

Energy & Natural Resources - Argentina

New hydrocarbons law reforms existing regime

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Introduction

The Argentine federal legislature recently passed a new law overhauling the existing hydrocarbons regime to encourage renewed investment in the sector. The industry underwent substantial growth in the 1990s following the privatisation of Yacimientos Petrolíferos Fiscales (YPF) and Argentina was a net hydrocarbon exporter until 2011.

The new law is the culmination of extensive negotiations between the federal government, the oil-producing provinces, YPF and other key members of the private sector in Argentina. In addition to the compensated expropriation of YPF, the new law provides the framework that the federal government believes will once again turn Argentina into a net hydrocarbon exporter and an important player in the industry globally.

This update summarises the measures implemented and considers how the provisions compare to the system that was in place in the 1990s, which led to the industry's expansion in Argentina.

Background

Prior to the 1990s, the Argentine energy sector was run by state-owned companies. In 1989 Law 23,696 set out the principles of government-led industry reform, ordering the decentralisation and privatisation of state-owned companies that undertook commercial activities.

The federal government launched a series of measures to address decentralisation, including the following:

- YPF and Gas del Estado were privatised.⁽¹⁾
- Permits for exploration and concession agreements to exploit oil fields were granted to private and foreign companies.⁽²⁾
- Oil companies were considered the owners of production and could export it or sell it in the local market.⁽³⁾
- Hydrocarbons prices were not controlled.⁽⁴⁾
- Export taxes and restrictions were eliminated.⁽⁵⁾
- Oil producers had the right to dispose of 70% of foreign exchange earnings from exports.⁽⁶⁾

In 2001, following Argentina's economic crisis and the devaluation of its currency, the federal government made several changes to the regulatory framework in order to prevent the increase of prices and tariffs and ensure supply to the domestic market. Consequently, the original free market framework was replaced by a system of regulated prices.

Hydrocarbon production declined; exports were not only taxed, but increasingly restricted to the extent that exports were prohibited until domestic demand had been satisfied. In practical terms, the incentives not only to export, but also to explore and produce were significantly reduced by the late 2000s; there was a substantial downturn in production as a result.

Since 2011 Argentina has been dealing with its loss of energy self-sufficiency. Fuel imports have increased over the last decade and have had a negative impact on the country's trade balance. In order to address the energy crisis, the federal government launched certain initiatives to encourage investment in the sector.

- Promotional schemes were introduced to increase hydrocarbon production by setting higher prices than the regulated prices for new hydrocarbons produced. These new prices were subsidised by the federal government using public funds.

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- Tax incentives were introduced for imported machinery and equipment used in the energy sector.
- The price of fuel was gradually increased.
- State-owned companies and private companies were encouraged to explore or exploit hydrocarbon areas and to carry out new projects for power generation; exploration permits and exploitation concessions were granted to develop new hydrocarbon blocks or recover previously exploited blocks.

The new law goes beyond this and reflects the pressure that the provinces and federal government face over how hydrocarbons should be exploited.

New law in brief

After months of debate between the federal government, the provinces and the private sector, the Argentine Congress passed a new Hydrocarbons Law on October 29 2014 to regulate the exploitation of unconventional hydrocarbon reserves and establish the conditions needed to support and attract long-term investment in the hydrocarbon sector.

The new law defines the exploitation of unconventional hydrocarbons as:

"The extraction of liquid and/or gas hydrocarbons through unconventional stimulating techniques applied to deposits located in shale gas and shale oil geological formations, tight sands, tight gas, tight oil, coal bed methane, and/or characterised, in general, for the presence of low permeability rocks."⁽⁷⁾

Bidding process

One of the main changes to the bidding process is the move from the existing, varied systems of awarding licences to a competitive bidding process which is uniform across Argentina, irrespective of the national or provincial authority that is holding the bidding process. This means that the competent authority must evaluate the level of work commitment proposed by prospective concessionaires before granting the respective licences.⁽⁸⁾

Moreover, in order to create a uniform federal regulatory framework, the competent authorities of the federal and provincial governments will collectively draft a model bidding contract.⁽⁹⁾ Once the request for tenders is published, each provincial enforcement authority will draft the specific bidding contract, ensuring that it is published widely and seen by the widest possible audience.

The tender will be awarded to the bidder that submits the most suitable bid. The national or provincial authority, as appropriate, will evaluate the proposed investments and exploration activities, with the power to reject all bids or directly award the tender to a sole bidder if only one bidder has submitted an offer.

Exploration permits

The new law provides for different time periods for exploration permits, depending on whether the exploration is intended for conventional or unconventional hydrocarbons.⁽¹⁰⁾ In the former case, the new law contemplates a basic term of three years, renewable for a second period of three years.⁽¹¹⁾ Exploration permits for unconventional hydrocarbons are also divided into two periods, but the basic term is set at four years, with the possibility of renewing for an equal term.⁽¹²⁾ In both cases, the new regime also provides for an additional extension of up to five years, totalling a maximum of 11 years for conventional exploration and 13 for unconventional licences. For exploration on the continental shelf and in territorial waters, each basic period concerning conventional exploration may be increased by one year.⁽¹³⁾

Holders of exploration permits must pay a surface canon (a periodic payment). The new law specifies the rate that the holder will pay annually and an advance fee for each square kilometre depending on the stage of the concession to which it relates. However, the fee can be subject to change to compensate investment in the exploration area.⁽¹⁴⁾

Finally, the restriction which prevented companies from holding more than five exploration permits has been removed; and when an oilfield under concession is proven to be commercially viable, the permit holder has the exclusive right to extract the hydrocarbons found.

Exploitation concessions

The new Hydrocarbons Law introduces different exploitation periods depending on the extraction method used:

- 25 years for conventional deposits;
- 35 years for unconventional deposits (which the law terms an 'unconventional exploitation concession', the first five years of which may be allocated to a pilot project to determine the viability of the resources); and
- 30 years for offshore deposits.⁽¹⁵⁾

Moreover, the amendment establishes that concessionaires will have the right to request multiple extensions for periods of up to 10 years, irrespective of whether they had already obtained an extension before the new law was introduced. This means that the new regime on concessions renegotiated by the provinces will give holders a right to request more than one unlimited extension.

In this sense, the new law provides that concessionaires may request extensions if they have fulfilled

their obligations, but the application must be submitted no less than one year in advance of the concession's expiry (previously six months).(16)

If a province has initiated the process to extend an exploitation concession originally granted by the federal government before the new law came into force, the province must grant the concession within 90 days of the law's entry into force. In this case, parties granted an extension may apply for a further extension of 10 years.(17) Once this negotiation window closes, the new regime will come into full force, so it is expected that there will be significant activity in the coming months.

A concessionaire may require the sub-division of granted areas into new unconventional exploitation areas and consequently may request that a new concession period be granted. Additionally, unconventional exploitation concessionaires are authorised – based on an adjacent and pre-existing concession – to request the unification of both areas as a single unconventional exploitation concession, provided that the geological continuity of both areas is proven.

The new law also provides that transport concessions will be granted and extended under equivalent terms to those provided for concessions and will have the same deadlines. Upon termination of a concession, facilities will return to the domain of the national or provincial government, as appropriate, without any charge.(18)

Provincial companies

Apart from boosting activity and investment in the oil market through the standardisation of contracts and attracting foreign investors by creating a more competitive environment, one of the new law's aims is to end the so-called 'carry system'. One of YPF's main issues was to establish a uniform bidding process throughout the country and limit the role of intermediary companies created by provincial governments.(19) These companies are typically involved in at least 10% of each project's activities without providing any capital.(20)

Accordingly, under the new regime, neither the federal government nor the provinces can create reserve areas and award them to companies which they control. Instead they must participate in the bidding process that the new law outlines. Under the new law, any vacant area which, prior to its enactment, had been reserved for provincial companies will be tendered under participation agreements under which provincial companies may be 'carried' only during the exploration phase. Existing allocations to provincial companies will not be affected.

New promotional scheme and uniform taxation mechanisms

The new law also introduces a promotional scheme for investment in hydrocarbon exploitation and partially modifies the tax benefit scheme.(21) At a national level, concessionaires are subject to the payment of customs duties and taxes levied on goods imported into Argentina. However, under the new promotional scheme, companies that invest more than \$250 million over a three-year period will be allowed to sell their production on international markets without paying export taxes and with no restrictions on the repatriation of profits and the importation of capital goods.

These benefits will be claimable from the third year after the execution of the project and will apply in the following percentages:

- conventional exploitation – 20%;
- unconventional exploitation – 20%; and
- offshore drilling exploitation – 60%.(22)

Additionally, the new law creates uniform tax mechanisms for hydrocarbon exploitation activities at national, provincial and municipal levels. In this regard, the provinces have agreed:

- to receive royalties of up to 12%, although the law allows for 3% increases in royalty payments for concession extensions to a maximum of 18%; and
- not to impose new taxes or increase the rate of tax for new investments.(23)

Comment

The key development introduced through the new law is the move towards a uniform regulatory system across Argentina. This is a commendable achievement, considering that Argentina is a federal state in which the right and title to exploit natural resources rests with the provinces under the national Constitution. Nonetheless, given that many deposits run through multiple provinces, it was a sensible and necessary direction to take to promote the development of the industry in Argentina.

Many of the regulations that were in place throughout the successful period of growth in the 1990s have been reintroduced, whereas the protective measures introduced following the 2001 crisis are now being wound back. In the coming years it will become apparent whether the changes go far enough.

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Endnotes

(1) Law 23,696 and Decree 1055/1989.

- (2) Decree 1055/1989 and Decree 2411/1991.
- (3) Decree 1055/1989.
- (4) Decree 1212/1989.
- (5) Decree 1212/1989.
- (6) Decree 1589/1989.
- (7) Article 5 of the New Hydrocarbons Law.
- (8) Articles 11 and 13 of the New Hydrocarbons Law.
- (9) Article 47 of the New Hydrocarbons Law.
- (10) Article 1 of the New Hydrocarbons Law.
- (11) Article 23 of the New Hydrocarbons Law.
- (12) *Id.*
- (13) *Id.*
- (14) Article 14 of the New Hydrocarbons Law.
- (15) Article 9 of the New Hydrocarbons Law.
- (16) Article 35 of the New Hydrocarbons Law.
- (17) Article 31 of the New Hydrocarbons Law.
- (18) Article 10 of the New Hydrocarbons Law.
- (19) *El Cronista*: "[El Gobierno estudia limitar el control de las provincias sobre el petróleo](#)", April 29 2014.
- (20) *El Cronista*: "[El Galuccio cree que el control provincial del petróleo limita las inversiones](#)", May 22 2014.
- (21) Title 2 of the New Hydrocarbons Law.
- (22) Article 19 of the New Hydrocarbons Law.
- (23) Article 16 of the New Hydrocarbons Law.

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