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LATIN AMERICA ADVISOR ▸ ENERGY

FEATURED Q&A

What's Ahead for Latin America's Oil Sector Next Year?

Q This year saw a number of major changes in Latin America's oil sector, with Mexico finalizing a long-anticipated reform to open its energy sector to foreign participation and a steep drop in oil prices late in the year putting pressure on major producing countries. What is the outlook for Latin America's oil sector next year? What are the countries and trends to watch going into 2015?

A Jed Bailey, managing partner of Energy Narrative: "Latin America's oil sector will face a tumultuous year in 2015 as the events that have recently shaken global markets continue to play out. Most importantly, countries and companies must adapt to lower and more volatile oil prices. A few, including countries in Central America and the Caribbean that rely on imported diesel and fuel oil for electricity supply, will see immediate benefits. Others, most notably Venezuela, will face deep government budget shortfalls and sharply reduced foreign currency earnings, putting their economies under even greater pressure. For most countries, however, lower oil prices will be a mixed blessing. A strengthening dollar will limit the relative local currency decline in the price of imported oil products, and many will also be affected by falling prices in other commodities. Indeed, past periods of low oil prices have seen Latin America underperform relative to the United States and led to defaults on their dollar-denominated debt. Most countries are better prepared today than they were in past decades, but adjusting to their new economic circumstances will still be painful. Lower and volatile oil prices will also complicate efforts to attract upstream investment. This is most important for Mexico's critical Round One auction of upstream blocks, but Argentina, Peru and Colombia also face important tests in attracting and maintaining investor interest. Brazil in

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U.S.-Cuba Policy Changes Won't Spur Oil Rush: Analysts

In a major policy shift, President Barack Obama announced Wednesday that the United States will restore diplomatic relations with Cuba. Analysts said the move could pave the way for future commercial opportunities, but is unlikely to immediately affect Cuba's oil sector. See story on page 2.

Photo: White House.

Inside This Issue

ENERGY SECTOR BRIEFS

Enel Sells La Geo Stake to INE, Exits El Salvador

Enel Green Power has sold its 36.2 percent stake in **La Geo**, a joint venture between it and the government of El Salvador to develop geothermal power, to state-run **Inversiones Energéticas** (INE) for $280 million, the Rome-based company said Monday. The deal comes as part of proceedings at ICSID in which Enel alleged that the government breached a shareholder agreement by not allowing it to increase its stake through further investments. The deal marks the end of Enel's operations in El Salvador.

Gran Tierra to Invest $310 Million in Peru, Colombia and Brazil Next Year

Canada-based **Gran Tierra Energy** will invest $310 million next year in exploration and development of its hydrocarbons blocks in Colombia, Peru and Brazil, according to the company's 2015 capital spending program announced Dec. 11. Of the total, $118 million will go to Peru, especially the Bretaña oil field in Block 95 and the Osheki-1 exploratory well in Block 107, and $156 million will be invested in Colombia and $34 million in Brazil.

IFC to Loan $300 Million for Panama Wind Farm

The World Bank's International Finance Corp. said Tuesday that it will provide $300 million in financing for the continuing construction of a 215-megawatt wind farm located near the city of Penonomé in Panama, which will be Central America's largest wind farm when completed, Reuters reported. The first phase of the project began came online last December. Power-generation investor **InterEnergy Holdings** is financing most of the project.

Oil & Gas News

Improved Relations With Cuba Unlikely to Spur Oil Sector: Analysts

U.S. President Barack Obama on Wednesday announced plans to re-establish diplomatic ties with Cuba after more than 50 years, creating speculation that the move could lead to an easing of restrictions on economic and commercial ties affecting the country's energy sector, the Associated Press reported. The waters off of Cuba's northwest coast are believed to contain sizable oil and gas reserves, and the U.S. Energy Information Agency estimated that as of January 2013, the country had proven reserves of 124 million, *Politico* reported. International oil companies have drilled there in the past, but did not find promising results. However, Sarah Ladislaw, director of energy and national security program at the Center for Strategic and International Studies, said promising locations remain and "there is lots more exploration people want to do," according to the AP. She said there has been some reluctance to work there for fear of angering the United States. In recent years, Brazil's **Petrobras**, Malaysia's **Petronas**, Russia's **Zarubezhneft** and Spain's **Repsol** have all searched for oil off of Cuba's coast, but exploration wells either turned up dry or were determined to not be not worth commercial development. This discourages other oil companies, Jorge Piñon director of the Latin America and Caribbean Energy Program at The University of Texas at Austin, told *The Sydney Morning Herald*. Some geologists "think it is worth going back and taking a second look, but now is not the time to do it." One factor is that would dampen interest in exploring in Cuba is lower prices for oil, which mean that companies are cutting their budgets and focusing on core operations. "There is not going to be a Cuban oil rush," said Pavel Molchanov, an energy company analyst with **Raymond James**, told *Politico*. "Just because U.S. companies have been unable to drill in Cuba doesn't mean nobody has been able to drill in Cuba," he said. If other companies had found significant amounts of oil, other international companies would come. An oil rush "would not have happened even if oil was at $100, but it's certainly not going to happen at these price levels," Molchanov added. However, if Obama's move leads to a loosening of the embargo, which only the U.S. Congress has the power to overturn, some companies will inevitably be interested. "It's all about the potential return on investment," an energy analyst who asked to remain anonymous told *Politico*. "If they make it competitive, they could get eight to 10 companies in there." This would require a reliable legal framework and a lucrative royalty regime among other things, the analyst said. While Obama's announcement did not include measures that would allow for major oil exploration deals by U.S. companies in the near-term, and even if U.S. producers aren't interested, improved diplomatic relations may open opportunities for drilling contractors and oilfield services. Piñon said Cuban oil projects are recovering about 10 percent of oil, but "If Cuba could get U.S. service companies **Halliburton** and **Schlumberger** to come in and give them the technological assistance they need with enhanced oil recovery, Cuba could increase that recovery factor to 17 or 20 percent," he told *The Sydney Morning Herald*. Recent drilling in Cuba has been constrained because wells had to be sunk with **Saipem**'s Scarabeo 9 because it does not contain more than 10-percent American-made components, a limit set by the U.S. trade embargo. Obama said Wednesday that the U.S. will begin

> "There is not going to be a Cuban oil rush."
>
> — *Pavel Molchanov*

To Our Subscribers

In observance of the Christmas and New Year's holidays, the next issue of the Latin America Energy Advisor *will be published the week of Jan. 5-9, 2015. We wish our readers a happy holiday season and a prosperous new year.*

talks with Cuba and Mexico over maritime boundaries, which could open opportunities in areas with murky ownership now, but any resolution would take years. [Editor's note: See related Q&A on Cuba-U.S. relations in Thursday's issue of the daily *Advisor.*]

Peru Awards Block III, Block IV Contracts to Graña y Montero

Peru's government on Dec. 12 awarded the rights to develop blocks III and IV in the northwestern Piura region to Lima-based **Graña y Montero**'s energy unit, *Gestión* reported. State energy agency Perúpetro approved the technical economic offer from Graña y Montero, the country's largest construction company. Block III currently produces around 3,000 barrels per day, while Block IV produces 900 bpd, Perúpetro said, according to Reuters. Graña y Montero will invest $600 million over 10 years in the two concessions, which will eventually produce more than 5,000 bpd combined, said Francisco Dulanto, president of the board of **Graña y Montero Petrolera**. Perúpetro president Luis Ortigas said that the company has committed to drilling 230 wells over 10 years at the blocks. Ortigas added that state-run oil company **Petroperú** will take a minority stake in each block, the size of which will be decided in the next 45 days, as part of its efforts to strengthen the company by partnering with the private sector. The concessions, currently held by Norway's **Interoil**, will be transferred to Graña y Montero in April. In related news, Perúpetro on Monday launched a bidding round for seven jungle oil and gas exploration blocks, *El Comercio* reported. The areas on offer include blocks 164 and 199 in the Loreto Basin, blocks 169, 175, 189 and 195 in the Ucayali Basin, and block 187 in the Madre de Dios Basin. Ortigas said that more than 10 international companies have expressed interest in participating in the round. Bids will be accepted until May, and the blocks will be awarded in August, according to Platts. The government expects an average of $450 million to be invested in each block, and companies must commit to a minimum 20 percent royalty and drilling at least two exploration wells at each block.

Colombia's Ecopetrol to Seek Replacement for CEO

The board of directors of Colombia's state-owned oil company, **Ecopetrol**, said Dec. 12 that it will seek to replace Chief Executive Javier Gutiérrez, who has headed the company since 2007, as part of its efforts to undertake a "strategic realignment." Ecopetrol, which has seen its shares plummet since early 2013, said it will use an international head hunting firm to locate a replacement for Gutiérrez, who will remain in his position until a replacement is found. The company's board thanked Gutiérrez for his work in a statement saying, "Under his direction, the company doubled hydrocarbon production, helping Colombia to become one of the top 20 oil producers in the world, and significantly increased revenues transferred to the state, allowing for more effective social investment programs in our country." Analysts said the board's decision reflects growing challenges for Colombia's oil sector, which include regulatory delays and pipeline attacks, Reuters reported. While many of the challenges were outside of Gutiérrez's control, the company has failed to meet its ambitious

Featured Q&A

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particular will face a daunting year as the Petrobras scandal evolves and companies reassess their appetite for high-cost deepwater exploration."

A **RoseAnne Franco, country and asset risk manager at Wood Mackenzie:** "Next year will be pivotal for Latin American oil and gas. The region has largely made a break with resource nationalism, with much of the region shifting toward resource maximization as governments focus on boosting value from their oil and gas resources. Mexico's recent liberalization exemplifies the trend, with the country launching its inaugural Round One in 2015. The tender will offer diverse opportunities, including deepwater, tight oil and heavy oil, among others. While Argentina promulgated its own hydrocarbon reform in October, expanding incentives and aligning fiscal terms, much of the industry will await the results of the October 2015 presidential elections; these should provide direction on the velocity of change and more economic certainty, which is critical to propel the country's unconventional segment. Meanwhile, Brazil is expected to be distracted by the recent allegations of wrongdoing against Petrobras and government officials, which will slow decision-making. That said, subsequent improvements in corporate governance could ultimately set the bar for NOCs in the region. Peru and Colombia both announced efforts in 2014 to reduce permitting times, and next year, regulators will focus on attempting to meet these targets. For the region's major oil producers such as Venezuela, the lower oil price environment will stress fiscal accounts, reducing maneuvering room and exacerbating political uncertainty. However, the overall trend for the industry is favorable as developments in Mexico and Argentina will likely cascade into more competitive terms throughout Latin America."

> "There is only one big trend to watch in 2015—how low oil prices will go."
>
> — *R. Kirk Sherr*

A **R. Kirk Sherr, member of the *Energy Advisor* board and president of Clearview Strategy Group, LLC:** "Market analysts often seek to sugarcoat bad news, but for Latin America, all angles look bad today as oil prices continue to fall. Lower oil prices mean lower revenues for state-owned companies, pressure (and a likely redo) on their investment budgets, challenges meeting debt payments and less tax resources for the government. This is

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production goal announced about five years ago to be producing about 1 million by 2015. The most recent figures show output of around 750,000 barrels including gas. "I don't think the shareholders wanted his head, because he had a good reputation, But it's a bad period and sometimes they promised to deliver some very difficult things, Diego Usme, an analyst at Bogotá stock broker **Ultrabursatiles**, told Reuters. On Monday, the company said that it is cutting next year's production target to 760,000 bpd, a 7 percent decrease from this year's goal, Bloomberg News reported.

Influence-Peddling, Sexual Harassment Claims Hit YPFB

Bolivia's state-run oil company, **YPFB**, on Dec. 12 became embroiled in a scandal, EFE reported. YPFB said that it "thwarted a clan of relatives and friends who formed several companies" in order to win contracts. Two company executives and four private-sector individuals were arrested, and prosecutor Leopoldo Ramos said he is investigating alleged influence-peddling and irregularities in the awarding of advertising and event contracts that may have cost the government between $360,000 and $430,000. Among those arrested was former press officer Selva Camacho, who is accused of hiding family links to companies that won contracts with YPFB. Camacho denied the allegations and accused CEO Carlos Villegas of sexually harassing her in the past and attempting to take revenge, claims which he denied. Villegas, who has headed the company since 2009, said he filed a defamation complaint against Camacho in September after she made similar allegations.

Villegas

File Photo: YPFB.

CEO of Embattled Petrobras Says She's Willing to Resign

The head of Brazilian state oil company **Petrobras**, which is currently beset by a corruption scandal, said Wednesday that she is open to resigning and that investigations into the allegations could hamper the company's production goals, *The Wall Street Journal* reported. CEO Maria das Graças Silva Foster, who took the helm in 2012 after most of the alleged corruption occurred, said she has discussed resigning with President Dilma Rousseff, but has decided to stay for now and has the president's confidence. Last week, Brazilian prosecutors filed charges against 35 people, including executives from the country's largest construction companies. Authorities allege that top Petrobras officials operated the scheme, allegedly involving contracts worth more than $4 billion, with inflated contract prices purportedly being sent to the governing Workers' Party and other politicians. A report released Thursday by a congressional investigative committee recommended that prosecutors file charges against 52 people, Reuters reported. A majority of the committee approved the report, which now goes to the two houses of Congress for debate and a vote.

Power Sector News

France's GDF Suez Wins Chile Power Contract

France's **GDF Suez** said Tuesday that its subsidiary **E-CL** won a contract to provide 5,040 gigawatt hours of power annually to Chile's central electricity grid for 15 years beginning in 2018, Reuters reported. The company said it will invest $1 billion to build a 375-megawatt thermal power plant and a related port, as well as invest $700 million in building a 600-kilometer (370-mile) transmission line to connect Chile's northern and central power grids. The power plant will be located in the port city of Mejillones. "This success, following the energy auction result in Brazil in November, is a new step for GDF Suez to achieve its ambition to be the leading private power producer on the continent within three years," CEO Gerard Mestrallet said in a statement on Tuesday. The producer is currently the third-largest private producer in Latin America behind **Enel** and **AES**, according to Bloomberg News. GDF Suez will develop about 18,000 megawatts of power capacity in the region through 2019, Mestrallet said, including the giant 3,750-megawatt Jirau hydrodam in Brazil. The company plans to focus on Uruguay and Colombia in the future as well as on large-scale wind farms gas-fired plants and hydrodams.

> "This success ... is a new step for GDF Suez to achieve its ambition to be the leading private power producer on the continent within three years."
>
> *— Gerard Mestrallet*

SunEdison Secures $146 Million Loan for Honduran Solar Complex

U.S.-based solar developer **SunEdison** has received a $146 million loan to build an 82-megawatt solar power complex in Honduras, Business News Americas reported Monday. The International Finance Corporation, the Central American Bank for Economic Integration and the OPEC Fund for International Development are providing non-recourse debt financing for the three solar plants, to be located in the Choluteca department. The complex will be comprised of the 23.3-megawatt Pacifico plant, the 23.3-megawatt Choluteca I and the 35.1-megawatt Choluteca II, SunEdison said in a statement. SunEdison expects to connect the plants to Honduras' gird in the second half of next year and will supply power to state electricity company **Enee** under a 20-year power-purchase agreement. The IFC is providing $85.9 million in financing, while Cabei and the OPEC Fund for International Development are providing $5 and $15 million, respectively. Honduras' government has approved more than 20 solar projects this year. The country is in place to lead a surge of solar PV installations in Central America, expected to reach 1.5 GW by 2018, according to analysis by **IHS**, PV-Tech.org reported in September. IHS estimates that

Honduras will have a cumulative 499 MW of solar installations by 2018, ahead of Guatemala with 291 MW.

Political News

Colombia's FARC Declares Unilateral Cease-Fire

The Revolutionary Armed Forces of Colombia, or FARC, rebels on Wednesday declared a unilateral cease-fire beginning Saturday, BBC News reported. The rebel group made the announcement in Havana, where it has been engaged in peace talks with Colombia's government for two years. During the course of the talks, President Juan Manuel Santos has refused to halt military action against the FARC, saying that would only allow the rebels to regroup and rearm. The peace talks began a new round Dec. 10 after they were nearly derailed by the FARC's capture of an army general who was later released. [Editor's note: See Q&A about the peace talks in Monday's issue of the daily *Advisor*.]

Economic News

Venezuelan Bonds Plunge to 16-Year Low, Maduro Confirms Subsidies

Venezuela's bonds declined Monday to a 16-year low amid falling prices for oil, the South American country's chief export, just after President Maduro said in a televised speech that the government has no plans to cut subsidies that provide Venezuelans with cheap gasoline, Bloomberg News reported. The country's benchmark bonds, which are due in 2027, declined 8.2 percent to 37.835 cents on the dollar as of Monday at 4:57 p.m. New York time. That was the lowest level on a closing basis since 1998, Bloomberg News reported. Swaps contracts that protect bondholders from non-payment show that Venezuela is perceived to have a 97 percent chance of defaulting over the next 12 months, according to data by **CMA**. Over the weekend, Maduro said in televised speeches that the country will not default unless it comes as part of a move by the government to increase economic development. He said, however, that there is no plan for such action. Maduro added that there is no need to cut government subsidies that allow Venezuelans to buy gasoline for 6 cents a gallon. He also said that the government will keep in place a fixed exchange rate of 6.3 bolívars per dollar for priority imports.

Colombia's Congress Approves Tax Overhaul

Colombia's Congress on Monday passed a tax law that will boost government revenue by 53 trillion pesos ($22.3 billion) over the next four years by extending and modifying tax laws that were set to expire at the end of this year, Reuters reported. Measures in the bill include a wealth tax on businesses, a profits tax, an individual wealth tax and an extension of a 0.4 percent charge on banking transactions. Businesses will pay a wealth tax of 1.3 percent in 2015, 1 percent in 2016 and 0.4 percent in 2017, after which the tax will be eliminated, and individuals with more than 1 billion pesos in assets will face wealth taxes based on the value of their assets. The profits tax, known as the CREE, sets a 5 percent charge on profits above 800 million pesos in 2015 and increases annually through 2018. The tax reform comes at a time that lower prices for oil, Colombia's main export, are hurting government revenues. "This bill will enable the country to continue leading in terms of growth in Latin America ... The country can be sure that we can stay on a positive growth path in a situation of lower oil prices," said Finance Minister Mauricio Cárdenas. Businesses criticized the tax reform saying that it could deter investment, and the government agreed to a smaller increase in the wealth tax but a larger profits tax after discussions with business leaders. The bill, which passed the Senate last week, now awaits President Juan Manuel Santos' signature.

Cárdenas

File Photo: Colombian Goverment.

POLITICAL & ECONOMIC BRIEFS

At Least 11 Killed as Rival Vigilantes Clash in Mexico

At least 11 people were killed Tuesday during a shootout between rival vigilante groups in Mexico's western Michoacán state, BBC News reported. The bloodshed happened in the town of La Ruana, with the clash being triggered by an "historic rivalry" between the two groups, said the state's security commissioner, Alfredo Castillo. In the confrontation, five members of a group led by Hipólito Mora and six members of the vigilante group led by his rival were fatally shot.

Anti-Government Protest Turns Violent in Haiti

An anti-government protest Tuesday in Haiti in which hundreds marched through the capital of Port-au-Prince to demand the resignation of President Michel Martelly turned violent, with demonstrators throwing stones at police and burning tires and police using tear gas to break up the crowd, BBC News reported. Demonstrators are upset with Martelly's decision to postpone legislative and local elections that were due to be held in 2011, an issue which led Prime Minister Laurent Lamothe to resign Sunday.

Argentina Making Progress in Improving Economic Data: IMF

Argentina has made progress in improving its economic data though it still must meet one more deadline to bring its statistics in line with global standards, the International Monetary Fund's board said Monday, Reuters reported. The IMF, which requires accurate information to analyze world economies, censured Argentina last year for providing inaccurate inflation and GDP growth, but said the country has met a timeline it set for changes.

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true from Mexico to Argentina. Lower oil prices also limit foreign investor enthusiasm while everyone tries to determine where the oil price bottom might be. Thus, ambitious sector-opening plans in Mexico may be delayed, and new offshore projects in Brazil look shaky. In this context, smaller producer countries (Colombia, Peru, Argentina) have even less to offer, considering they have few 'mega-projects' and small internal markets. Oil prices below $70 for any extended period will definitely have all but the largest investors looking outside the region—and prices are now trending below $60 for Mexican Maya crude (versus $98 a few short months ago). On top of the oil price issues, both Mexico and Brazil face daunting political challenges that further cloud the picture for investors well into 2015. Brazil is confronting an epic corruption scandal, with Petrobras at the heart of it. Mexico faces its own problems with serious questions about the rule of law emanating from the Iguala student teacher debacle. In short, there is only one big trend to watch in 2015—how low oil prices will go."

A Luis E. Giusti, senior advisor at the Center for Strategic & International Studies and former chairman and CEO of PDVSA: "The reform of the oil and gas sector in Mexico after almost 80 years of being closed will mark a watershed of historic proportions in that country, but will also have important global ramifications. The bid round will feature 109 exploratory blocks as well as 60 fields that are either in production or have certified reserves. The reform will allow companies to book reserves and carry out both upstream and downstream projects without involving Pemex. Interest in Mexico's auction has been intense, even with oil prices on a downward slide. A timetable from January to September 2015 has been laid out for awarding the projects. The process will open brighter times for the Mexican oil industry, but even if it marches ahead without major hurdles, it will take a few years to turn around the current Mexican oil and gas situation. Meanwhile, the new wave of production increase in the United States is well beyond expectations. The IEA in its World Energy Outlook 2012 predicted that the shale basins Bakken, Eagle Ford, Niobrara and Permian combined would reach 3.2 million barrels per day in 2025. That level was achieved in early 2013, and it now stands at 4.8 million bpd. This revolution is having tremendous implications worldwide, among them major changes in the international supply lines, impact on oil prices and geopolitical implications. In the first half of 2015, Latin American oil and gas exporting countries—Colombia, Ecuador, Mexico, Venezuela and Peru—will suffer large reductions in export revenues and will struggle to keep their budgets in balance. Also, international capital will be more conservative in measuring risk and economic return, so new investment plans will take a hit. Meanwhile, lower oil prices will improve the economies of oil importing countries by improving their trade balances. Although many factors will intervene in the evolution of oil price during the second half of 2015, if prices continue to slide, a production cut will become likely. In addition, the continued fall in prices is reducing the incentive of stockpiling and could translate eventually into an escalation of prices."

> "Developments in Mexico and Argentina will likely cascade into more competitive terms throughout Latin America."
>
> *— RoseAnne Franco*

The Energy Advisor *welcomes responses to this Q&A. Readers can write editor Gene Kuleta at gkuleta@thedialogue.org with comments.*

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