

LATIN AMERICAN

Law & Business Report



Volume 17, Number 7

July 31, 2009

Latin American Energy Markets - 2009

By Larry B. Pascal (Haynes and Boone LLP)

This article provides an overview of recent developments in the energy sector in Latin America.

Argentina

Promoting Exploration and Production Activities – Opportunities in the Provinces

Law No. 26,197, known as the “Short Law” due to its length, was enacted by the Congress in the summer of 2008 and has settled a specific constitutional issue as to the ownership of hydrocarbons. To this effect, the Short Law confers the power to grant exploration permits and exploitation concessions to the provinces or the National Government, depending on the location of the blocs, for liquid and gaseous hydrocarbons. The Short Law introduces a substantial change to section 1 of Hydrocarbons Law No. 17,319, by acknowledging the provinces’ right to grant concessions in the future.

Currently, the provinces are authorized to exercise the authority as the original owners of the hydrocarbons, and this authority has translated into a new role for them. Most of the concessions granted by the National Government will lapse in approximately nine (9) years, and the Short Law introduced the beginning of a new role for the provinces as the holders of the power to grant concessions. To this effect, the E&P sector is currently negotiating the extension of such concessions with the relevant provincial governments and this will surely give rise to a new relationship that will seek to adapt the regulatory

framework applicable to these old concessions to the relevant regulations that may be laid down in the future. Notwithstanding that national energy policies are within the scope of the National Congress, this new role of the Provinces could give rise to new business opportunities for investors as provinces begin to call for new bids.

Recent Development in the Provinces - Upcoming Opportunities in the Oil and Gas Sector in Argentina

Province of Salta

Salta is a northern province with a tradition in mining and oil and gas activities dating back to the 1950s. Governor Juan Manuel Urtubey has expressed his desire to promote additional investments in these key sectors and the provincial legislature is considering adopting measures to enhance investment stability and other protections. In addition, the Province of Salta has issued bid terms for oil and gas exploration for eleven (11) blocs (many of these blocs represent deep onshore gas exploration opportunities). These blocs, located near the border of Bolivia, represent a relatively higher exploration risk due to the high cost of exploration, and estimated at US\$ 80 million per well. However, the Shell / Pae Consortium has been quite successful with its Acambuco wells in the Macueta Acambuco area.

Province of Neuquen

The Province of Neuquen, the most important Argentine province in terms of oil and gas production, intends to issue bids with respect to 33 exploratory areas, some of them with a history of marginal gas production. These more mature areas may offer lower exploration costs and a greater likelihood of production compared to the above-mentioned opportunities in Salta.

Province of Mendoza

The western Province of Mendoza is famous for its fine wines, but it also holds approximately 15% of the country’s petroleum reserves. It is expected that bid invita-

Larry B. Pascal (larry.pascal@haynesboone.com) is a partner and the chair of the Americas Practice Group at Haynes and Boone, LLP (Dallas) and the author of the South American energy law chapter of the Matthew Bender publication Energy Law and Transactions. The author would like to thank the following people for their assistance with this article: Diego Rojas of the Rojas Law Firm (Bolivia), Ramon Azpurua of Squire Sanders & Dempsey (Venezuela), Sergio Salluh of Veirano Advogados (Brazil), Amalia Saenz of Brons & Salas Abogados (Argentina), and Nara Porto of Haynes and Boone, LLP.

tions for nineteen (19) exploratory blocs will be issued in the near future, some with a history of marginal oil and gas production.

Bolivian Natural Gas Sector

Introduction

In July 2004, Bolivia held a binding referendum in which a majority of voters approved the nationalization of the oil and gas sector. Subsequently, in May 2005, Bolivia adopted a new Hydrocarbons Law No. 3058. Although this law established the foundation for the nationalization of hydrocarbons, on May 1, 2006, the government under President Evo Morales issued "Nationalization" Supreme Decree No. 28701, by which the State effectively took control of the entire commercial and production chain of the oil and gas sector. Subsequently, in November 2006, applying the above-mentioned decree, the government, through the state-owned company YPFB, signed forty-four (44) new Operating Agreements with the private oil and gas producers then operating in Bolivia. These agreements remain in full force and effect.

Bolivian Newly Approved Constitution

Via the January 2009 binding referendum, a constitutional reform, drafted and strongly promoted by the governing MAS party was approved by 61% of the voters. Among the many reforms incorporated in the new Constitution was a provision allowing for presidential re-election. Also, Bolivia has scheduled general elections for December 2009, and this could mean that Evo Morales

could remain in power for at least two new presidential terms.

Finally, although the existing Hydrocarbons Law remains in effect, President Morales has announced a new hydrocarbons law to be passed under the new constitution. Following the passage of this law, it is expected that new regulations for each specific sector and activity will be adopted.

Economic Prospects for 2009-2010

Despite the short-term positive results following the 2006 policies and due both to internal and external factors, a return to the "boom" experienced in the 1990's is not likely for the foreseeable future. Although a domestic gas pipeline running from Cochabamba to La Paz and surrounding regions has recently been inaugurated, corruption scandals have put a liquids separation plant project on hold, and such delay is likely to continue to cause problems in meeting domestic demand. Moreover, whether YPFB will be able to meet its Brazil and Argentina supply commitments will depend on the demand of this coming winter season.

Analysts are predicting that in 2009 the Bolivian private gas sector will invest approximately US\$ 650 million in exploration and production and exports will reach US\$ 1.5 billion, compared with last year's exports which reached US\$ 3 billion, a noticeable reduction for a country very dependent on exports of its natural resources. Also, Bolivia's main gas export market, Brazil continues to move forward with the exploration and production of its own new gas fields, suggesting a desire to lessen its dependence on Bolivia.

Brazil

Background on Brazilian Oil Sector

Since 1999, the National Petroleum, Natural Gas, and Biofuels Agency (the "ANP") has sponsored annual bid rounds offering for concession onshore and offshore acreage for exploration and production activities in Brazil. Various private and national oil and gas companies from around the world have participated along with Petrobras and other local companies. These annual bid rounds have in general worked well. However, in 2007, the first hydrocarbon discoveries in the pre-salt layer of Brazil were announced. As discussed below, the enormous potential of the pre-salt layer discoveries has dramatically changed the dynamics of the oil and gas industry in Brazil, prompting the government to consider whether the existing concession regime may be too generous to be further used for the pre-salt area, given the circumstances.

Discoveries in the Pre-Salt Layer Fields

Recent discoveries in the pre-salt layer of Brazil suggest the existence of massive oil and gas deposits in both the Campos and Santos offshore basins which, if properly developed, could enable Brazil to become one of the largest countries in terms of hydrocarbon reserves in the

Block	Name	Members
BM-S-8	Bem-te-vi	Petrobras (66%)
		Shell (20%)
		Petrogal (14%)
BM-S-9	Carioca and Guar	Petrobras (45%)
		BG (30%)
		Repsol-YPF (25%)
BM-S-10	Parati	Petrobras (65%)
		BG (25%)
		Partex (10%)
BM-S-11	Tupi and Iara	Petrobras (65%)
		BG (25%)
		Petrogal (10%)

BM-S-21	Caramba	Petrobras (80%)
		Petrogal (20%)
BM-S-22	Azulo	Exxon (40%)
		Hess (40%)
		Petrobras (20%)
BM-S-24	Jupiter	Petrobras (80%)
		Petrogal (20%)
BM-S-48	Panoramix	Repsol (40%)
		Petrobras (35%)
		Vale (12.5%)
		Woodside (12.5%)

world. However, estimates of the required investment to fully exploit these resources range from US\$ 400 billion and US\$ 1 trillion.

The table shows the current pre-salt fields currently under concession and the members of the consortium.

There have also been other recent pre-salt discoveries outside the Santos Basin, such as Caxaréu and Pirambu, in the Campos Basin. In 2008, in order to coordinate all of the exploration and production activities carried out in the pre-salt layer, Petrobras created the Pre-Salt Layer Executive Management Team. The Pre-Salt Layer Executive Management Team reports to the Petrobras' Exploration and Production Executive Office.

Changes in the Brazilian Petroleum Law Stemming from Pre-Salt Finds

When the pre-salt discoveries were announced, the oil and gas majors and other actors naturally wanted to secure or expand their presence in the region. However, the size of the oil reserves in the Santos discoveries was much larger than originally expected, prompting the Brazilian government to delay awarding any additional offshore blocks until changes are made to the regulatory framework. Consequently, the government withdrew forty-one (41) pre-salt sites from the 9th Bid Round auctions in 2007, immediately after the size of the Tupi reserves had been announced, and also excluded the offshore fields from the 10th Bid Round auctions in 2008.

In May 2009, the ANP announced that the agency is conducting the preliminary work required for the 11th Bid Round. However, given the circumstances, there is a chance that for the first time in ten years, Brazil may not hold an annual bid round. Even if one were to be held, it is very likely that the government will use the same approach as taken in the 10th round and limit the bid to less attractive areas if a new regulatory framework has not been adopted by such time (as may well be the case). Recently, the director of the ANP stated that he expected a new round of auctions for oil blocks would occur by the end of the year, although pre-salt areas would be excluded.

In light of the pre-salt developments, the three most discussed scenarios for the pre-salt fields are the following (with the production sharing model generating more interest of late, as mentioned below):

Changes in the Concession Contract Model

Under this proposal, the concession model is maintained, and taxes and oil royalties are raised, including an increase in the special participation payment in order to provide more income to the government from the discovery.

Production Sharing Contract Model

Another proposal is to adopt a production sharing contract ("PSC") structure. Interestingly, the possible implementation of PSCs for the pre-salt layer has also

generated discussions with respect to the formation of a new state-owned company ("NOC"), whose sole purpose would be to hold the pre-salt assets. This NOC would manage the development of the oil reserves in the pre-salt area through partnerships with other firms, including Petrobras, in exploring the pre-salt areas that have yet to be auctioned. However, some critics of this proposal point out that Petrobras is already viewed as an NOC and that the formation of another Brazilian oil company could have negative implications for Petrobras, such as brand fragmentation and reduction in prestige as the unified national symbol. A recent announcement by the Minister for Mines and Energy Edison Lobao on July 14, 2009 suggests that the government foresees using a production sharing system for this area, as well as the formation of a new NOC.

Risk Service Contract Model

Under the risk service contract ("RSC") regime, the production goes to the host government instead of the oil company. The oil company is then rewarded for having found production by a cash payment per barrel, or per cubic meter, or similar measurement. The oil company may be granted the right to buy part of the production. Brazil adopted the RSC system in the past during the era of military rule, but it was abolished in 1988 due to the failure adequately to increase Brazilian oil production and reserves in that period.

The New Brazilian Gas Law

For a variety of historical reasons, the development of natural gas in Brazil and its importance in the national energy matrix has historically been only a secondary concern. However, given the global trend of increased demand for gas and fearful of the consequences of over-dependence on hydroelectric energy (particularly given the economic impact of the draught of several years ago which negatively impacted the supply of hydroelectricity), the Brazilian government has begun to place more importance on natural gas.

Given these developments, natural gas has recently played a more important and arguably unprecedented role in the Brazilian national strategy. However, the lack of clear rules to attract private investment to the country's gas transportation infrastructure has been an obstacle. In order to remove that obstacle, after more than four years of discussion, in March 2009, the Brazilian Gas Law¹ ("BGL") was enacted, regulating gas transportation as well as the treatment, processing, storage, liquefaction, re-gasification and marketing of natural gas.

Although the BGL contains sixty (60) articles, it is not a comprehensive reform package, and a number of important aspects remain subject to future political and regulatory decisions. To this effect, implementing regulations will be required before the legal framework is complete and fully functioning as intended. It had ini-

tially been hoped that these follow-up set of rules would have been adopted by June 2009, but to date no such rules have been released.

The BGL is innovative in a number of respects, including the introduction of a concession regime for the transportation of gas, which system will coexist with the pre-existing authorization system in the BPL. However, the BGL regime is considerably simpler than the complex authorization system under the BPL, which will now be restricted to gas transmission lines governed by international treaties, and those with a sole end user. In contrast, gas transmission lines of more general public interest will be governed by the BGL's concession regime.

The concession regime may allow better opportunities for directed governmental initiatives and the reduction of risks for both government and industry actors. This is due to the precarious legal nature of the authorizations, and the complex contractual structure that they imposed on various parties in the gas chain (from producer to final consumer). This prior legal structure proved incapable of attracting sufficient investment, but it is hoped that the concession regime will be easier to understand and better received.

Concessions will be bid out under a procedure whereby all interested parties will have the chance to secure a contract for transportation through existing lines or in lines to be constructed or expanded (a public call). Concessions will be granted to carriers who enter into commitments as required in the bid round.

However, all such concessions will still be regulated by the Ministry of Mines and Energy (the "MME") and the ANP. Significantly, the BGL requires the MME, after consultation with the ANP, to set an exclusivity period during which only the initial/original carriers, as owners, will be able to use a gas line. The current absence of such exclusivity has historically been a major obstacle for such carriers to manage the risks involved in promoting, financing and constructing this expensive infrastructure.

The BGL also allows the MME to authorize the use of public-private partnerships structures, to reduce the risk to private investors and promote cooperative investments between public and private entities. However, there are no clear directives as to how these structures would be implemented, which is an important defect, given the significant administrative, financial and legal hurdles in such structures. The BGL also transfers some of the ANP's current regulatory responsibilities to the MME.

Although the BGL is an important step forward, it leaves unresolved a chronic constitutional problem. The Brazilian Constitution grants the States a monopoly over gas distribution within State boundaries. However, the new Law liberalizes access to gas transmission and distribution, including for those who produce and import their own feedstock, which will reduce the States' exclusive right to regulate distribution. In this area, legal and political controversies may be difficult to avoid, and may affect the progress of some projects.

The Electricity Sector

President Luiz Inácio Lula da Silva ("Lula") re-election in October 2006 brought certain stability to the electricity sector, which helped attract new investment and new investors especially in the transmission and generation areas.

After Lula's reforms of the regulatory framework, distribution companies were required to purchase their energy through public bids, either from existing power plants or from new plants (i.e. that are not yet operating or have not received a concession or other authorization from the authorities). Via the "new energy" auctions, the government is attempting to give to new plants a guarantee that their energy production, and therefore their receivables, will be contracted as of the development of the project, which is essential for new devolving projects in order to obtain financing and to enter into EPC contracts.

New energy public bids are normally divided in two separate auctions, depending on the timing for the implementation of the projects (either three (3) or five (5) years). Also, a separate special auction is designed to sell energy from "green" plants, such as wind, biomass and solar plants. The reason for this separate auction is to make these plants more competitive, as their energy price is higher than for gas fired or hydro plants. Finally, the Brazilian government is also bidding concessions for transmission grids and substations, aiming to achieve the government plans for the expansion of the transmission system.

Venezuela

Recent Developments- Important Announced Commercial Agreements

In 2008 and early 2009, Venezuela also signed important international agreements with the goal of promoting the Venezuelan energy sector. Some of the most important agreements and international treaties are discussed below.

- (i) **ONGC Videsh – PDVSA Joint Venture for Orinoco Oil Belt.** In January 2008, the Republic of India announced a US\$ 400 million investment in ONGC Videsh-PDVSA for the exploitation of the San Cristóbal block of the Orinoco Oil Belt, and the formation of the joint venture Petrolera Indovenezolana, S.A., in which PDVSA's subsidiary, CVP, will hold a 60% interest and the Indian Ongc Videsh Ltd. would hold the remaining 40% interest. The joint venture was assigned the operations of the San Cristobal fields in the States of Anzoátegui and Guárico.
- (ii) **Eloy Alfaro Delgado Oil Refinery.** The government caused agreements to be signed for the construction of the "Eloy Alfaro Delgado" oil refinery by a joint venture consisting of PDSVA and Petroecuador in the Gulf of Guayaquil, which is projected to refine an estimated 300,000 barrels of oil per day, extracted in the Ayacucho block of the Orinoco Oil Belt.

- (iii) **Alliance with Russian Federation Companies.** The government entered into an alliance with the Russian Federation for the formation of a joint venture between PDVSA and the Russian firms Gazprom, Lukoil, and TNK-BP, for oil production activities in the Orinoco Oil Belt.
- (iv) **Agreement with Government of Belarus in Various States.** The government signed a preliminary agreement with the Government of Belarus to develop further oil production activities in Oritupano Norte and Ostra (State of Anzoátegui), as well as Block II in the State of Zulia.
- (v) **Agreements with Petroecuador and ENAP Chile.** The government signed agreements with Petroecuador and ENAP (Chile) for the exploitation of block 5 of Campo Ayacucho in the Orinoco Oil Belt.
- (vi) **Bidding Process for Carabobo Blocks in Orinoco Belt.** PDVSA announced that the selection of partners for the Carabobo Area of the Orinoco Oil Belt was delayed. The envelopes containing the bids will now be submitted and opened on July 28, 2009. The highest bidders for the development will be announced on August 14, 2009. The Carabobo Area is one of the richest areas in the Orinoco Oil Belt with quantified and certified reserves at 32 billion barrels of original oil in place (OOIP).
- (vii) **Merger of Petroindependiente, Petrowarao, and Lagopetrol.** In December 2008, PDVSA initiated the merger process of its subsidiaries Petroindependiente, Petrowarao and Lagopetrol, which has entailed the signing of an Agreement for Joint Study with its corresponding partners Chevron Lago de Maracaibo BV, Hocol-Maurel & Prom Venezuela SAS, and Perenco Venezuela-Petróleo y Gas ETVE S.L, in order to analyze the feasibility of merging these joint ventures, which currently operate in the West areas: LL-652, B-2X and Ambrosio, with a total production of 25,000 barrels per day.
- (viii) **PetroVietnam Joint Venture.** Additionally, the formation of the joint venture between PDVSA and PetroVietnam was authorized in December 2008. CVP holds a 60% interest and Petrovietnam holds the remaining 40%. The company was assigned the operations of the Junín 2 Norte block in the State of Anzoátegui.
- (ix) **Russia Joint Venture.** Representatives of the Governments of Russian and Venezuela signed an amendment to the Cooperation Agreement in the Field of Energy that had been signed in November 2008, in order to promote the creation and operation of a Joint Venture for an oil project in block Junín 6 of the Orinoco Oil Belt.
- (x) **Energy Cooperation Agreements with Japan.** Twelve strategic energy cooperation agreements were signed in April 2009 between the governments of the Bolivarian Republic of Venezuela and Japan to consolidate the development of the Orinoco Oil Belt and the country's gas and petrochemical sectors. In particular, four memorandums of understanding between PDVSA and the

Japanese companies Marubeni, Itochu, Mitsubishi, and Mitsui were signed to create a Joint Venture company with an interest in the Gran Mariscal Sucre project. In addition, a memorandum of understanding was signed by PDVSA and JOGMEC to develop energy cooperation that will facilitate the implementation of projects across the entire hydrocarbon value chain. PDVSA and Mitsubishi also signed the granting of a mandate to process the financing of 750 million dollars for a deep conversion project of the Puerto la Cruz Refinery; as well as the granting of a mandate that will benefit the company Itochu and will enable the financing of another 750 million dollars for the deep conversion project of the El Palito Refinery. Similarly, PDVSA and the Japanese companies Mitsubishi, INPEX and JOGMEC signed an agreement to carry out a joint study in the Junín 11 Block of the Orinoco Oil Belt, which will enable the completion of a project to develop hydrocarbon resources. Another memorandum of understanding was signed by PDVSA and the company Marubeni to carry out a joint study of potential financing structures to develop industrial condominiums in the extra crude upgrading complex in the Carabobo and Junin Blocks of the Orinoco Oil Belt. Finally, three memorandums of understanding were signed by PEQUIVEN and Marubeni, Mitsui and Mitsubishi to study the possibility of joint developments in the olefin and polyethylene projects in the Ana Maria Campos Petrochemical Complex, in the new fertilizer plant of the Jose Complex, Fertinitro and the Paraguana Refining Complex; develop the potential of financing structures for petrochemical projects in Venezuela, thereby allowing the participation of Mitsui in said projects; and also study the possibility of establishing petrochemical projects in the production and commercialization areas for ammoniac, urea, polyolefin and methanol in the Jose Complex.

- (xi) **Energy Cooperation Agreements with Argentina.** In May 2009, representatives of the Governments of Venezuela and Argentina signed three memorandums of understanding in the energy field: the first one for logistics, distribution and transportation by Fluviomar S.A. and PDVSA Naval; the second one for positioning, ownership and installation of the future re-gasification facilities which will ensure natural gas supply in Argentina, and a third one by PDVSA Industrial and GMC Galileo, to conduct feasibility studies on the organization of a mixed company for manufacturing and assembly of compressors, nozzles of natural gas for cars, motor-compressors and technology for gas modular transportation.

1. Law No. 11,909/09.

Reprinted from *Latin American Law & Business Report*
©2009 WorldTrade Executive, a part of Thomson Reuters

www.wtexecutive.com