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September 8, 2013

Rt. Hon. Justice Sir Kenneth J. Keith, K.B.E.  
Prof. Georges Abi-Saab  
Maître Yves Fortier, Q.C.

Re: *Conocophillips Petrozuata B.V., Conocophillips  
Hamaca B.V. and Conocophillips Gulf of Paria B.V. v.  
Bolivarian Republic of Venezuela, ICSID Case No. ARB/07/30*

Dear Members of the Tribunal:

We have carefully reviewed the Decision on Jurisdiction and the Merits, dated September 3, 2013 (the “Decision”), and of course agree with certain important findings and conclusions that were reached by the three members of the Tribunal unanimously. For example, it is difficult to argue with the unanimous conclusion of the Tribunal that jurisdiction does not exist under Article 22 of the Venezuelan Law on the Promotion and Protection of Investments, a conclusion that excludes the bizarre US\$10 billion claim of the parent entity, ConocoPhillips Company, for alleged loss of U.S. tax credits, which undoubtedly would have been rejected even if jurisdiction had existed. Likewise, we believe that the unanimous conclusion of the three arbitrators that all of the fiscal measures taken by the Republic were covered by Article 4 of the Netherlands-Venezuela bilateral investment treaty (the “Dutch Treaty”) and therefore excluded from this case is well founded. We also note that those non-discriminatory and reasonable measures would not have given rise to any claim even if Article 4 had not been applicable inasmuch as they were perfectly lawful exercises of the State’s sovereign powers.

However, we regret to have to inform the Tribunal that we are at a loss to understand the part of the Decision in which the Tribunal’s unanimity was broken, in particular the finding of two of the three members on the issue of good faith negotiation of compensation for the 2007 nationalization. The view of the two arbitrators on this point is based largely on certain misapprehensions which we explain below and is unsustainable both as a matter of fact and as a matter of law. Indeed, while everyone knew that the amount of compensation for the 2007 nationalization was in dispute, the Republic’s good faith in negotiations was never even contested by Claimants.

We look forward to receiving the opinion of Professor Abi-Saab, but in the meantime we request a hearing specifically to address the issue of good faith negotiation and the relevance of the compensation formulas agreed at the outset of the Petrozuata and Hamaca projects as fundamental conditions of their authorization. That hearing is both essential for the quantum phase and necessary as a matter of fundamental due process. An issue as important as the one on which this Tribunal was not unanimous should not be decided except on the basis of a full record of facts and legal principles that are clear to all, which is not the case now.

With respect to the issue of good faith negotiation, we note the following for the record:

1. The majority decision is based entirely on the contention that Respondent did not negotiate compensation in good faith, which in turn is based on what the majority considers to be a lack of evidence concerning Respondent's position in the compensation negotiations. At the same time, the Tribunal has taken pains at the end of the Decision to "emphasise" that "it does not at this stage make a finding in respect of the relevance, if any, of the compensation formulas included in the Petrozuata and Hamaca Association Agreements to the determination of the quantum of compensation payable in this case" (paragraph 402). We do not understand how it is possible to find that the Republic did not negotiate in good faith when the relevance of the compensation formulas to the fair market value analysis has not yet even been decided. If those formulas are in fact relevant, and the voluminous evidence not even discussed in the Decision shows that they certainly are,<sup>1</sup> then how could the Republic possibly be found to be in bad faith for

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<sup>1</sup> See, e.g., **Ex. R-92**, Petrozuata Authorization, Sixteenth Condition ("The Association Agreement shall include provisions that allow Maraven to compensate the other parties . . . all without diminishing in any way the sovereign power to legislate, inherent in the very existence of the national, state and municipal legislative powers") and Eighteenth Condition ("[I]n no case do they in and of themselves give rise to liability on the part of the Republic of Venezuela, which could only arise in the event that such liability were to be assumed through a valid express legal act of its authorities."); **Ex. C-67**, *Strategy for Venezuela*, Conoco Venezuela Strategy Management Team, January 1994, p. 23 ("Conoco should not be surprised, if Venezuela (like other countries) finds some way to put an upside cap on project economics."); **Ex. R-101**, Letter from David Griffith, Conoco Inc., to Joffre Rodríguez, Maraven, dated February 8, 1994 (proposing a "sliding scale" compensation formula); **Ex. R-102**, April 1994 Steering Committee Presentation (describing how sliding scale formula addresses issue that "Gov't can take away economics"); **Ex. R-22**, Petrozuata Association Agreement, Section 9.07 (compensation provisions); **Ex. C-75**, Petrozuata Offering Circular, p. 72 (compensation for adverse governmental actions, including expropriation, is "limited by reference to an average price of Brent Crude Oil deflated annually to 1994 in the world market" and, if damages exceed US\$75 million in any year, compensation is limited to "the greater of 25% of the actual economic damage and the amount resulting from the Brent Crude Oil calculation"); **Ex. R-93**, Hamaca Authorization, Nineteenth Condition ("The Association Agreement . . . shall not impose any obligation on the Republic of Venezuela or restrict its exercise of sovereign rights") and Twenty-First Condition ("The Association Agreement will include provisions that allow for the compensation of Participants . . . . In no case will it be understood that the application of these mechanisms limits, affects or restricts in any way the power of the governmental bodies to adopt measures pursuant to the Constitution and applicable Laws."); **Ex. C-110**, May 1996 Phillips Presentation, p. 43 ("No stability clause"); **Ex. C-22**, Hamaca Association Agreement, Article XIV (compensation provisions); Respondent's Closing Skeleton, pp. 9-17, 28-31.

having offered an amount which, according to Claimants themselves, exceeds the amount resulting from the formulas? And even if the formulas are ultimately determined for some reason to be irrelevant notwithstanding all the evidence to the contrary in this case, how does that translate into a finding of bad faith? With all due respect, there simply is no way to reconcile the emphatic statement in paragraph 402 of the Decision that the Tribunal has not determined the impact of the compensation formulas with an affirmative finding of bad faith negotiation.

2. As the Tribunal observed, the parties did enter into a Confidentiality Agreement, but what the Tribunal apparently did not recall was that the agreement only covered discussions after November 2007.<sup>2</sup> The Decision points out that the Confidentiality Agreement did not prevent Respondent from discussing certain of ConocoPhillips' settlement offers made in June and August 2007 (paragraph 400). That is true, but the reason is the date the confidentiality commitment became effective. With respect to discussions prior to that date, Respondent was free to respond to Claimants' allegations and to show, based on Claimants' own offers, that their demand in this case was far removed from reality, but neither Respondent nor Claimants were at liberty to discuss the settlement discussions that took place after November 27, 2007.<sup>3</sup> That explains the lack of testimony regarding the progress of the compensation negotiations after that date. The Republic cannot accept the notion that the failure to breach confidentiality may be taken as proof of bad faith. Nor can the absence of evidence under such circumstances be turned into a presumption or inference of bad faith. That would be a most troublesome and unprecedented decision under any system of law.

3. There also seems to be some confusion concerning the distinction between the migration discussions and the compensation discussions following ConocoPhillips' exit from the projects in June of 2007. ConocoPhillips alleges that the Republic offered unreasonable terms for the migration, even though other companies, including its own partners in the Hamaca and Corocoro projects, Chevron and Eni, were able to negotiate satisfactory terms and successfully migrate to the mixed company structure, accepting terms that ConocoPhillips flatly rejected. The point here is not to debate the reasonableness of the parties' positions in the migration discussions. ConocoPhillips was free not to accept the migration, but the Republic was also not obligated to conform the migration to ConocoPhillips' wishes. Refusing to accede to ConocoPhillips' demands

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<sup>2</sup> The issue of when confidentiality became applicable arose at the closing argument during questioning by the Tribunal. Respondent explained as follows: "What happened, Judge, is they drafted a memorandum of understanding before the confidentiality agreement. We decided to put it in because they had said some outrageous things about our positions in the negotiation, things that were not true. And as a matter of fact, when they wanted the Confidentiality Agreement, we made very clear that it would only apply as of November . . . , and this predates that." Hearing Transcript, pp. 3705-3706 (Respondent's Closing).

<sup>3</sup> Annex 1 (attached hereto), E-mail exchange in January 2008, highlighting that the Confidentiality Agreement would apply only to negotiations after November 27, 2007.

during the migration process is not the same as bad faith negotiation, just as refusing to accede to ConocoPhillips' exorbitant demands for compensation after the migration process does not constitute bad faith.<sup>4</sup>

4. With respect to the compensation negotiations following ConocoPhillips' exit from the projects, the record shows that there were many compensation meetings over a long period of time, as confirmed by Mr. Goff in his testimony.<sup>5</sup> The question raised by this testimony is: What was ConocoPhillips doing all that time if in fact Venezuela's position was so outrageous as to constitute bad faith? The only logical conclusion from the undisputed fact that ConocoPhillips stayed at the negotiating table for so long is that it considered the Republic to be negotiating in good faith, as the Republic has done with all other international oil companies and other companies whose interests have been nationalized. Both the record of this case and the public record, including of settlements reached with companies after the June 2010 hearing, makes this point clear.<sup>6</sup>

5. To the extent that the Tribunal considers it necessary to see some evidence of negotiations post-Confidentiality Agreement, it can refer to the reports of statements made (notwithstanding ConocoPhillips' confidentiality commitments) by both Mr. Goff, ConocoPhillips' lead negotiator, and Mr. Lyons, published after the June 2010 hearing.

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<sup>4</sup> The majority states that three letters sent by Claimants on April 12, 2007, recounting discussions at meetings in March 2007 concerning ConocoPhillips' participation in the migration process and scenarios for compensation depending upon whether ConocoPhillips continued in the projects or exited, were not answered by Respondent (Decision, ¶¶ 380, 391, 393). However, the very next day, Dr. Mommer wrote a letter that was hand-delivered to ConocoPhillips' office in Caracas, stating that ConocoPhillips "has interpreted and distorted our conversations in such a manner that it calls into question whether it wishes to continue participating in the process" and that ConocoPhillips "is more interested in trying to build a procedural case than in concluding in a satisfactory manner the process of migration." Annex 2 (attached hereto), Letter from Bernard Mommer, Vice Minister of Hydrocarbons, to Albert Roy Lyons, ConocoPhillips, dated April 13, 2007.

<sup>5</sup> Hearing Transcript, p. 684 ("Q. Now, you were also heavily involved in the negotiations for compensation; isn't that right? A. Well, I have--I mean I signed a Confidentiality Agreement regarding-- Q. And I don't want you to reveal any of it. I just want to know whether you were involved in those discussions. A. I--I have been involved in discussions. Q. And they went on for a long time. A. They went on for a long time."). It was Mr. Goff, not Mr. Lyons, as the Tribunal seems to have understood, who was ConocoPhillips' lead negotiator, although ConocoPhillips' CEO, Mr. Mulva, also met several times with Minister Ramírez.

<sup>6</sup> Counter-Memorial, ¶¶ 112-117, 274, n. 211; Rejoinder, ¶¶ 238-244, 374; Hearing Transcript, pp. 336-337 (Respondent's Opening). In a proceeding in the High Court of Justice in London relating to one of the other upgrading projects initiated by an ExxonMobil subsidiary, the Court stated: "There has been a change of government since the Association Agreement was made. The new government strongly disagrees with previous policy. It has condemned the previous policy, and spoken of the need for change, in strong terms. [This] has not prevented the negotiation of mutually acceptable arrangements with the vast majority of foreign oil interests," and concludes by saying "I doubt – this can properly be described as a case involving a lack of compensation . . ." Annex 3 (attached hereto), *Mobil Cerro Negro Limited v. Petroleos de Venezuela S.A.*, High Court of Justice, 2008 EWHC 532, ¶¶ 55, 137.

In an April 2008 cable, the U.S. Embassy in Caracas reported on a conversation with Mr. Goff, stating:

According to Goff, CP [ConocoPhillips] has two basic claims: a claim for compensation for its expropriated assets and a claim based on the progressive expropriation of the underlying assets. Goff stated the BRV [Bolivarian Republic of Venezuela] has accepted that fair market value is the standard for the first claim. He said the BRV has moved away from using book value as the standard for compensation and has agreed on a fair market methodology with discount rates for computing the compensation for the expropriated assets. However, given the recent increase in oil prices, the fair market value of the assets has increased. As for the claim based on the progressive expropriation of the assets, Goff said the claim was on top of the fair market value of the assets. CP has proposed a settlement number and the BRV appears to be open to it. Goff added that CP also plans on increasing the settlement number for the second claim due to recent increases in oil prices.<sup>7</sup>

This report not only shows that Respondent was negotiating fair market value, but it also reflects ConocoPhillips' view that it was automatically entitled to any benefits of post-nationalization price increases based on the assumption that the nationalization was unlawful, not due to any bad faith negotiation but for other reasons.<sup>8</sup> Another U.S. Embassy cable from May 2008 reports on conversations with Roy Lyons, who apparently was giving his impressions to the Embassy of discussions with Dr. Mommer and other negotiators and expressing "optimism that a deal will be made" based on "the statements and actions of the Venezuelan negotiators."<sup>9</sup> We do not endorse everything reported in these cables, but the notion that the Republic did not negotiate in good faith because it never discussed fair market value is patently false, as both ConocoPhillips and the U.S. Government are fully aware.

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<sup>7</sup> **Annex 4** (attached hereto), Cable dated April 4, 2008, *ConocoPhillips Briefs Ambassador on Compensation Negotiations*, ¶¶ 4-5.

<sup>8</sup> As this Tribunal has unanimously found, that assumption was incorrect. Except for the issue of bad faith negotiation, which is negated by Mr. Goff's statement to the U.S. Embassy as well as the other points raised in this letter, this Tribunal has unanimously held that the nationalization was lawful. That necessarily means that ConocoPhillips had no basis for insisting on valuation as of any date other than the date of nationalization. Yet ConocoPhillips insisted on its erroneous view that fair market value meant it could benefit from any post-nationalization price increases. "On top of" that, it inflated its demand by disregarding the fiscal regime that was applicable to all other companies. How can that be good faith negotiation and Respondent's position not be?

<sup>9</sup> **Annex 5** (attached hereto), Cable dated May 23, 2008, *Update on ConocoPhillips Negotiations*, ¶ 9.

6. The fact is that settlement could not be reached in this case not only because ConocoPhillips refused to recognize the compensation formulas agreed at the outset of the upgrading projects, but also because ConocoPhillips had its own vision of fair market value, which included, in addition to constantly revised figures based on short-term price increases, valuation based on a fiscal regime that did not exist, without any consideration of either the extraction tax or the 50% income tax that all other companies were paying. The Republic obviously did not and could not accept the principle that valuation should be based on a fiscal regime unique to ConocoPhillips and inapplicable to the petroleum industry at large. We have noted the comment in paragraph 393 of the Decision that Venezuela did not know at that time that the fiscal measures would be excluded from this case. That may be true, but it is certainly not true that the Republic had any doubt as to the legality of its fiscal measures, whether or not the Tribunal were to hold that the claims based on the fiscal measures were to be excluded under Article 4 of the Dutch Treaty. As demonstrated at the hearing, the fiscal measures were non-discriminatory and not in violation of any stabilization commitment whatsoever, a point this Tribunal also noted in the Decision (paragraphs 350-351). No one can seriously argue that, regardless of what ConocoPhillips thought of the fiscal measures, the Republic had any doubt that they were perfectly lawful exercises of its sovereign authority. Nor can there be any question as to the reasonableness of the Republic's position that any calculation of fair market value, wholly apart from the question of the compensation formulas, would have to be based on the fiscal regime as it existed at the time of the nationalization and as was applicable to all other companies operating in the petroleum industry in Venezuela.<sup>10</sup>

7. The majority seemed influenced by the dearth of evidence concerning exactly what role the compensation formulas played in the compensation discussions. The Republic cannot fathom that point for two reasons. First, ConocoPhillips was obviously aware of the Republic's position on the relevance of the formulas. Indeed, Claimants themselves have never disputed that point. Throughout the hearing in our case, ConocoPhillips' witnesses and counsel tried to explain away the compensation provisions, arguing, for example, that they could not be the appropriate remedy for conduct such as "burning down the house,"<sup>11</sup> but no witness and no counsel ever said that the Republic considered those provisions irrelevant. Second, while there is also no doubt that, as Mr. Goff told the U.S. Embassy, the Republic was willing to consider the fair

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<sup>10</sup> Claimants argued that the Republic acted in bad faith when taking the fiscal measures. *See* Claimants' Memorial on the Merits, ¶ 338. That point was fully addressed by Respondent in its memorials and at the hearing. The Tribunal stated in paragraph 358 of the Decision that Claimants did not respond to our review of the cases, and added: "Counsel for the Respondent referred to that review and its understanding of the cases; he also contended, citing relevant authorities, that government officials are presumed to be acting in good faith. The Respondent came back to the good faith issue in the final rounds, when the matter was otherwise the subject of only limited attention." The "relevant authorities" to which we referred, and to which Claimants could not respond, are equally applicable to the actions of those negotiating compensation on behalf of the Government.

<sup>11</sup> Hearing Transcript, pp. 30-31, 165-170 (Claimants' Opening), 736-738 (McKee).

market value of the investments without considering the compensation formulas in the interest of attempting to reach an amicable settlement in good faith, that does not mean that the formulas were irrelevant or that the Republic ever conceded that point. Again, it would be a strange result to penalize a party willing to show flexibility in confidential, good faith discussions by interpreting such flexibility as a waiver of its legal rights under the basic terms and conditions governing the projects in question. As we pointed out in our February 28, 2012 letter to the Tribunal, even the U.S. Embassy was aware of the significance and operation of the compensation formulas. An Embassy cable from May 18, 2006 reported on the compensation mechanism as follows:

According to the partner at the Venezuelan firm, the strategic associations do not have a legal basis to fight the income tax increases or the new extraction tax. An ExxonMobil executive also told Petatt [the Embassy Petroleum Attache] on May 17 that his firm did not believe it had a legal basis for opposing the tax increases. The attorney stated, however, that each of the strategic association agreements has some form of indemnity clause that protects them from tax increases. Under the clauses, PDVSA will indemnify the partners if there is an increase in taxes. However, in order to receive payment, a certain level of economic damage must occur. In order to determine the level of damage, the indemnity clauses contain formulas that, unfortunately, assume low oil prices. Due to current high oil prices, it is highly unlikely that the increases will create significant enough damage under the formulas to reach the threshold whereby PDVSA has to pay the partners.<sup>12</sup>

If the U.S. Embassy understood in 2006 the relevance of the compensation provisions, there can hardly be any doubt that the Republic also understood it, particularly inasmuch as Dr. Mommer had written about this subject since the 1990s, as documented in his witness statement and as he testified in this case.<sup>13</sup>

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<sup>12</sup> **Annex D** (attached to the Letter of Respondent dated February 28, 2012), Cable dated May 18, 2006, *Temperature Rises for Strategic Associations*, released August 30, 2011, ¶ 5. The relevant time period should be the period of the negotiation and authorization of the projects in the 1990s, as that was when the terms and conditions of the projects, including the amount of compensation to be granted for expropriation and other governmental action, were established. Nevertheless, the Tribunal will note that the description of the compensation provisions in the U.S. Embassy's 2006 cable matches all other evidence in the record regarding the compensation provisions, including ConocoPhillips' own testimony and documents and both the testimony of Dr. Mommer at the hearing and his writing on the subject in the 1990s. See Mommer Direct Testimony, **Appendix 6**, Bernard Mommer, *Venezuela, Política y Petróleos* (Cuadernos del Cendes, Year 16, N° 42, September-December 1999), p. 23.

<sup>13</sup> Mommer Supplemental Testimony, ¶¶ 24-28.

8. Even without going through the details of the discussions that were covered by the Confidentiality Agreement, the Decision itself makes clear that ConocoPhillips was willing to settle for US\$6.5 billion (approximately 20% of the ridiculous amount Claimants sought in this proceeding), a point we are able to discuss because it was before the Confidentiality Agreement, while Claimants themselves say that they were offered US\$2.3 billion, before considering Corocoro (paragraph 389 of the Decision). Appropriately, the record does not show other proposals of Respondent, but even Claimants' own characterization of Respondent's proposal far exceeds our unrefuted calculations under the compensation formulas. We are unable to understand how an offer that Claimants themselves allege was made and actually exceeded what Claimants would be owed under the agreed compensation provisions could possibly demonstrate bad faith, unless the compensation provisions are irrelevant, and the Tribunal has emphasized that it has made no finding on that point. Moreover, even if the Tribunal were, contrary to all the evidence in the record, to deem the compensation formulas irrelevant in determining compensation, it is simply incomprehensible that a party could be held to be in bad faith for offering more than what is required by the terms of provisions that at least might reasonably be considered relevant. As the Tribunal is aware, we believe that not only can a reasonable argument be made as to the relevance of those provisions, but the record in this case is clear that they were the very basis on which the Hamaca and Petrozuata projects were authorized.<sup>14</sup>

9. We also point out that the amount that Claimants say was offered as early as March of 2007 is actually more than the amount that our experts have calculated as the true net present value of Claimants' interests (approximately US\$1.8 billion) even without considering the impact of the compensation provisions.<sup>15</sup> Claimants have not challenged that valuation, which is calculated as of the date of the nationalization, June 26, 2007, with the then existing fiscal regime in place; they have refused to even submit a 2007 valuation in this case and have insisted on disregarding the existing fiscal regime. We understand that reasonable persons may disagree with the exact amount our experts have calculated, but no one can seriously argue that any of the assumptions underlying our calculation, including price scenario, discount rate, production and cost projections, and fiscal regime, were made in bad faith, and the Tribunal has not found anything of the kind. In fact, the Tribunal will recall that Claimants studiously avoided challenging our experts at the 2010 hearing, not wanting to engage them, even going out of their way to make clear that they were not asking any serious questions on what are obviously key quantum issues.<sup>16</sup> On the technical side, Claimants even refused to cross examine a key witness despite having insisted that he travel to The Hague and sit for weeks waiting to

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<sup>14</sup> See n. 1, *supra*.

<sup>15</sup> Second Brailovsky/Wells Report, ¶ 194, Table 18.

<sup>16</sup> Hearing Transcript, pp. 3093-3096 (Claimants' Closing); Respondent's Closing Skeleton, pp. 34-35.



testify.<sup>17</sup> When questioned about these tactics, Claimants vigorously defended their right not to ask questions. That may be so, but given the professionalism exhibited in the economic and technical reports submitted by Respondent and the documentation supporting them, as well as the lack of any serious challenge on the substance of the reports by Claimants at the hearing, it is not even plausible to argue that our expert evaluations are in bad faith. Yet they show a 2007 fair market value even without consideration of the compensation formulas which is less than what Claimants say was offered by the Republic. We cannot understand how any offer in excess of our experts' good faith and professionally done calculations, made in an effort to arrive at an amicable settlement, could possibly be considered bad faith. On the contrary, an offer in excess of a good faith, professional valuation is by definition a good faith offer.

10. The majority seems to attach some significance to the fact that Claimants in their Memorial said that an offer of US\$2.3 billion was no more than 5% of the real value of their investments (paragraph 390 of the Decision). But apart from the obvious fact that Claimants' 5% statement was utter nonsense, Professor Abi-Saab correctly pointed out at the hearing that what existed in this case was simply a disagreement over the amount of compensation.<sup>18</sup> Disagreements about the amount of compensation do not render an expropriation unlawful and are hardly proof of bad faith. If Claimants' surrealistic calculations are the standard of good faith, and if the adequacy of Respondent's offers are to be judged against Claimants' demands, then one wonders why we even bother to have hearings at all.<sup>19</sup> One need only refer to the closing argument of Claimants' counsel in July 2010 to illustrate the absurdity of judging good faith by Claimants' demands. After agreeing with us that disagreements over compensation do not render a nationalization unlawful, counsel for Claimants nevertheless went on to assert that "an offer of Fair Market Value would have been of the order of seven to 10 times the amount of the offer actually made."<sup>20</sup> Ten times US\$2.3 billion, the offer Claimants say was made to them in March 2007, happens to be US\$23 billion, which is more than the absurd amount Claimants are claiming in this case (excluding the nonsensical claim of ConocoPhillips Company for U.S. tax credits) using the price increases after 2007 and disregarding the existing fiscal regime. It is also approximately four times the amount ConocoPhillips offered to settle for in August 2007. Claimants'

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<sup>17</sup> Hearing Transcript, pp. 2280-2286 (on the refusal to examine Mr. Cardona). *See also* Respondent's Closing Skeleton, p. 25.

<sup>18</sup> Hearing Transcript, pp. 3416-3418 (between Arbitrator Abi-Saab and counsel for Claimants).

<sup>19</sup> One also wonders how an offer in the amount Claimants say was made by the Republic could be considered bad faith and Claimants' demands in this case of US\$31 billion not be so considered. Note that Claimants' assertion that the offer of US\$2.3 billion was no more than 5% of the real value of their interests means that they believe the value was US\$46 billion, even more than their indefensible demand in this case. Such assertions cannot be taken seriously.

<sup>20</sup> Hearing Transcript, p. 3514 (Claimants' Closing).

position that the Republic was required to offer as compensation the surrealistic amount of US\$23 billion in order for the nationalization to be considered lawful is indefensible.<sup>21</sup>

11. The Tribunal may also recall that the compensation that Claimants say was offered by Venezuela in March 2007 for their interests in Petrozuata and Hamaca is in line with Claimants' own October 2006 valuations, which are in the record:

a. Venezuela's March 2007 offer to pay US\$1.1 billion for Claimants' interest in Petrozuata is very close to ConocoPhillips' internal US\$1.12 billion valuation developed only 6 months earlier.<sup>22</sup> It is impossible to understand how an offer for an amount that is virtually the same as Claimants' own valuation of its interest in late 2006 can be conceived as the product of bad faith negotiation.

b. The offer that Claimants say was made to them for the ConocoPhillips interest in the Hamaca project, US\$1.2 billion, is higher

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<sup>21</sup> The substance of this discussion was outlined on the final day of closing arguments, in which Respondent pointed out the following: "Now, there has been a lot of talk here about what is the nature of the compensation discussions, and they keep saying that all we offered was Book Value and that our offer was way too low, and I just don't know how one goes about addressing this other than let's look at what actually happened. Let's look at what we do know. We can't tell you everything because there are confidentiality agreements, but let's look at what we do know. We do know that Dr. Mommer has testified that we offered and did discuss compensation in good faith. . . . [W]e have shown you in good faith what we believe the Market Value is of these assets, and we've told you the impact of the compensation provisions. And I don't want to tell you where we came down in the offers but they seem to think that anything remotely resembling what we've showed you is actually [a] good faith value is a ridiculous offer. Well, the cases simply don't bear that out. The facts don't bear that out. We, in good faith, believe that we are right. And I think if you look at the record the way it stands today--we are going to go through some of this--unless you were to say that we had an obligation to value these properties without any fiscal changes which we believe were all perfectly lawful, with their extraordinarily high price scenario, is kind of a bootstrapping argument. They're saying the value is high because the valuation date should be moved. But if we're right, the valuation date shouldn't be moved, and what we were talking about when we were discussing compensation was June 2007 value, not when the price of the oil [is] \$144. And by the way, the price could very well go down do \$40 tomorrow. I hope not, but it's possible. We also know that their \$30 billion request is absolutely absurd. We know that they offered to settle somewhere between \$6 - and \$7 billion. . . . At least that's our good-faith interpretation of it. They've never actually refuted that. Judge Fortier asked where is this in the record? It's in Dr. Mommer's affidavit. And it's also in the exhibits to Dr. Mommer's affidavit. You have to do a little calculating and yes, but it's not that far off. That figure is a lot closer to our figure than it is to \$30 billion. So I ask: Who is being unreasonable in this case? We also know that there were over a year of intensive negotiations. They didn't reach fruition. But it seems to me, my experience is, if I'm sitting down with somebody for over a year and they are acting in bad faith, making ridiculous offers, I don't keep coming back to the table everyday, waiting for them to make a serious offer. That's not what happened. There is simply no basis in the record in this case for viewing this as an unlawful expropriation or confiscation." Hearing Transcript, pp. 3977-3979 (Respondent's Closing).

<sup>22</sup> See Third Brailovsky/Wells Report, ¶¶ 67-68 (citing Ex. C-474, ConocoPhillips RCAT Group, Building Production Capacity Reserves/Loss of Reserve Area COP, October 2006, slide 17). Apparently, the internal ConocoPhillips valuation was based upon the production and cost figures that ConocoPhillips was using as of that time, which were shown at the hearing to have been overly optimistic.

than the value reflected in the Petrolera Ameriven Hamaca Economic Model, dated October 30, 2006, which was the basis for the production and cost figures used by Claimants' experts. That model calculated the net present value of the entire Hamaca project, before considering repayment of debt, at US\$3.012 billion.<sup>23</sup> Based upon this valuation, Claimants' 40% interest, after taking into account its 40% share of the project's US\$774 million in debt as of year-end 2006,<sup>24</sup> was approximately US\$895 million. Again, there is simply no way of reconciling these undisputed facts with the notion that Venezuela's March 2007 offer was the product of bad faith negotiation.

12. The Tribunal seems to be under the mistaken impression that the Republic was not offering any compensation for Corocoro. That is flatly untrue. As Dr. Mommer testified, the parties were understandably focusing their discussions on the two upgrading projects with the greater value.<sup>25</sup> As already demonstrated in Respondent's experts reports, Corocoro's value was negligible, a point well understood by both sides.<sup>26</sup> The fact that the negotiation had not advanced on Corocoro does not mean that the Republic denied the principle of compensation for Corocoro.<sup>27</sup> It simply means that the parties concentrated on the larger projects and saw no point in spending time on the relatively insignificant amount that would be due for Corocoro under any compensation standard until the larger issues were resolved.

13. With respect to the compensation provisions in the Hamaca and Petrozuata projects, we have noted that the majority has focused exclusively on whether or not they played a role in the compensation negotiations. Frankly, we do not understand that. The Tribunal did not mention any of the extensive evidence referred to in our Memorials showing that those compensation provisions were the basis for the authorization of the projects in the first place.<sup>28</sup> Nor did the Tribunal mention the report from the U.S. Embassy in 2006 clearly explaining the operation of those provisions, which we pointed

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<sup>23</sup> See **Ex. LECG-129**, Petrolera Ameriven Hamaca Economic Model, October 30, 2006, p. 551. The cost and production figures used in the model appear to have been based upon the 2006 Hamaca Business Plan which, as demonstrated at the hearing, was also overly optimistic.

<sup>24</sup> *Id.*, p. 487.

<sup>25</sup> Hearing Transcript, pp. 1862-1863 (Mommer).

<sup>26</sup> Second Brailovsky/Wells Report, ¶ 193.

<sup>27</sup> ConocoPhillips' April 12, 2007 letter acknowledges that although ConocoPhillips had not yet received an offer for Corocoro, at the March 29, 2007 meeting "[w]e were informed at the time that such an offer would be forthcoming . . ." **Ex. C-241**, Letter from Roy Lyons, ConocoPhillips, to Rafael Ramírez, Minister of the Popular Power for Energy and Petroleum, and others, dated April 12, 2007. It further states that "any cash compensation component would be relatively small as such asset is not currently in production . . ." *Id.*

<sup>28</sup> See n. 1, *supra*.

out in our post-hearing letters to the Tribunal.<sup>29</sup> Given the wealth of evidence in the record on the compensation provisions, including Claimants' own documents from the relevant time period (the period of negotiation and authorization of the projects), and given the testimony at the hearing which confirmed that those provisions were an "upside cap on project economics,"<sup>30</sup> we fail to understand how it is possible to penalize Respondent for attempting in good faith to settle a claim by considering compensation in excess of what was actually owed under those compensation provisions. In effect, the Tribunal is stating that if the Republic had offered only the amount required by the compensation formulas and not a penny more, it would have been acting in good faith, but since it agreed to consider more than that amount in a good faith effort to reach an amicable settlement, it should be penalized. That conclusion is unsustainable.

14. We have noted an earlier passage from the Tribunal's Decision, in which all three members of the Tribunal concurred and with which we fully agree, stating: "It will do that bearing in mind how rarely courts and tribunals have held that a good faith or other related standard is breached. The standard is a high one" (paragraph 275, emphasis added). As stated in one well-known case: "A finding of the existence of bad faith should be supported not by disputable inferences but by clear and convincing evidence which compels such a conclusion."<sup>31</sup> A monograph on good faith in international law, referring to the decision quoted above, explains the high burden of proof a claimant would have in proving bad faith negotiations: "The *Tacna-Arica Case* remains an important case on the *legal* duty to negotiate in good faith, even if it also provides an example of how difficult it may be to convince a Tribunal of the bad faith of a State in a long and complex series of negotiations. . . . Nothing short of a demonstrable wilful refusal to proceed with negotiations, or an unjustified failure even to consider reasonable proposals, will probably suffice for a failure to negotiate in good faith."<sup>32</sup> If that in fact is the standard, we do not understand how the Tribunal can take the extraordinary step of inferring bad faith based on the lack of evidence concerning negotiations done under the

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<sup>29</sup> See ¶ 7, *supra*.

<sup>30</sup> Respondent's Closing Skeleton, p. 11.

<sup>31</sup> **Annex 6** (attached hereto), *Tacna-Arica Question (Chile, Peru)*, Opinion and Award dated March 4, 1925, 2 R.I.A.A. 921 (2006), p. 930. See also **Annex 7** (attached hereto), *Bayindir Insaat Turizm Ticaret VE Sanayi A. Ş. v. Islamic Republic of Pakistan*, ICSID Case No ARB/03/29, Award dated August 27, 2009, ¶ 143 (holding that "the standard for proving bad faith is a demanding one, in particular if bad faith is to be established on the basis of circumstantial evidence"); **Annex 8** (attached hereto), *Chemtura Corporation (formerly Crompton Corporation) v. Government of Canada*, Ad Hoc NAFTA Arbitration under UNCITRAL Rules, Award dated August 2, 2010, ¶ 137 (stating that "the standard of proof for allegations of bad faith or disingenuous behaviour is a demanding one"). This high threshold explains why findings of breach of good faith have been so rare. Writing about the International Court of Justice, a distinguished commentator observed that "the Court will be slow to accuse a State in its judgment of bad faith." **Annex 9** (attached hereto), Hugh Thirlway, *The Law and Procedure of the International Court of Justice 1960–1989: Part Three*, BRITISH YEARBOOK OF INTERNATIONAL LAW 1 (1991), p. 18.

<sup>32</sup> **Annex 10** (attached hereto), J. F. O'Connor, GOOD FAITH IN INTERNATIONAL LAW (Dartmouth Publishing Company 1991), pp. 100-101.

protection of a Confidentiality Agreement, and we in any event do not understand how the willingness to negotiate compensation in excess of that required by the formulas in the interest of avoiding litigation and maintaining good relations could possibly be confused with bad faith. While we think the record in this case definitively negates that conclusion, Claimants obviously cannot meet their extraordinary burden of proof on this issue. Indeed, the fact that one distinguished member of the Tribunal has dissented on this point itself should indicate that this is not one of those “rare” cases to which the Tribunal referred earlier, which are rare because they involve conduct so bad that any reasonable person would be able to come to the conclusion of bad faith.

15. Finally, the majority’s reasoning on the *Chorzów Factory* decision is difficult to follow. The majority seems to acknowledge that the *Chorzów Factory* standard of compensation does not apply where the expropriation would be lawful but for the payment of compensation (paragraphs 340-343).<sup>33</sup> It then goes on to find no basis for unlawfulness here other than lack of compensation. If *Chorzów Factory* is to be applied, the valuation date cannot be anything other than the date of taking.<sup>34</sup> This part of the Decision actually refers to a case in which one of the two arbitrators of the majority here was acting as President of the tribunal, *Santa Elena v. Costa Rica*,<sup>35</sup> distinguishing that case on the ground that it involved a lawful expropriation. But in *Santa Elena*, compensation was not granted until twenty years after the expropriation, and the offers of the parties showed that Costa Rica offered only one-third of the amount requested by the claimant. According to Claimants in this case, the amount offered by the Republic as early as March of 2007 was US\$2.3 billion, which is more than one-third of the amount Claimants sought in August of 2007. We fail to understand how the expropriation in *Santa Elena* could be considered lawful and the nationalization here considered unlawful due to alleged bad faith negotiation, especially since the Tribunal here has unanimously

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<sup>33</sup> At the closing, Claimants’ counsel agreed with this point, but then went on to assert that “an offer of Fair Market Value would have been of the order of seven to 10 times the amount of the offer actually made.” Hearing Transcript, p. 3514 (Claimants’ Closing).

<sup>34</sup> Moreover, even if the expropriation had been unlawful for reasons other than lack of compensation, that would not automatically mean that the valuation date should be the date of the award. Claimants themselves will argue that the valuation date would be the date of taking if it is higher than the date of the award, and, notwithstanding the increases in crude oil prices since 2007, other factors, including increased costs and production declines, may offset the price rise. The point here is not to argue quantum, a lengthy and highly technical exercise, but to highlight the questions of principle. It should be noted that, in any event, if the date of the award means the date of the final award in this case, it is difficult to see how there can be a valuation as of that date. This is not a simple case involving the valuation of a piece of real estate. It will undoubtedly take this Tribunal many months to assess the parties’ experts reports, quantum witnesses and arguments after the last quantum submissions. Given the volatility of oil prices and other factors, it is a virtual certainty that whatever decision is reached whenever it is reached will not be based on a valuation as of the date of the award.

<sup>35</sup> **Ex. CL-38**, *Compañía del Desarrollo de Santa Elena, S.A. v. The Republic of Costa Rica*, ICSID Case No. ARB/96/1, Final Award dated February 17, 2000, 14 ICSID REVIEW – FOREIGN INVESTMENT LAW JOURNAL 169 (2000) (“*Santa Elena*”).

found that, the issue of compensation aside, the nationalization in this case was lawful in all respects.<sup>36</sup>

The Tribunal will recall that over the past year we have suggested on many occasions a short hearing to address any points of concern. Given the split in the Tribunal, it is clear that good faith negotiation was a point of concern that needed to be addressed. We await the opinion of Professor Abi-Saab, which we will examine carefully upon receipt, but we now formally request that as soon as practicable thereafter, a limited and focused hearing be held to review the foregoing and the issue of the relevance of the compensation provisions, which the Tribunal left open in the Decision. We believe that somehow with the passage of time the memory of what happened at the 2010 hearing seems to have faded. It is also clear that the Tribunal was under certain misapprehensions with respect to the parties' confidentiality commitments and the progress of the negotiations after the migration. Before proceeding to a subsequent phase which may prove even longer than the first, we think we deserve clarification and explanation of the points raised in this letter, and we believe it is also fair for the Tribunal to have the opportunity to examine these issues with the benefit of all facts and of focused argument so that it will be in a position to address cogently the points which now cry out for elucidation.<sup>37</sup>

Very truly yours,



George Kahale, III

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<sup>36</sup> In paragraph 342 of the Decision, the majority states that “in *Santa Elena*, the valuation submissions by the Parties and the tribunal’s assessment related only to the date of taking,” but counsel to respondent in *Santa Elena* wrote an article making clear that claimant in that case had argued that the expropriation was “unlawful in failing up to that point to provide any compensation to CDSE, and the consequence of such an unlawful taking under international law was that CDSE would be entitled to the greater of (1) the value of the Property at the date of the taking, or (2) its value subsequent to the date of taking and directly prior to the date of the Award.” **Annex II** (attached hereto), Charles N. Brower and Jarrod Wong, *General Valuation Principles: The Case of Santa Elena*, in INTERNATIONAL INVESTMENT LAW AND ARBITRATION: LEADING CASES FROM THE ICSID, NAFTA, BILATERAL TREATIES AND CUSTOMARY INTERNATIONAL LAW 747 (T. Weiler, ed., Cameron May 2005), p. 761. In fact, a review of the *Santa Elena* decision makes clear that the valuation submissions did not relate only to the date of taking. As the tribunal in *Santa Elena* stated: “On the question of valuation, as noted earlier, the views of the parties are widely divergent. The Tribunal considers it useful to summarise the parties’ positions here: Claimant states that the fair market value of the Santa Elena Property, based on its highest and best use in the market place, is equivalent to its present day value, undiminished by any expropriatory actions of the Government and, in particular, by any environmental statutes or regulations enacted after 1978. Respondent contends that the relevant date at which the fair market value of the Property is to be assessed is the date of the expropriation decree, i.e., 5 May 1978.” **Ex. CL-38**, *Santa Elena*, ¶ 75.

<sup>37</sup> We expect Claimants to voice loud opposition to our request, but we do not expect much in the way of a substantive reply to the points raised above for the simple reason that there is no substantive reply. That in itself will speak louder than any pro forma opposition.