

New government set to introduce changes to energy sector

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Challenges for new administration

In November 2015 Argentina held presidential elections in which centre-right candidate Mauricio Macri was elected president. Macri assumed the presidency on December 10 2015 after 12 years of Peronist (centre-left) governance under Nestor Kirchner and subsequently Cristina Fernandez de Kirchner, his wife.

Argentina is a net energy importer and the sector is subject to substantial subsidies. The new government will need to manage the energy deficit and reduce the impact of subsidies on the public budget. Macri was critical of the energy policies of the Kirchner administration and believes that the existing regulations are hindering Argentine economic development and must be amended.

Macri and his government hope to tackle these issues by:

- encouraging foreign investment;
- reopening the economy – particularly for imports;
- providing access to international financial markets;
- relaxing foreign currency controls (ie, allowing foreign companies to repatriate earnings);
- devaluing the peso to reflect its real value, thereby making exports more competitive; and
- removing regulations that limit foreign investment.

Macri is also likely to reduce government spending and cut export taxes.

Energy policy

During his campaign, Macri emphasised that energy would be a key factor in the government's agenda and that a long-term state policy would be required to address the country's energy crisis.

Together with other opposition candidates, **(1)** he signed a statement of commitment **(2)** addressed to the Fernandez de Kirchner administration that included the following guidelines for a long-term policy to revitalise the energy sector:

- Energy policies must be planned as strategic state policies.
- A strategic long-term energy plan must be outlined and ratified by Congress.
- Argentina's energy matrix must be diversified to foster nuclear and renewable energy and reduce the use of hydrocarbons.
- An act outlining a plan for the construction of nuclear power plants must be enacted.
- The development and use of biofuels must be fostered.
- Efficient energy use programmes must be promoted.
- The role of the national and provincial administrations must be redefined.
- Hydrocarbons legislation must be reformulated to reconcile the interests of Argentina and its provinces and to facilitate the exploitation of resources, including offshore reserves.
- Hydrocarbon exploration should be fostered, including the exploration of conventional and unconventional fields, through international public tender processes.
- Regional gas and electricity markets should be fostered to take advantage of complementary energy resources and existing international electricity and gas connections.
- The government should encourage the management of YPF (Argentina's largest oil and gas company) to prioritise the exploration and development of Argentine fields. YPF will maintain its national and international market capitalisation and be allowed to enter into strategic agreements with national and international companies.
- Fair and reasonable customer tariffs should be set for generation, transport and distribution costs. Subsidies should be reduced and a social tariff introduced.
- Sustainable energy should be developed in line with international standards.
- The following emergency measures should be adopted:
 - An independent audit of hydrocarbon reserves should be conducted by a specialised company selected through an international tender process;
 - A normalisation plan should be implemented to resolve the supply problems that affect Buenos Aires; and
 - The existing system for energy imports should be revised, particularly as regards natural gas such as liquefied natural gas.

The statement of commitment was signed to develop a long-term policy which would become the cornerstone of the energy sector's future development.

New Energy and Mining Ministry

Macri's emphasis on market-friendly reforms is evident through his cabinet choices. He appointed Juan José Aranguren, the former chief executive officer of Shell Argentina, as energy and mining minister.

Aranguren has long been an outspoken critic of the interventionist energy policies of the Kirchner administration and has already announced that his administration will focus on a four-year energy plan to change the sector's rules, standardise the regulatory framework and guarantee legal certainty to regain the confidence of investors.

Hitherto, mining and energy matters (including hydrocarbons and electricity) have been managed by separate secretariats. The creation of a new ministry highlights the increased importance that the incoming government has placed on the energy sector.

The new Energy and Mining Ministry is divided into four secretariats: energy planning, hydrocarbons, electricity and mining. An Undersecretariat of Tariff Policies will also be created, which will report directly to the minister.

Owing to the direction taken by past administrations, the electricity sector's main characteristics include:

- increasing demand;
- frozen prices and tariffs;
- significant subsidies; and
- an energy matrix that is highly dependent on hydrocarbons.

At present, 98% of local power demand is satisfied through local generation (which requires fuel imports); the remaining 2% is provided by imports.

Aranguren's four-year plan aims to change the sector's existing rules.

Updating prices and tariffs and redefining role of subsidies

Between 2001 and 2015, power tariffs were reduced by 73% in real terms according to the consumer price index, due to a lack of tariff adjustment and inflation. Residential consumers pay 30% of their power bills. The remaining costs are covered by public funds.

In March 2016 Aranguren will introduce a plan to suspend the government's utility bill subsidy system, which contributes to the budget deficit. A gradual but sustained increase in gas and electricity prices is planned for almost all sectors – not only to cover the economic cost of supply, but also to establish a well-defined tariff for people below the poverty line.

The tariff increases also aim to remedy the disparities between electricity rates among different regions (eg, Buenos Aires residents pay seven times less for power than residents of Rio Negro, La Pampa and Cordoba).

(3)

Increase of power offer and diversification of energy matrix

In the last 10 years, electricity consumption in Argentina has grown annually by 4% on average. Investment in the generation sector is required to meet this rising demand. Between 2003 and 2014 11,590 megawatts (MW) were incorporated into the power sector, of which 70% were from thermal plants near points of peak demand, causing an increase in fuel demand that must be satisfied by imported fuels due to the decline in local production. The federal government pays the import costs; only a small percentage of these costs are transferred to residential users.

The new administration has announced that renewable energy will be included in the energy matrix to reduce dependence on hydrocarbons. Argentina recently issued Law 27,191, which modifies the previous national scheme for the use of renewable energy sources for electricity production. The new law has introduced incentives to attract private investment, diversify the energy matrix and produce 8% of electricity from renewable sources by 2017. The new administration will oversee the issuance of complementary legislation for new investment schemes.

Nuclear energy will also play a key role in the diversification of the energy matrix. The new administration is expected to continue supporting the Argentine Nuclear Plan. Argentina has three nuclear reactors (managed by state-owned company Nucleoeléctrica Argentina SA), which supplied 4.4% of electricity consumed in 2014. The planning and implementation of nuclear energy projects are handled by the National Atomic Energy Commission. The major projects to develop nuclear energy in Argentina include the following:

- The Embalse nuclear plant's operational life will be extended for another 25 years and its generation capacity will be increased by 7%.
- A prototype CAREM25 medium-power nuclear reactor(4) – a small, locally designed power reactor prototype with a 25 MW capacity – will be built. This will be the first nuclear power station entirely designed and built in Argentina and it promises to deliver improved electricity supply for remote parts of large urban centres and manufacturing centres with high energy consumption.
- A fourth nuclear plant will be built. Argentina and China have signed a cooperation agreement to build a new nuclear plant that features a light water reactor and enriched uranium. Argentina will be the architect-engineer of the project. The agreement requires that the parties use the maximum amount of local materials and services. This will be achieved through the transfer of technology to Argentine companies, including manufacturing components and fuel fabrication. The agreement also guarantees the supply of enriched uranium and fuel assemblies throughout the life of the plant. The estimated cost of the reactor is \$7 billion. The parties are also considering establishing a joint strategic partnership to develop and build nuclear reactors in Latin America which would see Argentina become a technology platform, supplying countries with nuclear technology that incorporates Chinese goods and services.

Investment is also needed to expand the existing power grid and to renew and extend the distribution infrastructure to guarantee supply on the warmest days of the year.

Hydrocarbons

Argentina is home to the second-largest shale gas reserves and the fourth-largest shale oil reserves in the world. Since 2012, when 51% of YPF (owned by Repsol) was expropriated, the exploitation of shale gas and oil deposits in Vaca Muerta in Patagonia has accelerated.

In the last four years Vaca Muerta has received \$15 billion in foreign investment and the new administration will be seen to continue attracting investors.(5) Aranguren faces the challenge of increasing oil and natural gas production by stimulating foreign investment at a time of low international crude oil prices.

The minister is publicly committed to improving investor confidence and fostering an increase in domestic production through a more unified and stable regulatory system for conventional and unconventional resources (including shale, offshore deposits and tight oil and gas) to guarantee legal certainty.

A key factor to date for attracting investment in hydrocarbon production has been domestic oil prices. In Argentina oil and gas production is essentially subsidised by the higher fuel prices paid by consumers. Although the price of oil has dropped below \$39 a barrel in the United States, up to December 31 2015 Argentina paid \$77 a barrel to support domestic production. Macri's administration has decided to continue this policy during 2016. On January 5 2016 Aranguren announced a reference price of \$67.50 per barrel for Medanito crude oil (a blend produced in Neuquén Province) and \$54.90 for Escalante crude oil (a blend produced in Chubut Province). The government expects to maintain the domestic prices in force during 2016 as long as there are no great changes to the price of Brent crude oil. Meanwhile, oil companies have agreed to maintain an appropriate level of investment comparable to recent years.

Comment

Macri is expected to send a package of economic reforms to Congress to create a more favourable climate for international engagement and foreign investment. The selection of former UN diplomat Susana Malcorra as foreign minister reflects Macri's focus on increased international engagement, including with the United States.

The new administration's policies are focused on a mutual commitment with other countries to foster cooperation and business opportunities. Macri's support for a quick resolution of international arbitration claims and the conflict with hold-out bond holders dating back to Argentina's economic default in 2001-2002, which was renegotiated, should also help to improve bilateral ties with other countries and encourage investment.

Investment is required in the energy sector for the development of hydrocarbon projects and the execution of power generation projects to meet rising demand and diversify the energy matrix. Macri's approach aims to boost private investment in Argentine energy, transportation, infrastructure and technology.

Argentina's potential return to the international banking and debt markets should further expand the country's options for capital.

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Endnotes

(1) Sergio Massa, Hermes Binner, Margarita Stolbizer, Julio Cobos and Ernesto Sanz.

(2) The statement of commitment was drafted in 2014 by a group of eight former energy secretaries who had been in office between 1986 and 2003. They produced and published documents detailing the structural problems of the Argentine energy sector and suggested guidelines that should be considered when drafting a long-term state policy to be agreed between the different sectors of Argentine society.

(3) "Aranguren says handing out energy subsidies is a 'crime'", *Buenos Aires Herald*, November 28 2015.

(4) The development of the Carem project was announced through Executive Order 1107/2006.

(5) See www.cronista.com/economiapolitica/Vaca-Muerta-atrajo-us-15.000-millones-en-los-ultimos-cuatro-anos-20151209-0067.html.

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