
<td></td>
<td>ExxonMobil</td>
<td>41.67</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Vebaoil</td>
<td>16.67</td>
<td></td>
</tr>
</tbody>
</table>

Source: PDVSA (Petróleos De Venezuela Sociedad Anónima).

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6 Official Gazette of the Bolivarian Republic of Venezuela No. 38410. Dated 31 March 2006. Conditions of the shareholders’ joint ventures that will rule the terms of the joint venture companies (empresas mixtas).
exploitation must contain the same terms as for licences, with the exception of (c) and (d) set out above. Article 51 of the Gas Law sets out the penalties for non-compliance with licence and permit conditions, including fines of up to 10,000 tax units (approximately US$ 175,000 at current values for tax units) and suspensions of up to six months. According to art. 25 of the Gas Law, licences for the exploration and exploitation of non-associated natural gas may be repealed by the Ministry for: (a) non-compliance with an exploration programme; (b) not completing exploration within the initial five years; (c) not making any special payments required by the state; (d) assigning the licence without prior approval; and (e) and valid reasons set out in the licence itself. Similar causes for repeal for licences issued for activities other than exploration and exploitation exist under art. 27 of the Gas Law.

**Unitization**

**Petroleum**

Unitization of reservoirs is dealt with in arts. 42 and 43 of the Hydrocarbons Law. Where a hydrocarbon reservoir extends over different production areas, the parties must enter into a unitization agreement for its production, to be approved by the Ministry. If the parties are unable to come to an agreement, the Ministry is to establish the provisions governing production. For reservoirs that extend into the territory of neighbouring countries, a unitization agreement must be entered into with the neighbouring country. The National Executive has the power to act to protect the interests of the state. In a Memorandum of Understanding of 2003, Venezuela and Trinidad and Tobago agreed to unitize their cross-border fields and in March 2007 both countries subscribed to the Framework Treaty relating to the unitization of hydrocarbons reservoirs that extends across the delimitation line between the Republic of Trinidad and Tobago and Venezuela.

The main features of this treaty are: (a) the implementation of the Treaty is by a joint Ministerial Commission (agreement by consensus), a Steering Committee and working groups as considered necessary; (b) the parties may jointly consult experts in the determination of the allocation of the reserves of each cross-border hydrocarbon reservoir (art. 3.3); (c) main operating decisions about the unit operator, the unit area, the development plan and the inter-licensee unit operating agreement require the approval of both states; (d) re-determination of the reservoir volumes to each state on the hydrocarbons initially in place seems to be possible at any time and at the sole request of any of the parties; (e) profits, gains and capital are taxed in accordance with each state’s laws and are explicitly based on the agreed allocation to which they are entitled (art. 7.2); (f) parties are jointly and severally responsible for ensuring the implementation of preventive measures in order to avoid environmental damages (art. 9); (g) access to pipelines shall be set in accordance with the applicable laws of each party and in light of reasonable, transparent and non-discriminatory terms (art. 10.2); (h) decommissioning plans and provisions for the creation of final decommissioning and disposal of installations is also required (art. 10.5.1); (i) dispute resolution of the interpretation or application of the treaty is by consultation or negotiation by the Steering Committee in the first instance or subsequently by the Ministerial Commission and the parties, while disputes over technical issues such as the allocation of the reserves are subject to joint consultation with experts (art. 21); and (j) the treaty does not establish an explicit duration, but it can be terminated by either state with a one-year written notice to the other party by means of diplomatic channels.

**Gas**

Articles 20 and 21 of the Gas Law cover unitization, in similar terms to those in the Hydrocarbons Law. Agreements unitizing gaseous hydrocarbon reservoirs across international boundaries must be approved by both the Ministry and the state Congress.

**Environmental protection**

Articles 127, 128 and 129 of the Venezuelan Constitution of 1999 provide for environmental protection. It is the right and duty of each generation to protect and maintain the environment, and the state also has a duty of environmental protection (art. 127). Article 129 imposes an obligation to conduct environmental impact studies before commencing an environmentally dangerous activity.

While both the Hydrocarbons Law (art. 5) and the Gas Law (art. 3) provides for environmental protection in very broad terms, Venezuela has two pieces of environmental legislation in place, applicable to the industry: the Organic Law of Environment 1976; and the Penal Law of the Environment 1992. The Organic Law of the Environment is the basic framework law for the protection of the environment in Venezuela, and lays down general principles for the conservation, protection and improvement of the environment for
the benefit of the quality of life. It sets down its own guiding principles, such as the principle of sustainable development, and also recognizes principles set out in international instruments. It authorizes the government to oversee and control environmentally dangerous activities; for hydrocarbon production, this control is exercised by the Ministry. It stipulates administrative civil and criminal sanctions for violation of standards established under decrees regulating this law. The Penal Law of the Environment creates specific environmental offences (being acts which violate legal provisions on the protection of the environment) and establishes criminal sanctions for these offences. It also creates obligations to conduct environmental audits for existing installations, and to complete environmental impact studies for future activities. Environmental licences, permits or authorizations must be obtained for each phase of oil and gas operations. The law can also require environmental restitution or clean-up.

Hydrocarbon activities are also subject to a myriad of regulations stipulating technical standards and limits to control activities with a negative impact on the environment, including regulations on hazardous waste, water effluents and atmospheric emissions, as well as specific regulations for the preparation of environmental impact assessments.

**Fiscal structure and government take**

**Petroleum**

Article 44 of the Hydrocarbons Law provides for a 30% royalty for the state, with reductions possible to 20% (for mature or extra-heavy oil reservoirs) and 16.66% (for bitumen blends) but only where production would otherwise not be economically feasible. Where reductions are allowed, the state has the power to increase the royalty back to 30% where economic feasibility would allow it. The royalty may be requested by the National Executive in kind or in cash (art. 45).

Five additional taxes are applicable to petroleum activities (art. 48). First, there is a surface tax levied on the granted area that is not being produced. This is equal to 100 tax units (with each unit being around US $1,750) per km² per year, and shall increase annually by 2% during the first five years and by 5% during subsequent years. Second, there is a fuel consumption tax, applicable to hydrocarbon by-products produced and consumed as fuel. The rate is 10% per m³ of gaseous product consumed. Third, there is a general consumption tax levied on each litre of hydrocarbon by-product sold in the internal market. The rate is fixed by the Budget Law each year, but will be between 30% and 50% of the final price paid by the consumer. This tax is paid by the consumer and must be withheld by the supplier and paid monthly to the National Treasury. Forth, there is a general extraction tax of 1/3 of the value of all the hydrocarbons extracted by the operators. This tax has to be paid on a monthly basis and operators are allowed to deduct due payments for royalties. Fifth, a 0.1% tax for export registry. This tax levies hydrocarbons export from any port of the National Territory.

While the ordinary income tax rate in Venezuela is 34%, in accordance with the Income Tax Law (2007 - arts. 11 and 53b) all upstream operators are currently taxed at 50%. Operators developing activities related to non-associated gas (downstream hydrocarbons activities, exclusively or the upgrade of extra heavy crude oil) are levied at 34%, as discussed below. With the payment of 30% in royalties and 50% in Income Tax, along with other taxes, the government take is approximately 82.5%.

The Hydrocarbons Law does not definitively rule out the application of state or municipal taxes to hydrocarbon activities (unlike art. 7 of the former Nationalization Law, which did) but based on a Venezuelan Supreme Court decision of 17 August 1999 (File No. 812-899) and the wording of art. 156.12 of the Venezuelan Constitution of 1999, the better view appears to be that these taxes do not apply.

**Gas**

Article 34 of the Gas Law provides for a flat 20% royalty for the state on the volume of gaseous hydrocarbons extracted from a reservoir and not re-injected, which represents a rise in royalty rates compared to previous regimes. It is noteworthy that there is no provision in the Gas Law enabling the government to reduce the royalty rate as an incentive for development as it is the case for liquid hydrocarbons (see above). This royalty may be demanded by the National Executive, through the Ministry, either in kind or in cash. As per art. 35 of the Gas Law, producers of gaseous hydrocarbons must pay taxes on such hydrocarbons when they are used as fuel, though these taxes are to be set in laws other than the Gas Law. The Law of Partial Reform

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7 The Operation Agreements were levied with a 16.67% rate since 2002 and before that with 1%. In the extinguished Operating Agreements (of the Rounds I and II) it was established that PDVSA had to pay the Royalty. In the Operation Agreements of Round III, the royalty should be directly deducted from PDVSA’s payments to the contractors (partners).
of Income Tax Law 1999 (last amended in February 2007), signed into law on the same day of 1999 as
the Gas Law, sets a maximum tax rate of 34% for all activities relating to non-associated gas (previously, companies involved in the exploration and production of natural gas were obligated to pay income tax of 67.7% in most instances). In addition, this new Income Tax Law creates a major tax credit for new gas investments and gives the President the power to partially or totally exonerate certain classes of taxpayers from income tax liability. On the whole, the new income tax regime has a positive effect on the gas regime in Venezuela.

Fixing the price of oil/gas

Petroleum

Article 60 of the Hydrocarbons Law gives the National Executive, through the Ministry, the power to establish hydrocarbon prices for the Venezuelan domestic market. These prices may be fixed in bands or using any other applicable system.

Gas

Article 12 of the Gas Law allows the Ministry to fix the price of gaseous hydrocarbons for the Venezuelan domestic market, taking into account principles of fairness. The rates for end consumers are set jointly by the Ministry and the Ministry of Production and Commerce. The bases for establishing the prices must be prepared by the National Gas Entity.

Foreign investment

The Hydrocarbons Law contains no provisions which exempt existing contracts or guarantee protection of investment. Article 24 of the Venezuelan Constitution of 1999 stipulates that retroactive application of legislation is forbidden. For some, this should provide some level of protection; for others, a law can affect the future effects under a given contract that was executed before the law came into force. Article 54 of the Gas Law provides that agreements for the sale and purchase of natural gas, entered into prior to the date the Gas Law came into effect shall remain in force for the specified term.


Foreign investment in Venezuela is overseen by the Superintendency of Foreign Investment (SIEX, Superintendencia de Inversiones EXtranjeras). It was originally attached to the Ministry of Finance (Art. 9 of Decree 2095); from 1997 to the Ministry of Industry and Commerce - Decree No. 1667/1996 - (which later became the Ministerio de Industrias Ligeras y Comercio). Decree No. 369/1999 establishing the functions of its Ministry attributed all matters related to national and foreign investment to the SIEX, as attached to the latter Ministry.

All investment is thereby required to be registered in SIEX within 60 days following constitution. There are also some labour restrictions on foreign investment in the terms of art. 27 of the Organic Labour Law, whereby foreign employees shall not exceed 10% of all workers in companies employing 10 or more workers. Further, art. 20 provides that certain posts (chief of personnel, captains of ships or airplanes for instance) shall only be occupied by Venezuelans.

Several economic sectors are either restricted or closed to foreign and private investment. In addition to the exclusion on the petroleum activities (as illustrated above), several instruments and regulations place variable restrictions on customs and tax services, maritime and air transportation.

Property rights are constitutionally guaranteed under Chapter V of the Constitution of 1999. Expropriation is allowed only on grounds of public benefit and social interest and by final judgment and after the payment of fair compensation (Constitution of 1999, art. 101). The Law of Expropriation for Public and Social Utility of 2002 sets forth the requirements and procedure for this kind of expropriation.

Thus, limitations on economic activities are only allowed on circumstances provided in the Constitution or established by law for reasons of safety, health or others of social interest (art. 96). Article 15 of the Constitution of 1999 provides for equality between foreign investors with nationals. Both shall enjoy the same duties and rights with such limitations or exceptions as are established by the Constitution or by law. Likewise, pursuant to relevant legislation, the treatment granted to the foreign investor and the investment is the national treatment. In addition, most favoured nation treatment is also granted in several investment promotion and protection agreements.

Foreign investment in Venezuela used to face no restrictions on the transfers of investment, remittances of capital, benefits, debt services or other remittances derived from foreign investment. At present, there is a
currency exchange regime that allows for remittances derived from foreign investment, dividends and others, once the investor fulfils the required administrative procedures (Exchange Covenant No. 1 of 2003). Venezuela has concluded 26 BITs (country specific list of BITs in United Nations Conference on Trade and Development, UNCTAD, Web site). In so far as international settlement is concerned, Venezuela is a member of ICSID as of 1995, the United Nations Convention on the Recognition of Foreign Arbitral Awards 1958, the Multilateral Investment Guarantee Agreement (MIGA), and the Inter-American Convention on International Commercial Arbitration 1975.

Settlement of disputes

Disputes related to the constitution of joint ventures and the performance of primary hydrocarbon activities, as well as to the licences of exploration and exploitation of non-associated gas hydrocarbons must be resolved by the courts of Venezuela (Hydrocarbons Law, art. 34 and Gas Law, art. 24).

Article 151 of the Constitution of 1999 establishes that in “public interest contracts, and unless inapplicable by reason of the nature of such contracts, a clause shall be deemed enclosed, even if not expressly, whereby any doubts or controversies related to such contracts which cannot be amicably resolved by the parties shall be decided by the competent courts of the Republic and in accordance with its laws, and shall not on any grounds or reason give rise to foreign claims”.

The exception included in this article (“unless inapplicable by reason of the nature of such contracts”) has not been construed unanimously.

On one hand, the exception included in the article has been construed as applying to contracts between sovereign states or between a sovereign state and an institution of public international law only, and/or contracts of an industrial or commercial nature. This was the interpretation of the Supreme Court in a judgment dated 17 August 1999 where it was held that, despite the fact that the Oil Association Agreements were contracts of public interest, such contracts could be subject to the exception of art. 151 because the exception refers to contracts between sovereign states; between a sovereign state and an institution of public international law; or to contracts of an industrial or commercial nature. The judgement stated that the term nature should not be construed by reference to the commercial nature of the contracts only; hence, the Venezuelan administration would be able to include an arbitration clause in other cases as it sees fit. Therefore, if the Venezuelan administration considers that it is in the country’s best interest to include an arbitration clause in a public interest contract, then this would be a relevant factor for consideration.

On the other hand, another line of interpretation has argued that these kinds of contracts – referred to activities of national security, with high impact in the economy, and subject to extraordinary requirements for their execution (i.e. Congress prior approval) – are to be considered as of public interest, and therefore, in accordance with art. 151 of the Constitution, submitted to the exclusive jurisdiction of the Venezuelan Courts. In the same sense, one of the senior judges in the referred judgment of the Supreme Court, concluded that all the clauses of the Oil Association Agreements were of public interest, thus rendering the whole contract not amenable to arbitration. He also argued for the application of art. 3 of the Arbitration Law, which states that disputes directly pertaining to the powers and functions of the state, or of persons or entities of public law shall remain excluded from arbitration.

In light of this position, the incorporation of international arbitration clauses in this kind of contract – if considered as of national public interest – must be then submitted to the prior approval of the President of the Republic according to the Decree, Internal Rule, No. 4, for the “Review of the draft national public interest contracts to be executed by the Republic”.

The position favouring the use of arbitration in this type of contract would see these as subject to the comprehensive Law of Commercial Arbitration enacted by Venezuela in 1998 (Arbitration Law), and arbitration as part and parcel of the system of justice of the Republic, as other forms of alternative dispute settlement (art. 253 of the Constitution of 1999 and Supreme Court Decision of 14 February 2001). Article 258 of the Constitution of 1999 encourages the use of arbitration, conciliation, mediation and other forms of alternative dispute settlement. The Arbitration Law made no distinction between domestic and international arbitration. Prior to the enactment of the 1998 Law, international arbitral tribunals were not always recognized to have exclusive jurisdiction even if parties contracted to arbitrate their dispute before them (Weininger & Lindsey: 2002).

For this position, arts. 22 and 23 of Investment Law of 1999 would be applicable. These provide that: in case there is an investment treaty between the home state of a foreign investor and the state in which the investment is made, or in case of disputes on which
provisions of the MIGA or ICSID apply, there is recourse to international arbitration; and at the investor’s choice, any dispute related to the application of the Investment Law can be subject either to national courts or to a Venezuelan arbitral tribunal, once the administrative procedure has been exhausted.

Recent developments in the Venezuelan hydrocarbon sector have also provided grounds for new approaches to this realm of dispute resolution. The forum selection clause contained in the conditions for the new joint ventures approved by the Venezuelan National Assembly in March 2006, provides that the Venezuelan Courts are the exclusive forum for the settlement of disputes between PDVSA or its affiliates (CVP) and the international oil companies without expressly providing for arbitration. Nevertheless, a more detailed examination of the clause could lead to a different thought in this regard.

The joint venture model approved by the Venezuelan Assembly provides for a forum selection clause in the following terms: “Applicable Law and Jurisdiction. This contract will be construed by and interpreted according to the laws of the Republic, and any dispute or controversy that might arise regarding the said [contract] and that could not be amicably settled between the parties, must be exclusively submitted to the decision of the competent courts of the Republic. Before initiating any [action before courts] the parties shall explore, in good faith and within the scope of the Hydrocarbons Organic Law, the possibility of using mechanisms to amicably resolve the disputes of any nature that might arise, including the possible request of opinions on technical matters, to independent experts appointed by mutual agreement […]”.

From the literal analysis of this clause, it is clear that the disputes that “must be exclusively submitted to the decision of the competent courts of the Republic” are those which would not been capable of prior amicable settlement by the parties. Therefore, it does not provide for an automatic submission of the disputes to the Venezuelan courts and, on the contrary, the clause seems to establish a condition precedent to the jurisdiction of the Venezuelan Courts. This condition is the exhaustion of amicable dispute settlement mechanisms by the parties “before initiating any [action before courts]”. Nevertheless, despite some broad references to what could be those “amicable mechanisms”, the joint venture model’s forum-selection-clause neither defines nor limits such mechanisms. Instead, when exploring for suitable “amicable mechanisms”, the clause compels parties to do so in good faith and “within the scope of the Hydrocarbons Law”.

The Hydrocarbons Law sets out the minimum conditions that must be adopted in a joint venture. Article 34 establishes that: “[…] 3. In the conditions of the joint ventures there must be included, and when not expressly shown they will be deemed as incorporated in them, the following clauses: […] b. The doubts and disputes of any nature that could arise due to the execution of activities and that could not be amicably settled by the parties, including the arbitration in the circumstances allowed by the law that rules the matter, […] be adjudicated by the competent Courts of the Republic, in accordance with its laws and shall not on any grounds or for any reason give rise to foreign claims”.

This clause, whilst establishing certain mandatory minimum conditions to the joint ventures (which are

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8 It continues: “It is understood that any important dispute, including for example, disputes regarding the Business Plan, work programs, development plans and related budgets, shall be addressed to the highest executives of both parties, who shall then meet to try to resolve the differences. In case that said dispute is not settled within sixty (60) days following the meeting held for such purpose, they shall inform the details of said dispute to the Ministry”.

9 Section III in regards to the joint venture companies (empresas mixtas), “Terms and Conditions for the creation and functioning of the joint venture companies”.

10 Referring to art. 33 of the Hydrocarbons Organic Law that states that: “The incorporation of joint venture companies and the conditions that will rule the development of the primary activities will require the prior approval of the National Assembly, to which effect the National Executive, through the Ministry of Energy and Mines, shall inform the [National Assembly] of all the pertinent circumstances to said incorporation and the conditions, included the special advantages provided for the Republic. The National Assembly may modify the proposed conditions or establish those which might consider suitable […] The joint venture companies will be ruled by the present Law and, in each particular case, by the terms and conditions provided for in the Agreement that in accordance with the law be enacted by the National Assembly […] Supplementary, the rules of the Commerce Code and other applicable laws”.

11 Arbitration is also recognized and promoted by the Venezuelan Constitution when establishing in its art. 258 that: “[…] The law shall encourage arbitration, conciliation, mediation and any other alternative means for resolving conflicts”.

12 “[…] including the arbitration in the circumstances allowed by the law that rules the matter” If the term “the matter” is related to the joint ventures and their conditions, the Hydrocarbons Law would be “the law that rules the matter”. This would be a redundant and futile statement of the law. On the contrary, if “arbitration” is “the matter”, the applicable law would be the Venezuelan Commercial Arbitration Law and hence, there would be enough legal bases to incorporate arbitration agreements in the joint ventures.
applicable despite the will of the parties) provides also for a hierarchy among the dispute mechanisms referred to therein. In first instance, parties are bound to exhaust amicable procedures (i.e. negotiation, mediation, etc.) including arbitration. Subsequently, if the disputes are not capable of being settled by means of those amicable procedures, the parties are entitled to resort to local courts.

However, despite the fact that art. 34 of the Venezuelan Hydrocarbons Law provides for the set of mandatory minimum conditions applicable to the joint ventures, the Venezuelan National Assembly approved a joint venture model lacking arbitration, hence, preventing parties from agreeing upon it when negotiating joint ventures. If this is the case, it seems that there could be grounds for investment disputes against the Venezuelan state on the basis of violations to the investors’ rights by preventing their use of arbitration in the joint ventures as provided for in the Hydrocarbons Law.

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13 Nonetheless, parties should not forget provision of art. 34 stating that: “in the conditions there must be included, and when not expressly shown they will be deemed as incorporated in same [conditions], the following clauses: […] 34.b […]”.
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