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Oil, Gas & Energy Law Intelligence

Argentina's Hydrocarbons Export Regime by D.G. Lamanna and D.E. Arias

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ARGENTINA'S HYDROCARBONS EXPORT REGIME

(<http://www.ogel.org/article.asp?key=2739>)

Dario G. Lamanna (*)

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"What does wealth require of law to be produced and created? What Diogenes required of Alexander; to stand out of its light!"

Juan Bautista Alberdi

Introduction

Recent relations between the Argentine government and the oil companies working there has included a group of measures that should be aimed at increasing the production needed to assure domestic supply. Those measure, however, have focused on stronger intervention in the economy than seen in the last decades. There is a certain incongruity between the two purposes, given that – on the one hand – the country needs to replace produced reserves and to take advantage of high international prices and – on the other - companies need legal certainty and respect for the rules of the game in order to program long-term investments. The government's actions and measures have not met their intended purposes and they contradict basic economic principles.

Background

As a result of the recent increase in international crude prices, the Argentine government adopted some time ago a policy of duties on oil exports for strictly tax purposes.

The idea is to control the evolution of internal prices and, in theory, to generate funds for the national treasury. The plan is to protect domestic consumers from the potential damages that may be caused to them, and to minimize the impact on the country's economic activity, the level of employment and the prices of domestic goods and services.

Although this measure impacts the profitability of the oil companies operating in Argentina, the national government believes that even after deducting the established export fees, the companies will still have enough profit for the normal course of business, and the conditions for future investments.

The new regulation increased oil export fees from 45% to almost 60%. Originally, through Presidential Decree No. 310 (13 Feb., 2002) and its amendments and additions, extended by National Law No. 26,217, and Presidential Decree No. 509 (May 5, 2007) and its amendments, the export fees were legally established.

Through Law 26,217¹, the Government enacted the 5-year extension of the 2002 oil export fee that had been implemented by Economic Emergency Law N° 25,561.

¹ Published in Official Gazette dated January 16, 2007. (The *Boletín Oficial* is the journal that publishes new Argentine laws).

In addition, through Resolution No. 394/2007 (Nov. 15, 2007) of the Ministry of Economy (Regime applicable to oil price for calculating hydrocarbon royalties of the Provinces), the export fees applicable to a group of hydrocarbons were modified; and reference and cut-off values were established for said products in order to assure the competitiveness of the national industry.²

This new rule repeals and annuls Resolution 532/2004 (Aug. 4, 2004), of the Ministry of Economy and Production and establishes new oil export fees of almost 60%.

It also establishes the new reference and cut-off values for hydrocarbons, which after this new resolution are as follows:

	Cut-off Value	Reference Value
PETROLEUM-BASED OR BITUMINOUS MINERAL-BASED CRUDE OIL <i>(aceites crudos de petróleo o de mineral bituminoso)</i>		
Petroleum	42	60.9
The others	42	60.9
PETROLEUM-BASED OR BITUMINOUS MINERAL-BASED OIL, EXCEPT FOR CRUDE OILS, PREPARATIONS NOT EXPRESSED OR INCLUDED ELSEWHERE, WITH A CONTENT OF PETROLEUM-BASED OR BITUMINOUS MINERAL BASED OILS HIGHER THAN OR EQUAL TO 70% BY WEIGHT, IN WHICH THESE OILS CONSTITUTE THE BASE ELEMENT; OIL WASTE <i>(desechos de aceite)</i>		
Light Oils <i>(aceites livianos)</i> and preparations		
Commercial hexane	74	108
Painters naphtha	62	90
Naphtha		
For Petrochemicals	39	56
The others	78	113
Kerosene		
For aviation	70	101
Other fuel oils <i>(aceites combustibles)</i>		
Fuel Oil	42	61
The others	22	32
Lubricating Oils <i>(aceites lubricantes)</i>		
Without additives	121	175
With additives	174	252

² As antecedents to the content of this provision, Laws 22,415 (Customs Code), 25,561 and 26,217, the Law of Ministries and its amendments, among others, are cited.

For the above-mentioned hydrocarbons, and if the international price is higher than or equal to the reference value, the export rate will be calculated by applying a formula

where the International Price minus the Cut-off Value will be divided by the Cut-off Value, and the result divided by a coefficient of 100. If the international price is lower than the reference value, a 45% fixed rate will be applied.

If the international price of oil is less than US\$ 45.- per barrel, the percentages to be applied will be determined within a period of 90 days. The new rule defines international price as the price of hydrocarbons prevailing in reference markets considered to be such because of their common use and significance as an export alternative from the Republic of Argentina³.

The official International Price will be set by the General Customs Department (“AFIP”, in its Spanish acronym).

At the same time, the National Department of Refining and Commercialization (“NDRC”) will fix the respective prices on a daily basis. The NDRC is part of the Assistant Secretary’s Office for Fuels of the Secretary’s Office for Energy of the Ministry of Federal Planning, Public Investment and Services.

For other derivatives, such as diisobutylene, white mineral oils (*aceites minerales blancos*), petrolatum, oil bitumen, sands, etc., for which no cut-off and reference value was fixed, the percentage of the export fee to be applied will be equal to the percentage resulting from crude oil (Cut-off Value US\$ 42.00 – Reference Value US\$ 60.90).

Finally, the new rule replaces Annex XV to Decree 509 of May 15, 2007, regarding the export fees for the tariff items of MERCOSUR Common Nomenclature.

This new regulation considers, among other things:

- the power of the Executive to establish the rate applicable to certain hydrocarbons for a term of five years,
- the decree establishing the export fees of specific hydrocarbons, the 25% increase in the crude oil (*aceite crudo*) export fee,
- the recent increase of the international oil price,
- the State’s duty to capture the income from depletable natural resources, along with the need to maintain sufficient profit for the private sector to continue investing.

However, the measure has been criticized by analysts, entrepreneurs, and by the provinces (states) that produce hydrocarbons. By placing a duty on oil exports, the State takes a higher portion of the oil revenues than that received by Venezuela (the companies receive no more than US\$ 42/bbl exported).

³ Article 3° of Resolution 394/2007 (Nov. 15, 2007) of the Ministry of Economy and Production

The prices of gas and liquid fuels had been much lower than international values and than those of neighboring countries. This began to change last year with constant increases in the values of naphtha and gasoil. But the result is predictable when artificially low prices are fixed: shortages. In fact, even though Argentina produces more natural gas than Bolivia, production does not meet the domestic market and the export commitments in winter. Shortfalls in liquid fuels have occurred in Patagonia and to the north of the country.

Contrary to what happened in the past, the subject measures have been adopted by the Assistant Secretary's Office for Domestic Trade, and not by the Secretary's Office for Energy, where said type of decisions were formerly made. The policy of the sector also seems to be in the hands of the Assistant Secretary for Trade and exceptional measures have also been taken in other sectors of the economy, such as suspension of meat exports by the application of a simple resolution.

Authorities of the producing provinces, at a meeting of the Federal Organization of Hydrocarbon Producing Provinces ("*OFEPHI*"), have made strong efforts to negotiate with the central government, in an attempt to suspend the increased duties or else to agree on a mechanism that minimizes the damage this increase means to the provinces.

An example of the results of said conversations has been the issue of Regulation of the Assistant Secretary's Office for Domestic Trade SSC 1/2008, which amends Resolution No. 394/2007 of the Ministry of Economy and Production.⁴

This regulation establishes (Art. 2°) that when the international price of crude exceeds US\$ 95 per barrel for oil intended for domestic consumption, the possibility will be analyzed of compensating the corresponding provincial treasury; also, the producing provinces may charge the royalties in kind and the Ministry of Economy binds itself to "*exert the maximum efforts aimed at procuring the necessary agreements between them (the provinces) and the sector involved in order for the royalties received to be monetized*" (Art. 3°), by virtue of the minutes signed in November 2007 (which is part of the regulation).

We note that although the subject regulation could constitute the beginning of a solution for the provinces, the provision only establishes indirect solutions through an uncertain path that depends to a great extent on the will of the central government.

Other duties

The mining sector is also affected by export withholdings, in spite of the fact that this sector of the economy is under a fiscal stability regime.⁵ All provinces approved the Law on Mining Investments, and the federal mining agreement was approved by Law 24,228. A

⁴ <http://www.infoleg.gov.ar/infolegInternet/anexos/135000-139999/136929/norma.htm>

⁵ Article 8 of Law on Mining Investments 24.196 prescribes: "*Mining undertakings included in this regime shall have fiscal stability for a period of thirty (30) years after the date of presentation of their feasibility study. Fiscal stability means that the total tax burden, as determined at the time of the presentation, of the companies that develop mining activities in the framework of this investment regime, cannot be further affected as a consequence of increases in the tax contributions and duties, whatever the name of the same may be, in the national, provincial, and municipal ambit...*"

standard 3% ceiling for royalties was accepted in this, and the rules of the game cannot be modified by the Nation by applying other encumbrances not capable of co-participation.

Some specialists believe, to promote productive activity and then favor measures that discourage it is contradictory. *“This favors a central government that increases tax revenues without control, and brings legal uncertainty to a sector that, on the contrary, should be protected.”*⁶

In recent press statements, a northwest mining province governor stated that although he recognized that this encumbrance was not envisioned when the investments were made, mining companies should negotiate and pay the duties with *“even a sense of solidarity”* due to the increase in the world price of metals.

Other measures

In early 2008, because of the persistent shortage of fuels, and sustained prices (in 2007, they rose 35%, reaching US\$ 1 per liter of gasoline), the central government, through the Assistant Secretary’s Office for Domestic Trade again informed the companies that they should roll back the prices to October 31, 2007; and that the Secretary’s Office for Energy would not grant the permits to export naphtha if domestic supply was not assured. The news (which rapidly reached the press and news agencies) not only concerned the refining companies, but the importing countries, such as Paraguay, where over 50% of the fuel consumed is bought from Argentina.

However, no resolution was issued and no provision was published in the Official Bulletin. The scheme will operate as follows: the Secretary’s Office for Energy will receive the orders, send them to the Secretary of Coordination of the Ministry of Federal Planning. This body will in turn decide whether or not the shipment is authorized, after consultation with the Secretary of Trade and the consent of the Minister of Trade. The procedure is based on a subparagraph of the Law on Supply: it was used to close the borders to naphtha, using the argument that oil companies privileged exportation and were not duly meeting local demand. Analysts considered these to be verbal exercises intended to calm public opinion.

The effect of the *“de facto”* prohibition would not be the same for all companies. Repsol, for instance, assigns 90% of YPF’s production to the Argentine domestic market, and the remaining 10% assigned for exportation, is a very low-quality naphtha.

This situation is very different from that of other oil companies that operate in the country, where a prohibition against export would in practice force them to cease operations. One week later, after reducing domestic naphtha and diesel prices, export restrictions were removed. This benefited the Spanish-Argentine company Repsol YPF, the Brazilian Petrobras, and the American Esso. These companies had agreed with the government to roll naphtha prices back to the values of the end of last October, which implies, in practice, a rebate of close to 15 percent.

⁶ Martínez, Víctor, *“Las Retenciones a las Exportaciones y la Minería”*, newspaper La Nación on-line (December 26, 2007).

The prohibition against export, however, remained in force for the English-Dutch company Shell, which did not participate in said agreement. The highest official of this company had told the press that "*the price reduction will result in higher demand, then, it is probable that the supply restrictions will be greater*". These statements aggravated the confrontation between the Argentine government and Shell. There was an immediate reaction: that afternoon, the general clerk of the government went to the company's building and demanded that the Shell president ratify or correct statements published in different media. In the opinion of constitutional law experts, this represented a threatening, manipulative, and useless action⁷. In the opinion of other jurists, sending the general clerk of the government to make demands on a company constitutes a "clear abuse of power."⁸

According to official Argentine government sources, on the date when this work was prepared, the Ministry of Economy was working on a draft resolution to modify the oil duty system in effect.

The changes were aimed at modifying the reference price of raw gasoline and some other minor technical issue, but no matter of magnitude or with a great economic impact was included.

However, oil companies continue to claim that investments in the industry are not feasible with the present level of duties on exports.

Conclusions

We believe that it is important that both the central government and the provincial states understand the actual dimensions of hydrocarbon matters in order to be able to design long-term solutions in a coordinated manner that may assure energy reliability as an essential component of any durable economic policy.

Failing that, the approach to short-term solutions may only result in decreased reserves, discouragement of exploration investment, and dependency upon other countries.

Given the international prices of commodities, and the delicate fiscal and commercial equilibrium that the country insists on reaching, we cannot yield to the temptation of trying to regulate what is by nature exceptional and temporary. The measures aimed at encouraging investments, increasing production, and rationally exploiting the country's depletable natural resources require a sense of permanency, far-reaching targets, and enough flexibility mechanisms for adjustment to new realities (such as exorbitant international price increases), so that the extraordinary benefits that may be generated also have a positive impact on the producing regions and tax areas.

Finally, it is essential that respect for rights and the application of the republican values of transparency, legality, checks and balances, and liability of public servants be the frame of reference of any governmental measure. We want to once again quote Alberdi, whose

⁷ "*A threatening and manipulative gesture*". This is the designation given by the Professor of Constitutional Law at the UBA, Gregorio Badeni, to the action taken by the Government in relation to Shell (La Nación on-line, January 25, 2008).

⁸ Opinion of the criminal law expert Juan Pablo Vigliero (La Nación on-line, January 25, 2008).

words have now gained an unusual relevance: *The government has not been created to become rich, but to be the guardian and sentry of the rights of men, the first of which is the right to work, that is, freedom to work and to engage in economic activities.... ownership is not actual wealth when it is not inviolable by the law and in practice*⁹. Only by recovering the values that inspired our Constitution can we reach sustained progress in peace and with justice.

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⁹ Alberdi, Juan B, “*Las Bases*” (Ed. Terramar, 1999).