LATIN AMERICA ADVISOR

ENERGY ADVISOR

A WEEKLY PUBLICATION OF THE DIALOGUE

www.thedialogue.org

October 19, 2018

FEATURED Q&A

Will Ecuador's New Contracts Attract More Oil Investors?

Ecuador's energy minister, Carlos Pérez, introduced a new production-sharing contract model this year in an effort to boost investment in the country's oil sector. // File Photo: Ecuadorean Government.

Q **Ecuador launched an onshore licensing round in September, which Energy Minister Carlos Pérez expects will bring $1 billion in investments. Pérez has been traveling internationally in an effort to attract more bids, promoting the government's latest adjustments to tax regulations and contracts as market-friendly. How do the recent changes in regulation benefit foreign investors? Will Pérez and the Ecuadorean government be successful in attracting more bidders? How important is the South American country's oil and gas sector to boosting the economy?**

A **Ramiro Crespo, president of Analytica Securities in Quito:** "There was a lot of national and international interest in the technical meeting on the oil fields in which Ecuador is seeking to boost investment. The change of service contracts to production-sharing contracts is fundamental: companies will be paid in barrels, not money. Risk is thus reduced to the industry's standard risk, without the country risk factor, especially in a country that is a notorious defaulter. This will attract better companies and investment. The last invitation to invest in minor oil fields was not so successful because it was for service contracts, adopted in former President Correa's government, which delayed payment for up to two years. Payment in barrels allows companies to sell them directly on the market; and Ecuadoreans will pay close attention to make sure Petroecuador's selling price is not constantly lower than private companies' prices. This will reduce corruption in exports, one of the reasons why Correa adopted the service contract model. If Minister Pérez is able to merge Petroecuador and Petroproducción and

Continued on page 3

TOP NEWS

ELECTRICITY

Argentina's YPF To Sell Stake to Asian Fund: Report

The Argentine state energy company is reportedly in advanced talks to sell a minority stake in its electricity unit to an Asian fund, which sources declined to name, as part of its plans to expand its power generation business in the country.

Page 2

OIL & GAS

PDVSA Planning to Pay $950 Mn on 2020 Bond: Source

Venezuela's state-run oil firm is reportedly preparing to pay holders of its 2020 bond by the end of the month after defaulting on most other payments this year.

Page 3

OIL & GAS

Bolsonaro Eyes Revisions to Oil Contract Model

Jair Bolsonaro, the front-runner in Brazil's presidential race, may revise the country's production-sharing model for oil contracts if he is elected president, Valor Econômico reported.

Page 2

Bolsonaro // File Photo: Bolsonaro Campaign.

OIL AND GAS NEWS

Bolsonaro Considers Revising Oil Contract Model: Report

Far-right Brazilian presidential candidate Jair Bolsonaro, the front-runner ahead of the country's Oct. 28 runoff, is considering revisions to Brazil's model of production-sharing contracts in its pre-salt oil fields, Valor Econômico reported Monday, citing unnamed sources within his campaign. The newspaper did not specify how Bolsonaro might revise the production-sharing model if elected president, but campaign sources said the changes would be part of an effort to fight political abuses that occurred during previous presidential administrations. Bolsonaro, who has been considering major changes to the country's state-run companies, also may end overseas financing by BNDES, Brazil's state-run development bank, the newspaper reported. Bolsonaro has long voiced support for state control of assets such as government-run oil company Petrobras and power provider Eletrobras. However, he has recently become more of an advocate for privatizing assets, in accordance with the views of some of his key advisors, Reuters reported. Other advisors to Bolsonaro, including some military generals, have advocated maintaining state control of assets, such as Petrobras, that they see as strategic. Bolsonaro's campaign did not respond to a request by the wire service for comment. Brazil's leftist Workers' Party created the production-sharing model for the pre-salt oil fields, and the model underwent revisions by the current government of President Michel Temer. In recent auctions, the model has attracted oil majors including ExxonMobil, Chevron, Repsol, BP and Royal Dutch Shell. On Tuesday, the Brazilian state company announced it was in talks with government-owned China National Petroleum Corporation, or CNPC, for the Chinese firm to form a joint venture in which Petrobras would hold an 80 percent stake and CNPC would hold the remaining 20 percent stake in the Comperj refinery in Rio de Janeiro and several offshore oil fields. In an Ibope poll published Monday, Bolsonaro maintained a commanding lead over his rival, Fernando Haddad of the Workers' Party. The survey showed Bolsonaro with 59 percent support, leading Haddad, who had 41 percent. [Editor's note: See Q&As on Brazil's presidential election in the **Oct. 9** and **Oct. 10** issues of the daily Advisor.]

Bolsonaro leads the runoff polls with 59 percent of support.

Ecuador to Issue Tender to Revamp Esmeraldas Refinery

Ecuador plans to offer a tender next year for a firm to build and operate two processing units of its state-run Esmeraldas refinery, Energy Minister Carlos Pérez told Reuters Oct. 11. The Andean country will award two 20-year contracts for the construction of new sulfur and fuel processing units under a build-operate-transfer model to revamp national oil company Petroecuador's largest refinery. "We have problems at Esmeraldas … We are doing a great effort to maintain the refinery in operation," Pérez said, adding that a modernization project that cost $2 billion during former President Rafael Correa's administration was insufficient. The new fuel unit will require an estimated $1 billion in investment, while the sulfur plant would cost roughly $200,000, Pérez said. The Esmeraldas plant currently refines 110,000 barrels per day. Also on Oct. 11, Pérez announced at a press conference that the Ecuadorean government had reached a deal with ICC-Tecnatom for it to carry out a technical and financial evaluation of the refinery to issue maintenance recommendations in December, El Comercio reported. At the same event, Pérez said Ecuador and Peru had begun talks to explore two oil fields at the border, possibly in the form of a joint venture between state-run oil companies Petroamazonas and Petroperú,

NEWS BRIEFS

Argentina's YPF in Talks to Sell Stake in Power Unit to Asian Fund: Report

Argentine state oil company YPF is in advanced talks to sell a nearly 25 percent minority stake in its electricity unit to an Asian fund, according to two unnamed sources, Bloomberg News reported Oct. 11. YPF, which sold a similar stake to General Electric in March for $300 million, is seeking to enlarge its power generation business in Argentina, adding partners to finance that expansion. The sources declined to name the fund.

Local Referendums in Colombia Cannot Block Energy Projects: Court

Local referendums in Colombia to bar mining and oil extraction projects cannot block such developments, the country's constitutional court ruled Oct. 11, El Tiempo reported. Several referendums to block mining projects over the past year and a half have forced some companies to change their plans, including AngloGold Ashanti, which last year halted a $2 billion project. The court's ruling involved a case brought by Mansarovar Energy Colombia, a joint venture between India-based ONGC-Videsh and China's Sinopec, Reuters reported.

Chile's Senate Approves Changes to Distributed Energy Legislation

Chile's Senate approved changes in legislation related to distributed generation last week, Renewables Now reported Oct. 15. The bill includes increases to the maximum installed capacity for distributed generation from 100 kilowatts to 300 kilowatts and allows the installation of jointly-owned systems. Energy Minister Susana Jiménez said the bill will help the government reach its goal of a fourfold increase in the capacity of distributed small-scale renewable generation by 2022.

Reuters reported. The crude produced at the oil fields would go to Peru's Talara refinery through an existing pipeline, and natural gas produced in Peru would be exported to Ecuador to offset low supply there, the energy minister said.

Newfoundland and Labrador, Guyana Ink Cooperation Deal

Guyana and the Canadian province of Newfoundland and Labrador signed an oil and gas cooperation deal on Monday, as the South American country prepares to become an oil producer by 2020, Demerara Waves reported. Under the agreement, which will be in effect for three years, the Canadian province will share its 30-year experience in the oil and gas industry as the Guyanese government seeks to exploit a series of oil discoveries off its shore in recent years. Guyana's inexperience in the industry makes it "more important that we benefit from the experiences of those who have done this before," said the Guyanese minister of business, Dominic Gaskin, who signed the deal, INews Guyana reported. Moreover, the two parties will collaborate in expanding economic and business opportunities related to oil and gas in Guyana and Newfoundland and Labrador, including in supply chain development, joint ventures and technology development, among others. The minister of natural resources of Newfoundland and Labrador, Siobhan Coady, visited Guyana as part of a trade mission with around 50 oil and gas industry experts from Canada that seek market opportunities and partnerships with local companies. [Editor's note: See related **Q&A** in the Sept. 21 issue of the Energy Advisor.]

Venezuela's PDVSA to Pay $950 Million on 2020 Bond: Sources

Venezuela's PDVSA plans to pay holders of its 2020 bond approximately $950 million by the end of October after defaulting on most other

FEATURED Q&A / Continued from page 1

capitalize on the new company by listing it in global stock markets, he could advance his objective: producing 700,000 barrels of oil per day. These companies will, for the first time, have audited balance sheets and will be supervised by stock exchanges, securities commissions, the judicial departments of several countries and by investors, who will demand 'conference calls' and results."

A **Paola Carvajal, principal of the energy practice at Arthur D. Little in Washington:** "The introduction of the new oil contract model in Ecuador is a positive measure to attract new investors. One of the key advantages of the production-sharing contracts (PSC) versus the previous service contract will be booking reserves by the contractor according to its production share. However, PSC requires an efficient and agile management system, since the government needs to monitor capital expenses, operational expenses and profits to apply adjustments to its share of the production. The implementation of this new contract model will be a challenge for the Secretaría de Hidrocarburos. The nine fields offered in the bidding round are located close to Petroamazonas oil fields, which could be an advantage for the operator because of infrastructure access, oil services and communities used to upstream activities. However, the blocks still need to demonstrate a significant potential to develop economies of scale attractive enough for investors. The awarding criteria for the blocks prioritize the production share offered to the government over the exploration activity commitments. It is the result of the low exploratory risk perceived by the authorities. The government expects to obtain at least 50 percent share of production, but the percentage could be adjusted based on oil price and production levels. Without a doubt, the success of this bidding round is key for the Ecuadorean government since overall production has been declining. The addition of new barrels will help to continue balancing the national finances, complying the long-term contracts with Asian companies and generating more resources for an economy highly dependent on the oil business."

> **"The implementation of this new contract model will be a challenge for the Secretaría de Hidrocarburos."**
> **— Paola Carvajal**

A **Mario Flor, partner at Flor & Hurtado in Quito:** "The new policy of promoting foreign investment in the hydrocarbons sector has been well received by primary actors in the industry. Since the issuing of Executive Decree 499, the government has demonstrated a real interest in developing new oil fields under production-sharing contracts. Under this type of model, the contractor assumes the risk of all investment and costs required for exploration, development and production. Once production starts, the contractor will have the right to participate in the area's production, which will be calculated using the percentages agreed upon in the contract depending on the volume of hydrocarbons produced. Additionally, the enactment of the 'Ley de Fomento Productivo' in August eliminated extraordinary income taxes, which will boost the contractor's profits, as well as the state's profits, due to the generation of both direct and indirect income. As such, this contracting model makes investment in the sector more attractive, since it gives greater dynamism to contractors' actions. This, in addition to the favorable tax framework, allows for a better business environment in the hydrocarbons sector, one of main pillars of the Ecuadorean economy."

Continued on page 6

bonds this year, according to sources at the company and in the country's financial sector, Reuters reported Monday. The state-owned oil company has fallen behind on more than $7 billion in principal and interest payments since the end of last year, according to Refinitiv data, as decreases in oil prices since 2014 and declining production have squeezed the country's coffers. But PDVSA is preparing to pay $840 million to cover an amortization payment on the 2020 bond by Oct. 27 and $107 million in interest payments within the next month, in order to stay current on the 2020 issue, which is backed by 50.1 percent of shares in U.S. refining network Citgo, the wire service reported. An unnamed source at PDVSA told Reuters that Venezuelan Oil Minister Manuel Quevedo, who is also president of the company, gave his approval to arrange the payment. Investors believe PDVSA will not default on the 2020 bond because of potential implications for Citgo, the wire service reported. The U.S.-based refiner has come under threat in recent months, after a U.S. federal judge authorized Canadian miner Crystallex to seize Citgo shares to collect a $1.4 billion compensation award to satisfy a Venezuelan government debt, The Wall Street Journal reported. "PDVSA has demonstrated via its legal efforts a strong preference to maintain ownership of Citgo," JP Morgan wrote in a note to clients last week. [Editor's note: See related Q&A in the Aug. 24 issue of the Energy Advisor.]

POLITICAL NEWS

Colombia Protesters Seek More Spending on Higher Education

Thousands of students took to the streets across Colombia on Wednesday, the second organized demonstration in less than a week to demand an increase in higher education funding, El Tiempo reported. Students from public universities organized protests in several Colombian cities, including Bogotá, Medellín and Cali, asking the government to comply with a list of 10 demands, among them an increase in the education budget of 4.5 billion pesos, or nearly $1.5 million, by the end of the year. On Tuesday, Colombian President Iván Duque agreed to expand the budget by one billion pesos over the next two years. "We do not agree with Duque's financial promise because we are demanding 4.5 billion pesos, which is the minimum public and technological institutions need to be able to function in 2019," Angie Delgado, the spokeswoman for one of the student groups that organized the marches, told El Tiempo. "Offering one billion pesos will continue suffocating our universities." According to the students, public universities are facing a $1 million deficit in outstanding salaries to professors and administrative expenses. The lack of

ADVISOR Q&A

Is Duque Pursuing the Right Anti-Drug Policies?

Q Colombian President Iván Duque this month signed a decree that outlaws the possession of even small amounts of marijuana and cocaine in public, allowing authorities to confiscate the drugs and impose fines. Duque's order followed statements that Colombian Foreign Minister Carlos Holmes Trujillo made in September at the Inter-American Dialogue in which he said the Duque administration would work very closely with the United States on anti-drug efforts, such as eradication of coca plants. Is Colombia's government pursuing the right anti-drug policies? What will such policies mean for drug consumption trends in Colombia? Will Duque's latest order lead to abuses by police, as his critics have argued?

A Hannah Hetzer, senior international policy manager at the Drug Policy Alliance: "President Duque's decree that allows for Colombian police to search individuals and confiscate their drugs outright ignores the 1994 Constitutional Court case that deemed it impermissible for the government to imprison people for drug use and allowed for the possession of small amounts of drugs for personal use. Duque's decree is an infringement on personal liberty, gives police leeway to engage in unnecessary searches, thereby increasing the potential for police abuse, and does nothing to stop the drug trade or the violence associated with it. Stigmatization and criminalization of drug use does not work to decrease drug consumption, nor does it provide people who are struggling with the treatment or support they need. Instead, criminalization is an unnecessary use of police resources and increases prison overcrowding, which is already an issue in Colombia and throughout much of Latin America. Duque is clearly trying to return to a more hardline, repressive stance on drugs, including punishing people who use drugs and emphasizing the eradication of coca plants. These approaches have been tried before, and they do not work to reduce drug use or cultivation. Instead of aligning himself with the Trump administration, Duque should learn from other countries that are moving away from drug policies based on punishment and repression, and embrace approaches that focus on health, human rights and development. The Constitutional Court declared that Colombians have a right to possess small amounts of drugs for personal use, and Duque and the Colombian police should respect that right."

EDITOR'S NOTE: More commentary on this topic appears in the Q&A of the Oct. 17 issue of the Latin America Advisor.

NEWS BRIEFS

Guatemalan Police Detain Organizer of Migrant Caravan

Guatemalan police on Tuesday detained a former Honduran lawmaker who had organized a large group of migrants who have been moving toward the United States, Reuters reported. Bartolo Fuentes was detained after U.S. President Donald Trump threated to cut off aid to Honduras, Guatemala and El Salvador if authorities in Central America failed to stop the group of as many 3,000 migrants from moving north. The foreign ministry of Honduras urged the country's citizens not to join the group.

Court Releases Keiko Fujimori From Prison

Peruvian opposition leader Keiko Fujimori was freed by an appeals judge late Wednesday, a week after she was arrested on corruption charges, the Associated Press reported. She remains under investigation over about $1.2 million in undeclared financial contributions to her 2011 presidential campaign that Odebrecht, the Brazilian construction firm, allegedly made. Ties to Odebrecht forced President Pedro Pablo Kuczynski, who narrowly defeated Fujimori in a 2016 presidential runoff, to resign from office earlier this year.

Brazil Economic Activity Rises 2.5 percent in August

Brazil's central bank on Thursday said economic activity rose 0.47 percent on a month-to-month basis in August. A higher figure than expected, the growth added to a 0.65 percent gain in July. In annual terms, Brazil's economic activity grew 2.5 percent in August. However, market analysts say the growth does not yet suggest the economy is on a strong trajectory. "At this stage of the cycle, the forward momentum is still underwhelming," Goldman Sachs economist Alberto Ramos told clients in a research note Wednesday.

government funding has prompted universities to boost enrollment fees, which in turn has negatively affected access, Semana reported. Student protesters are reportedly considering camping out in Bogotá's main square, Plaza de Bolívar, until Saturday, El Tiempo reported.

Temer Charged With Corruption, Money Laundering

Brazil's federal police on Tuesday charged President Michel Temer with corruption and money laundering and requested that he be put on trial, O Globo reported. The charges, which were signed by investigator Cleyber Malta Lopes, also involve Temer's daughter Maristela and two of the president's close aides and also say that his assets should be frozen. The charges revolve around allegations that Temer took bribes in order to favor companies that handle port management, the Associated Press reported. Brazil's attorney general, Raquel Dodge, now has 15 days to decide whether to pursue the case against Temer. If she agrees, then a two-thirds vote in Congress would be required to place him on trial, in which case he would be suspended from office while the trial occurs. His term ends Dec. 31. Temer, who denies wrongdoing, has faced charges in two previous corruption cases. However, both times, Congress rejected putting him on trial. The latest case involves a decree that Temer signed last year to extend concessions at the Port of Santos to 35 years from 25. The federal police report alleges that bribe money could have been used to pay for renovations at Maristela Temer's house in São Paulo between 2013 and 2015. Executives of the J&F company have admitted to seeking political favors in exchange for paying $280,000 to an aide to Temer, the AP reported. Attorneys for Temer on Wednesday asked the country's top court to annul the federal police report that recommended he be charged with corruption, Reuters reported. Temer took over the presidency in 2016 after former President Dilma Rousseff was impeached. He cannot be prosecuted while in office, unless the supreme court decides to strip his immunity.

ECONOMIC NEWS

U.S. Increases Size of Credit Line to Mexico

The United States has increased the size of a credit line for Mexico to use in times of crisis, according to a new deal signed on Wednesday, The Wall Street Journal reported. The U.S. Treasury Department tripled the size of a credit program, known as the exchange stabilization agreement, available to Mexico in the form of a "swap line" in case the country faces a currency crisis, allowing it to borrow as much as $9 billion. A previous agreement under the original North American Free Trade Agreement, or NAFTA, offered Mexico a $3 billion credit line. The "close coordination" of the Treasury Department and Mexico's finance ministry "reflects the mutual benefits derived from continuous economic growth and financial stability in both of our economies," Mexican Finance Minister José González Anaya said on Twitter after signing the deal with his U.S. counterpart,

González Anaya and Mnuchin (L-R) signed the new deal on Wednesday. // Photo: @JAGlezAnaya via Twitter.

Steven Mnuchin. "We continue to value the very close economic and financial cooperation that exists between our countries to help promote macroeconomic growth and stability, including on exchange rates," Mnuchin said in a Treasury Department statement. Mexico has an additional $3 billion line with the U.S. Federal Reserve and last year renewed an $87 billion flexible credit line with the International Monetary Fund amid uncertainty over trade relations with the United States, The Wall Street Journal reported. The deal comes as the United States, Mexico and Canada prepare to sign a revamped version of the NAFTA deal, known as USMCA, in late November.

FEATURED Q&A / Continued from page 3

A Jose L. Valera, partner at Mayer Brown LLP in Houston: "In September, the government launched the XII Intracampos oil bidding round, covering eight onshore blocks in the Orient basin. These blocks have conventional potential and are near producing areas, hence the name 'intracampos' for the bid round. Operations are to be carried out under a production-sharing model, which is permitted by the hydrocarbons law. By a July decree, the current administration issued new regulations for the production-sharing provisions of the hydrocarbons law. The percentage of production attributable to the state will be determined by the winning bids, under a formula that adjusts the state participation not only by reference to volumes of production but also by reference to prices. If in any year the benefits of the state are lower than the benefits of the contractor, a special tax ('sovereign adjustment') kicks in to equalize the benefits of the state and the contractor. The activation of the production-sharing regime is a welcome policy change, as the prior contract-service model resulted in stagnant production and almost no exploration. Unlike Venezuela, Ecuador has not doubled down on ruinous policies but is making smart and pragmatic changes to correct the course. Now that companies will have an economic incentive to risk capital in exploration, Ecuador's reserves and production should increase. Ecuador is currently at pains to fix its large fiscal imbalances. Prior resort to murky oil presales has not been economically beneficial. The government needs to balance large expenses importing and then subsidizing fuels, servicing foreign debt and supporting a large state payroll with more revenues and reasonable external financing. The new policies to develop the country's large hydrocarbon resources will bring much needed investment and revenue."

> **"The new policies to develop the country's large hydrocarbons resources will bring much needed investment."**
> — Jose L. Valera

The Advisor welcomes comments on its Q&A section. Readers can write editor Gene Kuleta at **gkuleta@thedialogue.org**.

LATIN AMERICA ENERGY ADVISOR
is published weekly by the Inter-American Dialogue
Copyright © 2018

Erik Brand
Publisher
ebrand@thedialogue.org

Gene Kuleta
Editor
gkuleta@thedialogue.org

Anastasia Chacón González
Reporter
achacon@thedialogue.org

THEDIALOGUE

Latin America Energy Advisor is published weekly, with the exception of some major U.S. holidays, by the Inter-American Dialogue
1155 15th Street NW, Suite 800
Washington, DC 20005 **Phone:** 202-822-9002
www.thedialogue.org
ISSN 2163-7962

Subscription Inquiries are welcomed at
freetrial@thedialogue.org