



# **VENEZUELA, STILL A UNIQUE DIAMOND IN THE ROUGH**

**JUAN CARLOS ANDRADE**

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Venezuela is the country with the largest oil reserves in the world. It has up to 309,000 million barrels of oil<sup>1</sup>. Also, according to the latest British Petroleum (BP) Statistical Review of World Energy<sup>2</sup>, with fourteen countries making up 93.5% of the world's oil reserves, Venezuela continues to lead. Between 2005 and 2015, Venezuela jumped from fifth place in the world to number one, as almost 200 billion barrels of oil reserves were identified. Venezuela discovered its first oil field in 1914 so, in addition to being the world leader in reserves, it has been in the oil industry for more than 100 years.

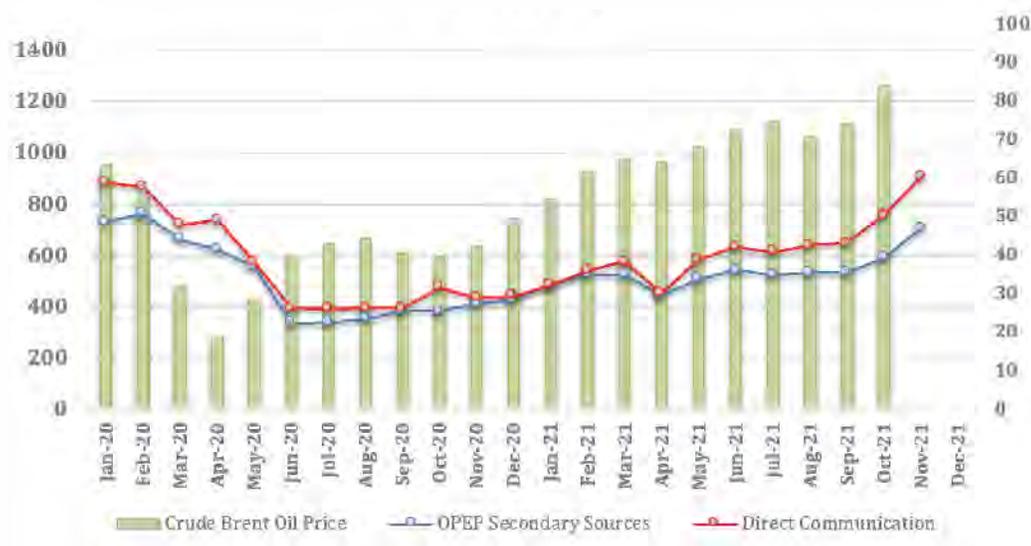
It is important to stress that despite international economic sanctions, and a world recession derived from the COVID pandemic, during the last eighteen months (July 2020 to December 2021), Venezuela has managed to increase production from approximately 336 B/d to 930 B/d.<sup>3</sup>

<sup>1</sup> See: <https://www.statista.com/statistics/273339/oil-reserves-in-opec-countries/#:~:text=Venezuela%20is%20the%20OPEC%20member.of%20some%20303.6%20billion%20barrels.&text=In%20that%20same%20year%2C%20the,109.45%20U.S.%20dollars%20per%20barrel>.

<sup>2</sup> See: <https://www.visualcapitalist.com/ranking-the-countries-with-the-largest-proven-global-oil-reserves-in-the-world/>.

<sup>3</sup> Mariana Parraga (Reuters) on December 27, 2021, published an article recognizing Venezuela latest efforts to increase crude production "How Venezuela pulled its crude production out of a tailspin".

**VENEZUELA'S OIL PRODUCTION (MBD) VS BRENT CRUDE OIL PRICE (\$/BL)**



Even under very complex circumstances, Venezuelan policy makers' measures to increase crude production have varied, but what seems to be a recent trend under Minister Tareck El Aissami's<sup>4</sup> tenure, is the continued and focused effort to develop "out of the box" solutions ranging from diluents' blending swaps to boosting extra heavy crude production from the Orinoco Belt, or to allowing private entities (through innovative and flexible contractual arrangements) to actively participate in the production of crude. Recently, Venezuela strengthened cooperation ties with Equatorial Guinea in matters of hydrocarbons by signing a confidentiality agreement between the Sectorial Vice President for the Economy, Tareck El Aissami, and the Minister of Mines and Hydrocarbons of the African country, Gabriel Mbaa Obiang<sup>5</sup>.

Leaving aside the obvious advantage of sitting on the largest proven reserves of crude in the world (holding a unique portfolio of extra heavy, medium, and light crudes)<sup>6</sup>, it is also important to highlight some additional advantages/circumstances of the Venezuelan energy sector which might attract foreign and local capitals, as well as some essential challenges that the Venezuela energy industry would be facing.

We do not envisage to undertake a detailed explanation of all of the above-mentioned circumstances; however, we would try to summarize some of which we believe might be

<sup>4</sup> Official Gazette No. 6,531 Extraordinary dated April 27, 2020. Mr. Tareck El Aissami was appointed Minister of the Popular Power of Petroleum.

<sup>5</sup> Public statement made on December 22, 2021, by the Ministry of the Popular Power of Petroleum.

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relevant. Below, a brief description of these circumstances/measures, and some of the challenges. We have divided our discussion in two main sections, namely, (1) selective specific advantages (i.e., production cost, existing facilities, qualified personnel, and strategic geographical location); and (2) public policies (e.g., Production Service Contractual Arrangements and Strategic Alliances; Anti-blockade Law and Debt Restructuring; Private Direct Investment; Legislative Agenda).

### 1. SELECTIVE SPECIFIC ADVANTAGES.

**Production Cost.** Venezuela still has a very attractive production costs which also vary from each production area (e.g., Lake Maracaibo, Orinoco Belt and the State of Monagas Northern Region), and it is known that when world class production areas are forced to shut down operations for crude price reductions, like US shale producers or those in the artic, Venezuela can endure and prosper. Another advantage of also holding heavy asphaltic crudes is enduring in a world that transition away from oil as a transportation fuel. Currently the only replacement for asphalt is cement which is far dirtier and more energy intensive product. Additionally, heavy, and intermediate crudes ar at a premium - especially in the US as its legacy refining infrastructure was designed to process that type of crudes. Similarly, extra heavy crudes are also attractive as a blending crude with lighter crudes to produce medium crudes require to feedstock medium deep conversation refinery.

Understanding the difference in each local region of production would facilitate incorporating tailor made incentives for the exploitation of reserves for each region. For instance, in 2017 the average production cost of the Orinoco Belt was in the range of 7 to 9 US Dollars per barrel of blended Merey<sup>16</sup> and from 12 to 15 US Dollars per barrel of upgraded crude oil. Allowing crude operators to combine the production of extra heavy crudes in the Orinoco Belt together with lighter blending crudes from the State of Monagas Northern production Region, would bypass the need of importing or reducing expensive diluents, and could result in an improvement of the production cycle once managed by the State-Owned company. Another option might also be allowing operators of extra heavy crude fields to import their own diluents, to create a potentially more efficient circuit under agreements with allied refineries for the processing of heavy and medium crudes. These business schemes might also be improved by permitting the final disposition of natural crudes in the international markets.

As to some conventional production regions such as Lake Maracaibo, allowing an active and efficient integrated contractual model of private maritime service providers, might also result in obtaining a significant reduction of production costs and a more efficient distribution of crudes to local refineries and export of crudes. These contractual arrangements might also be complemented with environmental remediation funds that would result in certain measures necessary to clean up a vital aquatic environment, such as the unique Lake Maracaibo <sup>7</sup>.

<sup>7</sup> Only deferred crude production in Lake Maracaibo could potentially reach 250.000 Barrels per day. In 2017 Lake Maracaibo production reached approximately 420.000 Barrels per day.

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**Existing facilities.** Of course, although some infrastructure would need to be replaced or some would require significant investments to be operative again, Venezuela still possesses a relevant portfolio of oil and gas facilities that might facilitate the recovery of its industry. For example, the Venezuelan Petroleum Chamber<sup>8</sup> (“Cámara Petrolera de Venezuela”) reported in several public presentations that by 2019 Venezuela had a refining capacity of 1,553,000 BD combining Bajo Grande, Paraguana, Isla, El Palito, Puerto La Cruz and San Roque. There are 3 petrochemical complexes that have a combined capacity greater than 7,000 MTMA, namely, Petrochemical Jose Antonio Anzoategui (Superoctanos, Supermetano, Metor, Fertinitro), Petrochemical Complex Moron Pequiven (Ammonia, Urea, Ammonium Sulphate, Nitric Acid, Sulfuric Acid, Phosphoric Acid, Superphosphate Triple, Granules, Power Plant and Electricity Distribution, Vapors and others), Petrochemical Complex Ana Maria Campos (Olefines, Vinyl Chloride Segment, MVC Plant, PCV Plant, Gas Segment, Ammonia Plant, Urea Plant, Propilven Plant.

For example, in terms of crude infrastructure, only in the State of Anzoategui, there are approximately 3,063 reservoirs, 9,452 oil wells, 67 oil fields, 1,366 kilometers of oil pipelines, 2,207 kilometers of gas pipelines, 17 water processing plants, 38 processing plants/gas, 10 water/steam injection plants, 167 gas compression, 6 tank farms, 156 flow stations, 54 energy plants, 11 terminals, 846 transfer capacity ICO (MMPDC), 520 transfer capacity Jose (MMPDC), 216 transfer basic companies (MMPDC) and 525 transfer capacity Northern Anzoategui (MBP).

Additionally, in the State of Zulia, there are approximately 1,494 reservoirs, 27,208 oil wells, 117 oil fields, 3 refineries, 1 petrochemical, 5,588 kilometers of oil pipelines, 2,263 kilometers of gas pipelines, 30 water processing plants, 2 processing plants/gas, 36 water/steam injection plants, 1 gas injection plant, 52 gas compressing plants, 15 tank farms, 439 flow stations, 7 energy plants, 4 terminals and 755 transfer capacity CRP (MMPDC).

As per the gas industry, Venezuela has 197,1 Bcf of gas (the 8<sup>th</sup> biggest gas reserves in the World). Venezuela also possesses 5,225 km of built gas-pipelines and approximately 25% more are being constructed<sup>10</sup>; there are 151 gas compression plants and 533 machines, transportation capacity for dry gas totaling 6,683 Bcf per day, and transportation capacity for rich gas totaling 900 Bcf Per day. Venezuela has the capacity to extract 2,950 Bcf per day of LNG.

**Strategic geographical location.** Venezuela is known for having various means of communication and commercialization. Obviously, Venezuela’s location at the northernmost point of South America implies many benefits when exporting and importing all sorts of products or goods, not to mention its proximity to American, European, and Asian markets due to its proximity to both the Atlantic and Pacific Oceans, the latter through the Panama Canal.

<sup>8</sup> The Venezuelan Petroleum Chamber is the largest Venezuelan petroleum chamber grouping petroleum service providers, and has currently more than 500 members, ranging from well service providers, EPC companies, drillers, procurement companies.

<sup>9</sup> This refinery is no longer active and inserted in the PDVSA refining circuit.

<sup>10</sup> This register dates to 2016 and is provided, as stated before, by the CPV.

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**Qualified personnel.** Despite what occurred in the industry during the last decade, qualified and experienced personnel are available locally to continue recuperating the energy industry, at least during a first phase of investment. We believe that well paid and experienced personnel are vital for the development of the Venezuelan energy industry. Allowing the participation of private operators and permitting private and flexible contracts to recruit talented personnel, would also help future recovery efforts.

## 2. PUBLIC POLICIES.

**Production Service Contractual Arrangements and Strategic Alliances.** From 2017 to date, a series of contractual arrangements have been created to enhance crude production; these models have been designed to allow private parties to collaborate with PDVSA in the recovery of crude production. There are at least three main contractual schemes that have been set up to incorporate private parties into the E&P sector, namely, 2020/2021 Productive Services Agreement (“PSA”), 2018/2019 Joint Services Agreement (“JSA”) and, finally, the 2020/2021 Strategic Alliances (“SA”). Both the PSA and its first version, the JSA, are purely contractual arrangements between private parties (normally a local service provider), and a PDVSA affiliate to carry out certain vital production activities under a private financing and operational scheme. In a nutshell, private parties would have the obligation to finance both the operating and capital expenses under consideration, for a fee that would vary depending on the corresponding model, namely, PSA or JSA. With certain differences, in both cases, the service contractor would have the right to select a designated crude offtaker responsible for managing the disposal of the barrels produced.

So far, one can conclude that the overall performance under the PSA and the JSA varies depending on various factors (e.g., the contractor’s real operating experience, access to finance, effective control of produced crude to be disposed internationally and/or a right selection of an efficient and international sound offtaker of the corresponding crudes or products assigned for payment); notwithstanding the above, and from public information obtained, it appears that some positive features and inclusions in the contractual models have been inserted (e.g., an international forum for dispute resolutions, private procurement of key required goods and services, and contractual flexibility to hire required personnel).

The strategic alliances that have emerged to date, consist of an umbrella agreement allowing a contractor or a group of contractors to provide services for a specific purpose, with payment-for-service mechanisms.

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**Anti-blockade Law and Debt Restructuring.** Because of the economic sanctions<sup>11</sup>, the Anti-Blockade Law<sup>12</sup> (“ABL”) was enacted in 2020, following approval by the Constituent Assembly<sup>13</sup>. It grants extraordinary powers to the President to alleviate sanctions and stimulate national and foreign investment in the country, including the participation or purchase of assets that are under the State’s administration or management. The Anti-Blockade Law provides that agreements can be entered into by the State and the private sector despite international sanctions, which prevent, among other things, US companies and/or other foreign companies<sup>14</sup> from doing business with the Venezuelan State. Therefore, prescription of bonds, bondholders, debt restructuring offers and any of the categories of debt swaps, could be applicable through the provisions of the Anti-Blockade Law for National Development. A program for debt restructuring would help reignite foreign direct investment into the country<sup>15</sup>.

Recently, as an example of debt for equity swaps, this year, non-US bondholders carried out an exchange of PDVSA and Venezuela bonds with a list price of \$360.9m for PDVSA’s 49% stake in the Dominican Republic refinery Refidomsa. According to certain public information circulated by international agencies such as Bloomberg<sup>16</sup> and Reuters<sup>17</sup>, the transaction was focused on PDVSA using its shares in Refidomsa to redeem a minimum section of its bonds that were held by a company in the Dominican Republic. The purchase price for the shares was €74m, equal to \$87.5m, implying 24.2 cents on the Dollar recovery for the bonds.

<sup>11</sup> Though under ABL sanctions are deemed to include any unilateral measure imposed by foreign nations to Venezuela, the US Sanction Program has been the one to most affect Venezuela’s State economic activities.

<sup>12</sup> Official Gazette No. 6,583 Extraordinary, October 12, 2020.

<sup>13</sup> There are some scholars and politicians that sustain the unconstitutionality of the ABL, namely: Allan Brewer-Carias (See: [chrome-extension://efaidnbnmnnibpcajpcglclefindmkaj/viewer.html?pdfurl=http%3A%2F%2Fallanbrewercarias.com%2Fwp-content%2Fuploads%2F2020%2F10%2F212.-A.R.-BREWER-CARIAS.-Una-Monstruosidad-juridica.-Ley-Antibloqueo.-4-10-2020.pdf&clen=664762&chunk=true\)%20and%20Luis%20Mendoza%20Potell%C3%A1%20](chrome-extension://efaidnbnmnnibpcajpcglclefindmkaj/viewer.html?pdfurl=http%3A%2F%2Fallanbrewercarias.com%2Fwp-content%2Fuploads%2F2020%2F10%2F212.-A.R.-BREWER-CARIAS.-Una-Monstruosidad-juridica.-Ley-Antibloqueo.-4-10-2020.pdf&clen=664762&chunk=true)%20and%20Luis%20Mendoza%20Potell%C3%A1%20) and Luis Mendoza Potellá (See: <https://www.aporrea.org/energia/a295880.html>). Interim National Assembly led by Mr. Guaido also denounced its unconstitutionality (October 20, 2020).

<sup>14</sup> For Instance, non-US companies that subscribe agreements with Venezuela in which obligations are denominated in US dollars.

<sup>15</sup> As stated before, the main set of sanctions that the ABL intends to avoid are the ones imposed by the US Government. That set currently consists of seven Executive Orders and more than 30 General Licenses. (See: <https://globalrestructuringreview.com/review/restructuring-review-of-the-americas/2021/article/debt-equity-conversions-in-venezuela>).

<sup>16</sup> Yapur, N and Fieser, E. Venezuela Debt Swap Breathes Life Into All-But-Dead Bond Market (See: <https://www.bnnbloomberg-ca/venezuela-debt-swap-breathes-life-into-all-but-dead-bond-market-1.1655727>).

<sup>17</sup> See: <https://www.reuters.com/business/venezuelas-pdvsa-cedes-stake-dominican-oil-refinery-debt-swap-2021-08-19/>.

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**Private Direct Investment.** The International Center for Productive Investment was created pursuant to the ABL and aims to offer a center for the support of new investment projects and economic growth in Venezuela, under the protection of the ABL. During 2020, senior officials of President Maduro's Administration confirmed that a re-privatization process is being undertaken and that they have been meeting with businessmen from the private sector<sup>18</sup>.

According to Bloomberg<sup>19</sup> Venezuela has about \$6 billion worth of foreign assets that could be offered to creditors. With respect to the oil and gas sector, allowing majority ownership of operating mixed companies by the private parties, and then allowing the use of debt instruments or reconciled claims as currency for payment of shares or other forms of participation in the oil and gas sector, might also be a very powerful tool to attract investors.

**Legislative Agenda.** It might also be necessary to modify some key articles from the existing *Hydrocarbons Organic Law*<sup>20</sup> to provide sounder legal grounds to facilitate financing and the injection of fresh capital to foster existing and future energy projects. Various reform projects of the *Hydrocarbons Organic Law* have emerged from several political actors<sup>21</sup>. Despite the differences in scope and ideological inclination, most of these projects coincide in allowing private parties to be in the driver's seat in the areas of exploration and production.

Among the different drafts that arose, their chief aim was to lessen Venezuela State's control on upstream activities by allowing private investors to be majority shareholders on operating mixed companies, and have effective control of the E&P activities, as well as allowing additional contractual schemes similar to the PSA and the JSA. Additionally, some of the proposals also allow private parties to market natural hydrocarbons (currently prohibited under Article 57 of the *Hydrocarbons Organic Law*). Finally, there is a certain consensus in reducing the government intake which seems to be high vis-a-vis other competing energy provinces.

On May 8, 2009, The Organic Law that Reserves Assets and Services Related to Primary Hydrocarbon Activities to the State<sup>22</sup> came into force. Through this law the government

<sup>18</sup> See: <http://ciipven.com/>.

<sup>19</sup> Yapur, N and Fieser, E. Venezuela Debt Swap Breathes Life Into All-But-Dead Bond Market (See: <https://www.bnnbloomberg-ca/venezuela-debt-swap-breathes-life-into-all-but-dead-bond-market-1.1655727>).

<sup>20</sup> Official Gazette No. 38,443 Ordinary, May 24, 2006.

<sup>21</sup> To the best of our knowledge, we believe there have been two publicly recognized drafts of a *Hydrocarbons Organic Law* modified, to wit: Anteproyecto de Ley Orgánica de Hidrocarburos- November, 2018, promoted by the Center for International Development of Harvard University; and the Anteproyecto de Ley Orgánica de Hidrocarburos- December, 2020, promoted by the Permanent Commission of Hydrocarbons and Mines of the Venezuelan National Assembly.

<sup>22</sup> Official Gazette No. 39,173 Ordinary, May 7, 2009.

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nationalized several services and assets that provided maritime services in Lake Maracaibo<sup>23</sup>. It is our understanding that there are various scenarios and options currently under discussion, to revert the effects of this legislation and, also, specific practical measures have been taken to allow the active participation of private service providers to increase crude production (e.g., as far as we know, PDVSA has signed “strategic alliances” with at least one counterpart to boost crude production in Maracaibo Lake). In this scenario, we would also applaud the inclusion of provisions that would consider the prevention and the remediation of environmental damages to Lake Maracaibo.

**Legislative Agenda.** (ZEE, by its acronym in Spanish). These are territorial spaces for the attraction of national and foreign productive investments based on economic stimuli (e.g., fiscal, financial and customs), legal certainty and coherent economic policies<sup>24</sup>. These areas have a special and extraordinary socio-economic regime, designed for the development of economic activities of public, private, mixed, and communal investment<sup>25</sup>. We believe these special zones might also facilitate the development of clusters of crude/gas production areas introducing attractive incentives.

### FINAL REMARKS.

As Venezuelans, we have a tremendous task ahead to recover and secure future opportunities and challenges that our energy industry will be facing. In our opinion, a combination of public and private collaboration is required. The energy industry is capital intensive and Venezuela has been producing crude and gas for over 100 years, therefore, there are talented people willing to continue to add value to the industry as well as some infrastructure that still is of use.

There are in Venezuela significant assets throughout all the value chain of its energy industry (upstream and downstream) that will facilitate and enhance the recuperation of its industry.

We applaud measures taken to allow the active participation of the private sector (both national and international) on the upstream activities, and would suggest some specific adjustments to the *Hydrocarbons Organic Law*.

<sup>23</sup>We have seen a recent trend of seasoned local maritime service providers that are currently investing resources to be prepared for a larger reactivation of E&P activities in Lake Maracaibo in 2022.

<sup>24</sup>See: <http://zeefachira.com.ve>.

<sup>25</sup>ZEE are responsible for a high percentage of industrial activity and a much higher percentage of exports in the world. ZEE are highly relevant factors in development of the most dynamic nations on the planet, such as, for example, China, Vietnam, South Korea, just to mention three of the most important.

<sup>26</sup>Venezuela has entered into Double Taxation Treaties with the following countries: Austria Barbados, Belarus, Belgium, Brazil, Canada, China, Cuba, Czech Republic, Denmark, France, Germany, Indonesia, Iran, Italy, South Korea, Kuwait, Malaysia, Mexico.

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It is also vital to provide guarantees and protections to local and international investors; Venezuela has over Twenty Bilateral Investment Treaties for the Protection of Investments still in effect, as well as 32 Double Taxation Treaties<sup>26</sup>. Honoring the existing contractual arrangements and inserting world class incentives to attract direct foreign investment would also enhance the recuperation cycle.

International sanctions are having and will continue to have an impact on the Venezuelan energy sector. However, in our view, the aim and objectives of such unilateral measures should not impede new actors and counterparts not bound by such actions to participate in the energy industry in Venezuela. We encourage finding negotiated solutions and adjusting such measures, in order to avoid that those most vulnerable (the Venezuelan society at large) indirectly endure their consequences.

Leaving aside all ideological discussion regarding energy policies, it remains critical for the future of the next generations of Venezuelans to understand the importance of quickly advancing towards the recovery of the country's energy industry, taking the realities of a not-so-distant energy transition into account.

Lastly, it would also be critical to find creative and innovative schemes to renegotiate Venezuelan sovereign debt. In fact, incorporating the energy industry could be part of the solution (e.g., debt to equity swaps). Achieving a quick and sound debt restructuring scheme would result in obtaining the cash flow and investments required to advance in the recovery of the energy industry<sup>27</sup>.



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<sup>27</sup> See a series of LEC Interviews and comments to world class experts on Sovereign Debt Restructuring. See: [https://www.linkedin.com/posts/lapadula-esteban-cadenas-abogados\\_thoughts-on-the-possible-restructuring-of-activity-6569954373269536769-bXyX](https://www.linkedin.com/posts/lapadula-esteban-cadenas-abogados_thoughts-on-the-possible-restructuring-of-activity-6569954373269536769-bXyX).