INTER-AMERICAN DIALOGUE'S
LATIN AMERICA ADVISOR ▸ ENERGY

FEATURED Q&A

How Much Do Latin NOCs Need International Credit Markets?

Q Last week, Colombian state-controlled oil company Ecopetrol sold $1.5 billion in bonds on international credit markets. The sale followed other international bond placements by Brazil's Petrobras and Mexico's Pemex, as state oil companies in the region are looking to tap foreign credit markets in order to bankroll their investment plans and take advantage of a rebound in investor confidence. Can we expect to see more foreign debt issuances by the region's state oil companies in the near future? How much do these companies need international credit markets to fund their investment plans?

A Guest Comment: RoseAnne Franco: "National Oil Companies (NOCs) with the most ambitious expansion plans should be expected to tap international credit markets periodically, but generally state companies have additional financing options at their disposal. First, governments themselves historically have served as a critical source of financing for NOCs. In the case of Petrobras, Brazil injected additional credit via the country's development bank (BNDES) to help offset the global liquidity crunch. The available financing was not only geared towards Petrobras, but also to local companies that procure oil services. Its 2009-13 business plan outlines an aggressive growth strategy entailing almost $175 billion in investments to develop numerous areas, including the promising pre-salt acreage. Second, being a state firm opens additional credit avenues, evident in the recent loan-for-oil deals with countries such as China and Japan. Relations between Tokyo and Caracas surely helped PDVSA secure at least $3.5 billion in financing in the past. Still, how much control these state oil companies have over their internal cash flow *vis-a-vis* the central government can also determine their need to resort to international credit markets; while histor-

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Rousseff: Pre-Salt Rules Could Create Social Investment Fund

Brazilian Cabinet Chief Dilma Rousseff, who visited Washington this week, is heading a commission to create new regulations governing the exploitation of Brazil's massive pre-salt oil reserves. See story on page 2.

Photo: Latin America Advisor.

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ENERGY SECTOR BRIEFS

Bolivia Plans to Invest $5 Billion in Oil and Gas Sector

Bolivian officials said earlier this week that the government would spend $5 billion over the next five years in order to increase production of oil and natural gas, Reuters reported. "During the next five years, more than $5 billion is forecast to be spent in the oil and natural gas sector on investments in exploration, operations and distribution," Energy Minister Oscar Coca said Tuesday in Cochabamba. Bolivia is the region's largest exporter of natural gas and has more reserves than any other country except Venezuela.

Pacific Rubiales: Colombia Pipeline Almost Complete

Canada's **Pacific Rubiales Energy** has said the pipeline it is constructing in Colombia is almost complete, Reuters reported Wednesday. Filling of the pipeline will start early next month, the oil and gas producer said. The pipeline will initially be able to carry 170,000 barrels of blended heavy oil per day and would be able to carry up to 260,000 barrels daily with upgrades.

Transocean Lands Estimated $558.5 Mn Contract With Petrobras

Switzerland-based drilling contractor **Transocean** said Tuesday it won a three-year contract from Brazilian state oil company **Petrobras** for its Cajun Express semisubmersible rig, which is currently operating in the US Gulf of Mexico for **Chevron**. Transocean put the value of the contract at $558.5 million, which would climb to $894.3 million if Petrobras exercises an option to extend it by two years. The term of the contract is scheduled to begin in the first quarter of 2010.

Oil & Gas News

Correa Takes Tough Stance on Perenco, France Expresses Concerns

Ecuadorean President Rafael Correa said Thursday his government will not back down from an ongoing tax dispute with French oil company **Perenco**, reported Reuters. "I'm ready to take this to its logical conclusion; we're not going to allow transnational [companies] to keep treating us like a colony," Correa told a local radio station. He did not specify what actions his government would take against the French company. Perenco last week tried to suspend production at two oil blocks in Ecuador, but state oil company **Petroecuador** instead took over the blocks' operations, claiming the suspension was illegal. On Tuesday, Ecuador's new oil minister, Germanico Pinto, said the government was analyzing a legal solution to the dispute and is still open to dialogue with the company. "The fields are at the disposition of Perenco, and the state is merely acting to ensure the continuity of operations and avoid damages to the installations," Pinto said, according to release on the ministry's Web site. In a letter sent Thursday to government authorities, Perenco argued that the takeover amounted to expropriation. The Ecuadorean government "plainly expropriated our assets and infringed our rights," the company said, according to a copy of the letter obtained by Bloomberg News. Perenco fired 342 workers last week after they sided with the Ecuadorean government, refusing to suspend operations. Now Petroecuador is asking the government for $10 million in emergency funds to continue operating the blocks. Pinto said Ecuador and France were maintaining cordial relations despite a statement from the French government expressing concern over the dispute. A spokesperson for France's foreign affairs ministry said Monday it regretted that Ecuadorean authorities had failed to implement measures previously decided upon by an arbitration tribunal. The tribunal had recommended that Ecuador stop a coercive process to collect the $327 million it says Perenco owes under a windfall tax law passed in 2006. "The Quito authorities' decision is not likely to attract foreign investment to Ecuador or create the business climate conducive to the development of economic and trade relations which France wishes to see," the foreign ministry spokesperson said.

Pinto

Photo: Ministry of Mines and Petroleum.

Rousseff Says Pre-Salt Rules Could Include Creation of 'Social Fund'

Brazil could set aside revenues from its newfound oil wealth to fund education and other social programs, Cabinet Chief Dilma Rousseff said Wednesday, reported Bloomberg News. Rousseff is heading a presidential commission that will recommend new regulations governing the exploitation of the so-called pre-salt reserves, which may hold up to 80 billion barrels of oil. The commission is slated to present its findings to the president by the end of August, and the government hopes Brazil's Congress will pass the legislation by the end of the year. The rules may include a plan to create a "social fund" to invest in education and fight poverty. "When you have this amount of oil, you need to avoid the so-called oil curse—a lot of oil and a lot of poverty," Rousseff said in Washington. The new regulations could give state oil company **Petrobras** a "pro-

"When you have this amount of oil, you need to avoid the so-called oil curse—a lot of oil and a lot of poverty."

— Dilma Rousseff

tected position" in exploiting pre-salt reserves, according to Brazilian Energy and Mines Minister Edison Lobao, who also visited Washington this week. Foreign and private oil companies would be required to enter into joint ventures with Petrobras in pre-salt blocks, although he said the commission was still considering whether the company would be made the operator of these blocks. Lobao rejected the idea that this model would be unattractive to private oil companies. "I would tell them that they have nothing to worry about. They will not be hurt; quite to the contrary, they'll be able to take part in all the auctions and in areas of oil exploration where risk is nearly null. They stand to profit," he said, speaking through an interpreter. Lobao also said he was not concerned about a Brazilian Senate probe into irregularities at Petrobras. "Congressional inquiries are a day-to-day thing for us, that's part of democracy," he added. The hearing, which will be headed by Joao Pedro of the ruling Workers' Party, is slated to begin Aug. 6. [Editor's note: look for a related Q&A on the pre-salt regulations in an upcoming issue of the *Energy Advisor*.]

PDVSA Boosts Employment Ranks Following Nationalizations

Venezuela is approaching its target of hiring 8,000 oil industry workers from private companies that the government recently nationalized, Dow Jones reported Wednesday. Oil Minister Rafael Ramirez said state oil company **PDVSA** has hired 6,900 former workers of foreign and local companies. This year, Venezuela has nationalized 74 oil services companies and expropriated their assets. PDVSA now employs approximately 80,000 employees, roughly double the number from when President Hugo Chavez took office in 2001. Some analysts believe the hiring is straining PDVSA's finances, but Ramirez said the company is boosting efficiency by reorganizing. "Costs are being reduced in a process that has had no problems," said Ramirez. He put the country's oil output at approximately 3 million barrels per day, although critics say it is closer to 2 million. Ramirez said PDVSA has started an audit to determine the value of oil services companies whose operations were nationalized in May, Agence France-Presse reported.

PDVSA now employs approximately 80,000 employees, roughly double the number from when President Hugo Chavez took office in 2001.

Featured Q&A
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ically the state has served as a major source for funding for NOCs, it also can conversely drain the NOC during economic downturns. This is a pressing concern with regard to Pemex as oil revenues account for almost 40 percent of fiscal accounts, and PDVSA as the latter assumes more non-oil obligations. Despite the additional credit options, with aggressive expansions planned by some NOCs and others assuming growing fiscal burdens, more frequent international bond placements look likely."

A **Guest Comment: Jose Luis Villanueva:** "We expect incremental issues from the national oil companies in Latin America—at least Ecopetrol, Petrobras and Pemex, all of which should issue again by the end of the year. Petrobras has $6.5 billion of bridge loans for the next two years that they need to refinance in the international capital markets. They have already issued $2.75 billion, so I would expect potentially another $1 billion by the end of the year. Pemex has a

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Halliburton Wins New Drilling Contracts in Brazil, Mexico

Texas-based **Halliburton** on Tuesday announced it won a $190 million contract from Brazilian national oil company **Petrobras** to provide drilling fluid services to offshore markets in Brazil. The award includes service delivery in the shelf, deepwater and pre-salt areas of the Campos, Santos, and Espirito Santo basins, the company said in a press release. The five-year agreement will begin in the current quarter. "Our Brazilian operations will be a key component in the further development of our Latin America franchise," said Jeff Miller, vice president of **Baroid**, a Halliburton product service line, in a statement. In related news, Halliburton has won a contract to drill 170 wells for Mexican state oil company **Pemex** at the Chicontepec fields starting in mid-August, Dow Jones reported Wednesday. Halliburton was the only bidder that met the technical requirements for the contract, according to the report. The company has not yet confirmed the award, and financial details of the contract were not covered in the Dow Jones report. [Editor's note: see related story on Pemex's E&P plans on page 3 of last week's issue of the *Energy Advisor*.]

Oxy Reports Higher Sales in Latin America, But Profits Fall in Q2

California-based **Occidental Petroleum** said Thursday that Latin American oil and gas sales volumes increased 37 percent in the second quarter of this year, the biggest percentage sales increase among its main regions of operation. Argentina sales were particularly strong within Latin America, the company said in a press release. Overall, the company's daily oil and gas sales volumes averaged 649,000 barrels of oil equivalent (boe) in the second quarter, compared with 588,000 boe sold in the second quarter of 2008. Occidental's profits were down sharply from last year, however, with second quarter net income falling to $682 million compared with $2.3 billion for the second quarter of 2008. Last week, the company announced that former US Commerce Secretary Carlos M. Gutierrez was elected to its board of directors. Gutierrez, who was born in Cuba, was chairman and CEO of **Kellogg Company** before serving as commerce secretary under former President George W. Bush from 2005 to 2009.

Power Sector News

New Brazilian Proposal for Itaipu Could Satisfy Paraguayan Demands

Paraguay is warming up to a new Brazilian proposal to address a long-standing dispute over revenues from the Itaipu hydroelectric dam, wire services reported Thursday. "There was an advance in Brazil's posture. The proposal establishes a just solution in tune with bilateral relations," said Paraguayan Foreign Minister Hector Lacognata, reported Brazil's Agencia Estado. Paraguay, which owns half of the dam and the electricity produced from it, says it does not receive enough benefits from its share of Itaipu because a 1973 treaty between the two nations requires it to sell its excess electricity to Brazilian state electric company **Eletrobras** at a fraction of its market value. Paraguayan President Fernando Lugo made renegotiating disputed aspects of the treaty a central plank in his campaign platform. The Brazilian proposal would allow Paraguay to sell its excess electricity freely on the Brazilian market and receive greater benefits from its participation in Itaipu. In exchange, Paraguay would have to give up aspirations to sell electricity to other countries in the region, like Argentina and Chile, which is forbidden by the treaty. The new deal is being prepared ahead of a bilateral meeting on Saturday between Lugo and Brazilian President Luiz Inacio Lula da Silva. Jorge Samek, Brazil's top executive at Itaipu, said that any deal decided upon by the two presidents will have to win approval in Brazil's Congress, reported EFE. Lula and Lugo are also scheduled to participate in Mercosur summit today in Asuncion. [Editor's note: see related Q&A on the Itaipu dispute in the Dec. 8-12, 2008 issue of the *Energy Advisor*.]

The Dialogue Continues

Is Brazil Relying Too Much on Hydro for its Energy Future?

Q France-based GDF Suez said last week it agreed to a 7.2 billion-real finance contract for the 3,300 MW Jirau mega hydroelectric project under construction in northern Brazil. Brazil has pressed forward with Jirau project, which is part of the Madeira River complex that also includes the planned 3150 MW Santo Antonio dam, despite criticisms from groups that highlight the environmental drawbacks of such large hydropower projects and other analysts who say the country should be doing more to diversify its sources of electricity. Are these types of large hydropower projects necessary to keep up with growing electricity demand in Brazil, or should the government be working harder to diversify its energy matrix, which in 2008 relied on hydropower for 88 percent of electricity? Is the government doing an adequate job planning for increased demand for electricity? In what ways do you see private companies—both domestic and international—playing a role in developing Brazil's electric sector?

A Guest Comment: José Soares: "Brazil's pursuit of large hydropower projects is part of a long- term strategy, which considers the huge potential for this kind of energy source in Brazil and the considerably lower cost of hydropower when compared to any other electricity source. The key issue is that most of the remaining Brazilian water resources are located in the Amazon region and as such a major challenge that stands out is how to balance the exploration of these hydropower resources with the least damage to the environment. These hydropower projects are necessary provided they are developed in compliance with the existing environmental legislation. A gradual diversification of Brazil's energy matrix has been already in place for some time now. Hydropower represents approximately 77 percent of the installed capacity but effective hydroelectric generation has been over 92 percent in the past in light of lower hydroelectric costs. According to the Brazilian model, the National System Operator (ONS) dispatches the energy with the lowest marginal cost, which in general is hydroelectric. The lower generation level of hydroelectricity in 2008 was due to the government decision to dispatch energy out of the order of merit to preserve the level of Brazilian reservoir water within determined limits by year end. According to ONS information, from 2008 through 2012, new hydropower capacity will represent just 42 percent of total planned energy coming on stream during this period. Given the current economic slowdown and provided the planned new generation projects come on stream as planned, the risk of an energy rationing is very low in the medium horizon."

José Soares *is assistant vice president in the global infrastructure group at Moody's America Latina in Sao Paulo.*

Editor's note: the above is a continuation of a Q&A published in the July 13-17 issue of the Energy Advisor.

Political News

Zelaya Establishes Base Near Honduras, Vows Border Showdown

Deposed Honduran President Manuel Zelaya on Thursday set up a base for himself inside a hotel in Esteli, Nicaragua, approximately 40 miles south of the Honduran border, where he said he was studying routes to re-enter Honduras, the Associated Press reported. Zelaya said he would make an attempt as early as Saturday by land, air or sea. He said the breakdown of talks between his side and the *de facto* government of President Roberto Micheletti, which ousted him June 28, left him no choice but to attempt a showdown at the border. Zelaya called on Hondurans to gather at the point where he attempts to cross and urged the military to stand down. "I am on my way to Honduras, and I hope most

Hondurans can overcome the checkpoints, that they head to the border, and that they not fear the soldiers," Zelaya told reporters at the hotel, where Venezuela's foreign minister accompanied him. To Honduran soldiers, he said, "Don't aim your rifles at the representative of the people or at the people." The Micheletti government has vowed to arrest Zelaya if he enters Honduras. It also ordered a curfew along the border. Organization of American States Secretary General Jose Miguel Insulza said he was still hoping the two sides could reach an agreement through talks and said Zelaya was being "hasty" by attempting to re-enter on his own. He said neither side has formally responded to the latest proposal by lead mediator Costa Rican President Oscar Arias.

Opposition Denounces Ortega's Push for Third Term

Opposition lawmakers in Nicaragua on Monday denounced President Daniel Ortega's push for constitutional changes that would allow him a third term in office, the Associated Press reported. On Sunday during an event celebrating the 30th anniversary of the Sandinista revolution, Ortega said he disapproved of presidential term limits because they are stricter than those for other elected offices. "If we are going to be just and fair, let the right to re-election be for all and people with their vote can award or punish," Ortega said. "This is the principle that we have to defend." Jose Pallais, an opposition lawmaker, said the president's push for the constitutional changes appeared similar to moves by Venezuelan President Hugo Chavez and ousted Honduran President Manuel Zelaya. Nicaragua prohibits presidents from serving more than two terms, which cannot be consecutive. Ortega ended his first term in 1990. In 2006, he won election again to a five-year term.

Peruvian Court Sentences Fujimori to 7 1/2 Years for Embezzling

A Peruvian court on Monday sentenced former President Alberto Fujimori to seven and a half years for embezzlement, the Associated Press reported. On July 13, Fujimori admitted to paying his former spy chief, Vladimiro Montesinos $15 million in public money to step down as Fujimori's government collapsed amid a corruption scandal. While Fujimori accepted the embezzlement charges, he argued he was not criminally responsible because he later repaid the money. On Monday, Fujimori did not appear to be dismayed by the sentence and told the court he would seek to have the ruling overturned. In April, Fujimori was sentenced to 25 years in prison for his part in death squad killings and kidnappings. He had previously been sentenced to six years in prison for ordering an illegal search. Peru does not allow prison sentences to accumulate, so Fujimori's convictions would place him behind bars for no more than 25 years.

Economic News

Mexican Central Bank Cuts Key Interest Rate Quarter Point

Mexico's Central Bank last Friday lowered its benchmark interest rate a quarter percentage point to 4.5 percent, Bloomberg News reported. The cut was a smaller reduction than last month's half-point cut and the bank, headed by Guillermo Ortiz, said it will "pause its current monetary easing cycle." This year, the bank has slashed its key interest rate 3.75 percentage points. The bank's announcement led to a strengthening of the peso Friday. In the first quarter of 2009, Mexico's economy, the second-largest in Latin America after Brazil's, contracted at its sharpest rate since the Tequila Crisis of the mid-1990s. Unemployment in Mexico has grown this year amid the recession in the United States, which buys approximately 80 percent of Mexico's exports. The outbreak of swine flu earlier this year shook the country's economy as tourists stayed away and the government shut down restaurants, theaters and schools. The outbreak may shave 0.5 percent off of Mexico's GDP this year, Ortiz has said. [Editor's note: see related Q&A in the July 17 issue of the daily *Advisor*.]

POLITICAL & ECONOMIC BRIEFS

Israel: Brazil Should Seek End of Iran's Nuclear Program

Brazil should use its ties to Iran to urge it to end its nuclear program, Israeli Foreign Minister Avigdor Lieberman said Wednesday during a visit to Brazil, Agence France-Presse reported. "I believe that Brazil, more than other countries, could try to convince the Iranians to stop their nuclear program," Lieberman said during a press conference with Brazilian Foreign Minister Celso Amorim, adding Iran "is a major threat, and not only in the Middle East." Amorim defended Iran, saying its nuclear program is "exclusively non-military."

Chavez Bristles at Colombia-US Military Deal, Drug Report

Venezuelan President Hugo Chavez on Tuesday sharply criticized Colombia's decision to allow the United States to strengthen its military presence and also bristled at a new report on illegal drugs, the Associated Press reported. On Tuesday, Chavez said Colombia's plan to allow more US military members to be stationed in Colombia amounted to "a threat against us." He also blasted a US Government Accountability Office report that says corruption in the Venezuelan military and government has aided drug traffickers.

Brazilian Central Bank Cuts Benchmark Interest Rate to 8.75%

Brazil's Central Bank on Wednesday cut its benchmark interest rate to a record low of 8.75 percent, Bloomberg News reported. The half-point cut was the smallest decrease in the overnight rate this year.The smaller rate cut is a signal that the bank's confidence is growing, and that Brazil is emerging from recession.

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very aggressive investment plan, which basically states that in order to get the amount of money they need—about $7 billion in 2009—they would issue between $2 billion and $3 billion on the international capital markets. They have already issued $2 billion, so potentially they will issue another $1 billion by the end of the year. Finally, Ecopetrol has a $6.2 billion capex plan for 2009, and it is currently issuing $1.5 billion in bonds. They'll potentially issue another $1 billion or so by the end of the year. In overall terms, Latin American national oil companies would be likely to issue in the international capital markets about a third of their needs. Obviously, Petrobras needs to issue significantly higher amounts. Thanks to the fact that Petrobras already has the government's word from development bank BNDES for more than $2.25 billion for the next two years and $10 billion from the China Development Bank, maybe its need to access international capital markets is not as high in percentage points but it's high in terms of dollars."

A Guest Comment: Hernan Arizmendi-Posada: "Even though the global energy sector has begun recognizing that Latin America could be a promising region for oil and gas exploration, thanks to the activities of some companies like Petrobras, Pemex, PDVSA and most recently, Colombia's Ecopetrol, there is still substantial absence of qualified investment made in the region. It can be said that the majority of the largest investors, both public and private companies in the worldwide energy industry (not including the majors who are already there) have not seriously considered the potential of the hydrocarbon industry that Latin America offers. They usually do not go further than simply showing surface interest, which could be due to the region still being considered 'taboo,' an unknown area that is perceived to be a political risk and where there are no clear rules for foreign investors. When we talk about the hydrocarbon resources in Latin America, in my opinion there are only a few countries such as Mexico, Brazil, Colombia, and Peru (with slightly less chance for Argentina) that will have the privilege to tap foreign credit markets in order to fund their investment plans and instill investor confidence. For these reasons, I doubt that we are going to see a significant increase of foreign debt issuances by the region in general. The reality for the remainder of the countries such as Ecuador, Venezuela and Bolivia among others, is that even though they have proven reserves, their energy future remains in question if they persist on their current political path; making it difficult to go to the international credit markets."

> "I doubt that we are going to see a significant increase of foreign debt issuances by the region in general."
>
> *— Hernan Arizmendi-Posada*

RoseAnne Franco *is lead analyst for Latin America in the Markets and Country Strategies group at PFC Energy.*

Jose Luis Villanueva *is a director in Fitch Ratings' Latin America corporate finance group.*

Hernan Arizmendi-Posada *is CEO of LAGO Energy.*

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Erik Brand,
General Manager, Publishing
ebrand@thedialogue.org

Gene Kuleta,
Editor
gkuleta@thedialogue.org

Matthew Schewel,
Reporter, Assistant Editor
mschewel@thedialogue.org

Subscription Inquiries are welcomed at freetrial@thedialogue.org

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