

OIL AND GAS INVESTMENTS IN COLOMBIA

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In 2003 Colombia introduced important amendments to its oil and gas laws making the country a very attractive destination for foreign investment. With the political challenges raised by its neighbors Venezuela and Ecuador, including the former's nationalization of several contracts, and no upstream foreign investment access in Mexico, Colombia is the best oil and gas destination at reach across the Caribbean.

U.S. energy policy of diversifying reliable foreign sources of oil must necessarily include Colombia as a trusted partner in the Western Hemisphere. Colombia is already the ninth largest supplier of oil to the U.S.¹ and follows Israel as top recipient of U.S. aid.

Colombian estimated potential reserves have been calculated at 47 billion barrels, crude oil reserves in 2006 were of 1.51 billion barrels and production reached 529,000 barrels.² Most importantly, eighty percent (80%) of the country's territory remains to be explored.

The amendments to the country's petroleum laws positively contributed to change the trend of declining production and exploration activities.³ The United States Energy Information Administration considers that the Colombian oil and gas investment regime is one of the most attractive in the world.⁴

Through the amendment, the national oil company no longer controlled the country's acreage for exploration and production purposes and was forced to compete with other operators, investors were allowed to own one hundred percent of their investment ventures and a sliding scale royalty schedule became permanent.

Foreign investors are entitled by law to the same rights and benefits as any Colombian investor with full remittance rights. The country contemplates special foreign investment and currency regulations for oil and gas business allowing for duty free imports. The Colombian Constitution protects investors against expropriations without due process and fair compensation.

¹ According to some reports Colombia is ranked as the seventh largest crude oil supplier to the U.S.

² The Oil and Gas Journal reported that Colombia's 2007 proven crude oil reserves were 1.45 billion barrels, the fifth largest in South America. Colombia's petroleum is lighter and sweeter than Venezuelan crudes. Colombia's export crudes are Cusiana, Cupiagua and Orito with API ranges between 28 and 36 degrees.

³ Colombia's oil production in 2006 reached 550,000 bpd more than the 540,000 bpd produced in 2005. Even though the increase in production was only slight what is most important is the shift from a declining trend in production since 1999.

⁴ See United States Energy Information Agency. Colombia country brief analysis. Available at <http://www.eia.doe.gov/emeu/cabs/Colombia/Oil.html>.

Some of the foreign investors that have believed in Colombia include BP, Exxon-Mobile, Shell, Chevron-Texaco, Occidental, BHP Billiton, Halliburton, Baker Hughes, and Schlumberger.⁵

Following several years of poor exploratory activity and the threat of becoming a net oil importer, Colombia changed the role of its *Empresa Colombiana de Petróleos* (ECOPETROL) and created the *AGENCIA NACIONAL DE HIDROCARBUROS*.

Colombian current hydrocarbon legislation is based on Law 790 of December 27, 2002 pursuant to which Congress granted special legislative powers to the Executive to introduce amendments to the country's administrative sector, including but not limited to redistributing administrative powers among administrative agencies, ordering mergers and creating new agencies. (*see* article 16, Law 790, 2002).

Under such legislative powers, the President issued Decree 1760 dated June 26, 2003 pursuant to which all powers previously reserved to ECOPETROL, the Colombian National Oil Company, to manage the country's hydrocarbon assets are now attributed to a new agency, the National Hydrocarbon Agency (*Agencia Nacional de Hidrocarburos*)⁶. The government's main purpose was to sever from a single entity control of all hydrocarbon assets and all exploratory, development, exploitation, refining, marketing and carriage operations. The *Agencia Nacional de Hidrocarburos* was created by Decree 1760 of 2003. The constitutionality of Decree 1760 of 2003 was reviewed and upheld by the Constitutional Court pursuant to Judicial Sentence C350 dated April 20, 2004.

Relevant Colombian authorities

An oil and gas investor in Colombia will have contact with at least the following authorities: *Agencia Nacional de Hidrocarburos* (National Hydrocarbon Agency); *Ministerio de Minas y Energía* (Ministry of Mines); *Ministerio de Ambiente, Vivienda y Desarrollo Territorial* (Ministry of the Environment); *Banco de la República* (Central Bank); *Dirección de Impuestos y Aduanas Nacionales* (National Tax Authority) and *Superintendencia de Sociedades* (Corporation's Superintendency).

Ownership of hydrocarbons

Ownership of oil in place in Colombia is reserved to the State, like it is the case with offshore reserves in the United States and unlike onshore reserves in the several states. Private parties may only acquire title over produced oil.

⁵ Foreign investment in Colombia involves many sectors of the economy in addition to oil and gas. Other investors, to mention a few, include Drummond, Glencore, Hewlett Packard, Microsoft, IBM and Nestle.

⁶ The main model followed in the formation of the Colombian Hydrocarbon Agency was the Brazilian National Petroleum Agency (*Agencia Nacional do Petróleo*).

Nature of the National Hydrocarbon Agency (NHA)

The NHA manages all available areas for oil and gas E&P in Colombia that are not under contract. The NHA is not an operator and acts simply as manager of the country's hydrocarbon wealth in a similar fashion as the Secretary of State under the United Kingdom's 1998 Petroleum Act and the Minerals Management Service regarding the U.S. outer continental shelf. Like the MMS, the NHA is responsible for collecting royalties.

The NHA is an autonomous administrative agency under the Ministry of Mines and Energy. The NHA has its own legal nature, patrimony and finances and its domicile is in Bogota. (see article 2, decree 1760, 2003)⁷. Information about the NHA, including upcoming rounds, may be obtained from its website at www.anh.com.co.

Among other, the Agency's powers include:

- to manage Colombia's hydrocarbon resources. (*see* article 4, decree 1760, 2003).
- to assign areas under its control for exploration and exploitation purposes. (*see* article 5.1, decree 1760, 2003)
- to draft, negotiate and execute contracts for the exploration and exploitation of hydrocarbons in Colombia. (*see* article 5.1, decree 1760, 2003). The E&P contracts are to be drafted pursuant to article 76 of Law 80/1993. The same provision authorizes the agency to require contracting companies to implement programs for the benefit of those communities located in the areas affected by E&P contracts (*see* article 5.7, decree 1760, 2003)
- to determine the volume of hydrocarbons that an operator has to sell locally to satisfy local refining demand and to establish the price of such sale.

As of January 1, 2004 new E&P contracts are in force in Colombia.

NHA is a political agency directly controlled by the President who appoints all members of its board (Ministers of Mines and Energy, Minister of Finance, National Planning Department, and two President representatives). This board authorizes all E&P contracts before they are presented for signature. Likewise, the board approves any new contracting models to be used by the NHA.

An oil and gas investor must be aware of the three ways of obtaining a contract with the NHA:

-Direct Negotiation.

⁷ Colombia's Constitutional Court found decree 1760 of 2003 adjusted to the Constitution and so ruled through judgment C-350/04 dated April 20, 2004.

- Open public bid.
- Closed bidding process with qualified companies.

Investor requirements

All acreage in Colombia is managed by the *Agencia Nacional de Hidrocarburos* (National Hydrocarbon Agency). A company interested in doing oil and gas business in Colombia is required to certify with the agency its competence and capacity in the following areas:

1. Financial. The company must be able to show that it has the necessary financial resources to meet its contractual exploratory obligations. (see article 2.4. Agency's Regulations for contracts for exploration and exploitation of hydrocarbon resources)
2. Legal. The company must be able to enter into contractual obligations with the Agency and other parties in Colombia pursuant to Colombian laws. (see article 2.5. Agency's Regulations for contracts for exploration and exploitation of hydrocarbon resources)
3. Operational. The company must be able to show a track record or experience as an operator abiding by best industry practices and with due regard for the environment. (see article 2.6. Agency's Regulations for contracts for exploration and exploitation of hydrocarbon resources)
4. Technical. The company must describe the members of its team who have the knowledge to conduct petroleum operations. (see article 2.7. Agency's Regulations for contracts for exploration and exploitation of hydrocarbon resources)

The Agency publishes on a periodic basis a land map indicating which areas are available and which are under contract.

Two basic contractual forms

The Agency contemplates two basic contractual forms (see article 6 of the Regulations):

- a) The **Technical Evaluation Agreement (TEA)**
- b) The **Exploration and Exploitation Contract**.

These agreements are essentially licenses to conduct non exclusive exploratory work and exclusive exploratory and production work.⁸

⁸ Very similar contractual models have been implemented by PERUPETRO.

Contracts are awarded by the Agency pursuant to any of the following procedures:

- a) On a first come first served basis. All TEA's are awarded on a first come first served basis scheme.
- b) As the outcome of a competitive bidding process.
- c) In response to an invitation process and for special areas.

The TEA's were introduced pursuant to Regulation 030/2004 (Acuerdo 30 del 2004). Its main purpose is to enable an investor to conduct exploratory work before executing an E&P contract.

Technical Evaluation Contracts or Agreements (TEA)

Through a Technical Evaluation Agreement an oil and gas company agrees to conduct limited technical evaluation operations at its exclusive cost and risk, to evaluate the areas hydrocarbon potential. As consideration for assuming such risks it is entitled to a preferential right to execute an exploration and production contract with the Agency over the same area.

The TEA's has two basic exploratory objectives:

- to conduct geologic and geophysical activities.
- to drill an exploratory stratigraphic well.

The TEA provides that such exploratory work is to be performed within an 18 month term.

An investor to whom a TEA is awarded has a preferential right (known by the agency as a "Right of Priority") to enter into an E&P contract over the same TEA area.

TEA's provide for an 18 month term for onshore contracts and 24 month term for offshore contracts. These terms are not inflexible and extensions may be obtained if required by the seismic or drilling work program.

One of the advantages of a TEA is that it may be executed directly by a foreign investor with no previous presence in Colombia. The TEA provide for the investor's corporate formation in the country within the first two months of the agreement's effective date.

The contractor's most important obligations under a TEA include:

- preparing and providing an evaluation schedule or work program.
- performing the technical evaluation operations.
- complying with area withdrawal requirements.

- payment of the fee (signature bonus) to the NHA.
- allow access to the area and surveillance of operations to NHA representatives.
- report to the NHA on the progress of the operations.
- prepare a final evaluation report to the NHA, signed by a geologist or geophysicist, with the analysis of the areas hydrocarbon potential.
- deliver the performance bond (stand-by letter of credit) in an amount of 10% of the contractor's budget under the contract, and as a performance guarantee.
- observe applicable environmental regulations and obtain all necessary permits.
- indemnify the ANH against any losses related with the operations.
- comply with all applicable Colombian labor law provisions.
- establish an abandonment fund.

Applicable law: Colombian law

Jurisdiction: Arbitration before the Colombian Chamber of Commerce.

Exploration and Production Contracts

The NHA issued its model hydrocarbon exploration and production contract (E&P). The main characteristics of this contract are: confirming State ownership of hydrocarbon reserves in the subsoil, granting an exclusive exploration and production license, granting the contractor a 100% work interest with no government carried interest⁹, and providing for royalties, taxes and bonuses as the sole government take.

The E&P's main characteristics are as follows:

- the contractor is solely liable for all costs and risks associated with the contract.
- Six (6) year exploration period divided into at least three exploration phases in which the contractor must perform minimum exploratory works.
- Twenty four (24) year production period following a formal declaration of commerciality. The exploitation term may be extended up to the economic life of the field.

Some of the contractor's most important obligations under the E&P contract include:

- perform the minimum work program
- notify the NHA in writing when a discovery is made.
- timely file a declaration of commerciality and an exploitation plan.
- conducting oil and gas operations under acceptable industry standards.
- being solely liable for any damages arising from oil and gas operations.
- pay royalties in cash or in kind to the NHA.
- measure and control hydrocarbons produced.
- avoid waste of natural gas.

⁹ The E&P thus differs significantly from the standard Association Contract with Ecopetrol. Under the NHA E&P there is no joint venture with the Colombian NOC, and the contractor's rights and obligations apply as under a sole risk operation.

terms.¹⁰

- pay rentals and bonuses to the NHA during the exploration and exploitation
- provide technical information to the NHA on an annual basis.
- observe the confidentiality provisions.
- maintain adequate insurance coverage as required by Colombian law.
- deliver to the NHA the performance bond (stand-by letter of credit) in an amount of 10% of the contractor's budget under the contract and as a performance guarantee.
- give preference to Colombian based suppliers of goods and services.
- meet the technology transfer requirements.
- observe all applicable environmental laws and obtain the necessary licenses and permits.

Applicable law: Colombian law

Jurisdiction: Arbitration before the Colombian Chamber of Commerce.

The Colombian National Oil Company (ECOPETROL)

Ecopetrol, the Colombian National Oil Company, now became another oil and gas operator and investor, in competition with international oil companies. Law 1118 of 2006 authorized *Ecopetrol* to become a publicly traded company and to issue stock that may be purchased initially by Colombians and later by any interested investor. Under the provisions of law 1118 of 2006, the Colombian nation retains at least 80% of the company's stock ownership.¹¹

Information about *Ecopetrol* may be obtained at www.ecopetrol.com.co.

Now, *Ecopetrol* is required to obtain the necessary capital to finance its own exploratory ventures. *Ecopetrol* splits the risk of its oil and gas ventures with multinational oil companies.¹²

Ecopetrol's goal is to substantially increase its exploratory program¹³, increase its oil production to at least 500,000 bpd by 2011 and become a multinational oil and gas company.¹⁴

Ecopetrol has executed sixteen E&P contracts with the NHA and is conducting direct sole risk exploratory works in another fifteen areas.

¹⁰ Rentals are calculated on the basis of the area's size and for each contractual phase. Bonuses are calculated on the basis of production at a rate of \$0.10 per barrel and are due twice a year.

¹¹ *Ecopetrol's* capitalization process follows examples offered by Statoil, Petrobras, ONGC (India), Sinopec (China), Rosneft and Gazprom (Russia).

¹² Occidental Petroleum Company, BP, Chevron, Total, and Petrobras are some of *Ecopetrol's* partners under the new joint ventures.

¹³ *Ecopetrol's* plan is to drill 27 wells in 2009, more than doubling the 13 wells drilled in 2007.

¹⁴ *Ecopetrol* wants to invest in Ecuador, Brasil, Perú, Venezuela, Argentina, and Trinidad.

Stability law (Law 963 of 2005)

On July 8, 2005 Colombian Congress approved law 963 to guarantee stability of all investments in the country above specific amounts¹⁵ following the date when the law became effective. The law allows the Colombian State to enter into stability agreements with foreign investors to guarantee that the terms and conditions applicable when the investment becomes effective will not be amended during the life of the investment. This law operates as a shield against future legislation that may have adverse effects on the investments initially agreed terms and conditions.

Adequate legal services

Oil and gas business is an international business. Understanding host country's laws is not enough. A foreign investor needs legal advice from counsel that understands the challenges of enforcing the host country's legislation, practical issues in negotiating contractual matters, and remedies beyond the four corners of the agreement. Few legal counsel understand both the United States legal system, including its states' oil and gas laws, and the legal systems of the Latin American jurisdictions. Fewer counsel practice law before courts in multiple jurisdictions.

In addition to providing sound knowledge of host country oil and gas and commercial laws, your outside counsel shall advise you an applicable foreign investment, environmental, customs, labor, tax and immigration laws, among other.

Understanding the risks associated with potential risks and exposures beyond the borders of the host country and the four corners of the E&P contract, is in the investors best interest. Lastly, having counsel that speaks your language and the language of the host country literally saves money. Our services are result oriented and cost effective.

Important facts about Colombia

Colombia is located in Northern South America and has borders with Panama, Venezuela, Ecuador, Perú, and Brazil. Its size is twice that of Texas or three times the size of Montana. Colombia has the third largest population in Latin America after Brazil and Mexico.

Area: 1.14 million sq. km. (440,000 sq. mi.).

Language: Spanish

Population: 44,400,000

Currency: Colombian peso. Exchange rate fluctuates daily

Capital: Bogota

Ports: Barranquilla, Buenaventura, Cartagena, Santa Marta, Turbo

Oil production in 2005: 539,000 bbl/day

¹⁵ Stability contracts are available for investments of more than 7,500 monthly minimum wages and for business such as oil and gas, telecommunications, energy generation and ports.

Oil consumption in 2005: 264,000 bbl/day
Oil consumption in 2006: 203,000 bbl/day
Natural gas production in 2005: 6.397 billion cu m
Oil exports in 2004: 289,700 bbl/day
Oil imports in 2004: 6,453 bbl/day
Pipelines in 2007: gas 4,329 km; oil 6,140 km; refined products 3,145 km
Largest fields: Cusiana-Cupiagua (BP); Caño Limón (Occidental)
Major pipelines: Orensa (500 miles); Caño Limón (460 miles); Alto Magdalena and Colombia Oil pipelines; Transandino.
Refined Crude capacity in 2007: 285,850 bbl/day
Major refineries: Barrancabermeja; Cartagena; Apiay; Orito; Tibú.
Most important exports: Oil, coffee, coal, bananas, flowers and apparel.