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FEATURED Q&A

What Is Generating Interest in Oil Exploration in Nicaragua?

Q Nicaragua currently has five onshore and offshore oil exploration projects and within the last month, both Houston-based Noble Energy and Nicaragua's energy minister on behalf of Spain's Repsol announced they will begin drilling wells off the country's Caribbean coast. What is drawing international oil companies to Nicaragua? What are the prospects for finding oil, both onshore and offshore, and does the country's regulatory climate provide the right incentives for oil exploration and development?

A Pablo Medina, Latin America upstream analyst at Wood Mackenzie: "The increased appetite of large companies for frontier exploration has drawn them to Nicaragua, which offers prospective acreage and attractive fiscal terms. Noble Energy has been a leader in this regard, holding positions in frontier areas such as Israel, the Falklands and now Nicaragua. Repsol has also actively grown its global exploration portfolio and has been building its Caribbean position in recent years. The focus for the IOCs is offshore exploration which has a high-risk, high-reward nature. There has been no offshore drilling in Nicaragua since the 1970s, and the Paraiso Sur well that Noble plans to spud in August will be the country's first ever deepwater well. The risk is certainly high, but if Noble is successful, then there will be positive implications for both Nicaragua and the wider region. The onshore opportunity is more limited and will likely only attract smaller companies. Nicaragua's regulatory framework is one of the more attractive in Latin America. The government has recognized the high-risk nature of the country's offshore acreage and has established an appropriate set of fiscal terms. Given estimated well costs of $100 million, an appropriate level of tax take is essential to attract companies to undertake wildcat exploration."

Continued on page 2

Pursuit of Regional Trade Pacts Threatens Global Talks: Azevêdo

Countries' pursuits of trade deals on the regional and bilateral levels are threatening efforts to restart global trade talks, said Roberto Azevêdo, the Brazilian who will become the World Trade Organization's first director-general next month. See story on page 3.

File Photo: Brazilian Government.

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NEWS BRIEFS

Fernández Renews Call for Negotiation Over Falklands

At a meeting of the United Nations Security Council in New York on Tuesday, Argentine President Cristina Fernández renewed calls for Britain to negotiate with Argentina over claims to the Falkland Islands, BBC News reported. Argentina in January assumed a seat on the U.N. Security Council and will hold the presidency of the body this month. Fernández called for a 1965 U.N. resolution that urged the two countries to negotiate to be enforced, saying the two nations need to "sit down and discuss."

Leader of Venezuelan Opposition Party Fatally Shot

A leader of the opposition Proyecto Venezuela party was fatally shot Monday night in the home state of late President Hugo Chávez, the Associated Press reported. A gunman riding on a motorcycle shot Pablo Uzcategui twice as he drove through the capital of Barinas state with his son, a colleague told the wire service. Robbery was not the motive in Uzcategui's killing, said National Assembly lawmaker Carlos Berrizbeitia.

Peru's Sol Falls to Lowest Level Against Dollar Since May 2011

Peru's sol dropped against the dollar by 0.3 percent to close at 2.7990 per U.S. dollar on Tuesday, its lowest level since May 2011, Bloomberg News reported. The sol has depreciated 8.7 percent this year amid speculation that the Federal Reserve will scale-back stimulus measures. The country's central bank responded to the drop by selling $10 million of U.S. currency in the foreign-exchange market and 90 million soles of dollar-linked certificates of deposit.

Political News

Colombia, Nicaragua Clash Over Disputed Caribbean Territory

The Colombian Foreign Ministry said Tuesday that it had not received a response from Nicaragua to its protest last week about the Central American country's decision to auction off oil exploration blocks in parts of the Caribbean that both countries claim, the *Los Angeles Times* reported. The Foreign Ministry's statement came a day after Colombian President Juan Manuel Santos said in a local radio interview that his administration would soon unveil its plan to keep control of Caribbean waters that the International Court of Justice said last year are Nicaraguan territory. "I can't announce any concrete measure, what I can say is we are going to make a thorough explanation and a series of announcements about how we are going to proceed," said Santos. Colombia is discussing the matter with foreign and domestic law firms in an effort to "protect Colombia's interests," Santos added. In November, the International Court of Justice in The Hague affirmed Colombia's control of Caribbean islands that had been under the country's control since its independence was recognized in 1819. However, the World Court also ruled that thousands of square miles of Caribbean territory east of the 82nd Meridian, which has historically been the countries' maritime border, belonged to Nicaragua. Last week, Nicaraguan President Daniel Ortega said that Colombia's claims to the disputed waters are "false," Colombian newspaper *El Tiempo* reported. The area is believed to have oil and gas deposits and is a prime fishing area for lobster and shrimp. Colombia has said that several treaties, the latest of which was signed by the two countries in 1928, confirm its control of the disputed waters. However, Nicaragua argues that it signed the 1928 treaty under duress during a time that U.S. Marines were occupying the country.

Ortega

File Photo: Nicaraguan Government.

Featured Q&A

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A Tom Donnelly, vice president of International Resource Management (Canada) Ltd.: "What is drawing international oil companies to Nicaragua? Opportunity! Most of the hydrocarbon reservoirs in North America today are well developed, and until we had horizontal drilling and multi-staged fracturing, some were even close to being depleted. The prospect of developing virgin reservoirs in new frontiers like Nicaragua is appealing. There are three requirements for hydrocarbon reserves: organically rich source rock, overlain by a reservoir rock, in turn overlain by an impermeable cap rock. These conditions exist in Nicaragua. From the onshore data we reviewed, we have observed live oil generally in about 1,000 feet of oil-stained and oil-saturated rock. We have also seen extensive data showing potential thick hydrocarbon producing zones and large traps. This is what led to the San Bartolo discovery announced last November by Industria Oklahoma Nicaragua, S.A (Indoklanicsa). Data of a less technical nature, but almost more telling, is accounts of a stream where if you poke the bottom with a stick, oil comes to the surface. Therefore, I am convinced the prospects for producing oil commercially in Nicaragua are very favorable. The regulatory climate of the Nicaraguan government is extremely positive. Our client, Michael Goyne, president of Indoklanicsa, has continuously impressed upon me how supportive the Nicaraguan government has been of the Sandino Basin Development to date. His assurance, coupled with a reasonable royalty and tax structure, leads me to believe that Nicaragua is an excellent place to invest in oil and gas exploration."

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Economic News

Regional Trade Accords Threaten Global Talks: Azevêdo

Countries' pursuits of regional and bilateral trade accords are hindering efforts to restart global trade talks, the incoming head of the World Trade Organization said Tuesday, Bloomberg News reported. Policymakers will find it difficult to devote attention to global talks while at the same time engaging in trade talks at the regional and bilateral levels, Roberto Azevêdo said at an event in Rio de Janeiro. "There's not enough time to work on everything," said Azevêdo, a Brazilian who will become the first Latin American to become WTO director-general when he assumes the post next month. "Once negotiations are going at full steam, it'll steal attention from the multilateral system." Nevertheless, Azevêdo added that proposed U.S.-European talks and the Trans-Pacific Partnership can be part of global efforts to lower trade barriers. Such agreements could even be models for future WTO negotiations, he added. Near the top of Azevêdo's agenda when he takes office is the ministerial conference planned for December in Bali. At the gathering, countries will seek to reach agreement on issues ranging from agriculture to concerns of least-developed countries. Azevêdo said that although it will be difficult to find consensus, it is important to show that the stalled Doha Round of trade talks can move forward.

Company News

Drummond, Striking Colombian Workers Fail to Reach Agreement

U.S.-based coal miner **Drummond** and striking workers in Colombia were unable to reach an agreement Tuesday to end the two-week work stoppage that has halted approximately a third of the South American country's coal production, Reuters reported, citing statements by the company and the main union representing workers. Birmingham, Ala.-based Drummond increased its offer on pay to the Sintramienergetica union, but it was insufficient to end the strike that started July 23. The union represents about half of the company's 10,000 workers in Colombia. Drummond has a port and two mines in the South American country. "There was no agreement because there was no direct contact made with the company," the union's vice president, Edgar Muñoz, told Reuters. "We won't accept these sorts of negotiations." Drummond also met with two other unions that represent workers, but Sintramienergetica "refused to participate" and has wanted to negotiate alone, the company said. The coal miner boosted its offer, saying it would pay workers 5 percent more for the first year and also said it would provide a one-time bonus of about $4,500. Sintramienergetica has sought a 9 percent pay increase with smaller raises in subsequent years. "Drummond has taken into account the requests of union negotiators, the industrial standards and norms, the current conditions of the market and above all, the needs of our employees and their families ... This is a very generous offer," the company said. Also at issue is the fate of 400 workers at Drummond's port. Some of them could be laid off when the company begins using conveyor belts to load cargo early next year.

The work stoppage has halted approximately a third of Colombia's coal production.

The Dialogue Continues

Which Way Is Latin America's Largest Economy Headed?

Q Brazil's government said July 22 that it will cut its expenditures by 10 billion reais ($4.5 billion) and at the same time lowered its forecast for economic growth this year by a half percentage point to 3 percent. Stagflation has become a looming fear in Latin America's largest economy as inflation hovers around the 6.5 percent upper limit of the central bank's target. At the same time, the government has recently been coping with protesters' demands for lower taxes and better public services. Where is Brazil's economy headed? Is the government taking the right actions to boost the economy, and which sectors stand to gain or lose the most as a result? How closely related are social protests with the public's economic concerns?

A Peter Sufrin, independent Washington-based analyst: "The simple observation that Brazilian political and economic deficiencies are inseparable brings to light the fundamental need for reform on both fronts. Issues such as tax reform, social security, infrastructure, health care and education, as well as the dicey relationship between Rousseff and Congress, reveal the compelling synergism of economic and political factors. In other words, economic reform is necessary but not sufficient. Certainly, issues such as infrastructure, transportation, health and education are economic in bent, but the political legacy of authoritarianism offers insight into the endemic and lingering obstacles of corruption, a stifled bureaucracy and the 'Brazil Cost.' Gilberto Rodrigues' observation that improvement of economic rights for the poor traditionally occurred without the development of political and civil rights, reflects the ongoing crisis of political representation at the federal, state and local levels."

Editor's note: The above is a continuation of a Q&A published in the Aug. 2 issue of the Advisor.

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Featured Q&A

Continued from page 2

Andrew Melsheimer, partner at Thompson & Knight in Dallas: "A better way to respond is to explain why oil companies are returning to Nicaragua. Approximately 26 wells were drilled offshore Nicaragua in the Caribbean Sea between 1943 and 1977. Several encountered hydrocarbons, with one testing 350 bpd. Given the era, none of the wells were declared commercial. Prior well tests and the limited science available at the time, coupled with an uncertain political situation, caused many to overlook Nicaragua, even though some believe that it shares geological structures similar to those in Mexico's Reforma/Cantarell area, Guatemala's Rubelsanto Field, Venezuela's Maracaibo Basin or offshore West Africa. Since the 1990s, Nicaragua has offered investors a more stable political environment, and the country is committed to developing its hydrocarbon industry as part of its goal to become self-sufficient. With that increased political stability, Infinity Energy Resources began to work with the Nicaraguan government in structuring its first bid round in decades. That tender process attracted companies interested in exploring the large structures offshore Nicaragua which could provide for reef development of organic-rich source rocks. Drilling will determine whether these structures have trapped commercial quantities of oil. Noble Energy's recent announcement that it intends to drill an exploratory well in the coming months demonstrates that one of the more successful exploration companies of late believes in this play and is willing to expose significant capital to test it. And not long thereafter, Infinity will begin its seismic program. As for the legal and regulatory climate, Nicaragua has comprehensive, investor-friendly hydrocarbon and environmental laws and regulations that govern offshore activities. To date, only three concessions (with Repsol appearing to be the fourth) have been granted under these laws. So the country is still learning and adjusting as activities progress under these concessions. And it would not be surprising if Nicaragua revisits, enhances and clarifies its hydrocarbon law as part of its efforts to attract more investment in the sector. For the time being, however, the government has shown a willingness to work with foreign oil companies and provide an environment that promotes their efforts in exploring and hopefully producing hydrocarbons offshore."

> "The government has shown a willingness to work with foreign oil companies and provide an environment that promotes their efforts."
>
> — *Andrew Melsheimer*

Federico Gurdián, partner at Garcia & Bodan in Managua and lead legal counsel for Indoklanicsa: "The opportunity access new and unexplored hydrocarbon reservoirs in a country that is actively promoting foreign investment is what is drawing international oil companies to Nicaragua, where to date a number of wells have been tested for oil or natural gas. Such is the case of Indoklanicsa, a Nicaraguan corporation owned by foreign investors. Indoklanicsa is the holder and operator of the only concession for exploration, exploitation and marketing of hydrocarbons onshore the Pacific area of Nicaragua, which was granted in 2004. Also, Spain's Repsol and Houston-based Noble Energy have announced that they will be drilling wells off Nicaragua's Atlantic coast in the near future. Thus, it appears that the country's regulatory climate provides the right incentives for oil exploration and development. In my experience, the Nicaraguan government has at all times been cooperative with regard to the Sandino Basin Development and the company's operations there."

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