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FEATURED Q&A

What Is Behind the Dispute Between Pemex and Talos?

The Zama discovery is located in the offshore portion of Mexico's Sureste Basin in the Gulf of Mexico. // File Photo: Talos Energy.

Q **A dispute between Mexican state oil company Pemex and U.S.-based Talos Energy has slowed down talks on developing the major Zama discovery in the Gulf of Mexico, Talos CEO Timothy Duncan told Reuters this month. The two companies claim to hold the majority of the Zama deposit and ultimately the rights to operate it. The case is seen as a test for Mexico's investment climate under President Andrés Manuel López Obrador, as it is the first time the country's public and private sectors will have to work in a joint oil reservoir since the previous government's 2013 energy reforms. What are the main reasons behind the companies' dispute? Will development at Zama begin any time soon, and how significant is production expected to be? To what extent does the case reflect a wider trend in Mexico's oil sector under the López Obrador administration?**

A **Kirsten Lorgen-Knapp, associate manager at Kroll, a division of Duff & Phelps:** "The Zama discovery, a test case for how Pemex and private companies divide up joint oil reservoirs after the 2013 reforms, has so far demonstrated the complications of political risk management in Mexico's new energy landscape. Zama, which lies beneath Talos' block and an adjacent block operated by Pemex, is Mexico's first non-Pemex discovery in nearly eight decades, and Talos has targeted first oil by 2023. Absent Pemex's data backing up its claim to a majority of the field, Talos' independent evaluation estimated that 60 percent of the field's reserves belong to Talos' block, giving it a strong claim as the operator of the shared field. Moving the discovery to Pemex's accounting books appears to be in line with the current govern-

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TOP NEWS

OIL & GAS

PDVSA Names New VP for Supply & Trading: Source

Venezuelan state oil company PDVSA has appointed Antonio Pérez Suárez to lead the company's supply and trading division, two sources told Reuters. The move follows an "energy emergency" declaration last week.

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OIL & GAS

Mexico Ratifies Rule Regarding Clean-Diesel Cars

Mexico's government ratified an environmental rule that truck and bus manufacturers must produce and sell only vehicles running on clean diesel starting in January of next year.

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OIL & GAS

Ecopetrol's Proven Reserves Up 9.6% Last Year: Report

Colombian state-owned oil company Ecopetrol, led by CEO Felipe Bayón, said a new independent assessment found its oil and gas reserves had risen 9.6 percent at the end of last year.

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Bayón // File Photo: Ecopetrol.

OIL AND GAS NEWS

PDVSA Appoints New VP of Supply & Trading: Sources

Venezuelan state oil company PDVSA has named an army lieutenant colonel as vice president of its supply and trading division in a shake-up at the firm that follows an "energy emergency" declaration and U.S. sanctions on a Russian trading brokerage that helped Venezuela export crude, Reuters reported Monday, citing two people with knowledge of the appointment. Antonio Pérez Suárez, who has no apparent industry experience, will now lead

Antonio Pérez Suárez previously led "Productive Venezuela," a state-run distributor of locally made prodcuts.

PDVSA's supply and trading division. Pérez was previously head of "Productive Venezuela," a state-run distributor of locally made products, Reuters reported. He will replace Marcos Rojas, who will maintain his position as international affairs chief at PDVSA, the sources said. Rojas had assumed the supply and trading vice presidency on an interim basis in June. PDVSA has not officially announced the change internally or externally, and it was not immediately clear whether the appointment was permanent or a temporary measure until President Nicolás Maduro's commission presents recommendations, the sources told Reuters. The company last week asked several vice presidents to step down as part of a series of measures that Maduro announced with the aim of revamping the company, including the creation of a commission to rehabilitate the country's crumbling oil industry, Bloomberg News reported. The moves came one day after the United States blacklisted Rosneft Trading, a unit of Russian state oil company Rosneft, which had been serving as an intermediary for Venezuelan crude exports since last year, in light of U.S. sanctions against PDVSA. The supply and trading position will likely take an important role given these developments, Reuters reported. Another company affiliated with Rosneft, TNK Trading International, seems to be picking up where Rosneft Trading left off, Bloomberg News reported. The broker is scheduled to load 14.3 million barrels of Venezuelan crude in the first two months of this year, as compared to 5 million in all of 2019, according to shipping reports, which also show TNK Trading has eight tankers already loaded or set to load, with Asia as their final destination. U.S. special envoy to Venezuela Elliott Abrams on Monday told Reuters that Washington would target recipients of Venezuela's crude, including those in Asia, as well as any intermediary that helps make those exports possible. "If Rosneft or any other companies play games like that with OFAC [the U.S. Treasury's financial intelligence and enforcement agency], all that will happen is additional companies will get sanctioned," Abrams said, Bloomberg News reported. "If they act this way, we will react."

Ecopetrol's Proven Reserves Increase by 9.6 Percent in 2019

Colombian state-owned oil company Ecopetrol's proven reserves of oil and gas rose 9.6 percent at the end of last year, according to a new independent assessment, Ecopetrol said in a statement released Feb. 20, El Espectador reported. The firm closed 2019 with 1.89 billion barrels of oil equivalent in proven reserves, also known as 1P reserves, more than the 1.73 billion barrels at the end of the previous year, Ecopetrol said. The company last year had an output of 242 million barrels of oil equivalent and added 408 million barrels in 1P reserves, Reuters reported. For every barrel produced, Ecopetrol replaced it with 1.69 barrels, the highest replacement ration in the last nine years, the firm added. Of the new reserves, about two-thirds were a result of technical management and financial optimization of the

NEWS BRIEFS

Oil Workers at Brazil's Petrobras Suspend Three-Weeks-Long Strike

Brazil's oil labor federation, known as FUP, has called off a strike at state oil company Petrobras following a labor court's decision last week to temporarily block the firm's plan to lay off employees at a fertilizer plant, Argus Media reported Feb. 20. In a separate case, the country's supreme labor court on March 9 is scheduled to hear the FUP's appeal to a previous court decision ruling the strike illegal. Approximately 21,000 workers participated in the strike, which began Feb. 1.

Colombia's Celsia Posts Increase of 72 Percent in Net Profit Last Year

The net profit of Colombian electricity company Celsia increased by 72 percent last year, as compared to the previous year, to $177.2 million, the company said last Friday, Reuters reported. The positive results were in part driven by the sale of a thermal facility and the solid performance of its energy-generation businesses in Central America, Celsia said. The company has a presence in Colombia, Panama, Costa Rica and Honduras, with total capacity of 2,398 megawatts of electricity.

Lacalle Pou, Paganini to Take Office in Uruguay

Luis Lacalle Pou is set to take office as president of Uruguay this Sunday, with Omar Paganini as his minister of industry, energy and mining, EFE reported. Paganini, an electrical engineer, has advised Lacalle Pou on energy policy and issues for years. "We have a close relationship," Paganini told reporters in December, El País reported. "Uruguay has to focus on achieving competitiveness in broad and convenient access to energy and on diversifying sources to go toward a sustainable matrix," Paganini added, according to the report.

company's assets, in addition to investment in new projects. An additional 164 million barrels of oil equivalent came from the development of unconventional deposits in the U.S. Permian Basin in partnership with Occidental Petroleum, Reuters reported. Seventy-three percent of Ecopetrol's total proven reserves, or the equivalent to approximately 7.2 years, consisted of crude, while gas accounted for the remaining 27 percent of reserves, or 10.4 years of production, the company said. On Tuesday, Ecopetrol reported a 14.7 percent rise in net profit, to 13.3 trillion pesos ($3.87 billion) for last year. The firm said a successful commercial strategy for its heavy crude oil boosted results. In the fourth quarter, Ecopetrol's net profit soared 51.5 percent to 4 trillion pesos, according to the company's filing with Colombia's financial regulator. "2019 was an outstanding year in operational and financial terms for Grupo Ecopetrol," CEO Felipe Bayón said in a statement. The company drilled 20 wells last year, above its goal of 12, it said.

Mexico Ratifies Rule Requiring Production of Clean-Diesel Cars

Mexico's government on Feb. 20 ratified an environmental rule that truck and bus manufacturers must produce and sell only vehicles running on clean diesel starting in January of next year, despite criticism from the auto industry, Reuters reported. A statement published in the Environment Secretariat's website said the rule, which requires the use of ultra-low sulfur diesel, or ULSD, was needed to ensure a healthy environment and "to be consistent with commercial partners in North America and the European Union." In the statement, the secretariat recognized the need to develop a plan for the fuel's distribution in a "more strategic manner," especially in cities and areas with air-quality issues. The government is working to improve distribution and availability of ULSD across Mexico, it added. Domestic availability of ULSD was at approximately 86 percent, taking into account production from state oil company Pemex, as well as imports, the state-

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ment's goal of re-establishing the dominance of Mexico's state energy companies and limiting the country's reliance on foreign capital to develop energy resources. But neither Talos nor the Mexican government benefit from slowing down progress on the field in which Talos has already invested $250 million. Pemex has yet to drill in its area of the field. Given Pemex's financial constraints, it could benefit from joint operations with Talos, a company that has operations in the U.S. Gulf of Mexico and is seeking to establish itself as an international operator. A politically driven slowdown on the development of one of Mexico's most promising oil fields is a discouraging signal not just for private energy investment in Mexico but for all companies seeking productive partnerships with the government."

A **John Padilla, managing director of IPD Latin America:** "Zama was the first and remains the most prolific discovery since Mexico's 2013 energy reform passage. Unitization negotiating delays have pushed back first oil estimates by at least a year, from 2022 to 2023, and agreement is still far from guaranteed. With 2C gross recoverable resources estimated at approximately 670 million barrels of oil equivalent, based on a recent Netherland, Sewell & Associates (NSAI) third-party assessment, the Talos-led consortium anticipates average and peak production of 90,000 barrels per day (bpd), and 150,000 bpd, respectively. Unitization is a well-established global mechanism for hydrocarbons that extend beyond man-made ownership boundaries. Unfortunately, instead of a technical focus, Mexico's first unitization has been politically charged and shaped from its onset. When the July 2015 discovery was made, Pemex claimed it knew the resource existed. And when a Reuters article in September of last year cited Pemex sources as saying the company was intent on operating the field, President López Obrador publicly denied it. Now that NSAI's report has been released, and it states that 60 percent of the resource lies in the Talos consortium-controlled Block 7, Pemex contradicts it without evidence, saying that the majority lies in its designated area and that it should operate the field. Beyond not having drilled or undertaken third-party assessments to back this and contrary to widely held belief, Pemex lacks expertise in Zama's water depths and lithology. Little dispute should be taking place, and we can only hope that cooler heads prevail. Failure to undertake technically based decisions will have potential ramifications that extend far beyond Mexico's energy sector."

> **"Pemex lacks expertise in Zama's water depths and lithology."**
> — John Padilla

A **Benigna Cortés Leiss, nonresident fellow in Latin American Energy at the Baker Institute and former general director of Chevron Energía in Mexico:** "The industry practice regarding unitization is based on the fact that hydrocarbon resources may cross adjacent blocks awarded to different parties/consortiums. The Zama oil field or Block 7 is an example. Block 7 was awarded in the first bid round held by the Mexican government in 2015. The Zama oil field was discovered in July 2017. Talos is the operator of Zama, located in Mexico's shallow water, and holds a 35 percent working interest in Block 7 in a consortium with its partners, Sierra Oil & Gas, Wintershall/DEA and Premier Oil. Following the discovery, Talos completed drilling two appraisal wells in 2019 and on Jan. 7, 2020. Talos contracted Netherland, Sewell & Associates to provide a contingent resource evaluation for the field based on available subsurface and drilling data. This independent evaluation de-

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ment said. However, trade association Anpact estimated that as of mid-2019, ULSD was available in only 75 percent of the country's gas stations, according to a survey of 345 outlets, Reuters reported. "Not having ULSD in 100 percent of the country represents an obstacle for carriers as they decide whether to renew their fleet," said Miguel Elizalde, president of Anpact, which represents companies including Navistar International Corp. and Volkswagen. President Andrés Manuel López Obrador's administration is under pressure to carry out environmental commitments, as several cities in the country show high levels of pollution, the wire service reported.

ECONOMIC NEWS

Mexico Cuts Forecast for This Year's Economic Growth

Mexico's central bank on Wednesday cut its forecast for the country's economic growth this year and also raised its view for inflation, saying the quickly spreading coronavirus has caused uncertainty about global growth, Reuters reported. The Banco de México said it now expects the economy to register growth of between 0.5 percent and 1.5 percent for 2020, down from its previous estimate of between 0.8 percent and 1.8 percent. "There is a high degree of uncertainty regarding this outlook, as the Mexican economy is expected to continue facing a complex environment ... especially uncertainty regarding the possible effects of the coronavirus outbreak on world economic activity and, specifically, on global value chains," the central bank said in a statement. The more dim view came a day after revised government data statistics showed that the country's economy contracted 0.1 percent last year, its first contraction since 2009. Mexico is a large exporter of products, including cars, that rely on imported components and raw materials, and the coronavirus outbreak has disrupted global supply chains and demand. "This outlook anticipates a more gradual recovery of domestic demand throughout the forecast horizon, in a context in which the global economy continues showing weakness and U.S. industrial production expectations have been revised downwards once again," the central bank, known as Banxico, said. The bank also increased its outlook for annual

ADVISOR Q&A

How Serious Have Costa Rica's Fiscal Problems Become?

Q Costa Rican Finance Minister Rodrigo Chaves this month announced that the government is planning to sell state-owned liquor distillery Fanal and a public bank in a bid to lower expenditures and use savings to pay down debt. The announcement came the same day as Moody's Investors Service downgraded the country's long-term issuer and senior unsecured bond ratings from B1 to B2. Standard & Poor's credit rating for Costa Rica stands at B+ with a negative outlook, the same as Fitch's latest rating. Why are ratings agencies taking a dim view of Costa Rica's finances? Are the government's plans to sell some of its assets financially significant, and what else should it do to manage the country's ballooning deficit? What factors are driving Costa Rica's growth, and what headwinds will the economy face in the period ahead?

A Eli Feinzaig, economic consultant and chairman of the Liberal Progressive Party (PLP): "At 7 percent of GDP, Costa Rica's fiscal deficit exceeded the government's own projections by 0.8 percentage points in 2019, despite a 1.1 percentage-point jump in tax revenues due to the implementation of the December 2018 fiscal reform. The primary deficit jumped to 2.8 percent from 2.2 percent in 2018. Finance Minister Rodrigo Chaves' announcements lacked credibility for the same reason that the deficit ballooned: the government has shown no taste for fiscal discipline. His proposed action plan is lacking in detail. His promise to cut tax evasion in half within two years depends on a highly unlikely timetable of events, and no particulars were provided as to how that goal could be achieved. Although the minister's plan to concession the state-owned liquor distillery and sell a public bank are a welcome policy change, success is not guaranteed in a highly divided congress. Furthermore, with public debt hovering near 60 percent of GDP, the government is expected to raise no more than $200 million from both transactions, barely 0.5 percent of outstanding debt. With the full impact of the tax increase on economic growth to be felt only in 2020, current expenditures growing 50 percent faster than revenues, a weak economy growing well below its full potential and unemployment (12.4 percent) at its highest in four decades, the government's plan to close the budget gap by selling relatively minor assets and tightening tax collection efforts will further erode consumer and producer confidence, which already stand near historic lows. It is precisely the opposite of what is needed at this juncture."

> **"The government has shown no taste for fiscal discipline."**
> — Eli Feinzaig

EDITOR'S NOTE: More commentary on this topic appears in Tuesday's issue of the Latin America Advisor.

NEWS BRIEFS

Cuban Dissident Faces Trial in Controversial Case: Supporters

Supporters of leading Cuban anti-government dissident José Daniel Ferrer said he was due to go on trial on Wednesday on charges of abducting and assaulting another man, in a controversial case that is being closely watched by European officials, Amnesty International and the U.S. Embassy in Havana, Reuters reported. The Cuban government has not confirmed if Ferrer was going on trial, but it did say he was arrested and in jail. Ferrer is the leader of the Patriotic Union of Cuba (UNPACU), one of the biggest and most active opposition groups in the country.

Mexico Allows Docking of Cruise Ship After Negative Results for Coronavirus

The Mexican government on Wednesday allowed a cruise ship with more than 6,000 people aboard to dock in Mexico after being denied entry in two Caribbean ports due to concerns over coronavirus, said MSC Cruises, the ship operator, Bloomberg News reported. The cases were later disproven, as the crew members suspected of being infected with the fast-spreading virus were found to have the flu. Jamaica and Grand Cayman had previously barred passengers from disembarking there.

Hard Currency Used in More Than 50% of Buys in Venezuelan Cities

More than half of all basic goods sold in major cities in Venezuela are bought using hard currency, economic consultancy Ecoanalitica said Wednesday in a report, according to Reuters. Approximately 52 percent of goods including food and clothing are bought with U.S. dollars or euros, a figure that is closer to 90 percent in cities closer to Colombia, such as San Cristóbal and Maracaibo, the report said.

headline inflation for this year's fourth quarter to 3.2 percent, up from a previous estimate of 3 percent. The government's decision in December to increase the daily minimum wage by 20 percent, the second major minimum wage increase in two years, has also put upward pressure on inflation. Mexico's weakening economy has presented challenges for President Andrés Manuel López Obrador, who took office in December 2018, promising 4 percent annual growth. López Obrador plans to publicly present a plan to revive the country's economic growth by the end of the month, his chief of staff, Alfonso Romo, said earlier this week, Bloomberg News reported. [Editor's note: See related **Q&A** on the economic effects of the coronavirus outbreak in the Feb. 11 issue of the daily Latin America Advisor.]

POLITICAL NEWS

El Salvador Assembly Passes War Crimes Bill, Bukele Vows Veto

El Salvador's Legislative Assembly on Wednesday passed a controversial law aimed at allowing the prosecution of crimes committed during the country's bloody civil war, Reuters reported. Soon after, President Nayib Bukele on Twitter said he would veto it, arguing that the law does not abide by a ruling by the country's Supreme Court, the Associated Press reported. "A true reconciliation law cannot be a law of disguised amnesty," he wrote. The law was approved by 44 of El Salvador's 84 deputies. Eleven lawmakers voted against it, one abstained, and the rest did not attend the session. Supporters of the legislation argue that it is intended to ensure that nobody receives an amnesty or pardon for their crimes during the war, but opponents, including human rights organizations, have argued it will result in the opposite, Reuters reported. Bukele has called the bill, which covers compensation, reparations, history and access to military and police archives, "an amnesty law that protects war criminals." The law would also make it illegal to praise disgraced figures for their role during the civil war. The main point of criticism is that it would allow judges to significantly commute sentences for reasons of health or age, or because alleged perpetrators collaborate, Reuters reported. El Salvador's civil war lasted from 1980 to 1992 and left nearly 75,000 people dead and 8,000 missing.

Killings of Female Activists in Colombia Rise by 50%: U.N.

The number of women activists killed in Colombia increased by nearly 50 percent last year, according to United Nations figures released Wednesday. Last year, 108 human rights defenders were killed, 15 of them women, according to an annual report on the situation in Colombia produced by the Office of the U.N. High Commissioner for Human Rights. "We are alarmed," Alberto Brunori, the U.N. human rights chief in Colombia, said in reference to the numbers, Deutsche Welle reported. Colombian President Iván Duque's administration has been criticized for not doing enough to prevent violence against social leaders in the country. The president told journalists on Wednesday that the number of activists killed has dropped overall since he took office in August 2018. "There is a reduction, but the figure should be zero," he said, blaming the killings on rebels of the National Liberation Army, or ELN, as well as dissidents of the former FARC rebel movement and criminal gangs involved in drug trafficking and illegal mining. The U.N. report urged the government to redouble protection efforts, Reuters reported, and it cited a lack of sufficient protection from the state as one of the reasons behind the increase. [Editor's note: See related **Q&A** on the killings of social leaders in Colombia in the Jan. 24 issue of the daily Latin America Advisor.]

> **President Iván Duque blamed the killings on ELN rebels and FARC dissidents.**

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termined that the gross recoverable resource estimate was approximately 670 million barrels of oil equivalent of high-quality oil with API gravity of approximately 28 degrees. Netherland, Sewell & Associates estimates 60 percent of the total resources of Zama are located in Block 7 with the remaining reservoir extending into the adjacent block to the east, owned by Pemex. The Block 7 consortium signed a two-year pre-unitization agreement with Pemex in September 2018. This agreement facilitates the sharing of information regarding the drilling results in both blocks. Since Pemex has not drilled a well in the adjacent block, Amoca-Yaxche-03, it does not have data to share to date. Talos, not wanting to delay the development of Zama, has submitted its Zama data to the Secretariat of Energy (SENER), which will pass it to the National Hydrocarbons Commission for technical review. SENER will define next steps and resolution. Given Mexico's objective to increase production and Talos' goal to have first oil from Zama in 2023, it would be to the benefit of Mexico for Pemex to drill a well on the adjacent block and to exchange data with Talos. Pemex and Talos should also agree on an equity split between the blocks and on who will operate the field, and all parties should execute a unitization agreement."

A **David Shields, independent energy consultant based in Mexico City:** "Energy policy under President López Obrador has taken a more nationalistic, less friendly turn toward foreign investors. Yet, he has promised to honor the license and production-sharing contracts signed under prior reforms. The spirit of such reforms is that Pemex should be a beneficiary from shared exploitation of oilfields with private companies, whether it be through joint ventures (farmouts) or unitization agreements, as in the case of Zama. The Block 7 consortium led by Talos has drilled four wells on the Zama prospect and has proven the reservoir extends across both blocks. Pemex is not required to drill on its side to further appraise the field. It essentially could allow the Block 7 consortium to proceed with the project and ensure first production as early as possible, while maximizing asset value and allowing Pemex to focus on its own extensive development portfolio. However, Pemex seems unwilling to negotiate and acts as if the shallow-water field were its own and that the Block 7 contract were of no significance. This attitude seems unwise at a time when credit-rating agencies are mulling a downgrade of Pemex and Mexican sovereign debt to junk status. Ultimately, if Pemex does not work with the Block 7 consortium on Zama, the message to investors will be: do not drill any wells on blocks adjacent to Pemex properties, as you will not be allowed to move forward. For now, the government has decided not to have more bidding rounds, but the least that can be demanded is clarity and legal certainty on existing contracts and projects."

> **"Pemex seems unwilling to negotiate and acts as if the shallow-water field were its own..."**
>
> **— David Shields**

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

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