Venezuela and OPEC, Fifty Years Later

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On 14 September 2010, OPEC celebrated its fiftieth birthday. Venezuela was one of five founding Members, together with Saudi Arabia, Iran, Iraq and Kuwait. But more than that, Venezuela, in the person of Juan Pablo Pérez Alfonzo, played a stellar role in setting up this organisation, at the side of Saudi Arabia, represented by Abdullah Al-Tariki. These two men shared one vision, centred on the question of the price of oil. This common vision was embodied in the OPEC Founding Resolution (14 September 1960), which speaks of nothing but prices. In order to stabilise them, that resolution suggests the regulation of production as a possible option. (The Venezuelan government formally ratified the OPEC treaty in May 1961.)

Pérez Alfonzo and Tariki drew inspiration from the American experience. In the United States, from the decade of the 1930s onwards, petroleum production was subject to regulatory bodies at the state level which, in turn, were organised into an Interstate Oil Compact Commission that had as its main objective the creation of stable economic conditions. This *modus operandi* was legitimised in terms of embodying a conservation policy for an exhaustible natural resource for which such conditions are a *sine qua non.* Conservation measures require a steady and continuous expenditure and investment flow, which in turn requires stable prices. This link was acknowledged by the US Supreme Court in the disputes surrounding the runaway production of oil in Texas. Furthermore, at an international level, in 1947, the General Agreement on Trade and Tariffs (GATT) explicitly recognised that measures which governments could adopt related to the conservation of exhaustible natural resources would not be subject to the rules defined in the agreement, which were meant to deal with acts undertaken in the commercial sphere (Article 20: General Exceptions).

A less formal but no less effective form of production control was the one exerted over much of the world's output by the International Petroleum Cartel – constituted by the companies colloquially known as the Seven Sisters – which complemented the production control exerted over US output by the regulatory bodies of oil-producing states. However, after World War II, with increasing competition in the world market, the Cartel weakened. Finally, this situation reached a critical point in 1959. As far back as 1947, the United States had already become a net importer of oil, and the lack of control over growing oil imports was threatening tens of thousands of marginal wells. The US Federal government therefore closed the loop on the production control scheme at the state level with a mechanism for the control of imports at the Federal level. With this, of course, the downward pressure on oil prices in the world market became much greater.

Pérez Alfonzo was conscious of the danger that this trend represented for oil-exporting countries. For the space of decades, prices in the world oil market had been determined on the basis of prices in the United States, with appropriate adjustments for differences in transportation costs and crude quality. Needless to say, within the United States, it was the costlier production – that is, the output from marginal wells – which determined the general price level. However, the production costs in oil-exporting countries were only a fraction of the costs of these marginal wells. Therefore, with the break-up of this unified structure (as the United States partially closed itself off from the world market), exporting countries were in danger of witnessing a calamitous fall in oil prices and, consequently, in their fiscal income from oil. Hence the sense of urgency to create an organisation capable of establishing mechanisms for the control of production at the level of nation states, as such an arrangement would allow oil exporters to maintain the link between international market prices, on the one hand, and US domestic prices, on the other.

The Venezuelan Ministry of Mines and Hydrocarbons

Already in 1959, Pérez Alfonzo had created a *Coordinating Commission for the Conservation and Commerce of Hydrocarbons* (CCCCH) within the Ministry of Mines and Hydrocarbons. This entity had to authorise all export transactions, and if these were to take place at discounted prices, it had the power to deny the corresponding export permit and even to order production cutbacks by the companies purporting to export this oil (something which it did on a number of occasions). Furthermore, the Ministry retained experts from the *Texas Railroad Commission* – the most important of all the state entities regulating oil output in the United States – in order to prepare *prorationing* of Venezuelan oil production, following the example of Texas. Pérez Alfonzo's dream was that Venezuela, and ultimately OPEC, would form part of an international body that would regulate world oil prices, along the lines of those established for coffee, sugar and some other raw materials.

Despite the sense of urgency which prevailed at the birth of OPEC, its Member Countries only managed to agree on a joint production program much later, for the years 1965/6 and 1966/7. Despite this belated agreement, both attempts failed at the execution level, for two main reasons. Firstly, Venezuela was the only country in a position to force its concessionaires to comply with governmental directives, as it enjoyed the full panoply of its sovereign rights: jurisdictional sovereignty, tax sovereignty and regulatory sovereignty. In every other Member Country, in contrast, the concessions were still subject to the *general principles of the law of civilised nations* and *international arbitration*. Ashraf Lutfi, Secretary General of OPEC in 1965/6, summarized in 1968 the difference between the governance of oil in Venezuela and in the other Member Countries as follows:

> In my references to OPEC's problems about the need for financial adjustments and revision of the abnormal legal provision in oil agreements, I should, of course, have made exception for Venezuela on many grounds. Many of the problems discussed are the exclusive concern of the Middle East countries since they have been to a large extent solved in Venezuela. There it is the government that to some degree plays the paternal role *vis-à-vis* the oil companies, and on the whole, oil operations in that country are not favored with special privileges unavailable to other commercial and industrial sectors. The oil operations, foreign and local alike, are subject to the law of the land and pay whatever taxes the government sees fit to impose generally on all sectors without discrimination. If disputes arise between oil operators and governmental agencies, such disputes are taken to the local courts as a matter of course. (...) its government is able to recommend any level of income taxation without having to obtain the prior approval of the foreign operators, as is the case in the Middle East. In general therefore, the Venezuelan Government is free from any fetters on its authority to formulate the oil policy of the nation regarding existing oil exploitation arrangements. (Ashraf Lutfi: *OPEC Oil*, Beirut, 1968; p.72)

On the other hand, Venezuela was already a mature petroleum province. Production was increasing slowly, and approaching its peak (which occurred in 1970, at the same time as in the United States). Again in sharp contrast, production in all other OPEC Member Countries was growing by leaps and bounds. Hence, the interest of all such countries in stabilising prices was reduced by OPEC's great success at stabilising fiscal income per barrel produced. Indeed, in the Middle East fiscal income was based on the companies' posted prices, and not on market prices. And after the foundation of OPEC, the companies never again adjusted their posted prices downwards, in spite of the continuous fall of market prices. This tax reference price mechanism proved satisfactory

for the petroleum-exporting countries of the Middle East and acceptable to the international oil companies and the powerful consuming countries. Whereas the only alternative, the control over output, was the very last thing that the latter were willing to share with – much less hand over to – the oil-exporting countries. Again, we may quote Ashraf Lutfi:

> The Majors' ability to manipulate production in the Middle East has been, and still is, a potent weapon which they have used and will no doubt continue to use to very good effect against individual countries in the area. Agreement on their part to operate in accordance with an OPEC Joint Production Program would effectively entail a relinquishment of the weapon that has enabled them to surmount many a storm in the past for the production program is in essence an instrument whereby OPEC itself, rather than the oil companies, can assume the responsibility for deciding on the production level from the OPEC area as a whole, as well as the output from each member country. (Ashraf Lutfi: *OPEC Oil*, Beirut, 1968; p.68)

As things turned out, Venezuela understood that the country had no other option but to follow the patterns set in the Middle East, and stopped pushing the issue of production control. In contrast to the situation in the Middle East, fiscal revenues in Venezuela were based on market prices, but in 1966 the country introduced fiscal reference prices (which were to be agreed with the companies for a period of up to five years), thereby neutralising the fiscal effect of the ongoing downward trend of oil prices in international markets.

Petróleos de Venezuela, Incorporated

During the 1960s, developments in the world oil market unfolded as Pérez Alfonzo had envisaged: world demand, then growing at an accelerated rate, absorbed excess production with relative ease. The turning point came in 1970. In 1973, the United States suspended all production cutbacks and, for the last time – through the good offices of the oil Majors – attempted to freeze oil prices worldwide. But the Majors were no longer in control of the world petroleum market. Thus, the United States had to resign itself to seeing its domestic prices become aligned with international oil prices, now significantly higher. The so-called OPEC revolution was irresistible: Member Countries were now determined to decide production volumes on a sovereign basis. This was the *de facto* nationalisation of concessions, which would be followed, in due course and in every case, by a *de jure* nationalisation.

"Pérez Alfonzo's dream was that Venezuela, and ultimately OPEC, would form part of an international body that would regulate world oil prices"

The OPEC Revolution took place in the midst of the Fourth Arab–Israeli War and its sequel, the selective embargo decreed by the Organisation of Arab Petroleum Exporting Countries (OAPEC), above all against the USA and the Netherlands. Faraway Venezuela kept to the sidelines in this fracas. Nevertheless, in December 1973, the two most important Venezuelan concessionaires, Exxon and Royal Dutch-Shell, took the country by surprise by declaring their agreement in principle with their nationalisation. As a matter of fact, the thought of nationalising them had not even crossed the mind of the government of Rafael Caldera, in office at the time: 'I have to admit (...) it never crossed my mind the possibility or convenience to nationalize Creole, affiliate of Standard Oil, Shell de Venezuela, affiliate of Royal Dutch-Shell (...)' (Rafael Caldera in *El Nacional*, 27 December 1973). This tactical gambit led to a resounding strategic success: nationalisation in Venezuela would be implemented in accordance with the design drawn up by the major international oil companies themselves.

Petróleos de Venezuela, Sociedad Anónima (*Incorporated*), would be a joint stock corporation with only one shareholder, the Venezuelan state. PdVSA was conceived as a holding company, and the more important concessionaires would become affiliates, but now presided over by the highest-placed Venezuelan managers within them, rather than by foreigners. The PdVSA Board of Directors would in turn protect these affiliates from the 'political' intervention of the State. In essence, the fiscal regime would also remain unchanged. So it is fair to say that, at the level of the concessionary companies in Venezuela, the shift brought about by nationalisation was strictly limited to a change in their ultimate shareholder. Everything else stayed the same. It is hardly surprising, then, that PdVSA's affiliates took over – lock, stock and barrel – the ideology of the former concessionaires. And in the wake of nationalisation, the Venezuelan political class, which had always maintained its distance and critical faculties relative to the foreign concessionaires, would have to deal with men who dressed up in a *liquiliqui* (the traditional Venezuelan informal business attire) and spoke in the name of the state oil company, the pride of the Nation.

As if this were not problematic enough, the original Venezuelan national oil company, the *Corporación Venezolana del Petróleo* (CVP), created in 1960 by the Ministry as an autonomous institute under its tutelage and control, was dissolved and merged with all the other small companies into a single affiliate. The Ministry thus lost its 'window' into the industry, as well as its managerial capacity. Furthermore, the members of the PdVSA Board of Directors would be appointed by the President of the Republic, without any consultation with the Minister of Energy and Mines. Thus, the stage was set and the dice rolled: throughout the next twenty years, the Venezuelan Ministry of Energy and Mines would

be transformed into a mere political brokerage for PdVSA, and PdVSA would take over Venezuelan oil policy.

As this takeover unfolded, PdVSA trained its sights firmly on OPEC. Only fifteen years after nationalisation, Andrés Sosa Pietri (president of PdVSA between 1990 and 1992) was openly disparaging Pérez Alfonzo as a myth and calling OPEC a resounding failure, while recommending that Venezuela should rescind its membership of the Organisation. What is more, Sosa Pietri suggested that Venezuela join the International Energy Agency (IEA), founded in 1974 by the USA precisely to contain the OPEC Revolution. According to Sosa Pietri, OPEC's best and only hope for the future lay in transforming itself into a research organisation, cooperating with the IEA.

But the thing that PdVSA really wanted to blow sky-high was the regulation of production that OPEC, in one way or the other, had practised since 1982. In Venezuela, PdVSA put its own particular spin on this regulation and the quota system that underpins it to this day. According to the PdVSA view at that time, the regulatory powers of the government derived not from its condition as a sovereign owner of an exhaustible natural resource, but from the fact that, as the company's sole shareholder, the government could give orders that PdVSA's officers were statutorily bound to carry out; i.e. to pass these orders on to their 100 percent-owned producing affiliates. Thus, when private oil companies returned to Venezuela in the 1990s as partners of PdVSA affiliates, the Venezuelan State oil company articulated the view that these partners would only be subject to the regulation of production by the Venezuelan State if their agreements with its affiliates so stipulated. As a matter of fact, though, the first agreements did not even mention the control of production. The issue was hidden away in side letters, in which the affiliates of PdVSA – turning their back on the Law, the government and the Nation – purported to committing themselves to absorb any cuts the government might impose. But with the progress of the political agenda of PdVSA, the topic formally began to rear its head in 1995. From then onwards, the agreements would state that the private partner would only be subject to the regulation of production if such regulation were the outcome of a commitment by the Republic within the context of an international treaty. In this way, PdVSA pretended to deny the Venezuelan state the sovereign right to regulate production of an exhaustible and non-renewable natural resource, a right to which any state is entitled quite apart from its participation as a shareholder in any production enterprise or in any international treaty.

Despite PdVSA's hostility towards OPEC, forcing Venezuela out of the Organisation was not a politically viable option for the Company. As an alternative, therefore, PdVSA sought to minimise the importance of OPEC. Starting with the government of Luis Herrera Campins, in 1979, Venezuela stopped publishing OPEC's Resolutions in the Official Gazette, as had been the practice up to then. Moreover, as a cornerstone of the policy to marginalise OPEC, PdVSA started propagating the notion that the reserves of the Orinoco Oil Belt were not even crude oil at all.

The traditional and most widely used non-specialist definition of crude oil (coined by the American Petroleum Institute) stipulates that crude oil is a liquid mix of hydrocarbons that flows under reservoir conditions, and remains a liquid at standard temperature and pressure conditions at the surface. The extraheavy oil of the Orinoco Oil Belt, however, is a flowing liquid under reservoir conditions but, on account of its considerable viscosity, it ceases to flow at standard ambient surface conditions. Thus, its transportation in a liquid state requires that it be either heated or else diluted with lighter hydrocarbons. This was the starting point for PdVSA to argue, towards the end of the 1980s, that the Orinoco Oil Belt actually contained immense reserves of *natural bitumen* (a *solid* in reservoir conditions), which led to the company rechristening the Belt as the Orinoco *Bituminous* Belt.

In any event, the company sustained the viewpoint that the output from the Orinoco Oil Belt ought not to be subject to the production agreements negotiated within OPEC. From 1996 onwards, this became Venezuela's official position: when Congress authorised the first association agreement between PdVSA and private parties to produce a boiler fuel known as Orimulsion (a mixture of extraheavy crude oil, water and a surfactant), the text of the authorisation referred to the extraheavy crude oil emulsified in the fuel as 'natural bitumens' and, for good measure, it stated that the production of such crudes 'would not be considered subject to the international commitments derived from the participation of the Republic of Venezuela in international organisations' (Official Gazette, 17.7.1996). At the same time, Bitor requested that the Ministry re-classify the company's reserves of extraheavy crude as natural bitumen, which was duly done in December that year. Immediately thereafter, Bitor started to project on its webpage the entire Orinoco Belt as a huge reservoir of natural bitumen, and PdVSA finally imposed the use of the name Orinoco *Bituminous* Belt in Venezuela. (However, PdVSA met with some resistance in the Ministry. Up until that point there was no official definition of crude oil in Venezuela, nor was it considered necessary to have one. But that very same year, 1996, the Ministry formally approved a definition of crude oil which only required that crude oil be a liquid in the original reservoir conditions – technologically the most important fact – but not at the surface. This definition has been published ever since in the Ministry's statistical yearbook *Petróleo y otros datos estadísticos*.)

Summing up: PdVSA was implementing its viewpoint that the Venezuelan government could only impose quotas of production on the private companies, if so provided in their agreements with PdVSA. Next, these agreements stipulated that production cuts would only apply if they were the result of a commitment of the government in the context of an international treaty of which Venezuela was a party. The

only relevant international treaty regarding oil was, of course, OPEC. Hence, implicitly, PdVSA was asserting that the Orinoco Oil Belt and its production were not covered by OPEC, as this reservoir did not contain crude oil but natural bitumen.

Consequently, according to PdVSA the Venezuelan State had no right to impose production cuts on its own, as this right was supposed to be a contractual and not a sovereign one, and all the agreements of that period of *Apertura* said nothing at all on the possibility of regulating production (until 1995), or only referred to such a possibility (starting in 1995) within the framework of an international treaty of which the country was a party.

Hence, as a practical matter, Venezuela would gradually withdraw from OPEC, in the same measure as output from the Orinoco Belt increased over time, and the production from the traditional areas declined. But in both the Orinoco Belt and in the traditional areas of production, those 100 percent PdVSA-owned affiliates would still be producing very substantial volumes of oil on their own account, and this output would be exposed to being reined back by the State, if only in its capacity as sole shareholder of the company. That is one of the reasons why, as far back as 1990, PdVSA had introduced a Motion for Interpretation in the Venezuelan Supreme Court, where it requested that the Court clarify the implications for association agreements with foreign companies of the fact that Article 5 of the 1975 Organic Law Reserving to the State the Industry and Commerce of Hydrocarbons (popularly known as *Nationalisation Law*) stipulated that the state entities involved in such contracts should hold 'a participation that guarantees control on the part of the State'. The judge entrusted with clarifying this matter was José Román Duque Corredor, who had begun his career in the legal department of Shell de Venezuela and had continued it after nationalisation in the legal department of Maraven (the successor affiliate to Shell). Duque Corredor ruled that 'control' was essentially a 'notion with legal connotations, more than economic or patrimonial ones'. Thus, the requirement for control could be met without a majority shareholding, and even without any shareholding at all: a legal artifice, a 'Control Committee' as it would come to be called, was deemed to be enough. However, the *Preamble* of this Law, which the justice never mentioned, referred explicitly to the question of control on the part of the State 'according to its majority interest'. But that was of no importance once the judge with his verdict cleared the way for the total privatisation, potentially, of Venezuela's producing fields.

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However, the Law required that each association be authorised by Congress. PdVSA, out of an abundance of caution, always asked for a minority stake for its affiliates, but significant enough not to give rise to any major concerns in Congress. Crucially, though, this stake was called 'initial', and the door was left open for PdVSA to divest itself of these shareholdings at its own judgment and convenience, whereas PdVSA affiliates were explicitly denied the possibility to become majority shareholders in their respective associations.

The rationale underlying this authorisation was incorporated in, of all places, the Bolivarian Constitution of 1999. The fundamental charter currently in force in Venezuela establishes in Article 302, that 'the State reserves for itself (...) all petroleum activities, as defined by the respective Organic Law'. Now, the 'Organic Law' in force at the time was the 1975 Organic Law Reserving to the State the Industry and Commerce of Hydrocarbons (and in the context of Article 5 of this Law, as interpreted by the Supreme Court 'reservation' meant nothing more than a 'control committee'). Moreover, in Article 303, the Constitution further defines the scope of this reservation in the following terms: 'the State will retain the totality of the shares of Petróleos de Venezuela, S.A. (…) with exception being made of the shares of affiliates, associations (…), enterprises and any other which have been constituted or were to be constituted as a consequence of the business development of Petróleos de Venezuela, S.A.' Thus, PdVSA, the holding company that does not produce a single barrel of oil or cubic foot of natural gas, has to be owned exclusively by the State. In contrast, its affiliates which do produce oil and gas can be 100 percent privately owned. Thus, PdVSA could be transformed into the new contracting and licensing agency, in charge of the administration of the natural resource according to the criteria of international investors, replacing for good the old Ministry, which was historically committed with the administration of the natural resource according to national criteria.

Venezuela, Coup by Coup

The anti-national petroleum policy that PdVSA promoted from its very inception was, essentially, a *hidden agenda*. For its promoters, the objective was to prevail in practice, not to win arguments (*vincere, non convincere*). A particularly favourable juncture to make progress in the implementation of this agenda arose in 1989, when Carlos Andrés Pérez became President of the Republic for the second time. Pérez had been President between 1974 and 1979, the years of nationalisation and fiscal *bonanza*; but now he was confronted with public finances in deep disarray (due to the collapse of oil prices in 1986), and his government was forced to go cap in hand to the International Monetary Fund.

Moreover, Carlos Andrés Pérez had, personally and on his own responsibility, insisted on incorporating in Article 5 of the Nationalisation Law the possibility of association agreements subject to a controlling participation of the state (the original draft presented to Congress denied

any possibility of association agreements or joint ventures with private parties). Fifteen years later, during Pérez's second stint in office, the modifications to the original language of this article that he himself had introduced would play a decisive role in the advancement of PdVSA's Hidden Agenda, in no small measure thanks to the invaluable help of the Venezuelan Supreme Court. As well as determining that no shareholding by a state entity was necessary to fulfil the requirement of 'State control' in the associations contemplated in Article 5, the Supreme Court for good measure annulled legislation dating from 1967, which related to the contracts that CVP – the original Venezuelan national oil company – could celebrate with private parties. This legislation established that CVP, in case of disputes, could only be sued in the ordinary courts of Venezuela, and also that CVP's contractual arrangements would in no way prejudice the tax sovereignty of the Venezuelan State. After Judge Duque Corredor annulled this legislation, PdVSA was able to incorporate in all its association projects presented for the consideration of Congress the principle of international arbitration against the affiliates in question, mainly under the rules of the International Chamber of Commerce (ICC). Next, these affiliates conceded guarantees to their respective private 'partners' against certain sovereign actions of the State, undertaking to indemnify these 'partners' if such actions (defined as 'discriminatory') were to have negative economic consequences for the projects in question. In other words, in these associations, PdVSA affiliates assumed the role of hostages against the long-standing sovereign rights of the Venezuelan state, ultimately their sole shareholder.

Of course, the value of a hostage would be that much greater to these partners if it possessed assets potentially subject to attachment in friendly jurisdictions, but these affiliates had none. Thus, overcoming this limitation has to be seen as one of the key objectives of PdVSA's Internationalisation policy, a programme initiated during the early 1980s, whereby PdVSA acquired shareholding stakes in twenty refineries and storage facilities outside of Venezuela. In order to square this attachment circle, all that PdVSA had to do, and actually did, was to guarantee the commitments of its affiliates. Thus, in the end, PdVSA itself assumed the role of a hostage. (Hence the damaging and malicious – albeit ultimately unsuccessful – *ex parte* asset-freezing orders against PdVSA that ExxonMobil obtained in early 2008 in the High Court in London in the wake of the nationalisation of the Cerro Negro upgrading Project. Moreover, both of the arbitrations that ConocoPhillips and ExxonMobil have brought against PdVSA before the ICC also involve the question of OPEC quotas that the government of President Hugo Chávez applied to their associations in the Orinoco Oil Belt.)

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PdVSA's willingness to act as a hostage, while valuable, was not enough for Royal Dutch-Shell, as this company wanted the option to use arbitration against the Republic itself. Thus, in 1991, and with the collaboration of PdVSA, the Venezuelan government negotiated and initialised a bilateral investment treaty (BIT) with The Netherlands. By means of this treaty, Dutch investors in Venezuela would enjoy the right to bring disputes with the Republic before the International Centre for the Settlement of Investment Disputes (ICSID); conversely, of course, the myriad Venezuelan investors in The Netherlands would enjoy exactly the same right! However, to PdVSA's great frustration, the Venezuelan government did not ratify this treaty.

Another area where not everything was going according to plan for PdVSA involved the control of production. The Oil Opening Policy was predicated on an enormous expansion in Venezuelan production. An explicit condition of this plan was that output expansion would not be subject to curtailment as a result of OPEC quota commitments. However, this proved a bridge too far for Carlos Andrés Pérez, who was convinced of the great importance of OPEC for Venezuela. Pérez refused to sanction the unbridled growth in Venezuelan output. Hence, there were a host of circumstances that may explain the interest of PdVSA – and even its participation – in the impeachment proceedings (or coup d'état, to call it what it really was) that cut short his presidency.

This coup d'état was judicial in its nature. Carlos Andrés Pérez was accused of embezzlement and the Venezuelan Supreme Court determined, surprisingly, that the ensuing investigation would require that Pérez be separated from office. Pérez resigned immediately, seven months before the end of his constitutional term. (The legal process ended years later with Carlos Andrés Pérez being found guilty on minor embezzlement charges.) One may safely assume that PdVSA was part of this conspiracy[1] not least because, during the six months of the interim presidency of Ramón J. Velázquez, PdVSA's Hidden Agenda made gigantic strides. The plan of accelerated expansion of production received the green light, and the Venezuela–Netherlands BIT was ratified. To date, 27 other BITs have followed, but the Dutch BIT was absolutely decisive. It is not for nothing that international oil companies operating in Venezuela such as ConocoPhillips, ExxonMobil, Chevron, ENI, the China National Petroleum Company (CNPC), etc., put themselves forward and organise their affairs as Dutch entities, and all with the exclusive objective of having access to international arbitration against the Republic. (At present, ConocoPhillips and ExxonMobil are suing the Republic before the International Centre for the Settlement of

1 This conclusion is based on my personal experience as a Senior Advisor to the Department of Strategic Planning of PdVSA at the relevant time.

Investment Disputes (ICSID), on the basis of the Dutch treaty.)

Five years after the defenestration of Carlos Andrés Pérez, the world petroleum market collapsed, in no small measure thanks to PdVSA's policy to maximise production whatever the price. Nevertheless, PdVSA declared publicly that it would not cut back its production by a single barrel. What is more, in statements to the specialised trade press, some of the company's executives announced that it was their intention to use price competition to drive high cost marginal US production out of business. Needless to say, the price collapse brought about a savage fiscal crisis, which came on top of twenty years of negative growth rates in Venezuela's per capita Gross Domestic Product. The Venezuelan political regime, for so long the envy of the rest of Latin America, was in a state of imminent collapse. During the month of January of 1998, a year of presidential elections in Venezuela, a former Miss Universe was leading opinion polls with figures of about 40 per cent of the prospective vote, and professional pollsters dismissed out of hand the prospects of candidate Hugo Chávez. Come December 1998, with prices in the doldrums and the exchequer in ruins, Chávez won the presidential elections, receiving 56 per cent of the votes cast.

The management of PdVSA had actively worked to put an end to what is now known as the IVth Venezuelan Republic. The company's top managers harboured no doubts that, following the demise of this political formation, the future of Venezuela would rest in their own hands and they would therefore be free to pursue their Hidden Agenda at leisure. Never for a single moment did it cross the minds of these managers that there could arise a popular, national and revolutionary alternative to this agenda. But arise it did, in the form of the Bolivarian Movement led by Hugo Chávez. Chávez's election victory left the company's high officers in a state of shock. Admittedly, they were still strong enough to promote parts of their Hidden Agenda with certain success, as witnessed for instance by the text of Articles 302 and 303 dealing with hydrocarbons in the new Constitution. Outside of Venezuela, however, things had taken a turn for the worse. The Chávez administration promoted and defended a new agreement on quotas within OPEC, and forced PdVSA to comply with the Republic's output commitments. Prices recovered, and to this day they have never again fallen to levels even remotely near those which prevailed during the 1990s. In addition, Chávez convened a second OPEC Heads of State meeting, which took place in Caracas in the year 2000. Finally, in November 2001, the Venezuelan government enacted a new Organic Law of Hydrocarbons, which left no doubt about the seniority of the Ministry with respect to PdVSA. The new law rendered the 1975 Nationalisation Law (and its Article 5), null and void. It also established that any new hydrocarbons project would require a majority shareholding by the State enterprise participating in it. Faced with such initiatives, the PdVSA leadership finally lost patience and participated in the preparation and execution of a second coup, this time a military coup d'état, which took place on 11 April 2002. After this coup fizzled out, the management of PdVSA prepared its very own and exclusive coup, the third, which this time around had an economic nature. Thus, in December 2002, the PdVSA management ordered a work stoppage and the blockade of the main export points for oil with PdVSA's own vessels, actions which led to an almost total cessation of oil production in the country. The overwhelming majority of the PdVSA management cadres participated in the Oil Sabotage, but the workers did not abandon their posts. As a result, the Sabotage ended in the comprehensive defeat of these managers, and all those who had abandoned their posts with no legal justification were not allowed to return to them. The constitutional head of State, President Hugo Chávez, put an end to the state within a state that PdVSA had become. With the defeat of the Oil Sabotage, there remained no doubt that in Venezuela there was only *one* head of State.

OPEC, The International Energy Agency and Venezuela

When the current OPEC quota system began in 1982, the Member Countries agreed that petroleum condensates would not be a part of it. Condensates are jointly produced with natural gas, but at atmospheric pressure, they pass from a gaseous to a liquid state (in cryogenic gas treatment plants, more liquids can be extracted from natural gas to turn it into dry gas). For a variety of technical and economic reasons, it made no practical sense to fix production quotas for natural gas and, as a result, it was considered sensible to exclude from the quota system condensates derived from free or *associated* gas. However, this decision was but the preamble for a long and intense discussion within OPEC on the issue of condensates, which only concluded in 1988, when the OPEC Conference approved a formal Resolution which defined condensates with technical and scientific precision.

Venezuela (through PdVSA) participated very actively in the OPEC discussions around the issue of condensates, and it took full advantage of them in order to introduce the issue of the nature of the extraheavy crude oil from the Orinoco Belt on the agenda, albeit by the back door. After all, if it could be argued that condensates were not crude oils subject to quota because they were not found in a liquid state in the reservoir (as required by the conventional definition of crude oil), then a similar sort of argument could be made, *mutatis mutandis*, for the extraheavy crude oil from the Orinoco Belt. In the latter case, as was explained above, Orimulsion (PdVSA's 'liquid coal') served as the spearhead in this effort, for which PdVSA could count on the enthusiastic support of the IEA. Indeed, as early as January 1993, the IEA had classified the alleged 'bitumen' contained in Orimulsion as non-conventional oil, and announced that henceforth it would be reported together with natural gas liquids (NGLs). Given that the quota system definitely did not cover NGLs, associating the Orinoco 'bitumen' with

them carried the implicit message that the latter should also not be subject to any OPEC quota.

Towards the end of 1993, Venezuela embarked in earnest on its plan of accelerated expansion of production (both in the Orinoco Belt and elsewhere in the country), determined to drive a coach and horses through its OPEC quota ceiling. A confrontation within OPEC was therefore inevitable. When it came to it, the Venezuelan oil minister Erwin Arrieta lied blatantly to the OPEC Conference – the assembly of Ministers – about the true levels of Venezuelan production, and disparaged OPEC as a 'club of Pinocchios'. Given the lack of truthful information, OPEC began to resort to the production estimates published in certain secondary sources (for the most part, trade journals) as an auxiliary method for ascertaining quota compliance. Finally, in 1998, OPEC chose six of these secondary sources to be the source of production estimates which would, in turn, be used as the basis for any discussions and any decisions relating to quotas. This meant, in a word, that the official figures published by the Member Countries would be ignored. Erwin Arrieta had prevailed. While he had to come clean about the fact that he had been misrepresenting the country's true production levels, the fact that the country's OPEC quota would thereafter be calculated on the basis of the estimates of secondary sources effectively meant that Venezuela had succeeded in making OPEC accept a significant increase in its official production allocation, of about 500 thousand b/d, to 2845 million b/d.

Moreover, at the insistence of Venezuela, the IEA was to be included in this group of secondary sources, whose mantle of leadership it assumed. And three years later, Venezuela expanded the commercial exploitation of the Orinoco Belt in a major way. With the coming on-stream of four large upgrading projects, PetroZuata (today known as PetroAnzoátegui), CerroNegro (today PetroMonagas), Sincor (today PetroCedeño), and Hamaca (today PetroPiar) began producing upgraded oil in March and August of 2001, April of 2002, and November 2003, respectively. In a relatively short period of time, production of extraheavy oil was to increase to 620 thousand b/d, to be transformed into 550 thousand b/d of upgraded crude oil. In preparation for such an increase the IEA announced in its monthly report for July 2002 that it would 'reclassify' the upgraded crude oil from the Orinoco Belt. Thenceforth, the IEA would no longer consider the extraheavy crude oil charged to the upgraders as part of its tally of Venezuelan production; instead, it would report separately the output of upgraded crude as non-conventional oil. Hence, as far as the IEA was concerned, extraheavy crude oil processed in the production of upgraded crude oil, like the extraheavy crude oil processed in the production of Orimulsion, was not covered by OPEC quotas.

"Towards the end of 1993, Venezuela embarked in earnest on its plan of accelerated expansion of production … determined to drive a coach and horses through its OPEC quota ceiling"

This change, according to the IEA, 'reflected the intentions of the association agreements' (IEA, Oil Market Report, 12 July 2002, p.22). For the time being, the immediate consequence was that the IEA adjusted downwards its estimate of the production of Venezuelan crude oil supposedly subject to OPEC quotas by 300 thousand b/d (and all the other secondary sources duly followed suit). Thereafter, these 300 thousand b/d would be reported, together with condensates and natural gas liquids (and, of course, the alleged 'bitumen' in Orimulsion) as part of the 'non-conventional oil' in the IEA's global supply balance (today, though, this upgraded crude oil appears to have vanished altogether from IEA statistics.)

The OPEC Secretariat followed the guidelines set by the PdVSA old guard and the IEA. In August 2002 the OPEC Secretariat completed an internal report with the title: 'Major Potential Resources for Future Non-OPEC Oil Supply: Deepwater and Bitumen'. This report talks about, *inter alia*, the Orinoco Belt, the four upgrading projects and Orimulsion, all as part of its analysis of 'Non-OPEC Oil Supply'. The classification of the Orinoco Oil Belt as non-conventional oil and non-OPEC reserves has since then become a recurrent feature in all publications and internal reports of the OPEC Secretariat in Vienna. Moreover, starting in September 2002, the Secretariat also included in its Monthly Oil Market Report the supply of non-conventional oils from other OPEC Member Countries (really a very modest amount) as part of the non-OPEC supply of liquid hydrocarbons.

Regarding the definition of 'non-conventional oil', a presentation of the Secretariat, dated September 2005, says that this concept comprises synthetic crude oil from tar sands, oil shale, bituminous sands, etc.', as well as 'emulsified oils (e.g. Orimulsion)'. In the study quoted before, 'upgraded crude oil' and 'synthetic crude oil' are used synonymously. Moreover, the OPEC Secretariat uses the following definition: 'Synthetic Crude Oil: A mixture of hydrocarbons ... that is derived by upgrading ... heavy oil' (Conventional and Non-Conventional Oil Reserves and Production Outlook, OPEC Secretariat, 8th Multi-Disciplinary Training Course, April 2008). (In practice, however, the upgraded crude oil does not appear in any OPEC statistics either).

But this latter internal presentation has gone one step further, by classifying the extraheavy crude oil itself as 'non-conventional oil'. With this, the OPEC Secretariat appears to accept that the whole Orinoco Oil Belt is beyond the reach of OPEC's quota system; and, hence, that the whole production of extraheavy crude has to be considered 'Non-OPEC supply' (as opposed to only that part of production destined for upgrading or

transformation into Orimulsion). Indeed, this novel OPEC definition also appears to cover the approximately 300 thousand b/d of extraheavy crude oil which is blended with lighter crudes, and exported thereafter to refineries abroad (typically as a blend called Merey 16).

However, the new Venezuela – the Vth Republic – has no intention to quit OPEC. Thus, the government has continued, and continues, to report the production of extraheavy oil as an integral part of crude oil production generally which, it should be pointed out, is consistent with the official definition of crude oil of the Ministry of Energy and Petroleum. As pointed out before, this definition does not require that crude oil be a liquid under normal surface conditions. (However, the official data on Venezuelan crude oil production is not consistent with the definition used by PdVSA, which is identical to the definition used by OPEC Secretariat). Moreover, in 2004, the Ministry re-classified again the reserves of Bitor as extraheavy crude oil, revoking its decision from 1996 classifying them as natural bitumen.[2]

Let us have a look at a numerical example. In August 2010, the IEA estimated the production of Venezuelan crude oil subject to quota at 2.230 million b/d, while the official Venezuelan statistics indicated an output of 2.803 mb/d (in both cases, condensates are excluded from the tally). The difference between the two figures, 573 thousand b/d, boils down, essentially, to the volume of upgraded crude oil. As a matter of fact, Venezuela produced 876 tb/d of extraheavy crude oil, which suggests that the IEA still includes as conventional crude oil those 300 tb/d which are blended with lighter crude oils.

This difference has given rise to a remarkable 'media war'. The government of Venezuela is accused of lying, as it was supposedly not able to recover production after the confrontation with the old PdVSA, between December 2002 and January 2003, which ended with the defeat of the old leadership and their followers. Not only in the international press, but also in the Venezuelan press, the numbers from the secondary sources are published every month as a 'proof' that President Hugo Chávez is lying. And as a matter of fact, the OPEC Secretariat, in its Monthly Oil Market Report, also reports the numbers of the secondary sources, but never quotes the official Venezuelan numbers (nor, to be fair, does it quote any official number from any other Member Country). Hence, in the media, the numbers from the secondary sources appear as being endorsed by OPEC. Moreover, in 2001, a Joint Oil Data Initiative (JODI) was set up with the participation of OPEC and the IEA, solemnly committed to transparency and proper information. The official Venezuelan numbers are published in the context of JODI, but with a footnote warning the user that there are doubts regarding their veracity.[3]

This 'media war' is, of course, the consequence of the defeat of the old PdVSA with its Hidden Agenda, at the precise moment when its leadership and its allies within the IEA were convinced that they had won the game. After all, as late as December 2001, the National Assembly had authorised another association to produce Orimulsion, and in its Authorisation the extraheavy crude oil to be processed was once again classified as 'natural bitumen' which 'would not be considered subject to the international commitments derived from the participation of the Bolivarian Republic of Venezuela in international organisations' (Official Gazette, 17.12.2001). Hence, in 2002, it looked as if the Orinoco Oil Belt – the largest reservoir of extraheavy crude oil in the world, comparable in magnitude to the reserves of conventional crude oil of Saudi Arabia – would be placed on the side of the powerful consuming countries on the international oil balance. But this was not to happen; for the time being, the Belt continues to be on the side of the petroleum-exporting countries. The Hidden Agenda continued to be a Hidden Agenda, albeit with more international ramifications than ever before. The 'media war' is meant to work as a thick smoke screen to prevent any discussion within OPEC at the relevant political levels, in the expectation of better times to come which may allow the Agenda to move forward once again. This media war, by the way, also is used to create tensions within OPEC, as according to the numbers published by the IEA, Venezuela supposedly is not complying at all with its OPEC quota commitments.

OPEC Crude Oil Production Allocations and Quotas

We should not lose sight of the fact that there is no official OPEC definition of 'crude oil', approved by the Conference – the meeting of the Ministers – and embodied in a Resolution; there is only an official definition, as already mentioned, of condensates. The reason is that there had never been any need for it. All Member Countries understood that the quota system was to be applied to all natural hydrocarbons which, with the sole exception of condensates, would make it to the market as a liquid and, therefore, had a bearing on price levels. Indeed, for more than half a century now, Venezuela has been producing crude oils which are not flowing liquids under normal surface conditions, but are not extraheavy either. This is the case, for example, of Boscán crude, a very heavy asphaltic crude which is exported in heated vessels. Similar situations can be found in some other Member Countries which

2 Venezuela ceased producing Orimulsion, for good, on 31 December 2006, essentially because the price of extra-heavy crude used to prepare it was aligned with the price of coal. This implied discounts of several dollars a barrel, even during the second half of the last decade of the past century (when prices were low). But such discounts increased to over fifty dollars a barrel in the second half of the first decade of this century, when prices were high. – For a thorough analysis of Project Orimulsion see Juan Carlos Boué: El Síndrome de la Orimulsión, forthcoming.

3 Venezuela has excellent official data on the production of hydrocarbons, as each cubic meter of liquid hydrocarbons or natural gas has to pay a royalty, collected monthly, according to its market value taking into account its quality (API, sulphur content, and liquids content of the natural gas).

produce lighter crudes with a high content of wax. OPEC always considered these crudes to be crude oil, and they were, and still are, reported as such in its *Annual Statistical Bulletin*.

Nevertheless, in September 2008, when OPEC agreed on new crude oil production allocations for its Member Countries, Venezuela was assigned an allocation of only 2.350 million b/d.[4] This number was the average of the estimates published by the six secondary sources already mentioned. Venezuela did not accept this allocation, pointing out that its true output was 3.054 mb/d. Nevertheless, by December 2008, OPEC production cuts totalled 4.2 mb/d, with Venezuela's share in the cut being 364 thousand b/d. Now, had the cuts been based on Venezuela's official figure, its share in the production cut would have had to be increased by an additional 109 thousand b/d. Definitely, the Orinoco Oil Belt seems to have been excluded from the OPEC quota system. And Venezuela's production allocation now represents less than 9 percent of the total subject to quotas.

Perspectives

The Chávez government emerged much strengthened after the defeat of the plebiscitary motion to revoke the constitutional mandate of the President, in August 2004. By then, unexpected changes had shaken up the world oil market, which had led in turn to unprecedented price rises. As a consequence of this structural change in world oil markets, the Chávez government began a revision of various agreements celebrated during the heyday of the Oil Opening policy. This process culminated in the government requiring that all the private parties to such agreements migrate to new terms that would comply with the contents of the new Organic Hydrocarbons Law of 2001.

Among the changes introduced as a result of the migration process, one should highlight the fact that each association (or 'mixed company' as the new law denominates them) is granted access to a specific acreage through Presidential decree, and no longer by mere agreement with PdVSA affiliates. This decree reaffirms fully and explicitly the sovereign right of the State to regulate production. This right is not limited or circumscribed in any way by the OPEC quota system, given that decisions on this matter require the unanimous agreement of all Member Countries.

"OPEC's real power … is based … on nature, and the decisive fact that 85 per cent of the world's proven oil reserves are to be found within the national boundaries of OPEC Member Countries"

All countries of the world enjoy the sovereign right to manage the natural resources found within their national boundaries. In the case of exhaustible resources, this right has special characteristics. The countries that belong to OPEC do not acquire this right by virtue of their adhesion to an international treaty, as suggested by PdVSA in the 1990s. Within OPEC, Member Countries simply share the burden of regulating production, with a view to furthering stability in the world petroleum market.

The position of the PdVSA old guard on this issue at that time reflected, of course, the views of the IEA and the powerful consuming countries of the world. Ever since the 'OPEC Revolution' of 1973, these actors never let chances pass by to cast aspersions on OPEC as an illegitimate, if not downright illegal, cartel of producers. In order to spread this vision and allow it to take root in all relevant environments, both the IEA and the main consuming countries have engaged in systematic efforts to erase from the collective memory the American origins of the control of oil production, as well as its associated recognition as a conservation policy by Article 20 of GATT. Even so, in 1989, the USA–Canada Free Trade Agreement incorporated the relevant text of this GATT article (and this precedent was upheld when this treaty became the North American Free Trade Agreement after Mexico joined it). But shortly after, there came the collapse of the Soviet Union, which brought in its wake a proposal for a European Energy Charter that, in 1994, became the Energy Charter Treaty (ECT). Originally, the ECT was supposed to respond to the complementary nature of the resource riches of the countries of the former Soviet Union, on the one hand, and the technological and financial resources of Western Europe, on the other. Yet the ECT ended up embracing a new language which no longer speaks about natural resources, but only energy resources. In this way, the ECT points toward and highlights the market, and conceptualises petroleum as just another commodity, distancing it as far as possible from its natural origin. This is of great importance because this natural origin is associated, inevitably, with the concept of sovereignty over exhaustible natural resources. Moreover, in the vision put forward in the ECT, and with the privatisation of oil and gas resources serving as the backdrop, oil-exporting countries are no longer considered sovereign in this domain: they are simply capital importing countries. Ultimately, the ECT is nothing more than a multi-lateral investment treaty. Throughout the whole of its text, the concept 'natural resource' does not appear a single time (hardly surprising when one considers that Third World oil-exporting countries were explicitly excluded from the treaty negotiations). But there is one passage of the Treaty which is out of tune with the content of the rest, and whose presence reflects the participation in the negotiations of Norway, a highly developed oil-exporting country. Even though Norway accepted in the main the new language embodied in the ECT, it succeeded in forcing the adoption of the following Article XVIII (although ultimately it did not ratify the ECT).

4 The new crude oil production allocations were published, as usual, on the website of OPEC. However, on that occasion, the OPEC Secretariat withdrew the information the next day.

SOVEREIGNTY OVER ENERGY RESOURCES

> Each state continues to hold (...) the rights to decide the geographical areas within its Area to be made available for exploration and development of its energy resources, the optimization of their recovery and the rate at which they may be depleted or otherwise exploited, to specify and enjoy any taxes, royalties or other financial payments payable by virtue of such exploration and exploitation, and to regulate the environmental and safety aspects of such exploration, development and reclamation within its Area, and to participate in such exploration and exploitation, inter alia, through direct participation by the government or through state enterprises. (ECT, 1994: Art.18)

The heading of this article inevitably brings to mind that famous United Nations Resolution from 1962, entitled 'Permanent Sovereignty over Natural Resources'.

The threats to the sovereign rights of countries (especially those of the lesser developed variety) were by no means limited to the change in language referred to above. In 1994, with the creation of the World Trade Organisation (WTO), the GATT was incorporated *in toto* to this treaty. Up until the creation of the WTO, threats which purported to present OPEC as an illegal cartel had to contend with the problem that, in the first place, there was no statute which could serve as the basis for such an assertion. But if the concept of petroleum were to be restricted to energy resource, to the produced oil, and the still to be extracted natural resource in the subsoil were ignored, then oil could be seen merely as a basic commodity. By means of this sleight of hand, the WTO and its arbitration courts would acquire very significant leverage over oil-producing countries, not least because all OPEC Member Countries have joined or are seeking to join the WTO. Now, the aforementioned Article 20 of the GATT specifies that another allowable exception to its rules involves measures 'undertaken in pursuance of obligations under any intergovernmental commodity agreement'. However, for an agreement of this nature to be legally valid, it has to comply with a two-fold requisite: 'to criteria submitted to the Contracting Parties', i.e. Member Countries of WTO, 'and not disapproved by them or which is itself so submitted and not so disapproved'. In other words, this kind of agreement has not to be formally approved by the WTO but, at the very least, not objected to by WTO member countries. The point is, of course, that the majority of WTO member countries are oil-consuming countries.

The above reflections make it easier to understand the evolution of the oil regulation framework in Venezuela during the years of the Oil Opening Policy. What was being prepared, in essence, was the regulation of production in the context of a *commodity agreement*. But it was not supposed to be a *commodity agreement* between the producing countries and the consuming countries, based on the recognition of the sovereign rights of the former to regulate extraction rates of an exhaustible and non renewable natural resource, as was in the mind of OPEC's founding fathers; on the contrary, it would be a commodity agreement that would seek to deny these countries such rights.

The oil multinationals, as well as the consuming countries, were then and are still acutely aware of the inescapable necessity to regulate the world petroleum market. This is a historical lesson of long, long standing. But what they never wanted and still refuse to accept is that this regulatory function be in the hands of a dozen Third World countries. Thence stems the policy initiative of trying to force OPEC to operate within the jurisdiction of the WTO. This may in time allow, by means of all sorts of legal acrobatics, the interpretation of the OPEC treaty as a commodity agreement. For good measure, it underpins veiled and not-so-veiled assertions about OPEC's purported 'illegality'. Were this initiative to come to fruition, the current OPEC quota system would change into one that would be lorded over by the WTO: in other words, by the most powerful consuming countries which also constitute the IEA.

Thus, there is no doubt that the policy of the powerful consuming countries consists in creating favourable conditions to drag OPEC into the realm of WTO and its rules on commodity agreements, against the backdrop of the implicit or explicit threat that any unwillingness on OPEC's part to play ball may very well lead to an outcome where it is formally condemned as an illegal cartel of commodity producers. The power of this alleged cartel would rest on its 40 per cent share of the international petroleum market. However, the truth is that OPEC's real power is not reflected in this 40 per cent figure. OPEC's real power is much greater. It is based not on the market but on nature, and the decisive fact that 85 per cent of the world's proven oil reserves are to be found within the national boundaries of OPEC Member Countries, including the Orinoco Oil Belt.