REGIONAL ASSOCIATION OF
OIL, GAS AND BIOFUELS SECTOR COMPANIES
IN LATIN AMERICA AND THE CARIBBEAN

Preparing the Latin American and Caribbean oil and gas industry for the 'new normal'

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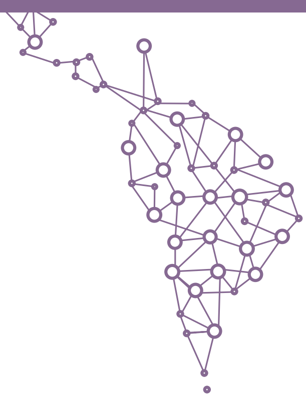

EXECUTIVE REPORTS

Preparing the Latin American and Caribbean oil and gas industry for the ‘new normal’

What are LAC governments doing to support the sector during the crisis and to continue developing its hydrocarbon resources?

Introduction

The perfect storm created by oil price crash and COVID-19 has wreaked havoc worldwide. From a regional perspective, it is worth recalling that Latin American and Caribbean (LAC) economies rely heavily on revenues from their oil and gas resources as an important source of income and a long lasting crisis will have a dramatic impact on the society wellbeing.

Some forecasts indicate that exploration and production companies, including IOC’s, will reduce CAPEX budgets for 2020 by around US$ 100 billion. This will considerably limit the amount of exploration budget available for licensing round acquisitions, at least in the short term.

Operators will continue to focus on cost discipline for some time. Since prices collapsed in mid-2014 unit development costs came down by as much as 50% and the industry gained in productivity embracing new technology with a strong focus on costs. This -in turn- has affected the profits and margins of oilfield service providers.

With pandemic control and sanitary measures for the society as top priority, governments and regulators in the Region have taken a series of steps designed to mitigate the impact of a harsh oil price recession on operators. Some of these steps include also the attention to the sustainability of service providers, which are sizeable employers, to guarantee the subsistence of a strong supply chain sector.

This report briefly describes some of the individual strategies and initiatives taken by Latin American and the Caribbean governments to ensure the survival, attractiveness and sustainability of the oil and gas sector and its value chain in their countries.

Most governments also believe that some of these sectoral focus measures would have a medium-term structural macroeconomic impact regarding investments and movement of foreign currency in the domestic market and capital inflows from abroad.

Argentina

Suspension of policies and incentives aimed at accelerating the production of hydrocarbons from the Vaca Muerta shale in the face of low demand for oil and gas and falling prices.

Simultaneous evaluation of support measures, such as setting a minimum oil reference price for local producers at US$45/b, aimed at decoupling from international levels with the aim of raising domestic production and limiting imports. **The Argentinian “Creole barrel” would freeze the price of local oil sales and protect hydrocarbon-producing companies and provinces from the collapse of oil prices.** The Creole barrel would function similarly to a subsidy, although it would be paid by oil consumers, from households to industrial producers and the State itself. Non-integrated exploration and production small and medium companies have also expressed their support for the measure, arguing that it is crucial to protect productive activity and jobs. However the measure could affect the largest integrated companies in the local industry, such as the NOC, YPF and Pan American Energy, as they carry out large-scale refining operations that would have to buy crude oil at an artificially expensive price, which will put pressure on their margins.

In early April, the tender for the construction of the first section of a 15Mm3/d gas pipeline was postponed for the third time after no bid was submitted. The project, which would link Tratayén in Neuquén province to Salliqueló in Buenos Aires, was estimated to require investment of US$800 millions

In March, the NOC, YPF, said it would reduce its CAPEX by US$700 millions, primarily on exploration, gas production and growth of its reserves. In April, it closed several wells in its most productive unconventional block, Loma Campana, because it was running out of space to store crude.

The Ministry of Energy also decided to extend the current gas supply contracts between producers and distributors until June 30, thereby postponing the new auctions traditionally held in February. Tenders in the last two months to supply generators have yielded average prices of less than US$2 per MBTU, significantly lower than last year’s US$3.5 / MBTU, already considered too low by the industry.

During April, there has been no records of hydraulic fracturing stages in Argentina’s Vaca Muerta unconventional play (compared with 470 stages in March).

Bolivia

Government is hesitant of whether to prioritize more expensive local fuel production or ramp up imports of cheaper refined products. Authorities argue that the latter would curb alternative energy efforts, lead to unemployment and impact balance of payments.

The low oil and gas price will have an impact of around US$700mn in terms of gas exports this year, but may save some US$550mn on fuel imports. **The most relevant negative impact is on natural gas sales to Argentina and Brazil as Bolivia uses international crude benchmarks in its gas pricing formula.**

Prioritization of projects to increase storage capacity to support production from the country's fields (i.e., not for the import of refined products) until economic activity resumes.

In the short-term, Bolivia plans for maximizing the consumption of domestic gas and reactivating the Bulo Bulo ammonia and urea plant, to increase gas demand and generate revenue from the export of urea to the region.

For the medium term and post-coronavirus environment, the priority is the national industry, including financial re-engineering of the liquid fuels market through a temporary fiscal push to promote local production, including green fuels.

Signing of interruptible gas supply contracts with new customers, starting in October after winter is over. This would cover possible supply and demand gaps due to reduced offtake by Argentina and Brazil.

Regionalization of YPFB (the NOC) beyond Bolivia through partnerships for hydrocarbons industrialization and petrochemicals to develop a logistical value chain for selling products.

Brazil

Authorization for operators to postpone for nine months those activities that were due to be finished –by contract- during 2020. Further extensions could be offered following an evaluation after the crisis is over.

Tolerant exploration and production rules such as extension of deadlines for companies to present development plans, annual work programs, and monthly production data.

Postponement of some legislative changes that could impact the oil and gas industry, such as some of the measures for the new legal framework for the gas market program to open up the market for private sector players and procedures to speed up the issuance of environmental permits.

Permission for low output operating fields to flare up to 100,000m3/d of natural gas.

The Energy Minister is trying to coordinate efforts to bring private infrastructure investments to the country.

Suspension of operational routines such as the collection of oil and gas samples and inspections of measurement instruments.

The NOC, Petrobras, launched a new incentivized retirement program as part of its cost reduction efforts to increase saving.

Update and simplification of the decommissioning rules to allow for a quicker deactivation of approximately 100 older platforms. The new rules are also expected to benefit suppliers since the decommissioning plans will be published in advance to give services firms and shipyards the opportunity to better prepare for the required investments.

It is possible that Brazil collaborates with current international efforts led by OPEC to reduce production and stabilize oil prices.

Chile

Created in 2014 to protect the consumer, Chile's Mechanism for Stabilization of Fuels Price (MEPCO, in Spanish) could prevent that a significant increment in oil prices does not end up rising prices on pump.

Crude refineries of the Chilean NOC, ENAP have been operating below the installed capacity piling up inventories and seeking to secure the domestic fuels supply, in spite of the dip on sales. This 2020 will be a complex year for ENAP since there are no expectations of a turnaround in international oil prices, rather a downtrend for some time. Investments are being reviewed to keep ENAP sustainable in the aftermath of the crisis.

Colombia

Option for operators to extend deadlines for exploration programs and postpone the submission of block development plans.

Postponement of the Permanent Process of Allocation of Areas (PPAA) bidding schedule.

To ensure the continuity of operations of the hydrocarbon industry in Colombia, operators are allowed to consider redirecting investments in delayed exploration projects to other upstream activities.

Update of the map of areas available to companies in its permanent licensing process so that interested operators can make requests according to the present situation of the country requesting the agency to incorporate the areas in upcoming cycles of the PPAA.

To ensure energy security, the government is fostering investment in unconventional basins and will publish technical requirements for fracking pilot projects. Focus on ratifying environmental regulations, to pave the way for the country's first shale drilling campaigns. Important IOC's and the NOC, Ecopetrol, have submitted plans for unconventional pilots.

Temporary reduction of oil and gas pipeline tariffs and agreements between producers and transporters, which account for around 45% of total operation costs for oilfield producers.

Extension of deadlines for payments of economic rights by block operators. However, deadline extensions do not include royalty obligations for production.

Fast-tracking of rebates on value added tax and simplification of rules related to letters of credit for block commitments.

The licensing round, which had been due to conclude mid-year, is now scheduled to end in December.

Ecuador

Ecuador energy sector authorities are working to reactivate tenders to finalize them within this year. Tenders will be resumed in a transparent manner, without resorting to direct awards. The bidding, prequalification, qualification and selection of the best offers will work in all cases and include the payment of a cash bonus.

Deferral of debt payments to obtain liquidity and face the health emergency and low oil prices crisis. The Government seeks to renegotiate with Ecuador sovereign bondholders. Recently, the Ministry of Economy and Finance reported that it obtained the approval of the Request for Consent to postpone the payment of the debt of the –upstream- NOC, EP Petroamazonas.

Among the tenders to be awarded before the end of the year is the 20-25 year contract to operate the Esmeraldas oil refinery, which includes the construction of a line to convert waste into clean products.

The crude oil exports carried out by the –downstream- NOC, EP Petroecuador, while the Force Majeure declaration remains in force, will be carried out until the technical and operational capacities of the company allow it. EP Petroecuador can apply the declaration of fortuitous case as long as the conditions and capacities to operate in a technical manner do not exist, otherwise it must comply with the existing commitments.

The conditions of the operational facilities of EP Petroecuador allow these exports to be fulfilled, since, at present, the storage tanks have an inventory of crude oil, the same that because they are operational, allow exports to be made and, therefore, in these circumstances Force Majeure is not applicable.

Guyana

Guyana contracted professional services to develop the government structure for more efficient management of the sector. It is also working to conclude the Market Price Determination Procedure and Provisional Crude Oil Basket for marketing Guyana’s crude.

The government is developing some internal capacity building mostly for suppliers/ manufacturers and trying to promote local business development. Actually, the country’s Local Content Policy has been completed and is now being implemented.

Guyana basin remains attractive because of the lower breakeven price compared to other basins in the world.

The main operators have decided not to cut CAPEX for the offshore exploration, drilling and development of the hydrocarbon resources in this country. However, current travel restrictions in place worldwide have impacted normal operations in the Stabroek Block, and this may slow down drilling activities.

Mexico

Mexico will focus on higher refining capacity and more domestic fuel production to help reduce the impact of the crude sell-off on its NOC, Pemex. Taking advantage of low prices for the Mexican crude basket, the NOC will direct an additional 400,000b/d of crude oil to the production of fuel to raise the low capacity utilization rate at Mexican refineries and reduce imports of gasoline and diesel.

If needed, and in order to avoid penalties, upstream operators, especially those with production contracts, must submit modifications to their drilling, exploration and development plans to the regulator immediately or invoke force majeure clauses. This applies also to the NOC, Pemex. However, the suspension of energy contract terms and deadlines has been extended to end of May.

The NOC, Pemex will halt crude production at newly drilled oilfields.

Plans to expand private energy storage capacity with some terminals finished by the end of 2020.

Pemex has slashed its 2020 CAPEX budget by US$1.66 billion and will benefit from a presidential decree authorizing US$2.66 billion in fiscal relief for the remainder of 2020. Pemex is also expected to receive an estimated US$309 million in additional income from its oil hedging program.

Paraguay

The NOC, Petropar has extended to the end of May the deadline to submit letters of interest and qualification documents in the international upstream bidding round for three blocks issued earlier this year.

The NOC also pushed back the presentation and opening of bids to July 31 with awarding and contract signing now penciled in for September.

Peru

The national hydrocarbon agency, Perupetro, presented some measures to the Ministry of Energy and Mines focusing on maintaining productive capacity of oil and gas to avoid the stoppage of production and contributions to the treasury from the sector and avoid loss of jobs.

Perupetro is coordinating measures with individual companies to ensure that the security and sanitary measures in the operation are maintained and supervising operators to ensure energy supply is maintained.

Recent supreme decree authorizing the gradual renewal of economic activities through a four-phase plan starting this month. The first phase covers activities related to mining and industry, specially hydrocarbon projects of national interest.

Suriname

The recent discovery -by some independents and IOCs- of a new series of offshore oil reservoirs increases the already growing appeal of offshore E&P activity in the Guyana-Suriname basin, which is expected to become a significant oil hub in the coming years.

As long as the breakeven price of development stays below forecasted oil price and far below competing basins (Gulf of Mexico, West Africa, Brazil) and with the recent back-to-back exploration success, **Suriname should be in a good position to remain very attractive for IOC's to come/continue to explore offshore.**

The breakeven price for deep water Suriname is likely to be the same as Guyana. However, economics will play a role depending on how the future oil price is formulated for the participating companies.

Trinidad & Tobago

By the end of May, the government expects to draft mechanisms to facilitate the resurgence of Trinidad and Tobago's economic activity across different sectors, including energy. The emphasis will be on removing constraints to private investment.

The government has estimated that the crisis will increase over 60% the projected budget deficit for fiscal 2019/20. The country's GDP this year is now forecasted to contract 5% compared to 1.5% increase projections 4 months ago.

The revenues of the energy services sector was down on average by 56%

For its part, Heritage Petroleum, the NOC upstream operator, reported that it is following a strategy of storage of oil production to be sold as the oil market improves.

The National Gas Company, NGC, signed a Framework Agreement with a private upstream operator and with Heritage Petroleum to develop plans and foster a strategic partnership with respect to the development, sale and purchase of natural gas and natural gas liquids -produced from onshore fields- to existing markets.

Uruguay

Continued promotion of Open Uruguay Rounds highlighting the transparency in the process of decision-making, a previously available database and a clear and predictable schedule, as well as extremely low exploratory program requirements (up to six years without well commitment) and a sound and fair contract model.

The terms include the possibility of qualification exclusively for the Exploration Period with or without exploratory wells, as well as for the Exploration and Exploitation Periods, with technical and economic requirements significantly differentiated in each case.

The Uruguayan NOC, ANCAP is currently holding meetings and data rooms with different interested companies for the next instance of November.

Venezuela

The government sent out a New Hydrocarbon Organic Law for consideration by the Assembly. **Venezuela aims at restructuring the NOC, PDVSA, and considering legal mechanisms to promote private partnerships.**

The law recommends that PDVSA keeps its 60-70% stakes in Venezuela's five most productive joint ventures.

The law proposes allowing private companies to operate fields -even fields with massive reserves that have always been in PDVSA 's hands- and market crude themselves. Private participation is also allowed in the refining sector.

Creation of a regulatory agency, the Venezuelan Hydrocarbon Agency, within the first three months after the law is approved, separating the Ministry of Energy and Petroleum from PDVSA and splitting their regulator/regulated roles.

It also proposes that PDVSA cut its stakes in several fields to 50.1% from 60% while allowing private companies to operate refineries. For fields operated solely by PDVSA, it proposes converting them into joint ventures by selling stakes, or signing joint service agreements in which PDVSA pays a private company to operate the field.

Progressive and flexible fiscal regime. Government take reduction.

The law includes progressive reduction of gasoline subsidies.

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This report is based on information obtained from journalistic sources, specialized consulting firms, official government sources, as well as from ARPEL and qualified sources to which ARPEL has access.

Sources: BNAmericas (https://www.bnamericas.com/es), Wood Mackenzie (https://www.woodmac.com/), Rystad Energy (https://www.rystadenergy.com/), OilPrice (https://oilprice.com/), Global Data (https://www.globaldata.com/), ANCAP (https://www.ancap.com.uy/), Staatsolie (https://www.staatsolie.com/), OLADE (http://www.olade.org/), Janet Cesar (ARPEL consultant)

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ARPEL is a non-profit association gathering oil, gas and biofuels sector companies and institutions in Latin America and the Caribbean. Founded in 1965 as a vehicle of cooperation and reciprocal assistance among sector companies, its main purpose is to actively contribute to industry integration and competitive growth, and to sustainable energy development in the region. Its membership currently represents over 90% of the upstream and downstream activities in the region and includes national, international and independent operating companies, providers of technology, goods and services for the value chain, and national and international sector institutions.

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