

## *Dear Friends and Clients,*

With our newsletter we would like to inform you of recent and significant legal developments in the field of energy law in Argentina

Best regards,

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#### MHR EDITORIAL ARTICLE FOR THE FIRST ISSUE OF A NEW PRESIDENTIAL TERM

The start of a new decade, coupled with a new political cycle of macroeconomic and energy policies, prompts us to write an editorial article in our first Newsletter of 2020, on the need for adequate long-term policies in the energy sector.

Let's face it, there are few countries in the world that, like Argentina, fluctuate recurrently between antagonistic macroeconomic policies, none of which has been successful in reaching long-term sustainable growth, but only pyrrhic victories which destroy whatever good or bad was done by the preceding Administration, achieving sometimes a short-term boom at the cost of a subsequent severe economic crisis. This is why, among other reasons, Argentina **needs stable policies and regulatory frameworks.**

Moreover, past Argentine energy policies have lacked any meaningful balance between Argentina's public needs and private investors' needs, many times resulting in a zero-sum game of binary options that lead to mutually exclusive alternatives. The results of these inconsistent policies can be seen in the natural gas shortages and destruction of our natural gas export market caused by the government intervention in the wholesale natural gas market during the 2002-2015 period, as well as in the policies insisting on dollar-denominated natural gas prices to be passed-through to utility tariffs -with inadequate mitigation for residential users- during the period of large currency devaluations between 2015 and 2019. Unless Argentina abandons unsustainable options and instead begins creating **policies that adequately balance public interest needs and investors' needs**, it will not attain long-term stability.

One of Argentina's most difficult challenges is to achieve **fiscal solvency and global competitiveness**. All past scenarios of high investment inflow to Argentina were ultimately cut short as a result of the failure to meet these goals, which derived in a crisis, which in turn created incentives for the sitting government to change the rules, generally in a disruptive manner, creating uncertainty about stability and the rule of law. For these reasons, in order to attract investments, Argentina has resorted to programs that include half-baked promises by the government regarding sales prices, currency stability, take or pay obligations or other government commitment, which in most cases were ultimately breached. A small portion of those investment inflows were at-risk investments dedicated to produce goods and services in Argentina for export at global market prices. This is evidence of Argentina's serious long-term competitiveness weakness.

Like any problem, this is also an opportunity. Argentina's oil & gas export potential, together with exports from the mining and technology sectors, have a larger probability of receiving substantial at-risk investment to produce goods and services that may compete in global markets. But having the greatest potential is not enough to achieve effective global competitiveness. This needs to reduce **Argentine government-take to that of comparable global oil & gas competitors**, such as the United States of America.

So, let's translate these four basic needs into future energy policies and regulations.

Starting with the renewable energy sector and facing the critics of the new energy administration to the previous Administration's *RenovAr* program, **investment regulatory stability** surges as the most important need. It is of the essence that the policies in the renewable energy sector respect the existing vested rights of investors. This means abiding by the terms of existing and performing renewable energy PPAs. Altering the rules and contracts in force would send the wrong message and have a severe adverse impact on future investments, not only in the renewables sector, but in the energy sector in general (for example, the on-going off-shore oil & gas program and unconventional development prospects at Vaca Muerta), let alone the perception of Argentine political risk of foreign investors and creditors in general. Argentina will need **creative and well-balanced policies between public interest needs and investors' needs** with respect to the impact of the August 2019 financial crisis in the timely performance of the PPAs.

Other investments in the electricity sector, such as thermal generation and electricity transmission, must also continue to have **investment regulatory stability** by means of policies that continue to frame future investments under the Public-Private Partnerships Law No. 27,328 and its regulations. This law was enacted by the previous Administration but favorably voted by prominent representatives of the then political opposition who are now part of the new Administration. This regime replicates other successful regimes in Latin America aimed at replacing government funding with private at-risk funding with all the regulatory features, generally used in project finance, for the financial entities involved in the Project.

Argentina's vast potential for receiving foreign investments in the energy sector is today associated with the long-term development of its oil & gas reserves. But these investments will not materialize if Argentina does not provide sufficient safeguards and guarantees that they will be immune from our past history of recurrent economic cycles pegged with aggressive shifts with respect to foreign exchange, tax and energy regulation. That is why the oil & gas industry and the current Administration are currently working on a bill (as opposed to a lower ranked regulation) providing the core regulatory need highlighted at the forefront of this article: **regulatory stability**. Hopefully, this bill will be voted by representatives of both the party in power and the opposition, and represent the first step towards the construction of long-term policies to be followed by future governments.

That is why all the drafts of the bill currently circulating on companies' and government desks, tackle at least three mainstream political risks: **(i) foreign exchange; (ii) tax; and (iii) export permit stability**.

Argentina's current macroeconomic context suggests that it would be unlikely for it to generally abandon exchange controls in the short term. That is why currently the correct strategy is a focal approach to **eliminate or mitigate foreign exchange controls**, particularly if implemented in business sectors that through export revenues, job creation and local industry reengineering, will provide the rest of the economy the flows required to support the inevitable pain of future transformation. This focal approach was implemented by China in the 1970s when it began opening up to global markets by creating a special economic zone in the Guangdong Province, that decades later spread to and transformed the whole Chinese economy.

**Foreign exchange stability** rules may be coupled with special instruments such as off-shore trusts or escrows that provide twofold protection: (i) protection to the investors and their lenders that export proceeds may be segregated and directly allocated to the payment of cross-border debt and the import of goods or services needed to develop the relevant projects; and (ii) protection to the government that any excess export proceeds needed by the Argentine economy will be repatriated.

**Tax stability** should provide investors a long-term tax scenario for their investments, covering all federal and provincial tax jurisdictions, but also tax benefits, including the elimination of export taxes, so that Argentina is at least placed in a competitive position vis á vis other comparable oil & gas export competitors (in resource terms) such as the U.S.A.

**Export permit stability** requires the issuance of long-term and irrevocable export permits for designated volumes of oil and natural gas or LNG, as applicable. It also needs both a paradigm change and the abandonment of past binary options. The paradigm change refers to the test to be applied when approving oil and natural gas exports. Because of the unconventional revolution, we now know that the resource is available for many generations, but what is lacking is the capital to develop those resources. Rather than existing proven reserves, what today determines the future sufficiency of domestic supply is the investment policy in the

oil & gas sector. Likewise, the main potential risks that natural gas exports may create for the domestic market are not so much those referred to potential shortages, but to the impact of such exports on domestic prices, and consequently the impact of such exports on the competitiveness of the rest of the economy and the consumers.

The United States and Canada, both countries with significant unconventional oil & gas resources, have recently changed their tests to grant natural gas export permits, in order to incorporate resource availability and an analysis of the impact of the relevant export on the economy in general. An example of this change of paradigm may be seen in the Cheniere Corpus Christi LNG 2015 application for export permit

#### CHENIERE CORPUS CHRISTI LNG 2015

The **abandonment of failed binary policies** becomes decisive with respect to the oil & gas self-sufficiency test. China lost its self-sufficiency and became a net energy importer as an inevitable cost to advance to the pole position of the economies of the world. Should Australia allow LNG exports from the Western regions to Japan at 12 dollars per MMBtu, when at the same time it may need to import LNG at 6 dollars for its Eastern regions?

In today's global economy, Argentina would be wealthier if it allowed firm export permits both for natural gas and crude oil exports, while tolerating imports during the winter natural gas peaks or any crude oil short-term needs of our local refineries. A policy of firm irrevocable export permits is not only a need of investors and financing providers, but also a rational public policy associated with economic growth built on the basis of long-term export projects that will allow the reengineering of our industrial infrastructure for the production of goods and services associated with such export projects. Fostering exports such as unconventional deep crude oil that today is not needed by local refineries, will not only increase crude oil domestic production in general, but also allow the commercial development of the associated gas that is extracted from such projects.

Firm export permits will not per se satisfy final investment decision regulatory tests, if not complemented with additional **regulatory stability guarantees throughout the export project value chain**, including transportation, processing, storage and liquefaction, as the case may be. Investors and creditors of transportation, LNG plants and appurtenant facilities will demand that their investments be protected against government intervention on their off-take agreements, particularly in respect of contracts related to the primary placement of their new capacity, which constitutes the main source of revenue required to repay loans and recover the equity investment.

All these stability guarantees will be weakened if they are not accompanied by investment contracts in which the government accepts international arbitration to resolve any disputes. This will be a real challenge for the new Administration. International arbitration in a neutral forum is a worldwide tool to encourage foreign investment that is used inter alia by Perú (for example Decree-Law No 031-2004-EM on LNG Plants).

Last, but not least, is the issue of domestic market prices, in which Argentina has never been able to escape binary options. This is an area in which it becomes essential to apply long-term solutions resulting from **well-balanced policies between public interest needs and investors' needs**.

Deregulated domestic prices for crude oil should be a relatively easy task for the new Administration. It was its own policy since 2014, and was continued by the previous Administration until the temporary intervention of 2019. Disruption of this policy would be harmful and neither serve the short nor long term public interest.

Natural gas presents a more challenging scenario. Public needs regarding natural gas for residential consumption require that the natural gas component of utility tariffs be denominated and adjusted in local currency. On the other hand, investment feasibility for domestic natural gas development projects requires dollar-denominated wholesale prices.

The new Administration is already working on resolving this dilemma through public tendering of long-term gas supply agreements. Under these structures, the government, who manages the economy and is responsible for currency devaluations, should bear the currency risk between the dollar prices payable to local producers and the peso-adjusted prices that utilities may pass-through to their customers.

All other natural gas domestic wholesale prices should be deregulated, in order to provide the necessary signals to make viable the investments that are required to develop our domestic resources.

Argentina's history proves beyond doubt that short-term policies have the same result as providing drugs to an addict: they give a short-term relief, at the enormous cost of reducing any chance of long-term survival.

While we recognize that this article could cover several other issues with respect to future energy policies, we have focused on certain essential matters without which this new chapter of energy policies will result in yet another short-term cycle in our pendular history.

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