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FEATURED Q&A

Will Mexico See an Oil Sector Renaissance?



A "historic and significant" oil discovery in the Gulf of Mexico is perhaps the world's largest in five years and followed energy-sector reform spearheaded by President Enrique Peña Nieto's. // File Photo: Mexican Government.

Q U.S. energy company Talos, Mexico's Sierra Oil & Gas and the United Kingdom's Premier Oil on July 12 announced a "historic and significant" oil discovery in shallow waters of the Gulf of Mexico, which the consortium says is the largest find anywhere in the world in the last five years. The Zama well is estimated to contain between 1.4 billion and 2 billion barrels of light oil. How important are these latest discoveries? Will the new finds spark a flurry of interest—and more significant investment—from international and domestic investors to Mexico's oil and gas sector? Will the discoveries and increasingly populist tendencies in Mexico's political races ahead of next year's elections tempt politicians or officials to modify the country's oil reform agenda or change its rules for foreign investors?

A Lourdes Melgar, Robert E. Wilhelm fellow at the Center for International Studies at the Massachusetts Institute of Technology, and former Mexican deputy secretary of energy for hydrocarbons: "Mexico's landmark energy reform is providing tangible results only three years after the enactment of the secondary legislation to the 2013 constitutional reform. July 12 of this year proved to be a memorable date, with the awarding of 21 oil contracts in the bids of Round 2.2 and 2.3, and the announcement of a major oil discovery in the shallow waters of the Gulf of Mexico. The consortium formed by Mexico's Sierra Oil, the United Kingdom's Gas Premier Oil and the United States' Talos Energy as operator successfully drilled exploration well Zama-1, finding light crude oil and associated natural gas, which the consortium estimates contains between 1.4 and 2 billion barrels of

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TOP NEWS

OIL & GAS

PDVSA Raises Crude Sales to Rosneft

The Venezuelan state oil company has reduced sales to its U.S.-based refining unit, Citgo, while boosting oil sales to Russia's Rosneft.

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RENEWABLES

Enel Receives License to Operate Brazil Solar Plant

Italian energy company Enel on July 28 received an environmental operating license for its 260 megawatt solar plant in the Brazilian state of Piauí.

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OIL & GAS

Mexico Outlines Goals for NAFTA Talks, Prioritizes Energy Security

Among Mexico's goals for the talks is strengthening regional energy security. Kenneth Smith, the current director of the Trade and NAFTA Office at the Mexican embassy in Washington, will lead the talks.

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Smith // File Photo: University of Kansas.

OIL & GAS SECTOR NEWS

PDVSA Raises Crude Sales to Rosneft, Cuts Sales to Citgo

Venezuelan state-run oil company PDVSA has lowered sales of crude to its U.S. refining unit Citgo, while increasing sales to Russian state oil company Rosneft, according to PDVSA documents, sources from the company and its joint ventures, Reuters reported Thursday. The change in supply levels is part of a plan signed



Martínez // File Photo: Venezuelan Government.

in May to catch up on past-due deliveries. "The agreement is linked to the debt refinancing. The idea is to catch up by reducing the number of pending cargoes [to repay debt]," a PDVSA source told the news service. Oil output in Venezuela has fallen since 2012, falling sharply this year amid low investment and payment delays to suppliers. Nearly all PDVSA customers have received lower volumes of crude as a result of the decreased output, including the United States. In May, PDVSA signed a plan with Rosneft to catch up on delayed cargoes. At a forum in St. Petersburg, Russia in June, Venezuelan Oil Minister Nelson Martínez said Rosneft would receive approximately 70,000 barrels per day as payment for a \$1.5 billion loan that Russia gave PDVSA in 2016. He did not give a reason for the agreement. Days later, Russia released a negotiation of bilateral loans with Venezuela in which Russia agreed to cut its projected state revenue by nearly \$1 billion in order to account for the expectation that Venezuela would not make its loan repayments on time. Rosneft has loaned Venezuela be-

tween \$4 billion and \$5 billion in recent years, which it expected would mostly be repaid in oil. Neither Rosneft nor Citgo were immediately available for comment.

Argentina's YPF to Invest \$150 Mn in Gas Pilot Project

Argentine state energy company YPF is planning to launch a \$150 million pilot project that will target unconventional plays as the company looks to develop Argentina's shale and tight resources, with a focus on natural gas, Platts reported Wednesday. YPF will invest in a five-year project to drill 13 horizontal wells on the Rincón de Mangrullo block, according to a filing with the Buenos Aires Stock Exchange. It will target gas in the Lajas and Mulichinco tight plays as well as the Vaca Muerta shale play. The company has decided to move forward with the project after being granted an extension to license the block until 2052, with the option for another extension. YPF has been operating the Rincón de Mangrullo block since 2013 in partnership with Petrolera Pampa, a

YPF will continue to develop part of the Rincón de Mangrullo block in partnership with Petrolera Pampa.

unit of Pampa Energía. It plans to continue to develop Lajas and Mulichinco in coordination with Petrolera Pampa, but will develop Vaca Muerta and the Quintuco play on its own. The company said it is currently producing five million cubic meters per day of gas from the 116 wells on the block, mostly from the Mulichinco play. Also as part of the pilot project, the companies plan to build two gas separation plants and a 34.2 mile-long pipeline to transport output from Loma La Lata, the biggest gas block in the country.

NEWS BRIEFS

Brazil's Pre-Salt Oil Production Surpasses Rest of Combined Output

Oil output at Brazil's pre-salt offshore oil wells surpassed the combined output from all other fields in Brazil for the first time in June, raising the country's oil output by 0.8 percent from the month before to an average of 2.7 million barrels per day, Reuters reported Monday. Production at pre-salt oil wells increased to 1.35 million bpd in June, up 6.4 percent from the month before, according to Brazilian oil watchdog ANP.

Veolia Posts 24 Percent Improvement in Latin America Revenue

France-based utility Veolia announced Monday that its Latin America revenue grew 23.7 percent in the second quarter due to significant price increases and good volumes in the region. Tariff increases in Argentina were especially positive for results, the company said, and as well as the consolidation of the Pedreira landfill in Brazil and the start-up of the Santa Marta water contract in Colombia. In May, Veolia signed a deal with Mexico City worth \$1 billion for a waste incinerator whose heat will be used to power the city's subway, Reuters reported.

Mexico Outlines Goals for NAFTA Talks, Prioritizes Energy Security

Mexico has outlined its goals for the upcoming renegotiation of the North American Free Trade Agreement, or NAFTA, according to a document seen by Reuters on Tuesday, the news service reported. Among the country's goals for the talks that are due to start Aug. 16 is strengthening regional energy security as the country works to implement the historic opening of its gas, oil and power sectors.

Mexico Sees Small Trade Surplus Amid Rise in Petroleum Product Imports

Mexico registered a \$62 million trade surplus in June due to an increase in exports of manufactured goods, which offset increased imports of petroleum products, The Wall Street Journal reported. The surplus brought the country's trade balance for the first half of this year to a deficit of \$2.91 billion. Exports from Mexico rose by 11.5 percent year-over-year to \$35.61 billion, while imports rose by 9.5 percent to \$35.55 billion. State-run oil company Pemex exported 1.16 million barrels per day (bpd) of crude oil in June, up from 958,000 bpd the month before and up from 1.1 million during the same period a year before. The value of Mexico's petroleum exports in June was up by 10.4 percent to \$1.78 billion, while imports of gasoline, natural gas and other fuels were 19.6 percent higher to \$3.1 billion. The \$1.32 billion petroleum trade deficit was offset by a \$1.38 billion surplus in nonpetroleum goods. Exports of manufactured goods rose by 11.3 percent, with a 17.8 percent jump in the exports of vehicles and auto parts alone. Steel and processed food exports also increased significantly.

RENEWABLES NEWS

Enel Receives License to Operate Brazil Solar Plant

Italian energy company Enel on July 28 received an environmental operating license for its 260 megawatt solar plant in the Brazilian state of Piauí, Renewables Now reported. The \$95.4 million Parque Solar Nova Olinda is expected to generate 600 gigawatt hours per year, which is expected to be enough to meet the energy needs of 300,000 local homes, the government said.

Odebrecht Energía del Peru Halts 750 MW Hydro Project

Developer Odebrecht Energía del Peru has put the construction of the 750 megawatt Rio Grande hydropower project on hold, Hydroworld reported Thursday. A notice from Peru's General Directorate of Energy and Environmental Affairs says Odebrecht requested that the

environmental impact statement filed for the plant be removed, which effectively prevents the project from advancing. Neither Odebrecht nor the Peruvian agency have given a reason as to why the proposal is no longer moving forward, or whether work on the project will ever resume. The original plan for the project would consist of two plants, the 600 MW Rio Grande-1 and the 150 MW Rio Grande-2, which would both be located on the Marañón River in northern Peru. The two facilities would require a combined \$2 billion in investment.

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gross original oil in place. If confirmed, this will be the third-most significant discovery in Mexico's offshore in the past 20 years. The news came three months after the Italian company ENI successfully drilled Amoca-2 in a field that Pemex previously discovered. The liberalization of Mexico's upstream sector is already a success story: in the midst of a sharp decline in oil prices and political uncertainty stemming from the renegotiation of

ity. Energy security needs should overcome ideological electoral rhetoric."

A David Shields, independent energy consultant based in Mexico City and editor of *Energía a Debate*: "The Zama oil find could

easily be overstated, since it is based on the drilling of just one well. But it is clear that several companies now are anxious to be seen as the heroes of this energy reform, just as the government wants to herald the reform as a success to the markets and to its political rivals. The markets are fast to pick up on any good (or bad) news related to Mexico these days. But is it hard for anyone to argue that Mexico has an alternative to the reform agenda, which is attracting oil companies from all over the world. Whatever government comes into power in Mexico in 2018—even if it is not hostile to the current one—will want to at least tweak the reform to put its own stamp on future energy policy. But if the reform agenda is seen to be working and shows tangible results, it will be hard for a future administration to justify a change of course. Some fear that a left-wing populist government could gain power next year and reverse reforms, but the left is severely fractured and has no support or reasonable arguments for reversing course and trying to rehash the old state-monopoly model. Also, the failure of a populist left-wing government that has lived off the revenues of the national oil industry in Venezuela

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“The liberalization of Mexico's upstream sector is already a success story.”

— Lourdes Melgar

NAFTA, Mexico has awarded 70 oil contracts to a wide range of oil companies through a competitive and transparent bidding process. Areas that otherwise would have been idle are being developed by companies that are bringing in expertise, technology and a fresh look at geology. Zama-1 will come into production as a new administration takes office in Mexico. The results of the reform will speak for themselves in terms of oil production, revenue and job creation. The technical design and constitutional nature of the reform should ensure its long-term viability.

POLITICAL NEWS

Brazilian Lawmakers Spare Temer From Impeachment Trial

President Michel Temer on Wednesday survived a vote in the lower house of Brazil's Congress that could have led to his suspension and permanent removal from office. Temer needed at least 172 members of the Chamber of Deputies to reject a move to try him on corruption charges or to abstain from voting, *The New York Times* reported. In the final tally, 263 lawmakers voted to support him, 227 voted against him and 23 others abstained



Temer // File Photo: Brazilian Government.

or were absent from the vote. In order to prosecute Temer, two-thirds of the lower house would have had to vote to formally send his graft case to the Supreme Court. The move would have led to Temer's suspension from office for as long as 180 days and a possible impeachment trial, in which he could have been permanently removed from office. That process played out last year when then-President Dilma Rousseff was ousted from office. Legislators who sided with Temer in Wednesday's vote said Brazil could not withstand continued political upheaval. However, lawmakers who voted to proceed with a trial against him said allowing him to remain in office would amount to supporting a culture of impunity in Brazilian politics. After the vote, Temer delivered televised remarks in which he called lawmakers' decision an "achievement for the rule of law," *The Wall Street Journal* reported. Temer is accused of pocketing more than \$150,000 from a meatpacking executive as part of a \$12 million bribe that he is alleged to have

ADVISOR Q&A

Is Maduro Turning Venezuela Into a Dictatorship?

Q **The 545 delegates of Venezuela's powerful "constituent assembly," which will have the ability not only to rewrite the country's Constitution, but also to overrule other government institutions, began receiving their credentials on Wednesday. The opposition and several foreign governments widely denounced Sunday's vote to elect the body, which President Nicolás Maduro says is needed to solve the country's political and economic crises, but opponents see as an effort by Maduro to increase his power. Has Venezuela become a dictatorship that is sliding into civil war, as some analysts have asserted? What will result from U.S. sanctions against Maduro? What should be the response from international actors such as the OAS and the United Nations? What will the constituent assembly use its power to do? What can be done to stabilize the country and its economy?**

A **Peter Hakim, president emeritus of the Inter-American Dialogue:** "The constituent assembly election is often cited as the decisive moment, the crossing of the Rubicon, in Venezuela's march toward a repressive, authoritarian regime. This is an exaggeration. More accurately, the election was one more regrettable step toward the dismantling of democracy—a process that started with the inauguration of Hugo Chávez in 1999, accelerated after the aborted coup against him in 2002, and proceeding steadily ever since. During this period, Chávez and his successor Nicolás Maduro either took over or undermined the nation's institutions, one after another, including its courts, electoral machinery, parliament, armed forces, state oil company (PDVSA), political parties and provincial and

local governments. Nearly all independent media came under Chavista control. So did many private enterprises, labor unions and universities. Sunday's election underscored once again that the Maduro government is determined to hold on to power indefinitely,

“ There is not much they can do now to reverse course.”

— Peter Hakim

and certainly is unwilling to yield it through democratic procedures. The re-arrest of two of the opposition's most important leaders was further warning that Maduro is not about to compromise with the opposition and is not intimidated either by the U.S. sanctions or by the condemnation of other Latin American countries. But it may also mean that the government is uneasy about the low turnout for the assembly election and the prospect of renewed, and potentially larger and more aggressive, protests. Democracy in Venezuela has long been in a desperate condition, and it continues to deteriorate. Too bad the United States and Latin American nations paid so little attention and responded so tepidly to the steady decay of Venezuela's democratic institutions and rule of law over so many years. There is not much they can do now to reverse course. In the weeks and months ahead, ordinary Venezuelans are likely to face an even deeper hardship, greater uncertainty and increasing violence."

EDITOR'S NOTE: More commentary on this topic appeared in the Q&A in Thursday's issue of the daily Latin America Advisor.

NEWS BRIEFS

Economists Expect Higher Inflation in Argentina

Argentina's inflation expectations for this year have risen sharply to 22.1 percent from 21.6 percent a month earlier, according to a poll of 55 economists published by the country's central bank on Wednesday, Reuters reported. The economists' estimate is well above the central bank's target rate of 17 percent and follows a 40 percent inflation rate last year. Inflation is a top concern for voters ahead of the mid-term elections in October.

Cuba Halts Issuance of Permits for Some Private-Sector Jobs and Ventures

The Cuban government on Tuesday announced it would suspend the issuance of permits for some private-sector jobs and ventures, including restaurants and renting out rooms in private homes, the government said in state newspaper Granma, the Associated Press reported. The suspension also includes growing industries such as private teachers, street vendors of agricultural products and dressmakers. Some officials have expressed concern about an increase in tax evasion and the use of raw materials from the black market in the private sector.

Odebrecht Agrees to Pay \$220 Mn Fine to Panama

Brazilian construction conglomerate Odebrecht has agreed to pay Panama a \$220 million fine and provide information about Panamanians who have received bribes from the company, Panamanian prosecutors said Tuesday, the Associated Press reported. Chief Prosecutor Kenia Porcell said the fine is part of a deal that was reached on July 26. Odebrecht has acknowledged paying \$800 million in bribes across Latin America and has reportedly paid \$59 million in bribes to win contracts in Panama.

received through an aide, The Washington Post reported. Temer denies the allegations and has resisted calls for his resignation. Temer, who served as Rousseff's vice president and became president after her ouster, is deeply unpopular in Brazil. His approval rating is just 5 percent, and more than 80 percent of Brazilians favor sending him to trial, according to opinion polls. Analysts have attributed his survival to his skills as a negotiator and doling out money to key congressional districts. In June and July, Temer's government awarded more than \$1.3 billion in discretionary funding, an unusually high amount during a time of austerity in which police departments, universities and hospitals have seen their funding cut, The New York Times reported, citing government watchdog group Open Accounts. Several other lawmakers are also under investigation in connection with the massive kickback scheme involving state-run oil company Petrobras and construction giant Odebrecht.

Venezuelan Attorney General Launches Probe of Election

Venezuelan Attorney General Luisa Ortega Díaz has launched an investigation into whether the results of Sunday's election to choose the National Constituent Assembly were manipulated, CNN reported. Díaz told CNN en Español on Wednesday that she had appointed two prosecutors to investigate claims of voter fraud and to investigate the directors of the country's National Electoral Council "for this very scandalous act that could generate more violence in the country than what we have already experienced." The controversial constituent assembly will have the authority to rewrite the Constitution and override the authority of the opposition-led National Assembly. The opposition boycotted Sunday's election, and 10 people were killed in protests related to the vote. Once considered an ally, Ortega has become the most vocal critic of President Nicolás Maduro's administration from within the government. Antonio Mugica, the CEO of London-based Smartmatic, which provided the voting technology for Sunday's vote, says

the vote tally of eight million people provided by Venezuela's National Electoral Council was overstated by one million votes. At a press conference Wednesday in London, Mugica said the turnout numbers were "tampered with." Maduro disputed Mugica's claim on Wednesday. "The stupid president of Smartmatic, under pressure from the United States and the United Kingdom, now says only 7.5 million people voted," he said. "I say it was more than 10 million."

ECONOMIC NEWS

Mexico Outlines Goals for NAFTA Negotiations

Mexico has outlined its goals for the upcoming renegotiation of the North American Free Trade Agreement, or NAFTA, according to a document seen by Reuters on Tuesday, the news service reported. Among the country's goals for the talks that are due to start Aug. 16 are its retention of unimpeded access to goods and services in the NAFTA region, more integration of the labor markets of Mexico, the United States and Canada, and establishing rules of origin in order to guarantee regional benefits, the document says. Mexico also wants to strengthen regional energy security as the country works to implement the historic opening of its gas, oil and power sectors. Another one of Mexico's goals for the trade talks is to strengthen the dispute resolutions and mechanisms of NAFTA, which goes against U.S. President Donald Trump's administration's stated goal of eliminating the so-called Chapter 19 tool. Under Chapter 19, binational panels oversee complaints about illegal subsidies and dumping and make binding decisions on the issue. The United States frequently lost such cases. The Mexican government also hopes to unify agricultural, animal and health safety regulations, protect the intellectual property of domestic content producers and bolster and create new measures to increase transparency and fight graft. The Trump administration last month released a 17-page list of its objectives for the talks.

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certainly does not go unnoticed. So, it looks like investors can remain confident about investing in oil and gas in Mexico.”

A **Benjamín Torres-Barrón,**
head of the energy, mining &
infrastructure practice group at
Baker & McKenzie in Mexico:

“These discoveries are extremely important and play a crucial role in the early years following the inception of the energy reform. It is not only the fifth-biggest discovery anywhere in the world in the last five years, but many energy experts also argue that it is one of the world’s 15 largest shallow-water discoveries in the last 20 years. The discoveries will generate interest from both international and domestic investors, since the well is the first one found by a private company in a new field in Mexico, after almost eight decades in which the state had a monopoly on the sector. The finding demonstrates the opportunity that the Mexican oil sector represents, and it will also generate good inertia for the rest of the upstream companies. I am sure this will trigger an increase in the number of proposals and participants in the following CNH bid rounds. Because of the proximity of this discovery to next year’s presidential election, it is a matter that may be used in the political discourse of each candidate. Some may defend this discovery

as one of the most important achievements thus far during Mexico’s energy reform, since it represents exactly the objectives pursued by this reform: new capital, new participants and a spirit of innovation that leads to new local jobs and concrete government revenues for Mexico. Expected participation from the Mexican state in the profits of the

“There may be voices attempting to revive nationalism and return to the philosophical idea that only Mexico’s government should exploit its oil.”

— Benjamín Torres-Barrón

project is 68.99 percent, plus all applicable taxes and fees throughout the life of the project. States like Veracruz, Tabasco and Campeche will clearly benefit from their proximity to the contractual areas. However, there may be voices attempting to revive nationalism and return to the philosophical idea that only Mexico’s government should exploit its oil and is not to be shared with private companies.”

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