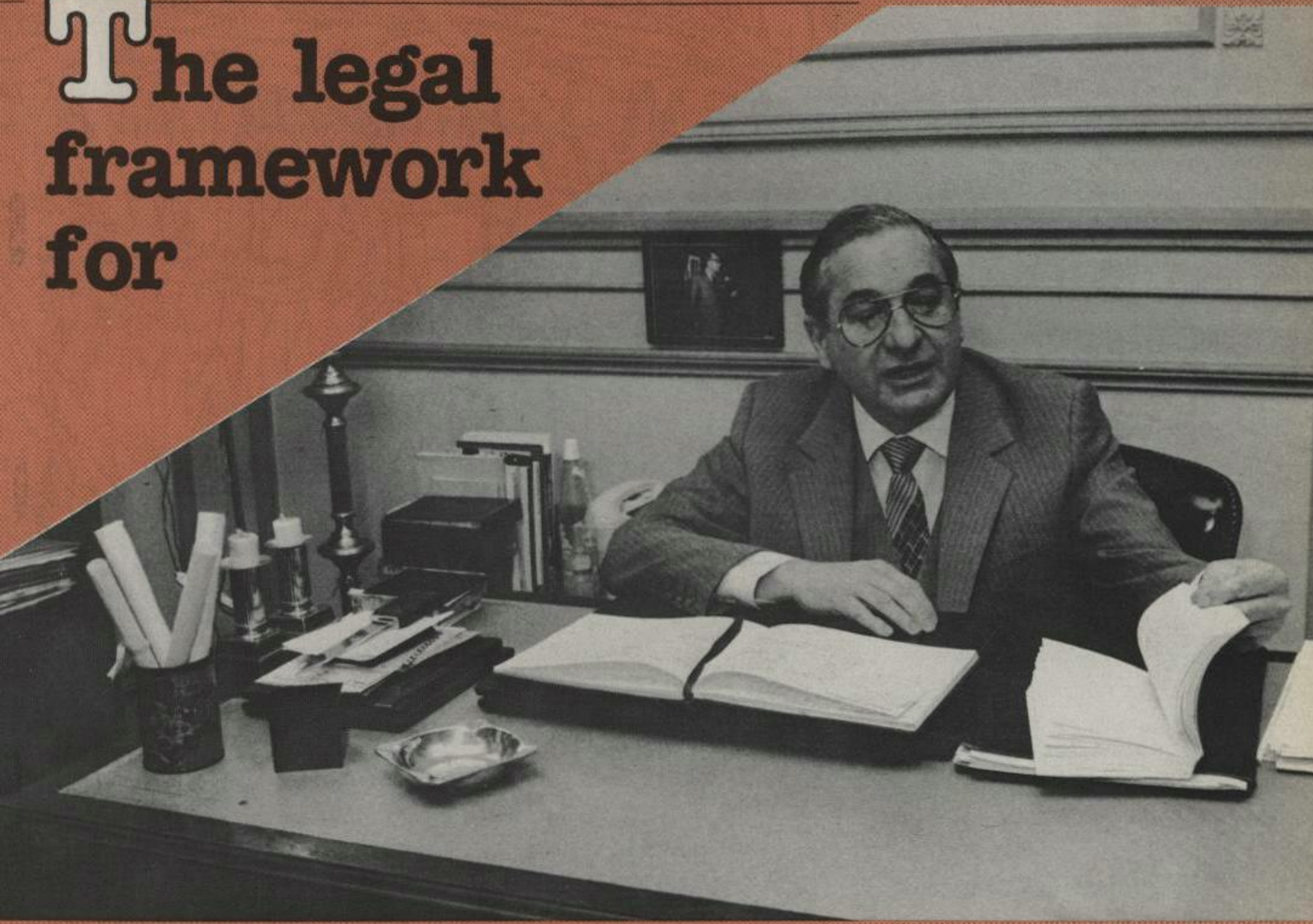
The legal framework for



the oil business in Argentina

By Dr. Ernesto Poblet

Argentina, has a long history as a producer of hydrocarbons, and a large part of it has been dominated by the monopolistic presence of the State, something which made private investors, local and international, less keen to invest Excessive regulation through resolutions, decrees and laws, brought about a system which did conserve our reserves of oil and gas, but one that delayed investment in exploration and made the import of crude oil and its derivatives necessary over several decades ● But all of that is now history ● Now, in the last decade of the 20th century, and interpreting the legal instruments in force in an adequate way, the country produces enough for its own consumption, with a surplus which can be exported, and with an ample range of new business on a solid footing, all of this the result of political will and of a legal framework, the one we offer to readers of this special edition of Petrotecnia.

The basic legal framework for the oil business in Argentina is Law 17319 of 1967. The first of its 105 articles confirms the legal tradition of countries formerly under Spanish rule: that is to say, contrary to the custom in nations of Anglo-Saxon background, "all liquid and gaseous hydrocarbon deposits, both on land and offshore (on the continental Shelf), belong to the State". According to regulations set forth by the Executive Branch, the parties entitled by the above law to engage in oil-related activities are State-owned, privately-owned, and semi-public enterprises.
License and lease holders enjoy ownership rights over produced hydrocarbons including the rights related to their transportation, marketing (crude oil as well as of oil products) and industrialization.
Article 11 makes specific reference to the State-owned enterprises, which play a fundamental role in the implementation of the Government's economic policies while the Executive retains the authority to grant new concession areas and allows private firms to participate in the oil business through development agreements.
Law 17319 also recognizes, through the agency of the State, benefits to be collected by the producing provinces in the form of exploitation royalties in proportions ranging between 5 and 12 percent of the well-head value of the oil produced and/or the gas marketed.

Exploration

The Hydrocarbons Law regulates the exploration system. An exploration license grants exclusive rights to carry out all the oil searching activities within a limited period of time, with a maximum of four years.
In the case of exploration being conducted offshore, the original period is extended for one additional year.
An exploration license holder acquires the right to an exclusive concession for the exploitation of the hydrocarbons he may discover in the relevant concession area. These licenses authorize the holder to develop and use transportation and communication media, buildings and facilities as required by exploitation, tract boundary fixing and all the necessary work to find oil and make the minimum investment needed to achieve success. A period of 30 days is established for the license holder who has found oil, to report the find to the relevant authority of application.

Exploitation Concessions

A concession grants the exclusive right to exploit hydrocarbon deposits in the pertinent holdings for a period of 25 years, with a further 10-year extension in case of optimum fulfilment of the grantee's responsibilities. Concessions are granted by the Executive Power and are sanctioned by decree. They cover hydrocarbon searching and production work, building and operation of processing and refining plants, building of communications and transportation systems for hydrocarbons, facilities, warehouses, camps, docks, piers and all other work or operations required for exploitation. Concession holders are obliged to make the necessary investment for the execution of the work with a view to optimizing hydrocarbon production. The scheme for reverting the concession back to the State implies transfer -at no cost and free from any obligation- of all of the pertinent wells including equipment and facilities, construction and stationary or mobile projects that have been permanently incorporated into the facilities, though not the mobile equipment not linked to field production, nor those facilities that are associated with the holder's rights of industrialization and marketing. In case the concession grantee finds minerals other than hydrocarbons he will have the right to exploit them, provided he meets the requirements set forth in the Mining Code.

Transportation Concessions

Transportation concessions grant the right to move hydrocarbons and their products by way of permanent facilities such as crude oil pipelines, product pipelines, storage and pumping stations; compressors; port, road and rail facilities; airfields; and all that is needed to transport oil and oil products.
The exploitation concession holder is obliged to become a transportation concession holder when he builds permanent facilities such as the ones mentioned above, for transportation beyond the boundaries of the concession area. The same rights can be granted to third parties in the same area.

Calls for Bids

The interested parties may submit bids to the Energy Secretariat specifying the guidelines for an investment program and defining the development site. Should the proposal be feasible, the Executive Power will make a public call for bids in which priority will be given -under equal circumstances- to the originator of the initiative.

System of Taxation

Holders of exploration licenses and exploitation concessions must pay all provincial and municipal taxes currently in force at the moment of signing their respective agreements, but shall be exempted from new taxes or share increments originated in either provinces or municipalities. At a federal level, license and concession holders must pay customs and import duties, exchange surcharges, and royalties. A scheme for exemption from any other tax is established for license and concession holders in respect of federal taxes of any kind, present or future which are linked to exploration of exploitation activities, except those which the parties themselves may have undertaken to honor by virtue of a contract.

The chapter that deals with taxation specifies the system, amounts, deadlines, and extensions for levies to be paid annually by service operators.

The same applies to the exploitation concession holder, for whom the system of royalties payment is also regulated. The latter also applies to gas exploitation and shall be settled in accordance with the volumes of gas produced.

Law 21778 (Risk Contracts) provides for another, special taxation system, but this has not been made use of by operators. However, it could be useful in the future, in order to avoid surprise taxation by decree, as was the case with the Houston Plan.

Imports

When it comes to materials, equipment, and other elements required for the oil/gas industry, the law delegates to the authority of application the right to lay down pertinent guidelines, placing State and private enterprises on an equal footing.

Assignability

License or concession rights may be assigned to third parties through authorization by the Executive Power. Assignees must fulfil the same conditions as required for license or concession holders. Failure to honor credit obligations on the part of a concession holder results in the obligation to assign full concession rights to the creditor.

An arbitration tribunal shall intervene in case of administrative declaration of expiry or annulment. This procedure is extended to disagreements arising between license or concession holders and the authority of application. The arbitration system will consist of three arbiters, one appointed by each of the two parties plus a third party. In case an agreement is not arrived at, the final arbiter will be the Chief Justice of the Supreme Court.

The law also entitles State enterprises to enter into agreements with any public or private legal entities concerning the contractual relationship deemed fit for the performance of their activities, including association.

The Executive Power and the Authority of Application

The Energy Secretariat is the law enforcement authority, but it is up to the Executive Power to grant licenses and concessions, extensions and assignments, as well as to approve associations and other contracts entered into by YPF (the State Oil Board) or Gas del Estado (the State Gas Utility).

A New Legal Framework

From 1967 onwards, Argentina's oil activities were governed by Law 17319, passed during General Juan Carlos Onganía's administration. In 1985, under the Radicals' constitutional government, President Raúl Alfonsín launched the Houston Plan, a policy scheme aimed at encouraging international capital to explore potential hydrocarbon-producing areas.

Two subsequent decrees (1443 in 1985, and 623 in 1987) established the rules that must govern all companies participating in the plan. By virtue of these arrangements, contractors assume exploration risks and contribute capital, know-how, equipment and other investments. A period of up to three years is established for prospection work, including geological, geophysical, geochemical surveys, drilling and other activities. A second period for exploration with a minimum amount of annual extensions up to a maximum of four years. There then follows a third period for exploitation -in case of discovery- with a one-year allowance made in order to asse and propose a statement on marketability of the project. Once marketability has been approved, exploitation and production will be for a period of 20 years, which may be extended up to a maximum of 30 years. The Houston Plan allowed the implementation of 78 agreements and the incorporation of important international companies to exploration activities in the country. But the Houston Plan was repealed as from January 1, 1991, with a view to designing a new legal framework for oil activities. Decree 1055 assigns priority to increasing oil and gas production, and defines secondary-interest areas as those which have remained inactive for five years or whose production is no higher than 200 m3/day. These areas, currently under YPF's control, revert to the State for further awards to private companies through competitive bidding. Areas are awarded to companies bidding the highest amount for "exploitation rights". Bids must relate to the area's reserves and the investment required for their reactivation. Successful bidders will enjoy free disposability of the oil produced.

A new system is established for the so-called central production areas. In this case, the main operator is YPF which will call for international competitive bidding for agreements or association in areas cleared by the authority of application, with the aim of obtaining the greatest possible production from the deposits concerned. The decree establishes a down-payment for "association rights" and the agreements will be in force during no more than 25 years. The share of the oil to which the investor company associated with YPF will be entitled -in proportion to the extent of its participation in the business- will be freely disposable and marketed on the domestic or international market. Contracts entered into through the Houston Plan may also join this free disposability scheme on condition that companies agree to shorten exploration periods.

Private companies are allowed to import oil and oil products in order to supply the domestic market. Finally, it was ruled that the areas of exploration YPF formerly reserved for itself must revert to the State, with a view to making them available to private risk capital.

Decree 1212 of November 14, 1989, promotes deregulation of the oil industry and establishes that the market is the main factor for price formation, amounts, values for transference and tax rebates. It further sets forth the development of the principle of competition between private and State companies, which will force YPF to become an efficient enterprise and compete on an equal footing with private companies.

The decree also proposes to reconvert the agreements scheme at present in force -by virtue of which YPF has compulsorily purchased all the oil produced by contractors- into a free disposability scheme for all the oil produced.

This decree further establishes a pattern of prices for natural gas, which will be fixed monthly by the Economy Ministry until market conditions are generated which create multiple suppliers. The selling price for power plants and businesses will be equivalent to 90 percent of the fuel oil mean price in the previous month. The price of pressurized gas will be fixed at between 70 and 75 percent of the price for gas oil as the previous month. The price for residential consumers will be set in accordance with the costs of the product, plus costs of conditioning, transportation and distribution.

The same decree includes provisions for deregulation of refineries and sales outlets, and guarantees free installation of refineries or expansion of already existing ones. The same applies to the installation of new sales outlets, and this decree transfers to municipalities and provinces the authority to police the above activities.

Decree 1589 of 1989 further implements the free disposability scheme both for crude oil and for natural and liquefied gas, and contains provisions making it compulsory for oil, product, or gas pipeline operators to transport third parties' hydrocarbons without discrimination and at equal prices.

The Legal Framework and YPF's Conversion

The deregulation plan for the oil industry, oriented towards the industry's development within the framework of a market economy, prompted the authorities to work out a new legal framework for YPF, a company which on account of its corporate weight has been a leader in the oil industry since the 30s.

Decree 2778, issued December 31, 1990, thus imposes the conversion of the company into a stock corporation. The latter will retain the acronym YPF as its trade name and the new entity will be governed by the rules and principles of Private Law.

The same decree provides the guidelines for a conversion plan for the company, and it will have to relinquish all those assets which reduce its efficiency, and will have to adjust its productive activity in the areas of exploration, production, refining, transportation and marketing, to principles of competitiveness which apply to private industries.

Once the conversion plan has been completed, YPF Corporation shares will be handled by the clearinghouse of the Stock Exchange, and YPF Corporation will offer private investors no less than 50 percent of the shares of its equity stock.

A bill submitted by the Executive to Congress closes the cycle begun by the government, aiming at a substantial transformation of the legislation that governs oil industry activities. This bill ratifies the transformation and privatization plan for the State Oil Company and at the same time tends to define the situation in the provinces, ownership of liquid and gaseous hydrocarbon deposits, those allotted to YPF, the ones corresponding to previous concessions, exploitation concessions at present in force, and areas eligible for bidding, with a view to granting exploration licenses and concessions when the new law is passed.

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