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Energy & Natural Resources - Argentina

Changes in oil and gas industry regulation

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As in many federal states, there is a tension in Argentina as to how federal and provincial governments can each obtain an appropriate level of income from hydrocarbon reserves, while at the same time setting such costs at a reasonable level so as not to discourage investment in the sector. It has been recognised recently that the balance may not be right at present and steps are being taken to rectify this issue. Specifically, draft reforms to the framework of hydrocarbon regulation are being debated by congressional committees.

Background

Argentina's hydrocarbon reserves are arguably its most valuable asset. Throughout the country's history, sovereignty over its natural resources has passed between the provinces and the federal state. This issue was addressed in the Argentine constitutional reform (1994), where sovereignty over natural resources – including hydrocarbon reserves – was vested in the provinces in which they were situated. Notwithstanding this, hydrocarbons are still governed by federal law, in addition to provincial law, and the federal state determines the limit and basis for calculating royalties.

Each province has its own procedure for granting exploration and exploitation licences, but must work within the parameters of the Federal Hydrocarbons Act.⁽¹⁾ As provinces are restricted in the amount of royalties that they can charge, they have created new ways to obtain revenue. One key way is to transfer all rights and titles to, and interest in, all reserves to companies owned by the province. These companies then enter into joint ventures with oil companies to develop their assets.

Meanwhile, the federal government has also sought to obtain revenue from hydrocarbons for the state's wider benefit. Specifically, a duty on the export of oil were introduced in February 2002. Initially, this export duty was fixed at 25%. However, in August 2004 the Ministry of Economy added an additional rate to the export duty when the price of West Texas Intermediate (WTI) was more than \$32 a barrel. Accordingly, the export duty is now levied at 45%.⁽²⁾ Since 2011, oil and gas producers have been required to repatriate 100% of the proceeds of their exports, whereas an exception of 70% of the proceeds had previously applied.⁽³⁾

In short, both the federal and provincial governments have taken steps which, when combined, have made investment in the sector less viable than it might have been. This reached a critical point in 2011, when Argentina became a net hydrocarbon importer for the first time in two decades.

Debate

Although the current debate is effectively between energy company YPF and the provinces, as the largest shareholder in YPF is the federal state, it is in essence a debate between the provinces and the federal state.

One of YPF's principal issues is that there are different procedures and bidding processes in each province. This, it argues, makes for an unwieldy sector which is not conducive to investment.⁽⁴⁾ Moreover, YPF has questioned the role of the intermediary companies created by provincial governments, which it considers to be unnecessary.⁽⁵⁾ These companies typically have a participation in each project of not less than 10%, without providing any capital.⁽⁶⁾

On the other hand, the provincial governments argue that these provincially owned companies carry projects that would not otherwise be invested in due to federal government measures, which they deem to have a greater effect on investment in the sector.⁽⁷⁾

Four provinces are leading the battle against the bill proposed by the national government – Neuquén, Rio Negro, Mendoza and Chubut. Moreover, the governors of each province have claimed that they are being extorted as they will not be invited to refinance debts with the national government unless they agree to the bill. In this regard, Neuquén Governor Jorge Sapag admitted that there is "tension" with the national government.⁽⁸⁾ The main objective of YPF – and therefore the national government – is to pass a law that is convenient to its board of directors. In this context, the governors have agreed to a counter-bill. However, Sapag has acknowledged that they are open to dialogue. For their part, the provincial governors have stressed that it would be pointless to pass a law that only the national government supports, since it must be ratified subsequently by the provincial legislatures. In short, YPF needs to agree with the provinces in order to get the reform through.

Proposed reform

Notwithstanding the near-universal acceptance of the need to reform, it has not been agreed what form it should take in the final text of the bill to be submitted to the National Congress.⁽⁹⁾ Recent meetings with the governors of the provinces that are part of the Federal Organisation of Hydrocarbon-Producing Provinces (OFEPHI),⁽¹⁰⁾ have been unsuccessful. Discussions have also been held with the representatives of major oil and gas companies operating in Argentina to discuss the current situation and future challenges.⁽¹¹⁾ Representatives of Total, Exxon Mobil, Sinopec, Tecpetrol, Pluspetrol, Roch, Medanito, CGC, Wintershall, Petrobras, ENAP Sipetrol, Chevron, Entre Lomas, PAE, Wintershall Oil and Capsa Pampa, among others, have submitted their views. Although, no final bill has been submitted to Congress, the draft proposed by the current political party in government – *Frente para la Victoria* – is focused on the need to:

- promote funding for the exploitation of unconventional hydrocarbons;
- increase foreign investment for the exploitation of unconventional hydrocarbons;
- avoid the need to import unconventional hydrocarbons; and
- promote private partnerships that invest in the exploration and exploitation of unconventional hydrocarbons, and avoid the 'carry' practice.

Moreover, it has been stated that this new legislative framework will:

- complement the existing legislation and specifically regulate the exploitation of unconventional hydrocarbons;
- provide for a new bidding mechanism for the exploration and exploitation of hydrocarbons and association between private energy companies and public companies;
- create uniform taxation mechanisms regarding hydrocarbon exploitation activities at national, provincial and municipal levels;
- establish minimum standards for a regulated, foreseeable and uniform use of the selection mechanics of grantees. Oil companies may use part of the taxes payable, as amortisation of capital (thus, instead of paying gross receipt tax, value-added tax or other taxes, they can spend that money on investing in exploration and exploitation activities);

- establish common minimum requirements for the protection of the environment in all regions in view of sustainable exploitation; and
- establish new limits for exploitation and exploration terms.

The discussion has not yet ended. However, President Cristina Fernandez recently received Sapag and Chubut Governor Martin Buzzi in order to come up with an official bill and has introduced changes that would facilitate the approval of the hydrocarbon law in Congress.

Comment

This issue has been debated repeatedly over the last 50 years and needs to be resolved for the benefit of all parties concerned – the federal state, the provinces and potential and current investors in the sector.

The current impasse is likely to lead to immediate change. but whether this will be a silver bullet remains to be seen. Both the federal and provincial governments depend on the revenue derived from hydrocarbons and it is difficult to see either party conceding if this will reduce its current return. This is not to suggest that a solution is unworkable, but sacrifices will need to be made in order to kick start the sector.

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Endnotes

- (1) Hydrocarbons Law 17,319, as amended, published in the *Official Gazette* (June 30 1967).
- (2) Decree 310 (*Official Gazette* (February 14 2002)), Decree 809 (*Official Gazette* (May 13 2002)), Decree 645 (*Official Gazette* (May 26 2004)) and its amendments.
- (3) Decree 1722 (*Official Gazette* October 26 2011).
- (4) *La Nación* Newspaper: "El codiciado oro negro: revive la pelea por los petrodólares argentinos", August 17 2014.
- (5) *El Cronista* Newspaper: "El Gobierno estudia limitar el control de las provincias sobre el petróleo", April 29 2014.
- (6) *El Cronista* Newspaper: "El Galuccio cree que el control provincial del petróleo limita las inversiones", May 22 2014.
- (7) See endnote six.
- (8) *Infobae* Newspaper: "Cuatro provincias petroleras enfrentan al Gobierno por la nueva Ley de Hidrocarburos", August 2 2014.
- (9) *Clarín* Newspaper: "Provincias más divididas por la nueva ley de hidrocarburos", June 17 2014.
- (10) OFEPHI official website.
- (11) *El inversor energético y minero* Newspaper: "El gobierno analiza propuestas de OFEPHI", June 18 2014; and *El inversor energético y minero* Newspaper: "La contrapuesta de los gobernadores por la nueva Ley de Hidrocarburos", June 23 2014.

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