

A PROTECTED BAY FOR ENERGY INVESTORS



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Whereas some countries have been unwelcoming to private investors in the energy sector, Argentina has passed legislation this year which should make it very attractive to new investors. Arif Hyder Ali, partner and co-chair of the international dispute resolution practice of Crowell & Moring LLP, and Tomas Chevallier-Boutell, associate at Fortunati & Asociados, report

The beginning of the 21st century has found oil companies caught up in the middle of a frantic race to increase production, pushed by thirsty markets and an unprecedented rise in international oil prices. However, political turmoil continues to shake various oil exporting countries, while nationalisation fever is sweeping Latin America. Though not completely free from this fever, Argentina appears to have defied the tide of instability that is flooding the region, offering oil companies a break from governmental harassment.

Indeed, recent amendments to Argentina's hydrocarbons law assign control of the country's hydrocarbon reservoirs to the provinces, thus encouraging Argentina's provincial states to continue on the path of promoting exploration and production that they had already begun with determination and success in 2006.

Argentina's legal framework

Unlike other countries in Latin America, Argentina adopted a legal framework under which, even though hydrocarbons belong to the state, concessions to explore and produce hydrocarbons may be granted to private parties. When extracted, concessionaires have full ownership of the hydrocarbons. In exchange for these rights, concessionaires are required to pay the provincial states a royalty that is calculated on the basis of the hydrocarbon production.

Accordingly, under Argentina's legal framework, partnership with state-owned companies is not always mandatory. Hence, in certain provinces investors may avoid the friction and conflict arising from commercial partnerships with the state.

Since Argentina is a federal republic with 23 provinces and an autonomous district, mining rights can belong to the federal state or to the provincial states. Argentina's current

hydrocarbons law, which was passed in 1967, establishes that the liquid and gaseous hydrocarbon reserves located within the Argentine Republic and its continental shelf belong to the federal state.

Before 1989, the federal state held a tight grip over the upstream and downstream sectors. At the same time, it was empowered by the hydrocarbons law to grant and revoke concessions to private or public companies and controlled YPF, which was

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a state-owned company until 1993. YPF held all hydrocarbons exploration permits and exploitation concessions, while private oil companies operated in the country as contractors of YPF. Therefore, the federal state not only controlled production but also set the price for crude and monopolised refining.

But towards the end of 1989, the winds of economic change began to blow across Argentina. The oil and gas sector was

squarely at the centre of the new economic reforms that would soon be implemented in the country. Encompassing a general liberalisation of the economy, the federal government of Argentina embarked on a deregulation and decentralisation process of the oil and gas industry. Of course, these processes could not coexist with the omnipresence of the federal state in the sector. Central to the new strategy of liberalisation, therefore, was the dismantling of YPF's monopoly and the decentralisation of the federal state's regulatory and policy-making control.

In 1989, a number of decrees were passed which provided for the deregulation of oil and gas prices and required YPF to sell majority interests in the production rights for major producing areas, as well as to sell and assign certain other production and exploration rights.

The fading of YPF's monopoly and the liberalisation of wellhead prices brought private investment squarely into the picture. Private oil companies were granted exploration permits and exploitation concessions and started playing a key role in the transformation of Argentina's energy market. Since then, Argentina has experienced an exceptional increase in production, so much so that in addition to exporting oil and gas, it is able to meet domestic demand largely through its own production.

Even though the first steps were taken with the deregulation decrees, this was only the beginning. In 1992, the Federal Congress enacted a law which provided for both YPF's privatisation and the assignment of all mining rights over hydrocarbons from the federal state to the provinces in which the hydrocarbon reservoirs are located. However, this law established that the effective assignment of the ownership of the mining rights to the provinces should be subject to

the enactment of a law passed by the Federal Congress in which the assignment would be regulated (called the transference law). Mining rights of the provinces were further endorsed by the 1994 National Constitution amendment granting constitutional status to the rights of the provinces over the hydrocarbon reservoirs.

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The long-awaited transference law was finally published on 5 January 2007. Acknowledging the constitutional rights of the provinces over their natural resources, the law amended article 1 of the hydrocarbons law and established that, depending on where the liquid and gaseous hydrocarbon reserves are located, they shall belong either to the federal state or to the provincial states. In the event that a particular province had a coastline, they were also granted regulatory rights over reservoirs located in the continental shelf, up to 12 nautical miles measured from the province's coastline. Ownership rights over reservoirs situated in the continental shelf beyond the 12 nautical miles limit were reserved exclusively to the federal state and subsequently transferred to Energía Argentina Sociedad Anónima (ENARSA), the newly created state-owned energy company.

Furthermore, the transference law did away with what was left of the federal state's power over the management of concessions, establishing that as of January 2007, the provinces would be responsible for the management of all the exploration permits and exploitation concessions associated with the assigned hydrocarbons reservoirs. Likewise, any type of exploration or exploitation agreements granted or approved by the federal

state were transferred to the provincial states. However, applicable laws set forth that this assignment would not affect the rights granted to anyone who holds a concession prior to the enactment of such regulations.

The enactment of this law represents the end of the decentralisation process that started with the federal state being the sole owner of natural resources and controlling the upstream and downstream sectors through a state-owned company. Today, centralisation and regulation are just a shade of what they once were in the 1980s. YPF has been completely privatised, the upstream and downstream sectors have been partially deregulated and mining rights have been fully assigned to the provincial states.

How this will affect investment

The assignment of concession rights to the provinces raises important questions. For example, will this delegation of authority spawn a multiplicity of local legal frameworks? Will Argentina's strategy of decentralisation, in fact, promote private investment?

In connection with the first question, it is not possible to ignore the fact that jurisdictional disputes among the provincial states and the federal state regarding the application of federal and local regulations may well be inevitable. However, the assignment of mining rights should not result in a labyrinth of local and national regulations. In fact, although some provinces did pass certain regulations concerning hydrocarbons and natural resources, the transference law indicates that the hydrocarbons law shall remain in force in the country as a whole. Furthermore, according to the Constitution, the federal state through Congress is responsible for "the enactment of [...] the Mining Code [...] seeing that such code[s] do nothing to alter local jurisdictions". Thus, even with the provinces being granted limited powers to legislate in hydrocarbon matters, they must exercise their property rights over the natural resources located in their territories in accordance with the regulations set forth by the federal state.

Regarding the impact on private investment, the facts speak for themselves. There is no doubt that decentralisation has created an incentive for provincial states to encourage investment and they have consequently engaged in an aggressive policy towards the promotion of hydrocarbons exploration and production within their territories.

In fact, in 2006 when the provinces were only entitled to grant concessions over certain areas of high geological risk, the governments of several provinces tendered for bids and granted exclusive rights for the exploration and exploitation of hydrocarbons

in areas under their jurisdiction. As the 2006 bidding process has been highly successful in certain provinces, more requests for proposals are expected to be announced, including the bid to grant concessions over the central areas once the existing concessions end.

Moreover, in November 2006, the Federal Congress enacted a law that established the guidelines for a promotional system with tax benefits aimed to encourage exploration and production. Provinces have the option to adhere to this system and, given the commitment to increase exploration and production displayed by the provinces so far, they will most probably warmly embrace this promotional regime.

Opportunities offered by Argentina's provinces constitute an interesting prospect for medium- and small-sized producers willing to pioneer in basins almost unexplored or to operate mature fields which offer significant potential for secondary recuperation operations. Moreover, energy demand in Argentina is following the broader economic trend,

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which registered a growth of 8.6 per cent in 2006. If the country is able to sustain this growth in the coming years, energy investment will not only be promoted but will be desperately needed.

With comparatively low political risk, a relatively stable legal framework, unexplored fields and the growing demand for energy from a heated economy, Argentina will most likely become an attractive target for energy investment. Given the current international scenario, where most oil exporting countries seem to be endlessly stationed on the edge of a political storm, Argentina displays many of the characteristics of a protected bay.