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FEATURED Q&A

Was Mexico's First-Ever Deep-Water Tender a Success?



Mexico held its first-ever deep-water oil auction since ending the monopoly held by state oil company Pemex, which is headed by José Antonio González Anaya. The tender attracted interest from major international oil firms. // File Photo: Pemex.

Q Mexico on Dec. 5 held its first-ever deep-water oil auction, attracting bids from foreign oil companies. Was the auction successful? What is the outlook for Mexico's oil sector as the country opens its deep-water reserves to international oil companies? What challenges will Mexico's oil sector face as these new projects move ahead? What lessons can be learned from Mexico's deep-water tender?

A Eduardo Canales, associate, and Steven P. Otilar, partner, for Global Energy Transactions at Akin Gump Strauss Hauer & Feld: "Ever since Mexico's energy reform was enacted in December 2013, the first deep-water oil tender was marked on everyone's calendar, because it would serve as a true gauge of Mexico's integration into the international energy stage. Round 1.4 only became more relevant in recent months as (i) Mexico's oil reserves and production rates continue to decline, (ii) the energy industry experienced uncertainty caused by oversupply and price volatility and (iii) oil companies had to reconfigure their value-creation strategies to weather the down cycle. Despite industry trepidations and an unclear market outlook, international oil companies as well as national oil companies with international portfolios converged in Mexico to beat even the most positive forecasts. Ultimately, eight out of 10 deep-water licenses were awarded to prominent companies like ExxonMobil, Pemex and Chevron, which are expected to have an associated investment effect of almost \$35 billion over the next 35 years. In addition to Round 1.4, the first 'farm-out' contract was awarded to BHP Billiton, who will partner with Pemex to explore and develop the Trion

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TOP NEWS

OIL & GAS

Colombian Peso Rises Amid Higher Oil Prices

The Colombian peso's value increased to 3,000 to the dollar from 3,200 to the dollar in late November following an announcement from OPEC and non-OPEC countries that they would cut oil production.

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OIL & GAS

Mexico Among Non-OPEC States to Agree to Oil Cut

Mexico is prepared to cut its oil production by 155,000 barrels per day in coordination with a wider effort among OPEC and non-OPEC member states to limit output and drive up global oil prices, according to Venezuelan Oil Minister Eulogio Del Pino.

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POWER SECTOR

Trump Taps Perry as Energy Secretary

During a previous bid for the presidency, Perry had said in 2011 that he planned to eliminate the Department of Energy.

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Perry // File Photo: State of Texas.

OIL & GAS SECTOR NEWS

Mexico Among Non-OPEC Countries to Agree to Oil Cut

Mexico is prepared to cut its oil production by 155,000 barrels per day in coordination with a wider effort among OPEC and non-OPEC member states to limit output and drive up global oil prices, according to Venezuelan Oil Minister Eulogio Del Pino, Russian state news



Del Pino // File Photo: Venezuelan Government.

agency TASS reported Saturday. "Yes, Mexico will reduce production by 150,000," Del Pino said, responding to a question from journalists. The comment was ahead of a meeting of OPEC and non-OPEC member states last weekend during which the non-member countries present agreed to cut output by 558,000 bpd for six months starting Jan. 1, CBC News reported Saturday. The agreed-upon figure was less than the 600,000 bpd OPEC member states had hoped for. Saudi oil minister Khalid Al-Falih called the deal "historic" and said it "is meant to accelerate the natural process of rebalancing" the international oil market.

Colombian Peso Rises Amid Higher Oil Prices

The Colombian peso's value increased to 3,000 to the dollar from 3,200 to the dollar in late November following an announcement from OPEC and non-OPEC countries that they

would cut oil production in a bid to drive up oil prices, Finance Colombia reported Tuesday. The announcement bumped oil prices to an 18-month high. The Colombian peso's value

The value increased to 3,000 Colombian pesos to the U.S. dollar.

has historically been tied to strong oil prices, which was especially evident when the value of both plummeted in 2014. The coordinated agreement between OPEC and prominent non-OPEC countries to limit output is the first of its kind since 2001, and it resulted in a spike in Brent crude to a high of \$56.36 per barrel. The peso's value also increased following a drop in the value of the dollar ahead of this week's U.S. Federal Reserve meeting. In related news, Fitch Ratings affirmed Ecopetrol's long-term foreign and local currency issuer default ratings, or IDR, at BBB with a negative outlook. It also affirmed the company's national long and short-term at AAA with a stable outlook for the national long-term rating. Ecopetrol's ratings are closely linked to Colombia's foreign and local currency IDRs, which are rated as BBB with a negative outlook, due to the fact that it owns 88.5 percent of Ecopetrol.

POWER SECTOR NEWS

Canadian Solar Starts Manufacturing at Brazil Factory

Canadian Solar has started manufacturing solar modules at a factory in Sorocaba in Brazil, Re News reported Monday. The facility has the capacity to produce 380 megawatts of solar power a year. The factory will supply Canadian Solar's projects in Brazil, three of which are currently under development. The three projects are the 191 MW Pirapora I project, which is expected to come online in the third quarter of

NEWS BRIEFS

Brazilian Wind Power Output Increases by More than 50 Percent

Brazil's wind power output increased by 52.7 percent during the first 10 months of this year as compared to the same period last year, reaching 3,577 average megawatts (MWa), according to the Brazilian Power Trading Chamber, See News reported Wednesday. Hydropower output also increased over the same period, recording 45,535 MWa, up 7 percent from a year earlier.

Oil Producing Nations' Heads of State to Meet Next Year: Maduro

Venezuelan President Nicolás Maduro said Dec. 8 that he had reached an agreement with Iran to call on heads of OPEC and non-OPEC member states to meet for a summit in the first quarter of next year where they will decide on a strategy for the oil market, Reuters reported. Maduro did not provide further details on the matter. Oil is Venezuela's only major source of foreign revenue, and the country has for years been pushing for measures to increase the price of oil.

Brazil's Average Domestic Oil Output Increased by 2% in November

Brazil's average domestic oil output rose 2 percent in November from the month before, according to a Petrobras securities filing, Reuters reported Thursday. The announcement highlights the state-owned oil company's efforts to increase exploration and production operations in some offshore fields. Petrobras said average oil production in Brazil was approximately 2.23 million barrels of oil equivalent a day in November. The company's total production, including Brazil-based and overseas operations, totaled 2.86 million boed last month.

next year, and the 109 MW Pirapora II and the 90 MW Vazante facilities, which are to come online in 2018.

Trump Picks Former Texas Governor for Secretary of Energy

U.S. President-elect Donald Trump on Tuesday announced that he plans to name former Texas Governor Rick Perry as secretary of energy, *The New York Times* reported. During a previous bid for the presidency, Perry said in 2011 that he planned to eliminate the Department of Energy. While serving as governor of Texas, a state rich in energy resources, Perry was a strong advocate for the extraction of the vast supply of fossil fuels within the state's boundaries. The Department of Energy is largely a national security agency and plays a leading role in designing nuclear weapons and ensuring the safety of the nation's nuclear arsenal. Approximately 60 percent of the Energy Department's budget is allocated to managing the National Nuclear Security Administration. When he was running for president during the most recent presidential election campaign cycle, Perry in 2015 called Trump a "barking carnival act" and a "cancer on conservatism." However, after dropping out from the election later that year, Perry enthusiastically campaigned for Trump in the months leading up to the election in November.

POLITICAL NEWS

Talks Break Down Between Venezuelan Gov't, Opposition

Talks between Venezuela's government and the opposition broke down Wednesday as each side moved to appoint its own members to the country's election board, *Reuters* reported. The two sides agreed to Vatican-mediated talks in October, but opposition members walked out of

the talks last week saying the government was violating its agreement to hold negotiations on new members of the country's five-person electoral board. The board this year has rejected the opposition's attempts to hold a vote to recall President Nicolás Maduro and the opposition has seen the board as loyal to Maduro. On Tuesday, the opposition-controlled National

Assembly moved ahead with a symbolic trial against Maduro, accusing him of human rights abuses in Venezuela and of being responsible for the country's economic problems. The Supreme Court, which frequently backs Maduro, then declared the National Assembly in contempt of the law and renewed the terms of two outgoing members of the electoral

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deep-water field, one of Pemex's most promising assets. Dec. 5 was a boon for Mexico: on one hand, the Mexican energy industry will benefit from the competition, innovation, diversification, employment, talent development and capital infusion required for these highly complex offshore projects, while on the other hand, the energy industry broke recent market trends and acquired long-term assets expected to have a concrete impact on their reserve-replacement ratios. Looking

“It is critical for Mexico to use this success as a stepping stone to address key challenges.”

— Eduardo Canales and Steven P. Otilar

ahead, it is critical for Mexico to use this success as a stepping stone to address key challenges that could fundamentally jeopardize the evolution of its energy industry and its conclusive integration into the international energy stage. Now that Mexico seems to have developed a good rapport with the energy industry based on the transparency, impartiality, receptivity and responsiveness that characterized every Round 1 auction, the focus will need to turn more granular—focusing on the other governmental agencies and industry regulations and standards—to further incentivize investment and facilitate the sustainable development of natural resources, while balancing the need for health, safety and environmental protection.”

A **Jeremy M. Martin, member of the Energy Advisor board and vice president for energy and sustainability at the Institute of the Americas:** “Mexico's deep-water auction was a soaring success. Eight of the 10 blocks on auction and the farm-out and partnership with Pemex were awarded, exceeding both the government's expectations and the estimates of many across the industry. Indeed, the key outcome from the auction was the boost it gave to the government as the nation's monumental energy reform process surges forward. The deep-water auction had long been said to be the key to attracting the globe's largest upstream oil and gas firms, and it delivered on that score with the likes of BP, ExxonMobil, Chevron, Total, Statoil, CNOOC and Petronas all emerging as winners. Moreover, with the eyes of the energy world focused on Mexico City, the government again conducted a transparent auction and one that counted a highly rigorous qualification and adjudication process. Despite oil price headwinds and capital constraints, Mexico proved that large projects can still be successfully tendered when resource materiality and fiscal terms line up. The Trion farm-out highlighted that Mexico's national oil company, though struggling financially and operationally, remains relevant as the new industry dynamics unfold. But beyond the importance of the level of blocks tendered and relative competition, there was some debate over the formula used to compute winning bids, that is, the calculation of additional royalties and biddable wells per block. Arguably, the formula undervalued additional work and wells vis-à-vis

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board. "The Supreme Court cannot substitute the Assembly's responsibility," said opposition lawmaker Juan Pablo Guanipa. Legislators from Maduro's party walked out of a National Assembly session on Tuesday and filed formal complaints with the Supreme Court against



Maduro // File Photo: Venezolana de Televisión.

opposition lawmakers. The political crisis is happening at the same time as a currency crisis in Venezuela. On Wednesday, Venezuelans thronged banks to deposit 100 bolívar banknotes, which are the largest in circulation and worth about three U.S. cents on the black market. Maduro outlawed the bills on Sunday in what he said was an effort to fight currency hoarding. However, new larger-denomination bills had not arrived at three of the country's largest banks as of Wednesday morning.

Temer Advisor Quits Following Corruption Accusation

An advisor to Brazilian President Michel Temer resigned on Wednesday after being accused of accepting illegal payments from construction company Odebrecht, The Wall Street Journal reported. The advisor, José Yunes, had been a "special advisor" to Temer and is among several people that a former Odebrecht employee named in a plea bargain, according to local media reports. A portion of an illicit payment of 10 million reais (\$3 million) to Temer's Brazilian Democratic Movement Party was reportedly delivered to the office of Yunes, who is an attorney. Yunes has denied wrongdoing, and in his resignation letter rejected the reports as "ignominious." Temer's office declined to comment on the matter. Last week, Temer himself was reported to have been accused of graft by

THE DIALOGUE CONTINUES

Is OPEC Helping Latin American Oil Exporters?

Q The Organization of the Petroleum Exporting Countries, or OPEC, on Nov. 30 agreed to its first oil output cut since 2008, causing oil prices to soar. Venezuelan Oil Minister Eulogio Del Pino had for months been lobbying OPEC countries to decrease oil output, as the South American country struggles to keep its economy afloat amid years of low oil prices. What does the agreement mean for Latin American oil-exporting countries? Will the production cut lead to a sustained increase in oil prices and more investment in Latin America's oil and gas sectors? Will the agreement save Venezuelan President Nicolás Maduro's government, which has been facing fierce opposition and calls for the president to step down amid a crippling economic crisis, high inflation and shortages of basic goods?

A Santiago Mosquera, professor at USFQ Business School: "OPEC's first output cut in eight years is positive for Ecuador due to the spike it caused in oil prices, while the mandatory cut in total production would have only limited impact as output is, nevertheless, falling again after posting few months of recovery. Arrears with private oil suppliers and limited liquidity at EP Petroamazonas, the state-owned company

responsible for oil upstream, are the key reasons behind the reduction in crude output. On the upside, and to partially compensate for the reduction in oil mature fields, recent developments in the Block 43 operation are adding more than 20,000 bpd to total output. The government expects total output from this block to reach almost 50,000 bpd in the coming months and 300,000 bpd at its peak in six years. According to an official revision, existing reserves at Block 43 reached 1.67 billion barrels, 41 percent of Ecuador's crude reserves. Higher oil prices do not automatically translate into higher revenues for the treasury. For instance, higher oil prices would help the government to partially reduce debts with private companies operating under the oversight of the hydrocarbons secretary, which have been accumulating debts when crude prices did not cover the tariff in oil service contracts after some deductions (i.e. 25 percent sovereignty margin and specific taxes). Higher oil revenues could also help to cut arrears with Petroamazonas' private suppliers under the assumption that the government considers this as a priority to rescue a suffocated industry."

EDITOR'S NOTE: More commentary on this topic appeared in the Dec. 9 issue of the Latin America Energy Advisor.

a former Odebrecht executive who cited the president 44 times in his testimony about the massive corruption case involving state-run oil company Petrobras. The former Odebrecht director, Claudio Melo Filho, told prosecutors that Temer requested money for his party's political campaigns directly from then-CEO Marcelo Odebrecht in 2014. Temer has dismissed the claims as "false accusations." In another

development in the Petrobras case, Brazilian chemical company Braskem said Wednesday that it had agreed to pay \$957 million in fines and damages as part of a deal with prosecutors investigating the scandal at the state oil company, The Wall Street Journal reported. Petrobras and Odebrecht control Braskem and own 97.1 percent of its voting capital, along with 74.4 percent of its total capital. Braskem

NEWS BRIEFS

Mexican Senate Approves Medical Marijuana Bill

Mexico's Senate on Tuesday approved a bill allowing the use of medical marijuana, Reuters reported. The bill, which was part of a proposal that President Enrique Peña Nieto submitted to Congress earlier this year, must be passed by the lower house of Congress in order to become law. The move would be a step toward legalization for a country that has long suffered from the violence of drug cartels.

Fitch Expects Stability for Central American, Dominican Banks

A new Fitch Ratings report said the Central American and Dominican bank rating outlook for 2017 is stable, reflecting some small changes in growth and financial performance. "In 2017, bank profitability will be stable, although the level will vary between countries. Nicaraguan and Dominican banks will maintain good profitability ratios, while Panamanian, Salvadoran and Guatemalan banks will lag peers," said the director of Fitch's Financial Institutions Group, Ronaldo Martínez. Fitch said loan growth rates in the region next year will be similar to those of this year, though downside risk exists for some countries.

Trump Selects Tillerson as Secretary of State

U.S. President-elect Donald Trump announced Tuesday that he had selected ExxonMobil CEO Rex Tillerson as his secretary of state, the Associated Press reported. Trump said Tillerson was "among the most accomplished business leaders and international deal makers in the world." Tillerson is known for having close ties to Russian President Vladimir Putin and was awarded the Russian Order of Friendship in 2013. The Senate Foreign Relations Committee will hear confirmation hearings for Tillerson in January.

declined on Wednesday to provide any details about any criminal acts it may have committed. Dozens of executives and politicians have been implicated in the Petrobras case, with some being sentenced to long jail terms.

ECONOMIC NEWS

Brazilian Senate Approves Temer's Austerity Measures

Brazil's Senate on Tuesday approved a controversial austerity measure that puts a spending cap on public spending at the level of inflation for the next 20 years, The Guardian reported. The decision came despite widespread public



Temer // File Photo: Brazilian Government.

demonstrations, including a violent protest in Brasília, against the measure. President Michel Temer is expected to sign the measure into law on Thursday. The passage of the legislation has been viewed as integral to Temer's wider austerity plan, through which he hopes to curb public spending to help pull Brazil out of its worst recession in decades. "Today was a show of force that Temer still has a majority in Congress to approve these reforms," said João Augusto de Castro Neves, Latin America director at the Eurasia Group. "From a more market perspective it's also a victory because it's a first step towards a more sound fiscal framework." Despite the fact that the legislation will instill confidence for the markets, the United Nations has called the bill the most socially regressive austerity package in the world, and critics in Brazil say it will do the most damage to the country's education and health systems.

Colombian Court Grants Santos Fast-Track for Peace Deal

Colombia's Constitutional Court on Tuesday granted President Juan Manuel Santos "fast-track" authority in order to quickly implement reforms mandated by the government's peace accord with the Revolutionary Armed Forces of Colombia, or FARC, rebels, the Associated Press reported. Under the 8-1 court decision, Colombia's Congress can begin passing legislation to implement the accords, some of which requires constitutional changes. Among the top legislative priorities is an amnesty bill for jailed rebels. The amnesty measure would shield rebels who have not been involved in war crimes or human rights violations from prosecution, Reuters reported. The fast-track authority will mean a quicker approval process, including fewer debates, and will protect the bilateral cease-fire, Santos' government has said. Colombia's Congress gave final approval to the government's renegotiated accord with the FARC on Nov. 30.

E.U., Cuba Sign Deal to Strengthen Ties

The European Union and the Cuban government on Monday signed a historic accord to increase trade, travel and diplomatic ties between the 28-country bloc and the Caribbean country, USA Today reported. In order to create the new deal with Cuba, the European Union had to retract its policy of demanding that Cuba improve its human rights record and change its one-party system before the two change their relationship. The European Union's previous position on Cuba was established under the 1996 "Common Position," which said that "full cooperation with Cuba will depend upon improvements in human rights and political freedom." The European Union will continue to urge Cuba to make these changes under the new deal, but will no longer require that the changes occur before expanding ties.

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additional royalties. This could prove to be a critical lesson and an issue to draw upon in advance of future bidding, but particularly in large-scale deep-water projects. Lastly, translating the investment commitments to exploration, employment, and particularly new production, will require time.”

A **Arturo Sarukhan, board member of the Inter-American Dialogue and former Mexican ambassador to the United States:**

“The auction of 10 deep-water blocks is the most significant step yet in Mexico’s effort to reclaim its spot as a global crude-producing powerhouse, and without sufficient liquidity and investment, Pemex would have continued to shrink. Unsurprisingly, the high-fives in Mexico City are proof that the auction played out competitively and drew big results. These were widely viewed as a validation of the Mexican government’s efforts to revitalize Mexico’s oil and gas industry, and of the tack and efforts taken in previous months and rounds to inject flexibility and pragmatism to the bidding rules. The capital investment commitments for all 10 blocks amount to approximately \$4 billion, with most of it going into exploration wells. More than three-fourths of prospective oil resources are located offshore in deep waters of the Gulf of Mexico, which is why—by the way—the landmark 2011 negotiation between the previous Mexican government and the United States for the joint exploitation of trans-boundary reservoirs in the so-called Western Gap in the Gulf is a key piece of the puzzle. Nonetheless, the real metrics and analysis to determine success are effectively further down the road. Beyond the inherent challenges to exploration and extraction, and the contracts being turned into productive oil and gas wells, Mexican authorities—and the political parties that supported the groundbreaking energy reform in Congress—need to ensure that they continue to win the punditry battle as well as the battle on the street. With presidential contenders teeing-up next

year ahead of the 2018 general elections, the hearts and minds of Mexicans will be key in politically ‘bulletproofing’ this critically important reform, as a constitutional reform to revert the opening of the sector would a huge uphill battle, and the direction of the Mexican-U.S. relationship in the Trump era could have a profound impact both on public opinion and political maneuverability.”

A **John Padilla, managing director at IPD Latin America:** “Mexico’s Round 1.4 auction was a resounding success, particularly

given the commitments it required, and the current oil price environment. Twelve new companies will now enter Mexico’s deep-water arena to begin delineating one of the world’s last under-explored offshore areas. The implications are vast; it will be fascinating to watch this ecosystem evolve. The biggest shift will likely occur within Pemex. It must digest and start to work in its new role as partner on the E&P side with BHP Billiton in Trion (the farm-down) and with Chevron and INPEX in Perdido’s Block 3. The billions of dollars in investment, which will not turn into production for several years, come as Pemex struggles with falling production—to the tune of some 375,000 bpd since the 2013 energy reform was passed. The government will have to double down on its efforts to turn that tide, whether that be through more blocks that can rapidly bring production online, more farm-downs and/or finally pushing through the long-delayed CIEPs and COPFs. The Mexican government’s ability to listen and receive feedback was key to making this bidding round a success. But competition from Brazil and the United States in particular looms. Mexico will still have to fine-tune its contract and mechanisms, to ensure it can build off this historic bid round’s success.”

The Advisor welcomes comments on its Q&A section. Readers can contact editor Gene Kuleta at gkuleta@thedialogue.org.

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Erik Brand
Publisher
ebrand@thedialogue.org

Gene Kuleta
Editor
gkuleta@thedialogue.org

Nicole Wasson
Reporter, Assistant Editor
nwasson@thedialogue.org

 THE DIALOGUE

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1155 15th Street NW, Suite 800
Washington, DC 20005 **Phone:** 202-822-9002

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Subscription Inquiries are welcomed at
freetrial@thedialogue.org

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