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Newsletter

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Latin America Quarterly Energy Update

Brazil

Results of Oil & Gas Licensing Rounds

This quarter, Brazil's National Petroleum Agency (**ANP**) held its first Oil & Gas Licensing rounds for pre-salt and non-pre-salt blocks for four and two years respectively. Following a period of economic turmoil and low global oil prices, the Brazilian government recognised the need to make changes to the previously criticised concession agreements and production sharing contracts used to contract for oil and gas licences.

Subsequent improvements to the terms offered under the concession agreements and recent increases in global oil prices led the 14th Licensing Round to achieve a record combined total signing bonus of BRL 3.8bn. Of this amount, BRL 3.4bn alone came from Petrobras and ExxonMobil. The companies' consortium comfortably outbid rivals for two blocks in the Southern Campos Basin, which borders the highly productive pre-salt fields. The only disappointment of the round was that, apart from Murphy Oil, none of the other new international oil companies registered for the auction submitted bids to become involved in the exploration and development of fields in Brazil.

Similarly, the removal of the requirement that Petrobras be sole operator of all pre-salt oil fields led to greater engagement by international oil companies, in both

the second and third pre-salt rounds. Petrobras took the lead role alongside Shell, BP, Statoil and ExxonMobil in securing significant interests in pre-salt fields located in the Campos and Santos basins. Winning consortia delivered a combined total of BRL 6.15bn in signing bonuses for six fields, in addition to profit oil percentages due to the government ranging from 11.53–80%.

Extension of REPETRO regime

A key factor cited in the development of the oil & gas industry in Brazil was the introduction of the REPETRO tax regime in 1999. The existing REPETRO regime provides for the suspension of federal import taxes for assets temporarily admitted to Brazil for the exploration and production of oil & gas. It also provided Brazilian suppliers with tax benefits by allowing for the fictitious export and re-importation of certain goods. This had been due to expire in 2020, but was recently extended until 31 December 2040.

In addition to the extension until 2040, in August 2017, the Brazilian government enacted Provisory Measure 795, including changes to the existing REPETRO regime, such as the inclusion of assets as expenses and how depreciation of the assets should be treated for withholding tax purposes. Additionally, the provisional measure intends to modify the

rules related to contractual split between the charter or lease of vessels and the provision of services. A further change to the tax regime is that the suspension of federal taxes on the importation of items on a permanent basis will only apply until 31 July 2022. The proposed new REPETRO regime will be applicable from 1 January 2018, subject to the conversion of Provisory Measure 795 into a permanent law by Congress, which must pass before 15th December this year to have legal effect.

Upcoming electricity transmission and generation auctions

The National Electric Energy Agency (**ANEEL**) plans to hold a further electricity transmission auction in December for eleven lots across ten states. The sale of four dominant lots aims to generate approximately BRL 9bn in investment. The auctions are to be held in advance of two renewable electricity generation auctions taking place in December 2017. ANEEL is aiming to give bidders the opportunity to establish whether viable transmission systems will be in place before submission of bids.

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Chile

Record Latin American price for electricity licences sees average price fall by 32%

A record low price was achieved in the tender for supply of electricity to distributors carried out in November in Chile. Chilean distribution companies are required to sign supply contracts, which are the result of public, open, non-discriminatory and transparent bidding processes. The award prices in the recent contract tender averaged USD 32.5 MWh, a price 32% lower than that of the auction in August last year. The process therefore not only broke a record domestically, but also regionally, producing the lowest average price in Latin America.

All the energy that the generators will provide to the distribution companies will come from Unconventional Renewable Energy sources (ERNC). This supply will bring about the development of new plants accounting for more than 500 MW, requiring an investment of around USD 1bn, according to the executive secretary of the National Energy Commission.

Ecuador to promote electric interconnection project with Chile through Peru

The government of Ecuador has expressed a strong interest in delivering and selling energy to Chile, which will only be possible through a connection via Peru.

The leaders of Ecuador and Chile have ratified commitments to strengthen bilateral cooperation in the areas of regulation and infrastructure, leading to the establishment of a regional electricity market, as well as to collaborate on energy efficiency and renewable energy.

Chile's electric highway interconnection project

An ambition, twenty years in the making, within Chile's electricity sector will be fulfilled in the coming months with the implementation of an interconnection between the Central Interconnected System (SIC) and the Northern Interconnected System (SING). This will revolutionise the national electrical system from Arica to Chiloé.

The unification of electrical systems that cover the national territory will allow for greater support to the operation of the Chilean electrical system, with a focus on a secure supply of the resource. The impact of interconnection has already resulted in reduced costs, which has led to lower power prices. With greater competition and availability of technology, the price of energy has been reduced by between USD 10 to USD 15 per MWh.

The SING-SIC interconnection will allow surplus energy currently generated by the SING to be introduced into SIC, which supplies the mining and industrial projects that require a significant amount of electricity for their operations.

The SING-SIC interconnection will create a single, safer electricity market, with greater price stability which will facilitate the incorporation of ERNCs into the energy matrix. This interconnection project between the two transmission systems is probably the most important in the history of the electrical sector in Chile.

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Colombia

New changes in the regulation of the primary market for natural gas

Recently, the Energy and Gas Regulation Commission (**CREG**), the highest regulatory authority for the electricity and gas sector in Colombia, issued Resolution CREG 114 of 2017. This has made adjustments to the commercial aspects of the wholesale natural gas market in Colombia.

With the issuing of Resolution CREG 114 of 2017, new contractual arrangements for the purchase of natural gas in the wholesale market have been adopted. These are Supply Contract CF95, Supply Contract C1 and Supply Contract C2. As of the entry into force of Resolution CREG 114 of 2017, "firm" supply contracts or those that guarantee supply, conditional transport contracts and transport purchase option contracts cannot be completed.

Likewise, Resolution CREG 114 of 2017 makes substantial changes to the mechanisms of commercialization of natural gas. In particular, it establishes that in the primary market, natural gas can be commercialized in three ways: (i) direct negotiation of the supply of gas at any time of the year for the execution of contracts in any form and for any duration where the natural gas comes from extended well tests or where commerciality has not been declared, minor fields, unconventional deposits or from

isolated fields, (ii) negotiation of long-term supply contracts of three or more years and, (iii) negotiation of supply contracts for a term of one year.

Renewable energies enter the market

Since the issuance of Law 1715 of 2014, which regulates the integration of non-conventional renewable energies into the National Energy System, the Government of Colombia has issued six decrees and five resolutions for the regulation of this law. In this way it has promoted the development and use of energy generated from renewable sources.

The decrees and resolutions define, among other elements, the self-generation guidelines for small, medium and large-scale renewable energies and likewise indicate the mechanisms for the expansion of coverage in the electric power service in the National Interconnected System (**SIN**) and in the Non-Interconnected Zones (**ZNI**).

Although approximately 70% of the energy generated in the country comes from hydroelectric power plants, the Government is seeking, through the incorporation of unconventional sources of energy, and particularly renewable energy, to complement the energy supply. This supply faces many continuing challenges regarding safety, security and supply efficiency due to climate change and drought seasons.

CREG issues new regulation to adjust the scarcity price of the Reliability Charge

At the end of September, CREG published Resolution 140 of 2017, modifying the scarcity price calculation, through a new methodology called "marginal price of scarcity". The scarcity price is one of the compensation schemes developed by CREG to determine the remuneration of energy generators during critical energy supply periods in the country. In particular, the scarcity price resolution fulfils a double function. On the one hand, it indicates the moment from which a daily and determined amount of energy can be demanded from the generators in critical periods in fulfilment of commitments that each generator previously acquired and, on the other hand, it indicates the price at which the energy delivered during said period will be remunerated.

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Mexico

CENACE announces first medium-term auction

CENACE, the operator of the Mexican electricity system, has convened the first medium-term electricity auction, whose purpose is to provide certainty and reduce the exposure of market participants to the volatility of short-term market prices. In this auction, all market participants may be potential buyers or sellers. Only the supply of electricity and power is allowed, and not clean energy certificates, which are included in long-term auctions. On the other hand, for offers of power, participants must reference their offers to power plants that are in commercial operation, or close to it, while virtual offers are permitted in the case of electricity offers. It should be noted that in these auctions an offer based on any kind of generation technology is allowed. The results will be announced in February 2018.

Progress in the third long-term auction

The process of the third long-term auction is about to come to an end, while the prequalification of sales offers have already been delivered and the participants are in the process of submitting their economic offers. The CFE (State production company) presented a purchase offer for a maximum amount of more than 5,5m MWh/year of clean energy, the equivalent amount of clean energy certificates, and more than 1200 MW/year of power. This year, for the first time, as a consequence of the implementation of the clearing house, different CFE companies have participated

as buyers, including Iberdrola Clientes and Menkent. It is expected that this auction will achieve the same success as the first two. The mechanism is the first of its kind in the world and has produced some of the lowest clean energy prices in history. The results of the third auction will be announced shortly.

Round 3.1 for E & P in shallow waters of the Gulf of Mexico

The National Hydrocarbons Commission published the first call for bids for Round 3.1 for exploration and extraction of oil in the shallow waters of the Gulf of Mexico under production sharing contracts with state-owned petroleum company, Pemex. It includes a total of 35 contractual areas in shallow waters, which cover an area of 26,265 km² and have approximately 2bn barrels of prospective resources. It should be noted that prequalified bidders from Rounds 1 and 2 may automatically pre-qualify subject to the requirements that they originally met being sufficient to comply with the requirements established in the bidding rules for this round.

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Peru

Three contracts signed with Anadarko Petroleum

Perupetro and American company, Anadarko Petroleum signed three contracts for exploration and exploitation of lots Z-61, Z-62 and Z-63 located on the continental shelf off the north coast of Peru. President Kuczynski stated that this is the first time that hydrocarbon exploration activities have taken place in Peru in depths of up to 1,000m. Anadarko Petroleum will invest USD 200m dollars throughout the exploration activities.

According to sources from Perupetro, the agency in charge of promoting investment in hydrocarbons, other companies interested in carrying out similar exploratory activities have asked to begin direct negotiations.

Changes in the Legal Framework for Exploration and Exploitation

Peru's Prime Minister has sought Congress' support to pass new laws, including updating the Organic Law on Hydrocarbons, which dates from the early nineties. While it contained important improvements to promote and encourage the hydrocarbon industry at the time, today

it requires adaptation to fit within the context of international prices.

The Minister of Energy and Mines, explained that this update will seek, among other measures, to reduce royalties (both for new and principal production); promote and exploit unconventional resources; introduce longer licence periods; provide incentives for exploration; and standardize contracts and their transfer.

The Prime Minister also indicated that within the modifications, they are considering introducing a new role for Perupetro in identifying resources and knowledge development, as well as having an environmental baseline for oil contracts.

A transmission line between Peru and Chile could be tendered by mid-2018

Chile's energy minister has indicated that they are considering an electrical interconnection between Peru and Chile. Both governments are considering how to connect electricity transmission lines and especially a 55km project linking the cities of Arica (Chile) and Tacna (Peru), as well as another,

longer line of up to 600km from the city of Antofagasta (Chile) to the Montalvo station in the south of the Camisea area (Cusco, Peru).

Regarding the timeline for the development of the project, the parties have indicated that by mid-2018 they should have the model available and thus be able to receive bids and commence construction. The aim is to complete construction during the term of Peruvian President Pedro Pablo Kuczynski.

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