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Newsletter

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Latin America
Quarterly
Energy Update

Brazil

New Government, New Energy Policies

Right wing, populist candidate, Jair Bolsonaro, was elected Brazilian President in a run-off with Workers Party candidate, Fernando Haddad, on 28 October 2018, and will formally assume power from 1 January 2019. His election marks a dramatic departure from the leftist politics of Haddad's party, which governed the country for almost 14 years from 2003 until the impeachment of former President, Dilma Rousseff, in August 2016. As well as his presidential victory, Bolsonaro's party and its allies made huge gains in congressional elections. Those gains were largely at the expense of the Workers Party and other more established parties, such as MDB and PSDB, which have held the balance of power between them for decades, and are tainted by recent corruption allegations.

During its years in power, the Workers Party promoted protectionist and state-driven policies in the energy sector, which have been widely criticised for deterring private investment, limiting growth and facilitating corruption. Michel Temer's centrist government, which followed Dilma's impeachment, had already begun to reverse some of these policies and adopt market friendly alternatives. It is expected that Bolsonaro's team will continue and accelerate this reform agenda, at least to the extent that he is able

to muster sufficient congressional support. With Bolsonaro only taking office on 1 January, it is too early to know the new government's detailed proposals for the sector. However, certain tendencies are apparent, which we set out below.

Oil and Gas

Oil and gas is a major driver of the Brazilian economy, reaching 13% of GDP in 2015. However, more than 20 years after the end of Petrobras' monopoly, the state-controlled energy giant continues to dominate the sector, operating more than 90% of upstream production, almost all of Brazil's refining capacity, LNG importation and gas transportation infrastructure, and a substantial portion of its gas distribution networks and gas-fired power plants. Petrobras' involvement in the Car Wash corruption scandal, and financial constraints resulting from its overleveraging, have resulted in a significant reduction in its investments and a more narrow focus on its most profitable, pre-salt projects.

Over the past couple of years, Temer's government has begun to implement successful reforms to attract private investment into the sector, raising over BRL 24bn (c. USD 6.3bn) in signature bonuses from six oil and gas bid rounds. Considering Brazil's public spending deficits, these revenues have been important, and there is broad

congressional support for a continuation of these policies. Bolsonaro has indicated that he will maintain and potentially expand planned licensing rounds for the next few years. It has also been suggested that he may replace the production sharing regime currently used for the most prospective pre-salt blocks, with the concession regime used elsewhere. Brazil's concession terms are generally preferred by oil companies, so this change may allow the government to further increase revenues from signature bonuses in the short term (although potentially at the expense of longer term production revenues).

One of Bolsonaro's immediate priorities may be to conclude negotiations with Petrobras regarding an amendment to the transfer of rights agreement, pursuant to which it was awarded the right to exploit 5bn barrels of oil in the pre-salt area in 2010. Reaching agreement on this would allow the government to put upwards of 6bn barrels of additional oil in these areas up for bidding. It has been suggested that signature bonuses for the right to produce these proven oil reserves could exceed BRL 100bn (c. USD 26bn).

There are interesting questions regarding the future of Petrobras under Bolsonaro. While running for President, Bolsonaro ruled



out a complete privatization of Petrobras, although that possibility has been espoused by his influential future Economy Minister, Paulo Guedes, and by the person nominated to become President of the company, Roberto Castello Branco. Any such move would be fiercely resisted by elements within Congress and society more broadly, and may be a step too far. However, it seems likely that Petrobras' ongoing divestment plan will continue and expand, selling non-core businesses to focus on its profitable deep water operations.

Bolsonaro has voiced his support for reforms to increase competition in the gas sector. During the Temer government, there has been intensive debate around the "Gas to Grow" initiative, which aims to regulate access to gas transportation networks, to de-verticalise the sector, and to allow independent producers to sell directly to distributors and consumers. Agreement has proven difficult due to the multiplicity of stakeholders, including state and federal governments, producers, distributors and consumers. However, Bolsonaro's team supports objectives, and Petrobras is already taking steps to offer capacity in certain infrastructure.

Another issue to be addressed by the Bolsonaro team relates to downstream fuel prices. Striking truck drivers brought the country to a standstill in May, as they blockaded highways in protest against rising fuel costs. This forced the government to introduce fuel subsidies and resulted in the resignation of the President of Petrobras, who insisted that its refinery prices should follow international prices. The Workers

Party's previous attempts to control inflation by requiring Petrobras to sell petroleum products at below international market prices, was one of the main factors in its severe financial difficulties. Bolsonaro's team has said that fuel prices should broadly follow international prices, without government subsidies, but that short term fluctuations may be smoothed out by hedging, and that fuel taxes could be reduced to avoid overburdening Brazilian consumers.

Power

Power in Brazil is still predominantly generated from the country's abundant hydro resources. However, over recent years, hydro's participation in power generation has dropped from over 90% to around 66%, as social and environmental concerns have made it very difficult to license new large scale projects. Bolsonaro's main promise for the power sector is to speed up environmental licensing for large-scale hydro projects, which can take up to ten years. It has been reported that his team may re-launch the 8GW Sao Luiz do Tapajos Hydroelectric project in the Amazon, after it was suspended in 2016 when Brazil's environmental agency rejected its licensing application.

Bolsonaro's election may prove good news for the country's small nuclear power industry. Nuclear power generation is currently a state monopoly, exercised by state-owned Eletronuclear, with two reactors at the Angra site in Rio de Janeiro state. A third reactor, Angra 3, has been under development, on and off, since 1984. Most recently, construction was halted in 2014 when it became

apparent that bribes had been paid by a cartel of construction companies to secure contracts. Nuclear power accounts for less than 3% of Brazil's electricity, but the country is thought to hold more than 5% of the world's uranium deposits. Oswaldo Ferreira, a retired general advising Bolsonaro, has advocated re-starting the Angra 3 project, and it seems that there are ongoing discussions with foreign companies such as Rosatom, CNNC and EDF regarding their investment in its completion.

The appointment of Admiral Bento Costa Lima as Ministry of Mines & Energy may also herald an expansion of this energy source. He is currently responsible for the Navy's development of nuclear technology.

Bolsonaro's focus on liberalising the natural gas value chain, is likely to create opportunities to expand gas-fired power generation. His seeming lack of environmental concern may even leave space for an expansion of coal power.

His impact on the development of renewable resources is less certain. Wind and solar power have seen rapid growth in recent years, supported by the availability of subsidised credit from the Brazilian Development Bank (BNDES) and by certain regulatory incentives. The liberal economic policies of Bolsonaro's team are likely to result in a reduced role for subsidised BNDES lending and other incentives. However, the costs of wind and solar have reduced to such an extent that they need little, if any, government support to compete with fossil fuels at current prices. Wind power has a strong domestic supply chain, which supports



considerable employment, so the government is unlikely to deprive this industry of new opportunities.

As with Petrobras, the fate of Brazil's state-owned power company, Eletrobras, is unclear. As well as disposing of a number of non-core subsidiaries and power distributors, the Temer government had proposed the company's privatisation this year. During an election year, that controversial proposal was shelved. Although Bolsonaro's economic team are considered to be pro-privatisation, the President Elect himself has said that "Electric power is vital, and therefore cannot be handed over to other countries," and he added "I'm in favour of privatising many things in Brazil, but not in the energy sector". He has expressed concern regarding the role of China in the Brazilian power industry, where Chinese companies acquired significant holdings in generation, transmission and distribution segments over the last few years. Although a full privatisation may remain unlikely, under Bolsonaro, Eletrobras is likely to continue divesting, restructuring and downsizing, with an inevitable reduction in its market share.

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Chile

Private investment planned for five years achieved its highest increase and reached USD 30,813m.

According to the latest registry of the Corporation of Capital Goods (CBC) and considering data from the second quarter of 2018, for the five-year period of 2018–2022, projected private investment reached USD 30,813m, which is 19.5% higher than the USD 25,790m recorded in the report for last January–March. This percentage increase was the highest between quarters since records were kept (2008). The increase is due to increases in practically all the sectors analysed by the CBC, which includes initiatives with defined timetables.

The largest increase in the private sector is recorded in mining, with a jump of 31.7%, which leads to total investments of USD 5,448m until 2022. The second strongest growth (27.7%) is observed in public works, due to the entry of concessions that will be operated by private companies and that are already awarded or whose tenders were scheduled.

Also noteworthy are the increases in the energy (17.6%) and real estate (15.4%) sectors, both with more than USD 1bn in additional investments when comparing the reports of the second and first quarter. The energy sector adds

initiatives for USD 8,540m to 2022, due to the entry of a new solar project and an expansion of a thermal power plant.

Meanwhile, the emergence of housing initiatives, mainly commercial ones, helped the real estate sector raise its investments to USD 8,134m for the five-year period.

When adding state projects, the global investment amount from 2018–2022 rises to USD 42,213m, involving 796 initiatives. This amount was 16.8% higher than the USD 36,150m of the report at the close of March, when the lowest five-year amount was recorded since 2008.

The Ministry of Energy expects the Arica-Tacna electrical interconnection study to be ready at the beginning of 2019.

The energy minister, Susana Jiménez, expects that the study that will determine the economic benefits of an Arica-Tacna electrical interconnection will be finalized at the beginning of next year, which would allow progress to be made in a regulatory agreement for the exchange of energy between Chile and Peru.

“The central issue to be able to realise the Tacna-Arica power line is to reach a regulatory agreement for the exchange of electric power. Therefore, the Ministries of Energy

of Chile and Peru are in the process of negotiating a bilateral regulatory instrument that allows both countries to exchange electricity,” explained the minister during her presentation at the Chile-Peru Business Council, which was held in Sofofa.

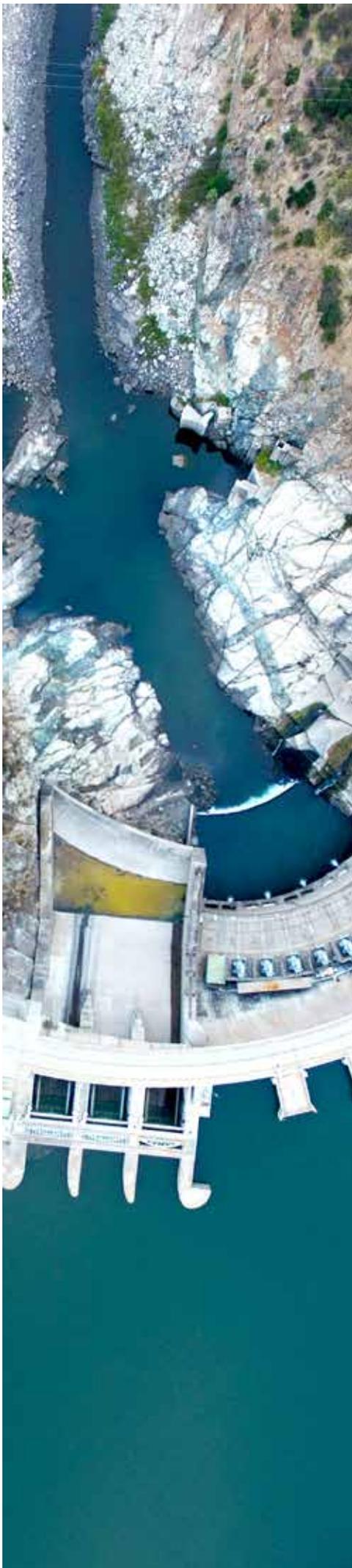
“This study aims to analyse the technical and economic feasibility of the electric interconnection between the systems of Peru and Chile at 220[kV], based on the previous studies prepared by the IDB. This update is mainly due to the fact that the previous study did not consider the union of the SIC and SING systems, and a scenario of prices and electricity flows that is very different from the current scenarios. We hope to have it completed by the beginning of 2019 at the latest,” Jiménez added.

The next binational, which will take place in Santiago, is scheduled for 26 and 27 November, in which the progress in energy between Chile and Peru will be reviewed, such as the regulatory agreement, the current study and institutional cooperation between both ministries.

The Ministry of Energy will analyse the inclusion of hydrogen as an alternative fuel in regulations.

The Minister of Energy, Susana Jiménez, said that the country's





regulations will be reviewed and updated, for which the use of alternative fuels, such as hydrogen, in the national energy matrix will be analysed, due to the potential that it has to be used in different sectors, from industrial to renewable energies.

"It is necessary to consider that in Chile there are no specific rules applied in the use of hydrogen as fuel. That is why, according to our Energy Route, we will work on the revision and updating of standards, incorporating the analysis of the use of alternative fuels that could be commercialized in the Chilean market, such as hydrogen, among others," she said.

Valente performs GPS office evaluation: Since its creation, 19 projects have been entered for USD 5,000m.

The Economy Minister, José Ramón Valente, completed an evaluation of his management in the portfolio, delivering results obtained by new institutions, amongst which he highlighted the Office of Sustainable Project Management (GPS).

"Since the launch of the GPS office, 19 investment projects have been added to its list for some USD 5,000m, which will translate into more than 6,200 jobs during its construction and 4,800 direct jobs in operation," said Minister Valente.

In his opinion, *"this is an economy that has been put back into motion, which is dynamic; part of this dynamic is shown in the investment figures, where there was a growth of 7.1% in the first half, a figure that we did not see for more than four years"*.

He also stressed that foreign direct investment tripled compared to the amount obtained in all of 2017 after closing at USD 8,335m in the period.

It should be remembered that among the objectives of GPS, is to combat the obstacles to investment *"accompanying the investor in the pre-approval process of investment projects, as well as making recommendations on public policies and improving the competencies of the evaluation offices of the projects investment"*.

According to the registry of the Ministry of Economy, there is a list of 219 initiatives for an amount of USD 58,790m in investment for the period of 2018–2021, which will generate about 285 thousand jobs throughout the country.

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Colombia

Colombian authorities seek to limit the scope of popular consultations

In recent years, municipalities have used the mechanism of popular consultations to prevent the execution of mining and oil exploration and exploitation activities in their territories. In fact, during the year 2017, seven popular consultations were held and currently there are 54 proposals that are pending to be voted on. This mechanism of participation seeks for the inhabitants of the municipalities that have a mining or petroleum vocation, to participate directly in the decision to advance or prohibit projects that may impact their territory.

From the view of oil and mining companies, this mechanism generates legal uncertainty and has a negative impact on the attractiveness of Colombia as an investment destination, since municipalities could prevent companies from carrying out their activities after the government has awarded them exploration and exploitation rights.

However, in the recent decision SU-095 of 2018, the Constitutional Court of Colombia seems to have put a brake on this mechanism. By means of the communication No. 40 of 11 October 2018, the Constitutional Court advised on the meaning of this decision, in which the lawsuit filed by the company Mansarovar Energy Colombia is analysed with respect to the decision issued by the Contentious-Administrative Tribunal of Meta, which considered whether the text of the referendum that was going to be carried out in the municipality

of Cumaral (Meta) that asked the citizens of this municipality whether or not they agreed to allow activities of exploration and exploitation of hydrocarbons, was in accordance with the Political Constitution of 1991.

According to the Court, the question of the referendum violated due process because it could not fall on matters outside the competence of the municipal authorities. In this regard, the Court indicated that the question sought to prohibit the carrying out of exploration activities of the subsoil and of non-renewable natural resources in Cumaral, with which it was deciding on a competence of the State as owner of the latter.

Thus, in the judgment of the Court, the Administrative Tribunal of Meta interpreted constitutional postulates in isolation and, therefore, in the review of the constitutionality of the question to be raised to the referendum, it did not systematically and comprehensively analyse the competences of various State entities, omitting those located at the head of the central national government, regarding the resources of the subsoil. Thus, the Full Chamber found that the existence of limits on the matters to be decided in a territorial referendum, specifically referring to the national constitutional competences on the use of the subsoil and the exploitation of non-renewable natural resources at the head of the State, implies that this citizen participation mechanism can not be used to prohibit extractive activities in a given municipality or district.

Although the full text of the decision has not been published in its entirety, this seems to indicate positive news for the extractive industry of the country that in recent years has suffered from projects that had slowed down as a result of the use, and in some cases abuse, of this mechanism.

Council of State suspends norms that regulate fracking in Colombia

At the beginning of November, the Third Section of the Contentious Administrative Chamber of the State Council decided provisionally to suspend Decree 3004 of 2013 and Resolution 90341 of 2014, the regulatory framework for the exploration and exploitation of hydrocarbons in unconventional deposits "fracking". The foregoing is the result of the decision of a precautionary measure requested by the plaintiff in a nullity action that is brought forward against these rules.

According to the Council of State, the accused norms do not include environmental considerations, which are fundamental to avoid potential risks to the environment and human health. Moreover, it is taken into account that Law 1530 of 2012, Conpes 3517 of 2008 and the Comptroller General, established the need to adjust the measures to authorize fracking to protect the environment and the precautionary principle. Additionally, it is pointed out that there are studies that indicate potential serious risks to the environment and that, in general terms, there is no well-developed knowledge of this technology.



In line with this reasoning, and in consideration of the potential risks that this technology can have on the environment and human health, the State Council considered that this precautionary measure was necessary, proportional and adequate, taking into account that the accused norms comply with the precautionary approach and the general obligation of due diligence that requires that all appropriate measures to prevent potential damages or risks that may result from activities associated with fracking, are taken.

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Mexico

Resale of Energy

The Governing Body of the Energy Regulatory Commission (CRE) issued the accord by which article 46, section I of the Electricity Industry Law (LIE) is interpreted.

By means of the said accord, it seeks to allow an end user to sell electric power to a third party, as long as the electric power is used within the facilities of the end user, such activity will not be considered commercialization, and therefore, it will not require the issuance of a permit or registration by the CRE, enabling the development of a new economic activity.

Among the main objectives, it seeks to encourage investment, research, innovation and competition in the electricity industry and promoting various economic activities for the sale of electricity for the benefit of consumers. The clearest business opportunity is that of charging stations for electric vehicles, commonly known as electric stations.

On the other hand, the Agreement offers alternatives to Real Estate Investment Trusts (FIBRAs), and/or developers of the real estate sector, who lease shared work spaces, offices, premises in shopping malls, or residential spaces, since, as part of their commercial strategies, they will now be able to offer the sale of electric energy according to the needs of their customers.

Long-Term Auctions 2018

Currently, the fourth long-term auction for the acquisition of electric power, Power and Clean Energy Certificates (SLP-1/2018) is in process.

According to the figures published by the National Centre for Energy Control (CENACE), purchase bids were received and accepted by a Basic Services Supplier, CFE Basic Services Provider, and five different Cargo Responsible Entities, Iberdrola Clientes, Servicios de Energía México Syem S.A.P.I. de C.V., Menkent S. de R.L. de C.V., FSE Suministradora Fenix S.A.P.I. de C.V., and Tuto Energy Trading S.A.P.I. de C.V.

On the other hand, CENACE received the prequalification requests for 396 sales offers corresponding to 34 Bidders.

The next phase will be the presentation of economic offers, which will begin on 30 November 2018. The decision, in accordance with the provisions of the calendar published by CENACE, must be carried out no later than 18 December 2018.

Simplification of Administrative Procedures for the Energy Sector

The governing body of the CRE approved new criteria to update the agreement A/043/2016 that regulates the permits granted in the electricity, petroleum, natural gas and LP gas markets, in order to speed up the updating of permits in the energy market.

As mentioned by the CRE, these new criteria will reduce the administrative process for updating the authorized projects from ninety to thirty days. With these modifications, the permit holders will be able to adjust their projects at any time, always keeping the CRE up to date with respect to the new scope of work.

The main benefits of the new criteria are:

1. In the electricity market, streamlining administrative processes will guarantee the reliability of the National Electric System at all times.
2. In the market for petroleum products other than LP gas, the assumption is included for the exchange of by-products, in specific Regular and Premium gasolines, in the tanks of the storage and distribution systems.
3. In the LP gas market, permit holders will be able to update the capacity of their storage plants.
4. In the natural gas market, 15 new update criteria were added for permit holders of natural gas transportation in the form of own uses and self-sufficiency societies.

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Peru

Draft Regulation of Citizen Participation

In August, the Ministry of Energy and Mines published the draft of the new Regulations for Citizen Participation to carry out hydrocarbon activities, in order as to receive comments, contributions and suggestions from interested business associations and the general population.

It is expected that, based on this Regulation, there will be citizen participation processes in accordance with the reality of the affected areas, in order as to provide the competent authorities and companies with an accurate assessment of what the population understands and expects the hydrocarbon activities developed in said area to be, which will avoid unnecessary social conflicts that put the integrity of the people and the infrastructure of said projects at risk.

Lithium for electric vehicles

In relation to electric vehicles, the Ministry of Energy and Mines has confirmed that it is working on a bill that will seek to promote and regulate electric and hybrid vehicles in Peru.

For its part, the Ministry of Economy and Finance, eliminated the Selective Consumption Tax for electric vehicles, which confirms the will of the Executive Power, to promote electric vehicles and implement the regulatory framework applicable to them and the necessary infrastructure to the recharge batteries.

This takes place against the backdrop of the discovery of what would be one of the largest reserves of lithium in the world, located in the Puno Region. As is well known, lithium is used in various technological items, among which are batteries for electric vehicles.

Norperuano Oil Pipeline and Lot 192

The state oil company, PETROPERU, hired the Argentinian capital firm Techint to develop a study on the modernization of the Norperuano Pipeline (ONP) so that it can be expanded and serve a greater number of oil wells.

The ONP, whose operation resumed in October after having halted for several months, has Lot 192 as a main source, which is the Lot with the highest production of oil in the country, amounting to approximately 12,532bpd, and which is also close to changing contractors. In fact, there are four companies that have expressed interest in contracting for the Lot, Sonatrach, Pluspetrol, Cepsa and Frontera Energy (the current operator).

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